Perspectives in Company Law and Financial Regulation

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Stakeholders and the legal theory of the corporation

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I. Introduction

It is a pleasure for me to write for the lively Eddy, always full of a variety of fertile thoughts, combining eloquence with rapidity. He has worked and published many learned treatises on the law of corporations and the field of finance, which has become more and more integrated in the study of corporations. This is because the capital markets need the producers of their 'deal objects' and continuously try to reshape these objects according to their wishes. For Eddy, I shall endeavour to go off the beaten track in search of a better theory of the corporation. My proposal also contains an incomplete inventory of areas where the science of corporate law is somewhat mired down.

II. Phenomenological analysis

A. The notion of a 'stakeholder'

When I am unsure about the exact meaning of a word like 'stake', I consult the Oxford English Dictionary, bearing in mind that a mad professor has made many contributions to it.[1]

A 'stake' is essentially a pole to which something is attached; historically, it might be a convicted person condemned to death by fire or other means, but when I hear 'stakeholder' I initially think of a situation of gaming where an independent party holds the prize money. This meaning is then extended to a person who holds an interest or concern in something, especially a business.

In the business of commercial law, the term 'stakeholder' is customarily used to show that we are not deprived of a social conscience;

[1] H. Sudermann, *The Mad Professor* (London: John Lane The Bodley Head Ltd., 1929).

when we point to the shareholders' interest, we have been taught to add, already routinely, that the corporation is also run in the interest of the stakeholders,[2] and here – in lacking any exact knowledge – we designate all classes of persons or functions – contractual or otherwise – that our imagination produces as being affected by corporate behaviour: workers, creditors, customers, the state, the environment, etc. Obviously, the shareholders are also stakeholders as the corporation's residual income belongs to them.

In this respect and as an example, the OECD Code of Corporate Governance provides that the 'corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises'.[3]

A further examination of who may be included in the circle of stakeholders leads to the question of the relationship between the different groups of stakeholders: what is the relationship of these stakeholders to the corporation if we do not merely characterize it as 'contractual'?

B. Approaches in economic theory

Digging deeper into the phenomenon of a corporation, we are not helped very much by the abstract constructions of the economists. The 'nature of the firm', based on the idea of transaction costs,[4] is indeed applicable to all participants in the production process. The 'bundle' or 'nexus' of contracts notion[5] is helpful to integrate many participants, but it does not provide a design for the relationship between shareholders and stakeholders. Also the idea of 'incomplete contracts', and hence the need of good corporate governance, does not lead us further.[6] Moreover, the view on the 'institution' is not able to say what the right stake of the stakeholders is, even though the institutional approach is seen as a remedy against decline.[7] 'Property rights' as a theory is developed when the choice for shareholder dominance has already been

[2] P. Forstmoser, Wirtschaftsrecht im Wandel', *Schweizerische Juristenzeitung,* 104 (2008), 133, 140.

[3] OECD, *OECD Principles of Corporate Governance* (2004), 21.

[4] R. H. Coase, 'The nature of the firm', *Economica*, vol. 4, 16 (1937), 386–405.

[5] O. Hart, *Firms, Contracts and Financial Structure* (Oxford University Press, 1995), 1–12.

[6] Hart, *Firms, Contracts and Financial Structure*, (note 5, above), 3–5.

[7] A. O. Hirschman, *Exit, Voice and Loyalty – Responses to Decline in Firms, Organizations and States* (Harvard University Press, 1970).

made. Economic property rights were defined as the individual's ability, in expected terms, to consume merchandise (or the services of an asset) directly or to consume it indirectly through exchange. According to this definition, an individual has fewer rights over a commodity that is prone to restrictions on its exchange.[8] Bearle and Means have shown that the focus of this view is circling around the relationship between shareholders and assertive managers.[9] Law and Economics give us tools to play with, but no legal clues.

1. Corporate governance discussion

The discussion about corporate governance was very helpful to open our eyes. It actually came out of the shareholder value chain of thought trying to tie down the 'selfish' managers:

> How do the suppliers of finance get managers to return some of the profits to them? How do they make sure that managers do not steal the capital they supply or invest it in bad projects?[10]
>
> Characterized by principal-agent issues, the problems addressed by corporate governance have been manifest in their impact on economic and efficiency and, at times, in the self-serving and/or abusive behaviour by management that jeopardizes company viability and the welfare of shareholders.[11]

Originally, it was the shareholder–manager relationship which seemed to be the main source of preoccupation; but now eyes are open wider:

> Pure shareholder wealth maximization fits poorly with a modern democracy. Everywhere democracies put distance between strong shareholder control and the day-to-day operations of the firm, shielding employees from tight shareholder control…How a nation settles social conflict and distances shareholders from the firm's day-to-day operation can thereafter deeply affect that nation's institutions of corporate governance.[12]

[8] Y. Barzel, *Economic Analysis of Property Rights* (Cambridge University Press, 1997), 3.

[9] A. A. Berle and G. C. Means, *The Modern Corporation and Private Property* (New York: The Macmillan Company, 1932), 188.

[10] A. Shleifer and R. W. A. Vishny, 'Survey of Corporate Governance', *The Journal of Finance,* vol. LII/2 (June 1997), 737.

[11] B. Shull, 'Corporate governance, bank regulation and activity expansion in the United States' in B. E. Gup (ed.), *Corporate Governance in Banking* (Cheltenham: Edward Elgar, 2007), 7.

[12] M. J. Roe, *Corporate Governance: Political and Legal Perspectives* (Cheltenham: Edward Elgar, 2005), 12.

> A firm has many stakeholders other than its shareholders: employees, customers, suppliers, and neighbours, whose welfare must be taken into account. Corporate governance would refer them to the design of institutions to make managers internalize the welfare of stakeholders in the firm.[13]

This widening of horizons could have led to an integrated theory of the firm, but destiny was, unfortunately, not kind with these efforts. The attention of the shareholder discussion was drawn in another direction. The discussion on stakeholders has shifted away to takeovers and their potential impacts on the various groups. On one side, takeovers were considered as an effective means to control inefficient, underperforming managers: a bad stock price was supposed to attract the sharks cleaning out the second tier people. On the other side, such actions were seen as a social challenge, mainly for the employees not having a golden parachute, or for not having any parachute at all. But, a defence also developed here, and an important argument was often brought forward (at least in Europe) that the corporation was not only prey for greedy stockholders, but also for an entire economic community of different stakeholders.

It is not only the national interest in certain key industries that created ideas of anti-takeover rules (ironically accompanying the realization of the 13th Directive – an unlucky number?),[14] but also (although perhaps less outspoken) the fear that enterprises might move to other locations on the planet.[15] The idea has been formulated that corporate decision-making centres involving important economic assets should be bound to given political communities and should not have the freedom to relocate elsewhere. The issue of the day is the (possible) impact of SWFs on sovereign states affairs.

2. Anatomy of the corporation

A recent structural elaboration, the anatomy of the corporation,[16] is also founded on the principal-agency theory. This is a characteristic

[13] V. Xavier, *Corporate Governance: Theoretical & Empirical Perspectives* (Cambridge University Press, 2000), 1.

[14] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids [2004] OJ L 142.

[15] Nokia, 'Nokia plans closure of its Bochum site in Germany', *press release* (January 15, 2008), www.nokia.com/A4136001?newsid=1182125.

[16] R. Kraakman et al., *The Anatomy of Corporate Law: a Comparative and Functional Approach* (Oxford University Press, 2006).

of almost all theoretical undertakings since the seminal work of Berle and Means.[17] The agency discussion is almost as old as the discussion on economic organization, which already occupied the ancients and is also found in Adam Smith's work.[18] The anatomy, however, goes a step beyond to include into the agency theory the shareholder–manager relationship and the concepts of majority and minority in the corporation; significantly, it also encompasses the relationship between the corporation and the stakeholders. With regard to the aim of corporate law, it has been noted that

> the appropriate goal of corporate law is to advance the aggregate welfare of a firm's shareholders, employees, suppliers, and customers without undue sacrifice – and, if possible, with benefit – to third parties such as local communities and beneficiaries of the natural environment.[19]

But all non-shareholders are merely 'contractual' partners or even exist only 'in fact'. Here, we get to a practically new age differentiation between 'status' and 'contract', a concept known since Maitland.[20] This might be justified because we also find severe warnings that the notion of agency should not be enlarged for political reasons.[21] Nevertheless, none of this is a sufficient theoretical foundation for the law of the modern enterprise.

C. Legal doctrine

In searching for a theoretical foundation, legal theory is of even less use than economic theory; this is attributable to the fact that the era of the 'grand' theories of the corporation as a legal person is over. For a long time, German legal thought tried to come to terms with the 'reality' of the legal person. A legal person is not a tangible reality, but a social phenomenon. Otto von Gierke demonstrated a strong sense of this idea

[17] Berle and Means, *The Modern Corporation*, (note 9, above).

[18] A. Smith, *The Wealth of Nations* (New York: The Modern Library, 2000; first edition 1776), translated into German by H. C. Recktenwald, *Der Wohlstand der Nationen* (Munich: Deutscher Taschenbuch Verlag, 1978), 629–30.

[19] Kraakman et al., *The anatomy of Corporate Law*, (note 16, above), 18.

[20] Cf. F. W. Maitland, *Introduction to Gierke's Political Theories of the Middle Age* (Translation), (Cambridge and New York: Cambridge University Press, 1987; first edition 1900).

[21] H. C. von der Crone, 'Verantwortlichkeit, Anreize und Reputation in der Corporate Governance der Publikumsgesellschaft', *Zeitschrift für Schweizerisches Recht*, vol. 2, 119 (2000), 239–75.

in his monumental works centring on the cooperative type of mutual interdependence.[22] At the end, from the idea of a 'legal person', it was only the farsighted concept of a bundle of assets and liabilities, separate and subject to specific governance for specific purposes, that prevailed.[23]

The endeavour in the 1970s and 1980s, namely to substitute the corporation by the 'enterprise' – a productive entity composed of all participating interests – did not succeed.[24] The main reason was that the discussion got stuck for more than twenty-five years with the conflicting (but beloved in Germany) aim of introducing workers' co-determination in the board rooms.[25] Thomas Raiser's most inspiring book[26] about the enterprise as an organization remained a lonely star, hinting at the neglected necessity of opening up legal thinking towards economic notions and tools.

If a corporation is not a tangible reality, it is an abstract legal construct. The famous Dartmouth case describes a corporation as

> an artificial being, invisible, intangible and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created.[27]

I would not hesitate to elevate the idea of a legal person to that of a real legal invention.[28] It enables the organization of both assets and people in an efficient manner. If we dig into legal history and notions, we find the idea of an 'Anstalt' in German legal doctrine, which is defined as a composition of material forces and personal means.[29] This legal concept, still

[22] O. von Gierke, *Das deutsche Genossenschaftsrecht*, 4 vols. (Graz: Akademische Druck- und Verlagsanstalt, 1954), vol. III.

[23] F. Wieacker, 'Zur Theorie der juristischen Person des Privatrechts' in *Festschrift Ernst Rudolf Huber* (Göttingen: Schwartz, 1973), 339 ff.

[24] P. Nobel, 'Das "Unternehmen" als juristische Person?', *Wirtschaft und Recht,* (1980), 27–46. Now looking again at the enterprise as a whole, composed of various interests, see M. Amstutz and R. Mabillard, *Fusionsgesetz (FusG), Kommentar* (Basel: Helbing, 2008).

[25] See M. Lutter, 'Societas Europaea' in P. Nobel (ed.), *Internationales Gesellschaftsrecht* (Bern: Stämpfli, 2004), vol. V, 35–8; G. Mävers, *Die Mitbestimmung der Arbeitnehmer in der Europäischen Aktiengesellschaft* (Baden-Baden: Nomos, 2002).

[26] T. Raiser, *Das Unternehmen als Organisation: Kritik und Erneuerung der juristischen Unternehmenslehre* (Berlin: de Gruyter, 1969).

[27] Trustees of Dartmouth College v. Woodward, 4 Wheat. 518, 636 (1819).

[28] H. Dölle, *Juristische Entdeckungen*: Festvortrag (Tübingen: Mohr, 1958).

[29] P. Tschannen and U. Zimmerli, *Allgemeines Verwaltungsrecht*, 2nd edition (Bern: Stämpfli, 2004), § 7 nos. 3–4.

used in the domain of public law today, combines both of these latter aspects, and it might also prove useful as a theoretical tool.[30]

The 'legal person' also allows for the preparation of preconditions for the creation of a great work in a structural manner; this comprises a setting in which we no longer have commanding kings and princes and must assure control through organizational means. It also signifies a setting that is acceptable for a democratic society.

It might be added here that, after we had overcome early (American) restrictions, we were able to create whole 'families' of legal persons, groups of companies or *Konzerne*. Their law still presents one of the really unfinished challenges of modern corporation law. Any major bankruptcy case shows this clearly.

The concept of the legal person was a prerequisite for the development of modern corporate law. However, it is of limited value for the development of a theory of the firm. Corporate law itself is probably not able to deliver a theory of the firm as it is (only) concerned with the structure of main command over the firm.

III. Reaching out for a new theoretical foundation of the firm

A. Traditional model of the entrepreneur

The entrepreneur, his ideas and his talent, in combination with other people and assets are still the basic ingredients of a capitalist market economy. There are, as we have seen, the property rights that continuously move the 'creative destruction'.[31] As in statistics, however, the reliability of results depends on large numbers, evening out the outliers; here, we must consider that the model of individual entrepreneurs is only true for a part of the economy. Although it is still an important part,[32] it is not the part where public attention is nowadays focussed. This comprises the part of the big enterprise, the group of companies, the firm, the *Konzern* and the listed corporation, usually multinational. For these, legal theory is somewhat at a loss.

[30] P. Nobel, *Anstalt und Unternehmen: Dogmengeschichtliche und vergleichende Vorstudien* (Diessenhofen: Rüegger, 1978), chapter 4.

[31] J. A. Schumpeter, *Theorie der wirtschaftlichen Entwicklung,* (Leipzig: Springer, 1912), 525–33.

[32] 99.7% of all enterprises in Switzerland are small and medium-sized businesses (up to 249 employees); 87.6% employ nine employees at most and are considered as micro enterprises. See Bundesamt für Statistik, Betriebszählung 2005, www.bfs.admin.ch.

B. Groups of companies

The model of the company law codes is still the single corporation. A few countries have tried to enact rules for groups of companies. The success was more limited than the ensuing academic discussion on the law of company groups. It also remained national and no (European) country could embrace the whole of its multinational corporations with a law of company groups, making one enterprise out of it. There is one major and main exception: the groups have to present 'consolidated accounts', making the economic unit more transparent. This is, to a large extent, sufficient as there are no downstream 'external' shareholders; but in case of financial difficulties, the creditors of subsidiaries remain as a major problem.

Here, the law and the legal scholars cope with a considerable number of instruments in order to come to terms with such problems. We are, however, far from a consistent approach in this matter. Corporate law has somewhat abdicated here; and the lawyers also seem to have gotten tired of the discussion on this issue.

For some time there was a short but emotional discussion in Switzerland as to whether a group of companies is a company itself.[33] In European law, things have not developed further than an aborted attempt to a (9th) Directive, and the proposals of the Forum Europaeum based on the French *Rozenblum* case, which only suggests a somewhat vague standard.[34] This proposal was recently commented on by Klaus J. Hopt in a friendlier manner. Hopt does not anticipate that there will be a European law of groups of companies in the near future; in his opinion, it is more likely that there will be a capital markets law, which takes the dimensions of groups of companies into account.[35] There are also a series of rules relating to groups of companies where the regulation and supervision of the capital markets are concerned;

[33] H. Peter and F. Birchler, 'Les groupes de sociétés sont des sociétés simples', *Swiss Review of Business and Financial Market Law,* 70 (1998), 113–124; R. von Büren und M. Huber, 'Warum der Konzern keine einfache Gesellschaft ist – eine Replik', *Swiss Review of Business and Financial Market Law,* 70 (1998), 213–220.

[34] Forum Europaeum Konzernrecht, 'Konzernrecht für Europa – Thesen und Vorschläge', *Zeitschrift für Unternehmens- und Gesellschaftsrecht*, (1998), 672–772, 705; The Rozenblum-concept is based on the point of view that the self-interests of the individual companies within a group have to be aligned with the overall interest of the group, i.e. with the group interest.

[35] K. J. Hopt, 'Konzernrecht: Die Europäische Perspektive', *Zeitschrift für das gesamte Handels- und Wirtschaftsrecht,* 171 (2007), 232, 235.

together with take-over rules, these are contributing to the creation of a European Capital Markets Law for large corporate groups.

The conclusion remains that we have no European law for groups of companies. The regulation of the SE, contrary to earlier proposals, no longer contains such rules. In view of the fact that the SE is becoming a preferred statute by big corporations; it is a pity that the occasion was missed.

C. The corporate governance discussion

During the past few years, the big issues in corporate law have concerned shareholder value and corporate governance, including the role of the auditors.[36] The corporate governance discussion has been somewhat stuck, continuously turning the same wheel with the hope that it might stop at a lucky number. There is, however, one issue that has politicized the corporate governance discussion: the discussion on executive compensation. In many countries, this topic caused a public outcry, which corporate lawyers were not really able to respond to, except with a considerable amount of political bias. The phrase 'pay without performance'[37] expressed the criticism of executive pay arrangements and the corporate governance processes producing them.

The response of the business circles was very clever and in the relevant corporate governance codes the links to performance were introduced as an obligation.[38] However, as 'performance' is difficult to measure, the appropriate question is whether this is the solution or not, at least in the long term. For a shorter period, it might be a ratio, combining share price and profit.

D. Underdeveloped shareholder governance

In my opinion, we have to take a second look at the basics: here we see that the corporation is built on the idea of the shareholder–proprietor who attends the general assembly as if it were a democratic political arena, in spite of the fact that voting rights are regulated in relation to capital

[36] F. H. Easterbrook and D. R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991).

[37] L.Bebchuk and J. Fried, *Pay without Performance: the Unfulfilled Promise of Executive Compensation* (Harvard University Press, 2004).

[38] Swiss Business Federation, *Swiss Code of Best Practice for Corporate Governance*, new edition (Dielsdorf: Lichtdruck AG, 2007), 17.

and not per capita. All in all, we are still far away from 'one share, one vote'. All endeavours of the more or less recent developments of corporation law were nevertheless directed at the improvement of shareholders' rights. Have we been successful? I do not think so. The fact remains that shareholders do not do what they could do. Academians have to learn to live with the reality that the majority of shareholders allow things that could be changed or disapproved to continue. The shareholders are entitled to select the company's chief executives, reject accounts, sue the directors, etc. But, they simply do not do this. It might thus be the case that the model is wrong. Shareholders can distribute their risk and they can also walk away. They are also not 'real' owners of the corporate assets, only economic beneficiaries.

It is true that I paint a kind of black and white picture here and that one could make finer distinctions. For instance, the American situation is somewhat different because the orientation of the federal security laws has caused many differences and has also had a very strong impact on the SEC.

All this has not prevented the big anti-fraud reaction of the US Congress through the Sarbanes–Oxley legislation, especially its section 404.[39] Another example is the necessity to distinguish between ordinary and institutional shareholders. The emergence of the latter has not only brought changes, but also problems related to their governance.

E. The firm as a result of varying bargaining power

Already the seminal work of Berle and Means (a lawyer and an economist) has described the modern corporation in terms of its transformation of private property.[40] In the New Economy, property rights correspond to the ability of an agent to capture the present cash-flow value that a given asset is expected to generate.[41]

In civil law countries this is even more difficult because we cling to the notion of undivided property and only allow, under strong Anglo-American influence, a distinction between property in the legal sense and 'economic property'. Here, we encounter systemic impediments because the whole of civil law is construed with the idea of a free individual able

[39] *Sarbanes–Oxley Act of 2002* (Pub.L. 107–204, 116 Stat. 745, enacted 2002–07–30).
[40] Berle and Means, *The Modern Corporation*, (note 9, above).
[41] U. Cantner, E. Dinopoulos and R. Lanzillotti, *Entrepreneurship, The New Economy and Public Policy* (Springer, 2005).

to contract and dispose of property in the sense of using it as an economic tool. There is no doubt that this individual might sell his shares; if he wants to have a say in the way that his money is invested, he has only one vote out of many. The decisive feature is that the individual shareholder cannot only sell but can also spread his risk over a number of corporations, whereas the employee-insiders are fully bound by their 'job'.

For lawyers the idea of a 'legal person' is a great achievement. A corporation can behave in economic matters, legally speaking, like a natural person. Legal theory, however, has had a hard time to come to terms with the development of such a 'person'. It is very difficult to bridge the gap to the economists, as they describe the firm as a bundle of contracts. In my opinion, the agency theory is in fact a legal notion taken up by the economists to support the lawyers' model, which was prone for derailment.

The bundle of contracts' approach is visibly also an abstract construction of legal elements, but for lawyers it is hard to re-integrate this idea back into the legal system. We might call a certain situation 'a bundle of contracts', but this will not be a legal term. Trying again, a 'bundle of contracts' is a plurality of contracts, maybe of the same contracts or of different contracts. With the idea of 'same contracts', we are not getting further than an unknown number of contracts. With different contracts we might see contracts with the state, contracts with investors, contracts with managers, labour contracts, creditors, etc. But, here we soon realize that the law is much further developed in that it already contains models to combine such contracts institutionally. What is the lesson to learn here? Perhaps it is the idea, as suggested by the economists, that everything should be based on the contract model. Then, the whole institution of the firm becomes a result of the relevant bargaining power.

Even though the contract model (the bundle of contracts) and the idea of bargaining power are closely linked together, bargaining power goes further in that not all bargaining power necessarily leads to a contract; therefore, it is more precise to talk about a 'negotiation model'. In this respect, an open system is formed because all stakeholders may have bargaining power, which is determined by a large number of parameters. In comparison with the principal-agent theory, a model that puts the bargaining power into the centre is able to give a more comprehensive picture of the reality of the firm. Even though the agency model (in its broad interpretation) may capture a large number of different stakeholders, it can only explain a certain part of the reality of the firm. As it focuses on the information asymmetry and the difference of interests

between the principal and the agent, it leaves out many aspects that may influence the relationship of the stakeholders. The negotiation model, on the other hand, may easily incorporate these two elements of the agency model: an informational advantage improves the bargaining power of a contractor, and it is virtually a standard situation in negotiations that the contracting parties have non-homogenous interests.

The proposed model may also include other elements that strengthen or weaken the bargaining power such as interrelations or coalitions among the relevant players, acceptance of a position in society or the law of supply and demand.

Bargaining power is not only the relevant criterion in the situation of actual ongoing negotiations among the stakeholders of a company. It remains the core factor in a corporation, even when the various stakeholders of the firm have committed themselves to follow certain rules for an agreed period of time. Contracts are to be seen as nothing but 'frozen' bargaining power. They show a picture of the moment. Corporate reality tells us that the principle of *pacta sunt servanda* does not prevent stakeholders from violating treaties. Once their negotiating power reaches certain strength, they may attempt to renegotiate a compromise to make it more favourable for them or simply behave contrary to the contractual terms.

Hierarchies and delegations are commonly found in corporations, and they are in line with the negotiation model: both regularly derive from concluded contracts. If they are established by non-contractual means, they may still influence the individual bargaining power of the involved persons and respectively have an effect on contracts.

Tangible and non-tangible assets of a company may be included in the contractual model as well. Assets may be owned or rented by the company or, e.g., licensed from IP owners. (If one understands contracts in a broad Rousseauian sense, even the so-called social obligation of property that is recognized in some states may be seen as contractual.) The ownership of assets may have an impact on the bargaining power as well, be it on the side of the suppliers or on the side of the shareholders/managers vis-à-vis the workers.

F. Implications of the negotiation model

When bargaining power is found to be the core factor of all activity within the corporation, the question of legitimacy of the individual power and respectively of the validity of the results of the negotiations

among the stakeholders may arise. A number of theories of the firm consider the criteria of legitimacy as an attribute for stakeholder identification and salience. In the negotiation model, legitimacy is only one of many aspects that may raise or limit the bargaining power. It may be a parameter that strengthens the position of a stakeholder. However, it may not serve as an additional factor next to bargaining power, which forms the basis of the theory of the firm.

The concept of the 'one share, one vote' is very much in line with the idea of legitimacy. The implementation of this approach was lately abandoned by the European Commission. Within the negotiation model, this concept of 'one share, one vote' is not helpful as it takes a – possible – result of a negotiation and turns it into a prerequisite of the negotiation.

Another question concerns the role of the law or regulation within the negotiation model. In this context, it is important to distinguish carefully between regulation and legitimacy. The law may be seen as the major external effect on the corporation. While the law sets clear limits to the bargaining power, legitimacy is somewhat an unclear element. It is the function of the law to limit the negotiation power of the contractual partners, who act without legitimacy. For example, as soon as monopolistic structures are identified, the negotiation power has to be looked at from the viewpoint of competition law. As we have seen, corporate law is not useful to develop a theory of the firm. However, the shift to a negotiation model also has legal consequences.

G. Bargaining power of stakeholder groups

Without going into any depth about the position of creditors, it is sufficient to mention that banks, if corporations need them at all, are usually quite able to bargain their position. It is even the case that industry is somewhat disadvantaged when facing investment bankers because their command of the channels to the capital markets as well as the 'customs duty' is often substantial.

Concerning labour, there is already a long tradition of examining bargaining power and establishing rules for negotiations, strikes and lockouts. Very often, instruments of state assistance are also involved.[42] It seems, all in all, that the law is able to come to terms with this aspect of 'social unrest', even though the power of the unions is very different in the various countries. And, all of this is customarily based on

[42] See for Switzerland: 28 III BV, for Germany: 9 III GG.

the contract model, enlarged, it is true, by the instrument of 'collective labour agreements'.

In Germany[43] (and in other countries, e.g. France, Great Britain, Italy, Sweden),[44] the workers entitlement to co-manage is well established.[45] This was the social model of compromise after the Second World War. Nowadays, co-determination is heavily criticized[46] and corporations try to evade it (e.g. by using the SE), but its abolishment is unlikely. It was, however, not possible to export the model into the European law as a general model, with the exception of the directive accompanying the SE statute.[47]

The bargaining powers have indeed changed in other places. The managers are much more powerful and they are much better organized than the shareholders. I am of the opinion that they have a large amount of bargaining power at their disposal, which is not matched by the shareholders.

A question arises as to who belongs to the management? I think that all people, except auditors, elected by the shareholders to hold office in the corporation, belong to the management group. This also comprises the Swiss Board of Directors (*Verwaltungsrat*), even though the management might be separate. Even the German *Aufsichtsrat*[48] belongs here, despite the contrary opinion of doctrine (and the courts)[49] still viewing it to some extent in the historical role as the shareholders' representative committee. In fact, one must concede that, compared with the management or the committee, the German *Aufsichtsrat* does not have the same degree of competence to govern the corporation.

[43] See German Montan-Mitbestimmungsgesetz (MontanMitbestG) of 21 May 1951; German Mitbestimmungsgesetz (MitbestG) of 7 May 1976 and German Drittelbeteiligungsgesetz (DrittelbG) of 18 May 2004.

[44] See J. Brown, 'Implications for the Disclosure of Financial Information', *Employment Law Bulletin,* 25 (1999).

[45] R. Göhner und K. Bräunig, ‚Bericht der Kommission Mitbestimmung', unpublished Report, Berlin, November 2004, 23–6.

[46] See criticism of the German Institut für Arbeitsmarkt und Berufsforschung, www.iab.de/de/195/section.aspx/Publikation/k051227n15.

[47] Directive 2002/14/EC of the European Parliament and of the Council of 11 March 2002: establishing a general framework for informing and consulting employees in the European Community, [2002] OJ L 80/29. See also P. Hommelhoff and Ch. Teichmann, 'Die Europäische Aktiengesellschaft – das Flaggschiff läuft vom Stapel', *Swiss Review of Business Law,* 74 (2002), 6 and M. Lutter, 'Societas Europaea' in P. Nobel (ed.), *Internationales Gesellschaftsrecht,* (Bern: Stämpfli, 2004), vol. V, 19–45.

[48] See §§ 98–116 AktG of Germany; P.C. Leyens, *Information des Aufsichtsrats* (Tübingen: Mohr Siebeck, 2006).

[49] See BGH II ZR 316/02 of 16 February 2004, *Zeitschrift für Wirtschaftsrecht und Insolvenzpraxis* (2004), 613 (MobilCom).

Furthermore, careful analysis is required. It must first be stated that the economic system of free enterprise requires a fair amount of free action of management, which it must then account for in a transparent manner. Then, a careful examination is needed of the aspect of the shareholder passivity. It is maybe 'rational' not only because of the cost–benefit relationship, but also because shareholders know that large incentives might produce large results. Generally, people are much more open-minded about a profit distribution than a situation where they see an asymmetrical loss bearing.

Here, we might see an inequality of weapons. The general meeting of shareholders is not an ideal bargaining arena. The model is flawed. The shareholders should be able to bargain with the management and then make recommendations to the AGM.

The bargaining model is a good model for the future and, currently, the agency model is outdated. Such a bargaining procedure requires an appropriate forum. A large hall with a fancy screen that only offers the possibility to accept or reject the motions presented is not constructive. Sadly, the only other alternative is disruptive activist action.

IV. Legal future of the enterprise

A. Organizational scheme

It can be anticipated that large enterprises will also play an important role in the future. These large enterprises need (and have) a legal organization. The legal organization consists of a number of legal persons, usually incorporated in various jurisdictions. An enterprise is therefore an international legal organization of decision making over assets. This is the economic reality for which we have to find solutions. The theory of the firm must be, above all, holistic and then duplex: it must encompass the corporate control of assets and the notion of the corporation as a social organization.

Already at this point we have to note that reality is further developed than the law. There is no truly (unitary) international organizational scheme. Not even the Societas Europea could succeed without deep integration and incorporation in the national law of the domicile. We must therefore make use of the existing instruments; but, we should cease to stick to fictitious concepts such as handling the responsibility of the (poor) board of a subsidiary as if there would be no 'boss'.

B. Creditors

Concerning creditors, I would distinguish between 'trade' creditors, belonging to the business, and 'financial' creditors. Trade creditors should be protected throughout the whole group. Financial creditors are sufficiently sophisticated to negotiate the securities they consider as necessary.

C. Workers

Workers are probably the most difficult subject. Their bargaining power comes primarily from the skills they can offer combined with the extent to which they form coalitions.

As far as the skills are concerned, it is the law of supply and demand that decides on the bargaining power of the workforce. In a globalized world, workers find themselves in competition with all workers, on a universal level. In a situation where the skills of the workers are of equal quality, the bargaining power is somehow reduced to the price of their labour. There is no right to maintain production in a place when a new combination of assets and a workforce at other locations is more efficient. This is the price of globalization of the economy. Structural changes cannot be avoided. A high level of specialization may be the best way to strengthen the bargaining power of the workforce. When negotiating on compensation schemes, the asymmetry of information between the management and the workers on the true financial situation of the company may strengthen the management's position. As far as groups of companies are concerned, the design of the compensatory schemes must take the situation of the whole group into consideration, and not only that of the relevant subsidiary.

The other aspect, the bargaining power that results from coalition structures, is declining as the influence of trade unions is constantly receding. This holds true for at least a number of branches and a number of jurisdictions.

Workers may be able to compensate their loss of bargaining power by getting another stake in the corporation. Regularly, workers are also consumers and consumers are also workers, which may result in a potentially high amount of bargaining power. However, this bargaining power is only potential as workers behave very differently in their role as consumers, and vice versa; e.g., as consumers they hunt for the product with the lowest price and as workers they ask for high incomes. The fact

remains that the bargaining power of the workforce may improve once the workforce buys shares of their own company. For that, however, a shift in the mentality of many nations is needed. We are still very far away from the worker as an employee–shareholder.

D. Consumers

From a theoretical point of view, consumers should have the most bargaining power of all stakeholders as they are the buyers of the products or services produced by the firms. However, their level of integration is very low. They act through the 'agent' of the consumers' associations. Their bargaining power will depend to a large extent if they manage to form more forceful coalitions.

Legal measures may improve their situation and lead to a more powerful position in the negotiation situation with corporations. As an example, class actions or legal remedies can be mentioned here.

E. Shareholders

Listing of a corporation means that shareholders and potential shareholders get much closer to the economic activity because a whole additional set of information is required to increase transparency. 'Corporate governance' then becomes a major issue here because for many people managers are per se suspicious persons. This leads (somewhat) to a temptation: the shareholders think that they are called to participate in the management; such a notion is, however, prone to lead to a lot of inefficiency and should be avoided at all costs. It should be crystal clear that the management is in charge of the firm. The management is also accountable for its acts and can be dismissed by the board of directors.

Shareholders are a disorganized group of individuals and often have only one opportunity in a year to express their opinion. Institutions like the 'supervisory board' or even auditors were, at one time, supposed to defend shareholders' interests. Nowadays, all being institutionalized with other directional goals, it would be worthwhile to study the idea of electing a shareholders' committee to negotiate certain items reflected in the AGM agenda with the management. A hot topic here is manager compensation. I do not think that the prevailing types of compensation, mainly in banks, have contributed much to the current crisis in the financial world. It is by far not natural law that gross profits are evenly distributed between staff and shareholders. The compensation system

should be a matter of negotiation, especially when it also comprises share (or option) allocations, usually at favourable rights; under these circumstances, the compensation system may dilute the position of the other shareholders and, in the medium or long run, may even have the effect of a transfer of control to the employee–shareholders.

F. Management

The principal-agent model does not hold true any more. It sounds nice, however, in a society of property owners. The historic origin is somewhat darker and must be attributed to a master–slave environment rather than to that of a modern democratic society. The agent has not only natural self interests, but is also the master of economic performance. His nomination is maybe the most important task of a board. Such agents are no longer simple executors of instructions given from above but business partners open to negotiations. It would also be the shareholder committee's task to accompany and supervise such negotiations.

V. Summary

Neither legal doctrine nor the theories of the economists offer a comprehensive theory of the firm. The agency model is outdated as we have moved from a structure of order and obedience to a world of pluralistic interests. As a consequence, we need to shift from a commandeering model to a negotiating model. This enables us to get to a theory of the firm that takes into account all different kind of stakeholders and to map all their differing interests. All the parameters that strengthen or weaken the bargaining power of the various stakeholders characterize the reality of the firm. Negotiations may result in contracts in the legal sense or not. The bargaining power is the key element that shapes the corporation in all its aspects.

The shift to a negotiation model has also legal consequences. We should come to solutions which also look at the legal person as a contract, which is to some extent performed by company law, but nevertheless open to negotiation results. The negotiating parties should be the shareholders, the management, the workers and – as far as credits are concerned – the banks. For various purposes (permits, tax) the State is a necessary partner as well.