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ARTICLE

THE TRANSFORMATION OF FRENCH CORPORATE GOVERNANCE AND UNITED STATES INSTITUTIONAL INVESTORS

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I. INTRODUCTION

By all accounts,¹ United States institutional investors² play an increasingly important role in United States corporate governance. According to the generally accepted historical account, institutional shareholder participation in corporate

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1. See, e.g., Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992); Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991); Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857 (1993); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445 (1991); Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10 (1991). But see John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991).

2. By institutional investors, I mean the kinds with which we are familiar in the U.S.: the public and private pension funds, mutual funds and bank collective investment funds, but not banks, insurance companies and venture capital or LBO funds.

governance is one solution to the basic corporate agency problem identified by Adolph Berle and Gardiner Means.³ That institutional investors would be an appropriate solution to the agency problem is based on the following logic. Many institu-

3. See ADOLPH A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 127-52 (1933); see also John C. Coffee, Jr., *The SEC and the Institutional Investor: A Half-Time Report*, 15 CARDOZO L. REV. 837, 838 (1994). The account goes as follows: Corporations need to raise large amounts of capital to attain the critical size necessary to compete in expanded domestic and international markets. This capital raising requires the involvement of large numbers of investors. Because a typical investor has only a small amount of assets invested in a particular enterprise, it is not cost efficient for the investor to closely monitor management. However, without shareholder monitoring, managers face the "moral hazard" of operating a corporation in ways beneficial to them, not the shareholders. See, e.g., JONATHAN R. MACEY & GEOFFREY P. MILLER, *BANKING LAW AND REGULATION* 124 (1992) ("[M]oral hazard' . . . denote[s] a condition in which the knowledge that a third party will bear the costs of some harm creates a risk that the actor may fail to take due precautions against occurrence of the harm."). A major problem for corporate law scholars is to understand and to propose legal solutions to this agency problem, that is, to achieve the most cost-efficient manner of monitoring the agents/managers. See Ian Ayres & Peter Cramton, *Relational Investing and Agency Theory*, 15 CARDOZO L. REV. 1033, 1036 (1994) (citing OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* 298-325 (1985)).

The recent focus on the institutional investor arose from the demise of another solution. The market for corporate control, i.e., hostile takeovers, is a time-honored U.S. solution to the corporate agency problem. See, e.g., Louis Lowenstein, *More Like Whom? Opening Remarks Before Columbia University Institutional Investor Project Conference on Relational Investing* (May 6, 1993), in 18 J. CORP. L. 697, 698 (1993). The threat of hostile takeover bids, so common most recently in the 1980s, arguably deterred management from promoting their own, not shareholder, interests. However, this monitoring solution suffered from adverse publicity and became more difficult legally to use in the 1990s. See, e.g., Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124, 125-26 (1994) (discussing the demise of the hostile takeover). As its importance receded, the institutional shareholder came to be seen as the preferred solution. See Lowenstein, *supra*, at 699. For some, institutional investment and monitoring is a more beneficial form of monitoring than the hostile takeover, which may discipline managers in a distorting way (e.g., by encouraging short-termism and other strategies that are not ultimately wealth-enhancing). See Ayres & Cramton, *supra*, at 1037-38. However, not all scholars believe that all, or even many, institutions will in fact adopt an activist position. See, e.g., Coffee, *supra*, at 843-44; Coffee, *supra* note 1, at 1318-28; Rock, *supra* note 1, at 469-78.

Legal scholars have proposed changes to existing law to increase this institutional investor activism. See, e.g., Coffee, *supra*, at 838-42 (reciting history of amendments to proxy rules); Black, *supra* note 1, at 821-30 (discussing legal impediments to shareholder activism); Bernard S. Black, *Next Steps in Proxy Reform*, 18 J. CORP. L. 1 (1992) (discussing further proxy reforms needed to promote institutional investor involvement). There has been a resurgence of takeovers recently, but this development owes much to strategic acquisitions, as opposed to transactions financed by "takeover artists". See, e.g., *Paramount Comm. Inc. v. QVC Network Inc.*, 637 A.2d 34 (Del. 1994).

tional investors own significant stakes in companies. It is costly for them always to use the "Wall Street rule" of selling their stakes if they are discontented with management. Thus, they have a strong economic stake in monitoring management, and, for economic and legal reasons, they are encouraged to embrace a stakeholder model, with its emphasis on shareholder primacy and investment return.⁴

The focus on United States institutional investors as a solution to the basic corporate governance problem led scholars to look outside the United States for comparable situations of institutional investor monitoring. Scholars observed that, in many other developed capitalist countries, certain kinds of institutional investors played a significant role in corporate governance.⁵ Scholars also asked whether, with certain legal

4. See Ayres & Cramton, *supra* note 3, at 1035, 1040-41; Coffee, *supra* note 3, at 892; Gordon, *supra* note 3, at 126 n.5. That institutional investors are willing to incur full monitoring costs although they receive only a limited percentage of the benefits has been questioned. See Coffee, *supra* note 3, at 906; Edward B. Rock, *Controlling the Dark Side of Relational Investing*, 15 CARDOZO L. REV. 987, 1030 (1994). As is clear from the title of the Ayres & Cramton article, a term for certain kinds of institutional investors is that of "relational investors." See Ayres & Cramton, *supra* note 3; Relational Investing, The Institutional Investor Project of the Center for Law and Economic Studies, Conference at Columbia University School of Law (May 6-7, 1993) (transcript of proceedings on file with author). The relational investor is one who closely monitors management and is willing to hold an investment for the long term in order to capture long-term gains. An example is Warren Buffett, who invests for the long term through Berkshire Hathaway. See Rock, *supra*, at 989. Generally, however, this definition of relational investor does not cover the kinds of institutional investors that are the subject of this Article. See Lowenstein, *supra* note 3, at 706.

5. See, e.g., Richard M. Buxbaum, *Institutional Owners and Corporate Managers: A Comparative Perspective* 57 BROOK. L. REV. 1 (1991) (discussing corporate governance in Germany); Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871 (1993) (discussing structure of Japanese corporate governance); Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927 (1993) (comparing corporate governance in the indicated countries); Ronald J. Gilson & Reinier Kraakman, *Investment Companies as Guardian Shareholders: The Place of MSIC in the Corporate Governance Debate*, 45 STAN. L. REV. 985 (1993). But see J. Mark Ramseyer, *Columbian Cartel Launches Bid for Japanese Firms*, 102 YALE L.J. 2005 (1993) (questioning the value of comparative corporate governance studies, given the relative unimportance of governance in comparison to competition in the capital and product markets); Roberta Romano, *A Cautionary Note on Drawing Lessons From Comparative Corporate Law*, 102 YALE L.J. 2021 (1993) (similar skepticism about the importance of corporate governance for the increase in shareholder value). This U.S. scholarly work generated studies by European scholars on the role of institutional shareholders in corporate governance in their countries. See, e.g., CONFERENCE ON

changes, particular techniques and models of non-United States institutional investor monitoring could be adapted to the United States context.⁶

However, scholars realized that this adaptation in most cases might be difficult or even impossible. Not only were foreign institutional investors unlike the United States ones—a German or Japanese bank was a different institution from a United States public pension fund—but foreign corporate governance situations were also products of complex cultural, social and economic forces often unique to a particular country. Although United States scholars might advocate borrowing from abroad a technique of institutional investor activity, the technique might not have the same effect in the United States context, even if it were legally permitted,⁷ because of the different cultural, social and economic forces here.⁸

The focus of this Article is somewhat different from those comparative legal studies.⁹ My inquiry is what happens when United States institutional investors, with their new importance and activism in United States corporate governance,

INSTITUTIONAL INVESTORS (Theodor Baums ed., 1992); EUROPEAN BUSINESS LAW: LEGAL AND ECONOMIC ANALYSIS ON INTEGRATION AND HARMONIZATION (Richard M. Buxbaum et al. eds., 1991); EUROPEAN TAKEOVERS—LAW AND PRACTICE (Klaus J. Hopt & Eddy Wymeersch eds., 1992); LEGAL HARMONIZATION AND THE BUSINESS ENTERPRISE (Richard M. Buxbaum & Klaus J. Hopt eds., 1988).

6. See, e.g., Buxbaum, *supra* note 5, at 34-38.

7. The comparative law work often led to an historical understanding of the legal limitations placed upon U.S. institutional investors, which limitations prevented such investors from performing many roles taken by offshore institutional investors. See Roe, *supra* note 1; see also Mark J. Roe, *Foundations of Corporate Finance: The 1906 Pacification of the Insurance Industry*, 93 COLUM. L. REV. 639 (1993); Mark J. Roe, *Political Elements in the Creation of a Mutual Fund Industry*, 139 U. PA. L. REV. 1469 (1991). See generally MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* (1994).

8. As Melvin Eisenberg has remarked, comparative corporate law studies do not necessarily have to lead to improvements in or adaptations for U.S. corporate law. However, in his view, they show possibilities available in other countries and thus can be helpful in enabling U.S. scholars to think of alternative corporate structures for this country. Melvin Eisenberg, Remarks at the Japan Society Conference: For Whom the Corporation? Corporate Governance in Japan, the U.S. and Europe (Apr. 29, 1994).

9. The work of Richard Buxbaum lies closest to the orientation of this Article. He has identified as an area for additional study the consequences for corporate governance of "the globalization of securities markets and the global reach of these American—and, to a lesser extent, Japanese and British—institutional investments outside their countries of origin, especially on the European continent." Buxbaum, *supra* note 5, at 3.

invest in non-United States companies and thus become participants in foreign corporate governance. That United States institutions are increasingly becoming shareholders of non-United States companies is a recognized phenomenon that owes much to globalization of the securities markets and theories of portfolio diversification.¹⁰ Moreover, in the privatizations that are occurring on nearly every continent, companies and governments are actively seeking the funds of United States institutional investors.¹¹

This inquiry into the United States institutional investor involvement in foreign corporate governance raises numerous interesting, but difficult, issues. An initial issue is whether these investors have exported their active role in corporate governance. I suggest that certain kinds of institutional investors, for the same legal and economic reasons explaining their involvement in United States corporate governance, have been "activist" abroad.¹²

Further issues arise from the question whether United States institutional investor activism is compatible with non-United States systems of corporate monitoring and governance. Because foreign corporate governance systems are culturally determined in a complex sense and because in many such systems powerful institutions already monitor corporate management, United States institutional investors might be unnecessary, or might at best complement these foreign monitors.¹³

However, many non-United States institutional corporate monitoring schemes grew out of, and are suitable for, a local market with small capitalization where most corporate financing comes from large financial intermediaries.¹⁴ As securities

10. See *infra* subpart II.A.

11. See *infra* text accompanying notes 39-43.

12. See *infra* subpart III.A. These will be the public pension funds, like CalPERS, that generally follow an indexing strategy and do not have the need for immediate liquidity required of mutual funds. See Coffee, *supra* note 3, at 860.

13. Ira Millstein has observed that this is a common assertion by those who believe that no change is necessary for corporate governance systems in developed countries. Ira Millstein, Remarks at the Japan Society Conference: For Whom the Corporation? Corporate Governance in Japan, The U.S. and Europe (Apr. 29, 1994).

14. Cf. ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 136-37 (1993); Buxbaum, *supra* note 5, at 4-5; see also Ramseyer, *supra* note 5, at 2006 (pointing out that, in a world where there is global competition for capital by firms that are competing in the global product markets, firms cannot rely exclu-

markets become linked and as competition for capital becomes more intense for enterprises competing in product markets on a global basis, certain kinds of local corporate financing, with their traditional institutional monitoring and corporate governance, may not survive. An important issue becomes whether the United States institutional investor, who is increasingly the typical investor in an economy where corporate financing is primarily market-based, might have a significant effect upon governance in a country whose economy is also being transformed into a market-based financing structure. In short, the presence of United States institutional investors might be a sign of impending change to a foreign corporate governance system.¹⁵

Corporate law scholarship's recent awareness of the array of possible solutions to the corporate agency problem cautions against a confident acceptance of the inevitable triumph of a United States-style market-based corporate governance structure throughout the world. A particular solution to the corporate agency problem is always a product of complex historical forces that include, but are not limited to, economic and market pressures.¹⁶ A particular corporate governance system and

sively on capital-raising in the local market if they are to survive).

15. It is thus ironic that the presence in a foreign market of U.S. institutional investors, whose involvement in corporate governance has been partly inspired by some European and Japanese models of institutional involvement, may suggest that traditional institutional involvement in that market is no longer tenable.

16. Cf. Coffee, *supra* note 3, at 842-43 (citing Roe, *supra* note 1, at 31-36). As Richard Buxbaum has observed, one must understand the broad cultural constraints on ownership and control of private institutions:

(5) Finally, an initial comparative analysis of the underlying social, political, economic, and even cultural constraints on potential structural changes in the ownership and control of private firms in the modern liberal economy is independently useful. It may help remind us of the enduring validity of social theory in an era in which the discrediting of a major wing thereof—Marxist theory—leaves important social issues, in the West as well as in the East, unilluminated by self-reflection.

Buxbaum, *supra* note 5, at 6. Mark Roe, too, has emphasized the importance of a cultural understanding of corporate structure: "Rather than using agency costs or contract theory or judicial doctrine to explain this or that feature as mitigating or reflecting managerial deviation from the maximization of shareholders' wealth, we must consider the role of politics, history, and culture." Roe, *supra* note 5, at 1997; cf. Joseph A. Grundfest, *Internationalization of the World's Securities Markets: Economic Causes and Regulatory Consequences*, 4 J. FIN. SERVICES RES. 349, 360-61 (1990) ("Economics, technology, and politics shape each other and interact, often in subtle but profound ways."); Lawrence E. Mitchell, *The Jurisprudence of the Misappropriation Theory and the New Insider Trading Legislation: From Fair-*

a form of institutional monitoring may not be fully compatible with global markets and global product and capital competition. However, noneconomic forces may maintain that system and form.¹⁷

An analysis of the effect of United States institutional investors on the transformation of a country's corporate governance is beyond this Article's scope.¹⁸ However, a given privatization, which solicits United States institutional investor funds, might be a useful occasion to study the interaction between these investors and a foreign corporate governance system. Not only is privatization generally presented as a process favoring markets and market-based financing, but it also brings to the forefront the complex, often contradictory, cultural forces at work in the particular corporate governance system and in corporate structure generally. Privatization could thus serve as a "privileged" moment to study United States institutional investors' impact on a given foreign corporate governance system.¹⁹

Because privatization is occurring throughout the world and is itself a voluminous subject, this Article is limited to

ness to Efficiency and Back, 52 ALB. L. REV. 775 (1988).

17. Richard Buxbaum has argued that corporate governance systems may "converge," as opposed to having one system prevail: "[o]ur domestic experience with the governance role of the institutional investors may inform the pending European experience even as it may be reciprocally shaped by Europe." Buxbaum, *supra* note 5, at 21. Buxbaum has further noted that:

As United States funds begin to flow into European stock markets in significant amounts, the American corporate governance situation, and especially the institutional sector's evolution towards an active role in corporate governance, will begin to have significance in the European setting. At the same time, the different factual and legal structures within which European corporate governance relations are embedded not only dictate a different pattern of assimilation for this new type of shareholder, but hold their own lessons for the future evolution of investor-manager relations on the American scene.

Id. at 21-22.

18. I understand that Professor Wymeersch is conducting a comprehensive study of European corporate governance, and changes therein. See Eddy Wymeersch, *The Corporate Governance Discussion in Some European States*, in CONTEMPORARY ISSUES IN CORPORATE GOVERNANCE 3-23 (D.D. Prentice & P.R.J. Holland eds., 1993).

19. Social scientists have long proposed that moments of political debate, or even political crisis, can bring to the forefront the transformation of social structures. Cf. James A. Fanto, *The Making of a Literary Critic: Professionalism and the Strategies of Authority* 47-50 nn.86-91, 456-62 nn.680-88 (1988) (unpublished Ph.D. dissertation, University of Michigan).

United States institutional investors' involvement in recent French privatizations. French corporate governance in the large, internationally competitive French companies is at a crossroads: State dominance of these companies is gradually declining because of privatization and a new corporate governance system for them is forming. On the one hand, in the relatively small French capital market, financial institutions may emerge as new sources of financing for French industry.²⁰ On the other hand, French market authorities have recently been attempting to develop their capital market, which should grow larger because of privatization, and European Union developments are pushing France toward an increasingly liberalized market economy. This capital market financing, with its hostile takeovers and United States-style institutional investor activism, is potentially at odds with financial institution monitoring in France. Thus, French privatization highlights, and to a certain extent has led to, this moment of transformation of French corporate governance. Moreover, because the size of French privatization requires in the long run non-French investment, particularly United States capital to succeed, it brings the United States institutional investors, with their newfound "activism," on the scene of the transformation and directly raises the issue whether they might have any effect upon it.

This Article proceeds as follows. Part II identifies investments by United States institutional investors made abroad because of globalization of the capital markets and privatization. Empirical evidence shows that United States institutional investors are investing offshore and in France. The evidence also shows that, in light of massive privatization occurring throughout Europe and France and because of limitations in domestic market capacity, United States institutional investor funds are needed for privatization, although the extent to which their funds are immediately needed is at issue.

Part III reviews evidence of the offshore activism of United States institutional shareholders and the reasons therefor. This part will show that the leaders of United States institutional investor activism, the public pension funds, are similarly

20. See *infra* subpart V.B.2 (discussing the role of financial institutions as "stable shareholders" in France).

the leaders in foreign activism. More generally, however, *all* United States institutional investors are increasingly taking seriously corporate governance as an integral part of their offshore investments. The strongest evidence of offshore activism by United States institutional investors is that an industry has arisen to aid these investors to understand and to participate in foreign corporate governance.

Part IV analyzes existing French corporate governance in large, globally competitive companies and current pressures to transform it. Government ownership of most of these companies resulted in a corporate governance system at first typified by complete government domination and later by a form of government relational investing that left considerable discretion to management. This management power furthered the government's goals because the background and formation of company executives created a continuity of interests between the state-owner and the managers. However, aside from privatization, powerful pressures in France are pushing French corporate governance toward an Anglo-American style capital market corporate financing. French government, market, and business authorities have all tried to improve the depth, liquidity and quality of the French capital market, with the goal of making Paris an important European finance center. More importantly, pressure for change comes from numerous European Union directives dealing with corporate governance and capital market issues that advocate a system of market-based corporate financing and corporate governance.

Finally, Part V examines the most recent stage of the ongoing French privatization, the involvement of United States institutional investors therein and their effect upon the transformation of French corporate governance. A review of French privatization suggests that it is putting into place an alternative to a corporate governance system based upon capital market financing. The privatization laws permit the Minister of the Economy to create a small group of controlling shareholders that arguably insulates the newly privatized company from market discipline. The full import of this core shareholder structure remains to be seen: it may provide company management with the time to focus on long-range plans, or it may lead to a closed, essentially oligarchic network of cross-ownership of financial and industrial companies.

United States institutional investors, which have partici-

pated actively in French privatizations, have generally been suspicious of a structure that may favor stable shareholders at their expense. However, given that the current French privatizations are primarily aimed at the French domestic market and that they have been attractively priced, United States institutional investor concerns have had little effect on the ongoing transformation of French corporate governance. This Part concludes with the observation that United States institutional investors may have more of an impact in further French privatizations if domestic interest in them declines. Even if they remain in their current subsidiary position, these investors at least draw our attention to changes in corporate financing and governance throughout the world, changes which we cannot ignore in the increasingly global capital markets.

II. GLOBALIZATION AND PRIVATIZATION

United States institutional shareholders will have an effect on foreign corporate governance only if they are making significant investments abroad and if non-United States companies, or countries, need their funds. Thus, as a preliminary matter, it is necessary to establish that United States institutional investors are investing abroad, particularly in Western Europe and France. It is also useful to show that governments and companies involved in privatization solicit the funds of these investors.

A. *Globalization of Investments*

United States institutional investors are making significant offshore investments.²¹ Statistics suggest that in recent

21. See Grundfest, *supra* note 16, at 350 ("the evidence shows that international investment activity has grown tremendously over the past decade, and there is reason to believe that international trading will continue to expand vigorously in the future"). At least once a week an article in the financial press describes non-U.S. investments by U.S. institutions. See, e.g., *World: Investment 1994—Gazing Into the Crystal Ball*, PLANNED SAVINGS, Jan. 1, 1994, available in LEXIS, World Library, TXTNWS File (pointing out that U.S. institutional investors attempting to counter "limited gains from equity investment" in the U.S. "have been diverting seemingly endless flows of cash overseas"); Jacques Neher, *Foreigners Look Beyond Gloom; Flood of Investment Money Favors Equities and Bonds*, INT'L HERALD TRIB., Nov. 4, 1993, at 19 ("We're seeing U.S. private and institutional investors fast increasing their holdings in European stocks and bonds as part of a secular trend to investing outside the U.S. . . .") (quoting Richard

years most of these investors have steadily increased their offshore investments.²² The flow of United States institutional investors' funds into Western Europe and France has generally followed this trend.²³

Spiegelberg, Director of Corporate Communications at Merrill Lynch, London); Rosie Shepperd, *USA: US Capital Markets—Growing Taste for Global Equity*, Reuters Textline Euroweek, Dec. 4, 1992, available in LEXIS, Europe Library, TXTWE File ("U.S. institutional investment in foreign equity is increasing year by year. . . . The success of any international stock offering is now largely dependent on U.S. demand."). A sign of the U.S. interest in foreign investment is that it is becoming increasingly easy in the U.S. to track performance of foreign companies. See Larry Armstrong, *For the Latest Line on ADRs, Get On-Line*, BUS. WK., Sept. 19, 1994, at 104 (describing how it is possible to obtain on-line information about foreign stocks).

22. See Thomas Olson, *Mellon Intensifies European Efforts Through Venture With French Bank*, PITT. BUS. TIMES, Aug. 3, 1992, at 7 ("The U.S. institutional investment market is generally judged to be a \$3 trillion realm of pensions, profit-sharing, endowments, public funds and the like") (comments of Mr. Adam); Shepperd, *supra* note 21 ("Figures produced by Greenwich Associates put the total (gross) volume of US institutional purchases of international equity at \$48.7[billion]."). Ms. Shepperd further observes that in 1992 "the 200 largest pension funds in the US have invested 12.5% of their portfolios abroad, which represents a steady 1% to 1.5% increase each year since 1988." *Id.* In addition, she notes that "net purchases of European and Asian equity by US institutions" is above "\$25[billion]; this figure in 1982 was only \$1.4[billion]," *Id.*; see also Norma Cohen, *US Pension Funds Increase Overseas Investment by 9%*, FIN. TIMES, Sept. 15, 1994, at 16 (describing how U.S. pension fund allocated \$22 billion to overseas investments for the first half of 1994); Howard Murad, *U.S. International Transactions, Third Quarter 1993*, in SURVEY OF CURRENT BUSINESS 62 (1993) ("Net U.S. purchase of foreign securities were a record \$45.3 billion in the third quarter, compared with \$24.1 billion in the second. . . . Net U.S. purchase of foreign stocks were \$24.4 billion in the third quarter, compared with the previous record of \$13.5 billion in the second."); *Pension Funds Can Shake Foundations of Financial Markets*, FIN. POST (London), May 4, 1993, at 15 ("U.S. pension funds . . . had invested just 4.6% [of] their assets abroad in 1991. But these were worth U.S.\$125 billion. Similarly, the 6.6% of assets invested outside the U.S. by American mutual funds was worth U.S.\$90 billion. . . . [However] U.S. pension funds are projected to double the share of foreign securities in total assets to 10% by the mid-1990s."); Rosie Shepperd, *US Investors Cool on Foreign Issues*, EUROMONEY, June 1994, at 10 ("Last year, large global funds based in the US poured record sums into international stock markets. Conservative estimates suggest that North American institutions invested \$160 billion offshore. That figure dwarfs the total amount of foreign investment for the whole of the preceding decade.").

23. David Buchan, *Scope for Plenty More*, FIN. TIMES, July 12, 1994, at IV ("As a home for foreign investment, France has remained relatively attractive in a European business climate that has depressed the 'animal spirits' of most investors."); James R. Kraus, *Credit Agricole Extends Its Reach With New Crop of Financial Services*, AM. BANKER, May 24, 1994, at 4 ("In recognition of the overseas movement by U.S. investors, Credit Agricole, one of France's larger banks is expanding into U.S. financial markets by reorganizing their existing American offices. Credit Agricole Securities will focus on distributing French and European securities

There are basic reasons for offshore investment by United States institutions. That a particular foreign company has strong economic fundamentals or that companies in a foreign market present favorable growth prospects are significant factors.²⁴ But the main reason for this offshore investment—portfolio diversification²⁵—is based upon finance theory. In a global market environment, an institutional investor reduces its risk by diversifying its portfolio, not only over a national market and its various industries, but also over the global market.²⁶ Thus, an overall decline in the value of in-

to U.S. institutional investors, such as pension and mutual funds, that are diversifying internationally.”); Howard Murad, *supra* note 22, at 62 (“Net purchases, primarily by large U.S. institutional investors, were largest for Western European stocks. . . .”); Madlyn Resener, *Europe: Shareholders of Europe, Unite!*, INSTITUTIONAL INVESTOR (Int’l Ed.), Nov. 1993, at 50 (“Attracted by lower price-earnings ratios and government privatization programs, and needing to diversify their equity holdings, U.S. . . . institutional investors have dramatically increased their investments in Europe during the past few years.”).

24. An example of a generally favorable view of a particular market is the recent investor perspective on France. See Barbara Wall, *In France, Confidence Despite Clouds*, INT’L HERALD TRIB., July 16, 1994, available in LEXIS, Europe Library, IHT File (“Confidence in the French equity market is surprisingly buoyant considering its leaden performance during the past 18 months. Analysts say that the majority of French companies are basically sound and due to benefit from an export-led recovery.”). But see Steve H. Hanke & Sir Alan Walters, *Too Clever by Half*, FORBES, Aug. 15, 1994, at 146 (“After pouring . . . billion[s] of francs into French stocks and bonds . . . foreign investors have begun to withdraw funds. . . . We would advise our readers to do likewise.”). Investor enthusiasm, of course, can change rapidly if investors are disturbed by fundamental problems affecting a particular economy. Geri Smith et al., *Mexico: Can it Cope?*, BUS. WK., Jan. 16, 1995, at 42 (pointing out that after the recent free fall of the Mexican peso and stock market “Mexico has shifted from a sure thing to a risky, developing country in the eyes of foreign investors”).

25. For a basic discussion of the unsystemic risks eliminated by portfolio diversification, see BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET 228-37 (1990). See also William J. Baumol & Burton G. Malkiel, *Redundant Regulation of Foreign Security Trading and U.S. Competitiveness*, 5 J. APPLIED CORP. FIN. 19, 23 (1993) (“As long as stocks in the portfolio do not move completely in parallel, fluctuations in the fortunes of individual stocks will at least partially offset one another and the resulting portfolio performance will be more stable than the fluctuations of the individual components.”).

26. See Baumol & Malkiel, *supra* note 25, at 24; see also Grundfest, *supra* note 16, at 362 (“Recently, however, investors have begun considering the benefits of diversification across national markets. Thus, instead of merely diversifying within domestic borders, investors now seek to hedge against domestic market risk by purchasing foreign equities, bonds, real estate, and other assets.”). Professor Grundfest makes a point often repeated in finance literature: most investors are insufficiently diversified and, thus, cross-border transactions are likely to increase as the diversification theory is increasingly put into practice. *Id.* at 366. For more

vestments in one country's market or industries could be balanced or hedged by growth in other investments in other countries.

Financial strategies and theories provide the rationale for foreign investment by United States institutions. However, institutions will not make these investments if their risks and related costs outweigh possible benefits, or are so unquantifiable as to make the investment unreasonable.²⁷ For example, the lack of liquidity of a particular foreign investment or market may make it difficult for an investor to manage its investment efficiently.²⁸ A foreign market may be subject to trading abuses that enhance the risk of unacceptable loss to an investor.²⁹ Moreover, there may be custodial and execution problems with offshore investing that collectively impose significant risks and costs upon a particular investment.³⁰

discussion of the benefits of international portfolio diversification, see Cheol S. Eun, *International Portfolio Diversification*, in DAVID K. EITEMAN ET AL., *MULTINATIONAL BUSINESS FINANCE* 367-87 (1992); ALAN C. SHAPIRO, *MULTINATIONAL FINANCIAL MANAGEMENT* 395-409 (1992); BRUNO SOLNIK, *INTERNATIONAL INVESTMENTS* 39-69 (1991).

27. See, e.g., Eun, *supra* note 26, at 383 (referring to possible high transaction costs for foreign investments); SHAPIRO, *supra* note 26, at 403 (describing barriers to international diversification); SOLNIK, *supra* note 26, at 59.

28. See SHAPIRO, *supra* note 26, at 403 ("The lack of *liquidity*—the ability to buy and sell securities efficiently—is a major obstacle on some overseas exchanges."); Coffee, *supra* note 1, at 1318-21 (discussion of reasons for desire for liquidity by institutional investors).

29. A frequently cited argument in efforts to improve disclosure and to address trading abuses in a non-U.S. market is that more outside investment will be attracted to a market regarded as being free of trading abuses. Cf. SOLNIK, *supra* note 26, at 60 (observing that "[i]f foreign markets were too inefficient a manager would probably not run the risk of investing in these markets to benefit the domestic speculators.").

30. The costs arise from what are often termed "back office" matters. They would include brokerage costs in making an investment in a foreign company, costs associated with the custody of such investment, if it needs to be held abroad (not in the form of American Depositary Receipts), and transactional costs involved in clearance and settlement of securities transactions. It has been reported that these costs are generally higher outside the U.S. See Baumol & Malkiel, *supra* note 25, at 20-21. Not only can these costs be significant, but if custodial or settlement mechanics do not work properly, an entire investment could be jeopardized. These concerns are not purely speculative. One has only to think of the U.S. "paperwork crisis" in the 1970s where back offices were so overrun with attempting to handle the transfers of certificated securities in the settlement process that securities were lost and transactions not completed. For a description of this crisis and its consequences, see MARSHALL E. BLUME ET AL., *REVOLUTION ON WALL STREET: THE RISE AND DECLINE OF THE NEW YORK STOCK EXCHANGE* 116-27

How these issues have been, and are being, addressed in international investing is beyond the scope of this Article. It suffices to say that there are ongoing national and international efforts to reduce the risks and costs of investing in foreign companies for all investors.³¹ In fact, United States market and regulatory authorities continue to create opportunities for United States institutions to invest in non-United States securities while retaining the protection of the United States securities laws.³² United States institutional investors will thus

(1993). Professor Grundfest has rightly observed that, without technological advances in telecommunications and computers, there would likely be few international securities transactions. See Grundfest, *supra* note 16, at 361-62.

31. On the international level, concerted efforts to improve the safety of cross-border investing has come from the Group of Thirty, an organization of market authorities from the most developed countries. In 1989, the Group of Thirty published a report on clearance and settlement in the securities markets with a list of recommendations that, if implemented, would help eliminate certain risks involved in clearance and settlement of national and international transactions. GROUP OF THIRTY, REPORT ON CLEARANCE AND SETTLEMENT SYSTEMS IN THE WORLD'S SECURITIES MARKETS (1989). The work of the Group of Thirty has been furthered by other international organizations, *see, e.g.*, INT'L SEC. MKT. ASS'N, TOWARDS A SINGLE EUROPEAN SECURITIES TRADING MARKET (1992), and by private market participants, *see, e.g.*, MORGAN GUAR. TRUST CO. OF NEW YORK, CROSS-BORDER CLEARANCE, SETTLEMENT, AND CUSTODY: BEYOND THE G30 RECOMMENDATIONS (1993). In this country, the Securities and Exchange Commission (SEC) has worked to further the goals of the Group of Thirty. See Report of the Bachmann Task Force on Clearance and Settlement Reform, Exchange Act Release No. 30,802, 57 Fed. Reg. 27,812 (1992).

32. In recent years, the SEC and the self-regulatory organizations ("SROs"), such as the stock exchanges, have facilitated investment by U.S. institutional investors in foreign companies. The most striking example is the promulgation of Rule 144A under the Securities Act of 1933, which permits an offering of certain kinds of securities to qualifying institutional investors without the need for offering participants to comply with the registration requirements of the Act. See 17 C.F.R. § 230.144A (1994). It was thought that foreign issuers would be less reluctant to offer securities in the U.S. if they had a "safe harbor" from these requirements. See Sara Hanks, *Rule 144A: Another Cabbage in the Chop Suey*, 24 GEO. WASH. J. INT'L L. & ECON. 305, 350-51 (1990).

Rule 144A was partly inspired by a concern among U.S. market authorities to maintain the dominant position of U.S. capital markets. This dominance would erode if large, sophisticated U.S. institutional investors would go offshore to purchase foreign securities. Cf. Baumol & Malkiel, *supra* note 25, at 21 (concern that onerous U.S. regulatory requirements could cause U.S. investors to move offshore for their trading in foreign securities). A debate is now underway in the securities bar over whether the SEC is adequately accommodating foreign issuers that wish to have access to the U.S. capital markets. The concern is not that U.S. investors will stop investing in the capital markets, but that they will go abroad. See E.F. Greene et al., *Internationalization of the World's Capital Markets: U.S. Regulatory Alternatives*, in AMERICAN BAR ASSOCIATION, SHAPING REGULATORY POLICY FOR THE

likely continue to invest in foreign companies, barring a cataclysm in the international markets.

B. Privatization

Given that United States institutional investors are increasingly investing in non-United States companies, it is not surprising to find that they are purchasing shares of privatized companies and that governments and privatized company managers solicit these investors. To understand this process, it is necessary to review briefly the structure of a typical Western European privatization.

In Western Europe, privatization generally involves the transfer of large, world-class companies that are owned or controlled by the government, directly or indirectly, to the private sector.³³ Privatization is generally a complex political and cultural process. As we shall see in the case of France, the transfer is typically justified under the liberal economic rationale that such companies will be operated more efficiently and productively if they are exposed to market discipline and freed from the control and protection of the government.³⁴ The ra-

CAPITAL MARKETS 1, 40 (1994) (arguing for more flexibility on the SEC's part in allowing foreign companies to register their shares for offer and sale in the U.S.).

33. See GIUSEPPE FAJERTAG, *PRIVATISATION IN WESTERN EUROPE* 35-36 (1988) (enumerating the kinds of privatization, including "floating all or some of the shares").

34. See FAJERTAG, *supra* note 33, at 37; Yacob Haile-Mariam, *Privatization of State-Owned Enterprises and the Law: Issues and Problems*, 7 EMORY INT'L L. REV. 35, 35-40 (1993) (discussion of the rationale for privatization); John Vickers & Vincent Wright, *The Politics of Industrial Privatisation in Western Europe: An Overview*, in *THE POLITICS OF PRIVATISATION IN WESTERN EUROPE* 1, 6 (John Vickers & Vincent Wright eds., 1989) ("At bottom, there is a deep-seated suspicion in neo-liberal circles of politico-bureaucratic compromises which usurp the role of the market as the mechanism for allocating resources. Uninhibited, market-oriented, profit-seeking entrepreneurs are preferred to budget-maximising bureaucrats and vote-maximising politicians."). Mary Shirley of the World Bank has explained well this rationale:

The existence of private property rights is a second reason why privatization results in better performance. Typically profit-oriented owners push their companies to perform better at lower costs and to be more service- and client-oriented. Unlike the public owner, private owners are usually quicker to change management and faster to respond to opportunities. This is due in part to the fact that private owners are motivated by their own stake in the company and in part to the fact that they are free of the political constraints that bind governments.

Mary M. Shirley, *The What, Why, and How of Privatization*, 60 FORDHAM L. REV.

tionale reflects a general dissatisfaction with, and discrediting of, a government's ability to improve the economic welfare of its citizens by operating directly large sectors of the economy.³⁵ That a government may improve its own financial position by ridding the public budget of companies in need of frequent capital contributions also explains privatization.³⁶

The transfer of a government-owned company to the private sector often involves the public sale of shares on securities markets. Depending upon the company and Western European country involved, this sale could be large in relation to existing market capitalization.³⁷ This small domestic market may

S23, S27 (1992).

Even those who cite the above argument for privatization recognize that the sale of a government-owned company into private hands will not alone transform a company into an efficient organization. As Shirley further observes:

Typically, privatization works best when it is only one part of a larger program of reforms designed to create an environment that promotes efficiency. Such a program usually includes: trade reforms encouraging competition and export; price reforms liberalizing markets; regulatory reforms safeguarding competition by removing obstacles to private entry and exit; and legal reforms assuring proper disclosure, enforcement of contracts, and due process.

Id. at S29; see also Colin Scott, *Privatization, Control, and Accountability*, in CORPORATE CONTROL AND ACCOUNTABILITY: CHANGING STRUCTURES AND THE DYNAMICS OF REGULATION 231-45 (Joseph McCahery et al. eds., 1993) ("However, it is apparent that ownership is only one aspect of industrial efficiency, and that competition and regulation play an important role."). Thus, if a privatized enterprise has a monopoly position (e.g., such as a public utility), the expected efficiencies from privatization might emerge only if competition were somehow externally introduced into the market. See COSMO GRAHAM & TONY PROSSER, *PRIVATIZING PUBLIC ENTERPRISES* 254-55 (1991).

35. See FAJERTAG, *supra* note 33, at 32-33; Vickers & Wright, *supra* note 34, at 6.

The global economy also pushes governments to privatize. A company may have difficulty competing globally if it is too closely linked with the policies of a particular nation. If a company suffers losses, national economic welfare is hurt when the government must cover the losses in its budget. See *id.* at 2 ("Economies of scale in some industries are now on a European or world level: industrial decisions rooted in national politico-bureaucratic compromises are perceived as hindrances in an environment demanding flexibility and speed in decision-making.").

36. See FAJERTAG, *supra* note 33, at 33 ("If the public undertakings and services are transferred from the public to the private sector, the State will no longer be in the position of having to subsidise them, taxpayers will pay lower rates of tax because the State will no longer need money for public-sector subsidies, and the users of public services will also, so the argument goes on, enjoy better services and lower prices, thanks to competition."); see also Vickers & Wright, *supra* note 34, at 7-8.

37. See Vickers & Wright, *supra* note 34, at 8 ("A third financial reason for privatisation, heard in Britain but more especially in France and Italy, is that it

arise from the fact that, for various reasons, retail investors have not traditionally purchased equity shares. A small domestic market may also be explained by the fact that there are few institutional shareholders in a particular country. A given domestic market may thus be unable to absorb all of the shares of a privatized company.³⁸ This domestic market limitation explains why a privatization often needs other than domestic investors to ensure its success.³⁹ Moreover, management of privatized companies may seek out foreign investors because, in losing the government as primary capital provider, management may want the greatest exposure possible to other foreign capital markets and investors so as to maximize the company's flexibility for future capital raising.⁴⁰

Consequently, in a Western European privatization, government authorities will generally structure a public sale to include non-domestic investors. A certain portion of the offered shares may be reserved for "international" investors.⁴¹ Given the purchasing power of United States institutional investors, governments often plan to sell them a large percentage of these shares.⁴²

fosters the growth of the stock exchange: it can widen capital markets by bringing in many new investors and 'deepen' them by introducing mature companies with strong market positions."). It is generally acknowledged that, with the possible exception of the U.K., Western European privatizations have as one goal to boost the size of the otherwise thinly capitalized European stock markets and to make them more available for corporate finance. See Richard House, *The Great European End-of-the-Century Asset Sale*, INSTITUTIONAL INVESTOR, Mar. 1993, at 87.

38. In the case of many European privatizations, their success is dependent upon foreign buyers; the importance of foreign purchasers is even more significant if domestic investors do not purchase expected amounts or if new pension funds do not materialize. See MORGAN STANLEY & CO., GLOBAL STRATEGY & ECONOMICS: EUROPEAN PRIVATISATION 9-11 (1993). In fact, one reason for a privatization is to increase stock market capitalization and thus to make a domestic market more liquid.

39. The need may not arise immediately, however, but only in later stages of the privatization. See *infra* text accompanying notes 225-27.

40. Cf. Vickers & Wright, *supra* note 34, at 18 (describing why managers of government-owned companies might prefer to be free of government oversight so as to concentrate properly on business goals).

41. Cf. MORGAN STANLEY & CO., *supra* note 38, at 2 ("In many of the large privatisations lined up in Europe, encouragement of the foreign investor will be crucial to the success of the programme.").

42. See Leah Nathans Spiro et al., *Wall Street's Global Power*, BUS. WK., Nov. 1, 1993, at 102 (discussing the importance of U.S. investment banks in global capital raising because of their "home-court advantage," i.e., their access to the "well-developed U.S. pension and mutual-fund system"); *Selling the World*, ECONO-

The support of United States institutional investors is needed for successful privatization of Western European companies. In fact, competition exists for United States capital, given the large number of planned privatizations in Western Europe in the coming years.⁴³ This need for United States institutional money in a competitive situation suggests that government and privatized company management should be sensitive, and even accommodating, to corporate governance concerns expressed by these investors. This observation raises the question of whether United States institutional investors are bringing abroad a corporate governance agenda.

III. THE "ACTIVIST" UNITED STATES INSTITUTIONAL INVESTOR ABROAD

This part first explores reasons for United States institutional investor offshore activism on corporate governance matters as well as obstacles to such activism. It next describes available evidence for the activism. Specifically, the evidence shows that United States investors are concerned about corpo-

MIST, May 8, 1993, at 81 (reports are that U.S. funds dominate money that is available for globalization).

43. The amount of privatization planned in Western Europe for the next five years is projected to be in the range of \$150 billion and includes (or has included) companies in the U.K., France, Italy, Spain, the Netherlands, Belgium, Sweden, Germany and Greece. See MORGAN STANLEY & CO., *supra* note 38, at 3-8 (listing countries and projected companies to be privatized); Dean Foust et al., *Financing World Growth*, BUS. WK., Oct. 3, 1994, at 100 (discussing demands on capital from countries around the world); House, *supra* note 37, at 87 (listing planned privatizations in different countries) ("Will there be enough capital to satisfy everyone? There are some worrisome signs. Current capital flows into Europe will not be enough to support the level of privatizations planned by European governments."); U.K.: *European Privatizations May Swamp Markets*, Reuters News Service, Jan. 24, 1994, available in LEXIS, Europe Library, TXTWE File.

The power of global capital points to a significant political issue: the ability of markets to dictate terms to governments. See Thomas L. Friedman, *When Money Talks, Governments Listen*, N. Y. TIMES, July 24, 1994, § 4, at 3 ("As more countries have gone capitalist, there is a huge global competition for cash and investors, so that governments can build roads, power stations and telephone systems that are the foundation for higher living standards."). Sometimes countries will go to great lengths to attract the global capital flow. See Joseph Fitchett, *A 'Traveling Salesman' in Hermes Tie; Tordjman Spreads the Word About France's Improved Investment Climate*, INT'L HERALD TRIB., June 7, 1994, (Special Report, French Economy), at II ("No effort is spared [to attract foreign investors]. Last month, a handful of U.S. pension fund managers—controlling \$400 billion that has to be invested somewhere—spent a week [being lavishly entertained] in Evian, the spa on Lake Geneva.").

rate governance in Western European companies, although for reasons of cultural unfamiliarity their activism there is more tempered than the activism they have recently displayed in the United States.

A. Reasons for United States Institutional Shareholder Activism Offshore

At a basic level, the reasons for institutional investor activism should be the same offshore as onshore. If product market and capital market pressures do not alone dictate corporate productivity and total shareholder return, *i.e.*, if corporate governance matters, shareholder-owner oversight of the management-agent could improve corporate governance and productivity.⁴⁴ This perspective also presupposes that investors will not always find it economically feasible to sell their holdings when dissatisfied with management, rather than participate in corporate governance.⁴⁵

Moreover, legal requirements that oblige United States institutional shareholders to take an "activist" position in corporate governance are essentially no different for foreign and domestic investments. If these investors must follow a "prudent man" rule as to their investments and if voting of shares and other activism could benefit the funds they are managing, the fiduciary duty would support investor activity offshore and onshore.⁴⁶ Although some uncertainty recently existed on

44. As Jeffrey Gordon has explained:

This [the statement that "[s]hareholders and society generally will benefit from a mechanism that replaces the firm's incumbent managers well before the firm succumbs to competitive forces"] is based on an assumption that corporate governance matters to the performance of the firm and thus significantly affects performance of the national economy. This assumption might be contested by those who believe that another factor, such as technological innovation or education of the work force, is the key variable and that governance, if it matters at all, is marginal. Corporate governance matters, however, because management matters.

Gordon, *supra* note 3, at 124 n.1.

45. Even an important critic of the importance of institutional activism, Professor Coffee of Columbia would admit that there are cases when activism is likely. See Coffee, *supra* note 3, at 869-71. Thus, I shall not revisit here debates on the general usefulness of institutional investor involvement as a response to the Berle-Means corporate agency problem, but shall presume its utility.

46. Howard Sherman of the Institutional Shareholder Services Inc. observes that, although there has been some uncertainty as to legal standards for funds with respect to voting securities held abroad, parties generally conclude that there

whether private pension funds had to vote foreign shares, Department of Labor guidelines stipulate that fund managers exercise their right of vote in these cases in an informed way.⁴⁷ While these legal prescriptions do not mandate activism, they demand more than a cursory treatment of voting rights or a "rubber stamping" of all management proposals.

No matter what the legal standard requiring the institutional investor to take seriously its oversight, the investor must consider the potential costs of its activism, even the costs of voting. Costs have been customarily greater in the foreign context than those in the United States market, which investors often reduce through operational efficiencies.⁴⁸ Whether

is a legal obligation to exercise voting rights on such securities, where the costs do not outweigh the potential benefits. See Howard D. Sherman, *Global Proxy Voting: Regulatory Requirements and Industry Solutions*, INSIGHTS, Dec. 1992, at 24. Mr. Sherman also contends that fund managers should "seek ways to lower the costs of voting in" markets where it is not currently economical to do so. For a discussion of the general fiduciary duties applicable to mutual funds and public pension funds, see BETTY L. KRIKORIAN, *FIDUCIARY STANDARDS IN PENSION AND TRUST FUND MANAGEMENT* 345-46 (1989).

47. See, e.g., Buxbaum, *supra* note 5, at 22 n.80. The Department of Labor, Pension and Welfare Benefits Administration recently issued an interpretive bulletin dealing specifically with voting of proxies by pension funds (private) subject to its jurisdiction. Department of Labor Pension and Welfare Administration Interpretive Bulletin, 59 Fed. Reg. 38,860 (1994) [hereinafter Dep't of Labor Release]. It stated that plan officials have the same fiduciary responsibility to vote proxies in foreign companies as they do with respect to U.S. corporations: "[I]t is the Department's view that the same principles apply. Namely, plan fiduciaries have a responsibility to vote proxies on issues that may affect the value of the [foreign] shares in the plan's portfolio." *Id.* at 38,861. The Department recognized that, in certain cases, the costs of complying with this requirement might outweigh the benefits to the plan. See *infra* note 48.

48. In its recent interpretative release governing voting by private pension plan fiduciaries, the Department of Labor specifically recognized that "the cost of exercising a vote on a particular proxy proposal [in a foreign corporation] could exceed any benefit that the plan could expect to gain in voting on the proposal." Dep't of Labor Release, *supra* note 47, at 38,861. Accordingly, the Department directed the plan fiduciary "to weigh the costs and benefits of voting on proxy proposals relating to foreign securities and make an informed decision with respect to whether voting a given proxy proposal is prudent and solely in the interest of the plan's participants and beneficiaries." *Id.* The fiduciary's decision "should take into account the effect that the plan's vote, either by itself or together with other votes, is expected to have on the value of the plan's investment and whether this expected effect would outweigh the cost of voting." *Id.* In fact, a fiduciary should consider "whether the difficulty and expense of voting its shares is reflected in their market price" when it makes the initial investment decision. *Id.*

The above suggests that a plan fiduciary cannot refuse to exercise a foreign proxy because the exercise is difficult or somewhat costly. Rather, the fiduciary must weigh the corresponding benefits to the plan, benefits that could come not

or not an investor made its investment in a non-United States company through the United States securities market,⁴⁹ the institutional investor needs information from the company as well as specific information about issues eligible for a shareholder vote. The provision of this information is often costly, as are its translation and any explanation of its significance to the investor. Even voting could generate significant costs because foreign proxy voting procedures could be complicated or cumbersome. For example, proxy rules might require the presence of a shareholder representative or the "immobilization" of shares for a certain period of time before the shareholder meeting.⁵⁰ The immobilization prevents an investor from making a

solely from the plan's voting, but its votes combined with those of similarly-minded shareholders. Moreover, if voting is difficult, the plan fiduciary should have purchased the securities initially at a discount to reflect these costs. This language should be read in conjunction with another part of the Release that specifically urges funds to take an activist position:

An investment policy that contemplates activities intended to monitor or influence the management of corporations in which the plan owns stock is consistent with a fiduciary's obligations under ERISA where the responsible fiduciary concludes that there is a reasonable expectation that such monitoring or communication with management, by the plan alone or together with other shareholders, is likely to enhance the value of the plan's investment in the corporation, after taking into account the costs involved.

Id. at 38,864.

49. Foreign equity is often traded in the U.S. in the form of American or Global Depositary Receipts ("ADRs"). ADRs evidence Depositary Shares that are issued by a U.S. bank and that represent an interest in underlying foreign securities that are held in custody by the bank. The general purpose of the ADR structure is to provide U.S. investors with a share denominated in dollars, which facilitates U.S. trading and settlement and which allows certain U.S. institutions that must hold dollar-denominated securities to invest in foreign shares. If the underlying issuer "sponsors" the program, the issuer generally agrees to provide English information on corporate events and to facilitate voting by U.S. investors. The ADR facility also provides for a currency exchange so that U.S. investors are paid dividends in dollars. *See generally* Joseph Velli, *American Depositary Receipts: An Overview*, 17 *FORDHAM INT'L L.J.* S38 (1994). It is reported that U.S. institutional investors feel that the existence of an ADR facility enhances the appeal of a foreign company. *See U.S. Fund Managers Plan to Boost Foreign Investment*, Press Ass'n Newsfile, July 21, 1993, available in LEXIS, World Library, ALLWLD File (citing Broadgate Consultants Inc. 1993 global investments trend survey).

50. For example, French companies generally require the immobilization of "bearer" shares for five days before a shareholders' meeting. Foreign investors will usually hold their shares in bearer form because it is difficult to hold shares registered with the company. *See SOCIÉTÉ NATIONALE ELF AQUITAINE*, PROSPECTUS 37 (1994) [hereinafter *ELF*]; *see also* Sherman, *supra* note 46, at 26 (describing various impediments, including blocking of shares, to foreign proxy voting).

profitable use of the shares during that period (e.g., by lending the shares).⁵¹

Until recently, the costs of obtaining information about, and of being able to vote shares of, foreign companies were high enough to make it questionable whether voting and activism by United States institutional investors for foreign companies were economically feasible.⁵² In global markets, information about world-class and other public companies is now readily available, and economists believe that major foreign markets operate efficiently.⁵³

Moreover, foreign proxy voting has become easier for institutional investors. As will be discussed below, numerous organizations exist that provide services ranging from advice on, to complete handling of, voting matters. Thus, structural problems no longer pose significant obstacles to United States institutional investors who wish to participate in foreign corporate governance.

B. United States Institutional Investor Activism in Western Europe

Economic and legal reasons thus suggest that United States institutional investors should participate in the corporate governance of foreign companies in which they have invested. Available evidence, which comes from press reports and conversations with interested parties, suggests that this phenomenon is in fact occurring, and is perhaps on the rise. In fact, as global portfolios of United States institutional investors grow, the real challenge in the corporate governance area is a "global" one: to participate in, and to affect, corporate governance in foreign companies.⁵⁴

51. Securities can be lent for profit, often for settlement purposes, on a short-term basis. See EUROCLEAR OPERATIONS CENTRE, SUPPLEMENTARY TERMS AND CONDITIONS GOVERNING THE LENDING AND BORROWING OF SECURITIES THROUGH EUROCLEAR (1991) (describing program of lending and borrowing of securities held in the Euroclear System, located in Brussels, Belgium and operated by Morgan Guaranty Trust Company of New York).

52. See Sherman, *supra* note 46, at 25 (pointing out how, until recently, it was difficult to vote proxies); see also STEPHEN M. DAVIS, SHAREHOLDER RIGHTS ABROAD: A HANDBOOK FOR THE GLOBAL INVESTOR 39-42 (1989).

53. See Baumol & Malkiel, *supra* note 25, at 26 ("Taken as a whole, then, the evidence supports the conclusion that markets for the shares of non-U.S. companies appear to be as efficient as those for U.S. firms. Publicly available information seems to be incorporated quite rapidly into share prices in all markets.").

54. See Joseph Lufkin, *International Proxy Voting and Corporate Governance*,

Activism by United States institutional investors has evolved as, advised by legal and business school academics who study corporate governance, the institutions have experimented with different tactics and relevant laws have changed.⁵⁵ The activities range from opposition to specific board resolutions considered to affect adversely share value because they entrench management, to attempts to structure the board or to affect board composition,⁵⁶ to the recently popular practice of pressuring management and the board in informal discussions and through the strategic use of the press.⁵⁷

INSIGHTS, Dec. 1991, at 26 (describing how "U.S. institutions must develop the capability to plan and manage integrated governance initiatives to be undertaken with regard to foreign countries and/or companies").

55. Legal academics and practitioners have made numerous suggestions about institutional activism. To name a few, Professors Gilson and Kraakman recommend that a professional class of outside directors be established so that institutional investors in a particular company can together select a representative from this class to monitor the company on their behalf. See Gilson & Kraakman, *supra* note 1, at 883-92. Joseph Grundfest proposes that, when opposed to a management position, institutional investors "just vote no" and publicize their opposition, producing a reputational harm to the company that would adversely affect company management. See Grundfest, *supra* note 1, at 928. Jeffrey Gordon argues for the resurrection of cumulative voting to ensure that institutional investors will be able to elect a representative to the board. See Gordon, *supra* note 3, at 165-74. While some of the recommended strategies have been tried, others have not yet found a following. See Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187 (1991) (proposal to elect board members for a five-year term where board members could not be removed).

56. See Gordon, *supra* note 3, at 132-42 (discussing various strategies open to institutional investors with respect to affecting the board, *e.g.*, ensuring an appropriate board structure, attempting to place certain members on the board, having a policy input).

57. A useful way of identifying particular strategies used, or board resolutions favored, by institutional investors is to review issues of the Institutional Investor Responsibility Center's *Corporate Governance Bulletin*. The Dep't of Labor Release, sets forth some of the more popular methods and issues on the activist agenda:

Active monitoring and communication activities would generally concern such issues as the independence and expertise of candidates for the corporation's board of directors and assuring that the board has sufficient information to carry out its responsibility to monitor management. Other issues may include such matters as consideration of the appropriateness of executive compensation, the corporation's policy regarding mergers and acquisitions, the extent of debt financing and capitalization, the nature of long-term business plans, the corporation's investment in training to develop its work force, other workplace practices and financial and non-financial measures of corporate performance. Active monitoring and communication may be carried out through a variety of methods including by means of correspondence and meetings with corporate management as

The perspective of United States institutional shareholders on Western European corporate governance is guided by their United States activities and views of United States corporate governance. United States institutional investors focus abroad generally on the same issues that concern them in United States corporations: management either attempts to insulate itself from market discipline or privileges other purposes over total shareholder return.⁵⁸ For the same reasons explaining their activism at home, pension funds are also the activist leaders of United States institutional investors abroad.⁵⁹ Given the number of Western European jurisdictions and the relative unfamiliarity of United States investors with the complexities of these foreign settings,⁶⁰ these United States insti-

well as by exercising the legal rights of a shareholder.
Dep't of Labor Release, *supra* note 47, at 38,861.

The effects of institutional activism have been adequately documented. See Black, *supra* note 1, at 828. It is again difficult to pick up the daily financial press without seeing a sign of institutional investor pressure on some company.

58. See, e.g., Martin Dickson, *Ballot Box Crusaders Ride to Foreign Wars: The Rise of Global Activism Among U.S. Institutional Shareholders*, FIN. TIMES, Mar. 3, 1993, at 21 ("U.S. institutional investors, having stirred up corporate America over the past five years with demands for better run business and more accountable management, are beginning to flex their muscles in other leading western economies."); Richard A. Melcher & Patrick Oster, *Yankee-Style Activists Strike Boardroom Terror Abroad*, BUS. WK., Mar. 15, 1993, at 74 ("[The] shareholder uprising is reaching across the globe. In Canada, Continental Europe, and Japan—where entrenched bank cliques, families, and governments hold sway over managers—shareholders are trying to change the balance of power."); David Waller & Martin Dickson, *California Activism Arrives in Germany*, FIN. TIMES, Dec. 10, 1992, at 20 (noting that non-German institutional investors have privately complained "that German companies are run more in the interests of management, workforce and vested banking and insurance contracts."). U.S. institutional shareholders are particularly concerned with counteracting the power of "established" European institutional investors that have control of companies or close links with management. See Leslie Wayne, *Exporting Shareholder Activism*, N.Y. TIMES, July 16, 1993, at D1 ("The overriding issue is that we are gradually chipping away at an old structure dominated by banks and other friendly investors that often have supermajority shares. . . . Unequal voting rights have given these old institutions the lion's share of the power and outside shareholders feel their interests are not being served.") (quoting Howard Sherman of Institutional Shareholder Services Inc.).

59. Reports in the press show that public pension funds, rather than other kinds of institutional investors, have been the most "activist" of the U.S. institutional investors abroad. See Wayne, *supra* note 58, at D1 (discussing activism of Wisconsin Fund (public pension fund) and CalPERS in Western Europe). Professor Coffee has explained why such institutional investors, rather than their counterparts, are prone to take activist positions. See Coffee, *supra* note 3, at 869.

60. At a recent conference on mutual funds and corporate governance, spon-

tutions are more inclined in the short term to adopt "blanket" or "generic" approaches to foreign corporate governance. For example, they are likely to identify resolutions they oppose or favor and to vote, or instruct their custodians to vote, in accordance with their policies.⁶¹

In their actions and statements abroad, United States institutional investors show that they are aware that they are on unfamiliar cultural and legal ground. This behavior supports Professor Coffee's observation that, in light of the large number of United States institutional investors and their tendency to diversify their holdings, they are likely to be more effective in corporate governance if they form broad-based coalitions with other investors on certain issues.⁶² Accordingly, instead of challenging a company's board or management themselves, these investors (even the public pension funds) prefer to follow the lead of a local shareholder or shareholder group and to limit public intervention to egregious governance problems.⁶³ One pension fund is reported to have said that it

sored by the Columbia Law School Institute on Institutional Investors, Robert Pozen, General Counsel of the Fidelity Group of Mutual Funds, remarked that, from his perspective, the corporate governance situation in Europe is complex, and that fund managers were only gradually learning to understand European corporate governance. Robert Pozen, *The Potential and the Problems*, Remarks at Columbia University Institutional Investor Project Conference on Mutual Funds and Corporate Governance (May 5, 1994). In a conversation with the author, Joseph Lufkin of the Global Proxy Services Corporation explained that many pension fund managers are completely unfamiliar with European corporate governance. Telephone Interview with Joseph Lufkin, Managing Director, Global Proxy Services (Apr. 6, 1994) [hereinafter Lufkin Interview].

61. See Sherman, *supra* note 46, at 27 (discussing the importance for a fund to develop "guidelines outlining general voting principles"). It is likely that, because institutions are on unfamiliar ground and because costs are potentially prohibitive, institutions are likely to take "generic" solutions to foreign problems or issues. See Gordon, *supra* note 3, at 135-37 (discussing advantages and disadvantages of generic, versus firm specific, strategies). However, Joseph Lufkin of the Global Proxy Services Corporation argues that institutional investors must move beyond the resolution stage to develop "less visible" ways of having a more effective influence on foreign corporations and their national regulatory systems. See Lufkin, *supra* note 54, at 23.

62. See Coffee, *supra* note 3, at 851.

63. See Resener, *supra* note 23, at 51 ("The idea is to identify nascent situations or to create situations in which we can encourage and support local investors with interests similar to ours.") (quoting Joseph Lufkin, managing director of Global Proxy Services Corporation). However, Lufkin argues that U.S. institutional shareholders must know when to act independently: "The most successful institutions will be those who know when to act American, when to act local, and when to take a more cosmopolitan approach." See Lufkin, *supra* note 54, at 23.

wants local parties to identify the important domestic market issues and to come to it for support.⁶⁴ These local parties could be organizations of small shareholders or domestic institutional investors.⁶⁵ Because the number of institutional shareholders (*i.e.*, pension funds, mutual funds) has been small in most Western European markets,⁶⁶ United States institutions cannot always find comparable institutions with which to join forces. However, U.K. institutional investors, particularly U.K. pension funds, are active in relevant European markets and thus are providing potential allies.⁶⁷

The strongest evidence of offshore activism by United States institutional investors is the industry that has sprung up to aid these investors to understand and to participate in foreign corporate governance. This industry has basically grown out of organizations that aid institutional investors on United States corporate governance.⁶⁸ These organizations

64. Telephone Interview with Robin Meszoli, Editor, *The Global Shareholder* (Apr. 4, 1994).

65. See *Europe: Shareholders' Rights in Europe*, *ECONOMIST*, July 3, 1993, at 72 (pointing out that shareholder activism, which is homegrown, is becoming more pronounced in Europe and gathering support from large Anglo-American funds); Sherman, *supra* note 46, at 25.

66. See Wymeersch, *supra* note 18, at 5-9 (discussing how institutional investors in European countries are often not truly independent, but are linked to financial groups or banks).

67. See Marlene G. Star, *Shareholder Activism Picks Up in Europe*, *PENSIONS & INVESTMENTS*, June 8, 1992, at 43 (discussing renewed activism by U.K. institutional investors); see also Bernard S. Black & John C. Coffee, Jr., *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 *MICH. L. REV.* 1997 (1994) (discussing U.K. institutional investors); Paul L. Davies, *Institutional Investors in the United Kingdom*, in *CONTEMPORARY ISSUES IN CORPORATE GOVERNANCE*, *supra* note 18, at 69-96 (describing U.K. institutional investors and their corporate monitoring).

One recent French example typifies U.S. institutional shareholder involvement with local market allies. Pinault-Printemps ("PP"), a large French retailer, purchased shares of a mail order company, La Redoute, and decided to effect a merger in which PP shares would be offered to La Redoute shareholders, which included the College Teachers Equity Fund ("CREF"). There was concern among La Redoute's shareholders that PP was directly or indirectly manipulating the price of PP and La Redoute shares before the merger ratio was determined so as to affect adversely La Redoute shareholders. A French shareholder rights group brought suit against PP for this manipulation and spurred investigation by the French market authority, the Commission des Opérations de Bourse. While not joining in the suit, CREF publicly stated its support for the plaintiff. See *Le Redoute Holders Back Pinault-Printemps Merger*, *WALL ST. J.*, May 19, 1994, at A10; *Shareholders Rights in France*, *ECONOMIST*, Mar. 12, 1994, at 87.

68. For example, the Investor Responsibility Research Center ("IRRC"), which

perform a number of tasks for the United States institutional investor. Some, like the Investor Responsibility Resource Center, provide information on foreign corporate governance issues through newsletters or an occasional book.⁶⁹ They might also perform studies of particular markets or market events.⁷⁰ Other organizations offer services in addition to general reporting of foreign corporate governance issues. These firms, such as Institutional Shareholder Services, Inc. and the Global Proxy Services Corporation, are best described as "global proxy" organizations: they actively assist United States institutional shareholders in voting their proxies. This assistance can include establishing with a particular investor voting guidelines on issues of corporate governance. It can extend further to the organization's voting for the investor. This may involve collaboration with the custodian bank holding the offshore investments for the pension or investment fund so that, with few exceptions, proxies are sent directly to the organization, which votes them in accordance with the established guidelines. The organizations meet any foreign proxy voting requirements by having contacts with local parties in the relevant markets. In certain cases, an investor may authorize the organization to communicate directly with companies on its behalf or to accompany the investor in such contacts.⁷¹ Global custodian banks have also developed foreign proxy services for

(as will be discussed below) provides information on corporate governance abroad, initially focused on U.S. shareholder activism. Its publication, *The Global Shareholder*, now supplements its U.S. focused publication, *The Corporate Governance Bulletin*. So also the *Issue Alert* publication of the Institutional Shareholder Services, Inc. ("ISS") recently began to include a section on foreign corporate governance entitled "The Global Report."

69. As mentioned in note 68, *supra*, the IRRRC publishes the *Global Shareholder*, which focuses on shareholder rights and corporate governance issues abroad, as well as on matters dealing with proxy voting. The IRRRC also publishes a number of books, one of which deals directly with the issue of U.S. institutional investors abroad. See DAVIS, *supra* note 52; see also INTERNATIONAL CORPORATE GOVERNANCE (Joseph C.F. Lufkin & David Gallagher eds., 1990) (surveys of market practices in different countries).

70. For example, several investors commissioned the IRRRC to do a full study of French privatization, with the help of Deminor, a consulting group based in Belgium and Paris. Telephone Interview with Robin Meszoli, *supra* note 64.

71. The above description is based upon a conversation with Howard D. Sherman, director of Global Proxy Services for the ISS (Mar. 22, 1994), the Lufkin Interview, *supra* note 60, and the Telephone Interview with Robin Meszoli, *supra* note 64.

their clients.⁷²

This industry has actively monitored Western European privatizations and explained their significance to United States institutional investors.⁷³ In particular, the organizations highlighted the corporate governance practices of privatized companies and the important topic of continued government ownership and involvement in the management of such companies.⁷⁴ How the global proxy firms aided United States institutional investors on the transformation of French corporate governance in the recent privatization will be treated below.

IV. FRENCH CORPORATE GOVERNANCE

The previous two parts of this Article explored investments and activism by United States institutional shareholders abroad. The next two parts focus on the transformation of French corporate governance through privatization, and the place of United States institutional investors in the process. To understand this transformation one must understand the existing system. Accordingly, this part will review significant aspects of French corporate governance in world-class companies.

This review recognizes that, like the United States system, the French system proposes a solution to the corporate agency problem. In France, as in the United States, someone must monitor the managers. My account emphasizes the historical and political factors that created the French solution and thus gives a cultural, not solely economic, understanding of French corporate governance.⁷⁵ This part also identifies the pressures

72. Global custodian banks, such as State Street Bank, Chase Manhattan or Morgan Guaranty, to name a few, would send the client translated information about proxy voting and arrange with their subcustodian in the local market to satisfy any local formalities with respect to voting. See Sherman, *supra* note 46, at 25. Even foreign clearance and settlement systems, either used as subcustodians by global proxy firms or acting as direct custodians, are improving their proxy services. See EUROCLEAR OPERATIONS CENTRE, NO. 94-R-007, PROXY VOTING: ENHANCED MEETING NOTIFICATION AND VOTING PROCEDURES (1994) (describing proxy voting services provided through the Euroclear system). I thank Margaret Conklin, Vice President & Assistant Resident Counsel of the Euroclear Operations Centre for providing me the above information.

73. See *infra* text accompanying notes 217-18.

74. See, e.g., Paul V. Dionne & Giorgio Bertinetti, *Italians Begin Searching for the Public Company*, ISSUE ALERT, July-Aug. 1994, at 9 (discussing Italian privatization).

75. A cultural account does not exclude a purely economic understanding of a

that French market reforms and European Union developments are placing on French corporate governance.

A. French Corporate Governance

This Section highlights three features of French corporate governance. First, it describes the central background feature: French government ownership and control of many internationally competitive French corporations. Second, it reviews the general ownership and management structure of the typical French government-owned corporation. Finally, the Section examines the position of minority shareholders in this corporation and French shareholder rights generally.

1. State Control of the Economy

An understanding of contemporary French corporate governance in the largest French companies requires an awareness of the recent role of the French government in the nation's economy. This role raises political and cultural issues, as well as economic ones. It is often said that French government involvement in the economy owes much to the French tradition of *colbertisme*.⁷⁶ Named after Jean-Baptiste Colbert, who was, among other things, a finance minister to Louis XIV, *colbertisme*, as practiced by its namesake, was designed to ensure that France had a significant trade surplus. Accordingly, through Colbert the French state founded national industries, and encouraged private industries through invest-

corporate governance situation. In fact, a properly cultural description should encompass the economic understanding. However, it also attempts to identify noneconomic forces or pressures that might hinder the realization of the most economically reasonable solution. Among economists, there is also some debate about what accounts for an economically satisfactory answer to a given problem and whether an economic account must embrace historical factors that led to a given situation. See Richard R. Nelson, Recent Evolutionary Theorizing About Economic Change (unpublished paper, on file with Columbia University School of Law, Center for Law and Economic Studies) (discussing recent increase of evolutionary, or historical, studies of economic phenomenon).

76. See Colin Gordon, *The Business Culture in France*, in BUSINESS CULTURES IN EUROPE 58, 98 (Collin Randlesome et al. eds., 1990) ("Such a system [of government influence over large private companies] underlines the strength of *colbertisme* in France, the idea of a strong, interventionist state which, particularly back in the 1960s and 1970s, had to be researcher, investor and financier. It alone had the necessary global vision.").

ments, all to produce goods for export. In sum, *colbertisme* was a policy of purposeful state action to create a national industry that would be competitive internationally.⁷⁷

Colbertisme provides the background, but reaction to the disaster of the Second World War offers a more immediate explanation of the present French government control of large French companies. The French perceived that economic and political shortcomings in the pre-War years had resulted in a lack of modernization of the French economy, which left France incapable of preparing for and reacting to German aggression. Historians explain that the pre-War period was complex and that the blame for structural French economic problems cannot easily be laid on particular shoulders.⁷⁸ However, throughout this period, the French government maintained a classic liberal economic perspective.⁷⁹ The market and capitalists, left to themselves, did not develop industries and the technology that would have enabled the French better to resist the German invasion.⁸⁰

That many capitalists had collaborated with the German occupiers and had been hostile to pre-War efforts to respond to French economic weakness did not help the cause of economic liberalism in the post-War years.⁸¹ Moreover, the powerful

77. See Jean-Baptiste Colbert, in *LE PETIT ROBERT 2: DICTIONNAIRE UNIVERSEL DES NOMS PROPRES ALPHABÉTIQUE ET ANALOGIQUE* (Alain Rey ed., 1993).

78. See ALAIN BELTRAN & PASCAL GRISET, *L'ÉCONOMIE FRANÇAISE 1914-1945*, at 6-25 (1994).

79. At times, the government attempted to develop certain economic sectors. According to Beltran and Griset, French government intervention in the economy occurred significantly during the First World War and began to develop during the Occupation. See *id.* at 6-8, 24-25. However, a classical liberal approach prevented the government from maintaining an active involvement in industry, particularly during the pre-World War II years. See *id.* at 10-11. More importantly, the French government had not rationally encouraged the development of new technologies, particularly in radio-communications and aeronautics, which proved crucial in World War II. See *id.* at 117-18.

80. Although the economic evidence is subject to different interpretations, it shows that during this period French companies were smaller than those in other developed countries and were controlled by families. Few developed the size to produce the needed advanced technologies and to compete in the international markets. See *id.* at 74-75; see also THEODORE ZELDIN, *FRANCE 1848-1945: AMBITION & LOVE* 63-76 (1979) (discussing French industrialists and their reputed family "closeness" and insularity).

81. See JEAN-FRANÇOIS ECK, *HISTOIRE DE L'ÉCONOMIE FRANÇAISE DEPUIS 1945*, at 4 (1994) (explaining the postwar hostility to company owners and management who "après avoir sabordé l'oeuvre du Front populaire, a soutenu le régime de Vichy, voire participé à la collaboration.").

Communist group in the French Resistance was generally hostile to capitalism.⁸² In addition to the Left, there was a general consensus that the French government needed to take an active role in industry and the economy if French companies were to attain the critical size and develop the technologies to compete in international markets and to preserve France's national sovereignty.⁸³

The French government's control of the economy and large companies during the post-War years is only briefly summarized here. It initially took the form of closing the French economy to outside influences and emphasizing growth based upon reconstruction from the war and infrastructure modernization.⁸⁴ As a central part of its economic direction, the government established economic "plans." Although developed originally as a way to assure the United States that Marshall Plan funds were being appropriately used, the plans had macroeconomic purposes of setting national economic goals and using traditional means (subventions, government contracts, favorable tax breaks, etc.) to help achieve them.⁸⁵ The government had company management and worker representatives involved in the elaboration of the plans so that a social consensus could be reached concerning overall economic goals. Moreover, the French government used all its means to stimulate

82. See BELTRAN & GRISET, *supra* note 78, at 25 (pointing to the existence of radical elements in the French Resistance who preferred a "break" with capitalism).

83. See *id.* at 178 ("Des formes de rejet du capitalisme se conjugaient avec la demande d'un État puissant capable d'une politique économique volontariste. L'industrie française devait être concentrée, les structures rajeunies. La planification, le dirigisme, les nationalisations apparaissaient à une majorité de Français comme des mesures d'urgence qui ne se discutaient guère. L'économie mixte-avec un État omniprésent-semblait la meilleure solution."). Beltran and Griset observe that a significant group that favored this union between the State and industry were engineers and other highly educated company management who understood the importance of technology and the need for companies of critical size to develop it. See *id.* at 84, 118-19; see also RICHARD F. KUISEL, *CAPITALISM AND THE STATE IN MODERN FRANCE: RENOVATION AND ECONOMIC MANAGEMENT IN THE TWENTIETH CENTURY* 203-07 (1981).

84. See ECK, *supra* note 81, at 7 ("Enfin, la fermeture face au reste du monde permet une profonde intervention de l'État. La compétitivité des entreprises, protégées de la concurrence étrangère et peu tournées vers l'exportation, n'est pas l'objectif majeur de la politique économique.").

85. See *id.* at 12-13 (explaining that French plans involved some forecasting and goal-setting and differed from those of a socialist economy that completely determined economic development).

economic growth and to improve the economic well-being of its citizens.⁸⁶

A key feature of the French government's post-War involvement in economic affairs was the growth of the public sector. Before World War II, the French government owned a few large enterprises that provided public services (*e.g.*, the Post Office and telephones), a few specialized financial institutions and companies in sensitive defense sectors (*e.g.*, airlines, train and marine transport).⁸⁷ The immediate post-War years saw significant nationalizations, some designed to punish collaborator owners. Other nationalizations were effected to enable the government to control reconstruction and remedy the pre-War failings of industry and finance. Accordingly, the government nationalized certain basic industries, such as gas and electricity, and large banks and insurance companies to enable the government to use their resources for modernization.⁸⁸ The new government-owned enterprises undertook projects, or entered technical areas, that private industry was reluctant to pursue. Its companies thus often acted as a competitive stimulus to private industry.⁸⁹ This government involvement was a success: France experienced approximately thirty years of growth and prosperity popularly known as "Les Trente Glorieuses."⁹⁰

The French government's involvement in the economy gradually evolved from its near absolute dominance in the post-war years. It allowed the markets to resume their control and opened French commerce to world trade, although the plan structure remained in place. With the opening of French companies to market competition, particularly world market

86. See *id.* at 14-17 (pointing out that the French government stimulated consumption by providing its citizens with a social security system that protected them from the typical life risks, *i.e.*, sickness, old age, disability and maternity; it financed investments through its control of funds placed in state-controlled savings and financial institutions).

87. See *id.* at 13.

88. See *id.*

89. See *id.* at 13-14. Eck cites nuclear energy, as well as continued exploration for sources of traditional energy, as examples of the achievement of French state-owned companies. He observes that, in auto manufacturing, the government forced Renault to produce something that it had on its drawing board for years, but that it had neglected to pursue: an inexpensive popular car.

90. See *id.* at 8. The thirty years of success were brought to an end by the oil crises of the 1970s.

competition, the nature of government direction of enterprises changed. The government encouraged most state-owned enterprises to compete internationally and promoted "national leaders" in industries to compete effectively beyond French borders.⁹¹ Thus, direct and indirect state influence over French companies remained an accepted part of French economic life. It was thus not surprising that in 1981, when the Socialists came to power in the middle of an economic crisis, they turned to further nationalizations.⁹²

2. Ownership Structure and Management

Because of nationalizations after World War II and in 1982, the French government controlled a major portion of the French economy.⁹³ Its ownership of companies took several forms, such as the integration of a company within a public department, or the direct, or indirect, ownership of controlling shares of a private company.⁹⁴

91. *See id.* at 32-34.

92. *See id.* at 49-52 (observing that the nationalizations of 1981-1982 had primarily economic purposes: to include major industrial companies within a coherent industrial strategy and to compel nationalized banks to support the credit needs of small and medium-sized French companies).

93. In his book on French privatizations, Michel Durupty provides statistics concerning the French government's involvement in the economy before the 1986 privatizations. MICHAEL DURUPTY, *LES PRIVATISATIONS EN FRANCE* (1988). For example, in 1985 French companies falling into the "*secteur public*" encompassed approximately 25% of all industrial workers, 35% of fixed capital (excluding financial and agricultural enterprises) and 20% of value added (excluding financial and agricultural enterprises). *See id.* at 9-17; *see also* ECK, *supra* note 81, at 51 (presenting statistics of French involvement in industry in 1980, 1985 and 1990, which establish, for example, that in 1990 the public sector accounted for 23% of exports); Gordon, *supra* note 76, at 62. One has only to consider the list of some of the nationalized companies to get a sense of the government ownership of the French economy. Leaving aside the pre-War state-owned or controlled companies such as the PTT (Postes et Télécommunications), the SNCF (Société Nationale de Chemins de Fer Français, or the railroads), Air France, and national credit establishments, in the immediate post-War years nationalization included Renault, SNECMA (specializing in airplane motors), EDF (Électricité de France) and GDF (Gaz de France), the Banque de France, Crédit Lyonnais, Société Générale, Banque Nationale de Paris (all banks) and numerous insurance companies. In 1982 nationalization reached 12 industrial companies, two financial conglomerates and 36 banks, two airplane companies and various electrical or communications companies. *See* ECK, *supra* note 81, at 52 (French government controls "outre l'énergie et les transports, la distribution du crédit et une part importante de l'industrie, en particulier dans les secteurs de base").

94. Companies within the French public sector are thus an "*établissement*

The French government has addressed the classical corporate agency problem in the private companies that it owns in several ways. First, French law requires that, in such situations, representatives of the French government sit on the French equivalent of the board of directors.⁹⁵ Given the typical board composition,⁹⁶ and the State's ownership percentage in these companies, the French government controls the board. Second, the government appoints (and fires) the chief executive officers of the state-owned companies.⁹⁷ Third, the government can exert numerous "*contrôles*" on the company, *i.e.*, through inspections, the placing of a government representative in the company, and the examination of a company's accounts.⁹⁸

However, complete domination of French companies by their state owner has not been the rule. The evolution of the French state sector in the post-War years explains this relative lack of domination. After World War II and again after the Socialists took power, the French government exerted significant control over its companies, using them to serve political

public industriel et commercial" or a private company with share capital (the "*société anonyme*"). See JEAN KERNINON, *LES CADRES JURIDIQUES DE L'ÉCONOMIE MIXTE* 56 (1992). The former is a category within French administrative law, while the latter is simply a private company some or all of whose shares are held, directly or indirectly, by the French government. See *id.* at 72. A private company generally falls within the French public sector if the majority of its capital is held by the French State, although certain legal interpretations would place within the public sector those companies "controlled" by the state, *i.e.*, where the State can control management. See *id.* at 73. Given that, until recent privatizations, many major French credit organizations, banks and insurance companies were all owned by the French government, the French government ownership of private companies was often made through such institutions. See Gordon, *supra* note 76, at 80 (discussing French bank and insurance ownership of industrial companies and that many of these banks and insurance companies are government controlled).

95. See KERNINON, *supra* note 94, at 78. French private companies with share capital have two kinds of structures: a board of directors (*conseil d'administration*) supervising management or a surveillance board (*conseil de surveillance*) sitting above a management board (*directoire*). The latter structure, which is not widely used, limits the surveillance board's duties to selecting the members of the *directoire* and to reviewing the board's actions. See MICHEL JEANTIN, *DROIT DES SOCIÉTÉS* 275 (2d ed. 1992).

96. Under French law, the board of a company within the public sector generally consists of three groups: government representatives; representatives of consumers (also selected by the government); and labor representatives. See KERNINON, *supra* note 94, at 78.

97. See *id.*, at 79-80.

98. See *id.*, at 81-89.

and economic purposes, such as reconstruction and unemployment. These periods typified a form of relational investing where an enterprise would serve purposes other than the central capitalist purpose of maximizing profits for an owner.⁹⁹

Because of political and economic pressures, the French state has gradually given a significant entrepreneurial independence to public sector companies. Aside from certain leftist groups, French politicians have rejected anticapitalist purposes for French state-owned companies.¹⁰⁰ Moreover, many of the state-owned French companies are competing in European and world markets. Thus, if the companies do not succeed in such markets, they can impose, and have imposed, significant financial burdens on the French state.¹⁰¹ Indeed, the latter day *colbertist* position of creating national leaders in industry among the state-owned companies is evidence of the government's recognition of the importance of market competition.¹⁰² For many public sector companies, therefore, the overall goals have become productivity and competitiveness, not particular state social purposes.¹⁰³

Accordingly, the French government has increasingly left much discretion to management for the operation, as well as

99. This form of control demonstrates what Professor Rock terms the "dark side" of relational investing. The relational owner does not so much improve total shareholder return, but gains direct or indirect payoffs or sales. For example, if a bank owned an industrial company, the bank could be expected to receive most of the lending work generated by that company. See Rock, *supra* note 4, at 1002-03. When the state is the major relational investor of a company operating in the competitive markets, the State may derive benefits that have nothing to do with profit-maximizing, but may have much to do with helping society in general (as in the case of reconstruction) or politically strong groups (e.g., workers, when a company is used to increased employment).

100. The evolution of the board structure of such companies reveals the lessening of importance of anticapitalist purposes championed by the Left. Board representation was to include workers, consumers and government with the idea that public sector companies would work for the good of the country as a whole. In fact, the government has generally controlled these boards so that companies serve specific state economic, not necessarily national, purposes. When, as discussed below, the state promotes the competitive position of companies in world markets, the direct social purpose of these companies becomes more tenuous. See KERNINON, *supra* note 94, at 75-77.

101. See *id.* at 39-42 (discussing the difficulty the French State has to balance its budget while supporting state-owned companies with the necessary funds for their operation and development).

102. See *id.* at 34-36.

103. See *id.* at 89.

the overall direction, of state-owned companies. The French government acts in ways that United States proponents of relational investing would like to see characterize United States institutional investors. French government representatives and company management establish together something akin to a "plan" on a company level.¹⁰⁴ This plan sets an overall strategy for the company and middle-term goals for it to achieve. Generally, if the goals are met, the state leaves management alone. Only when the company is in trouble is the French state likely to exert the considerable power at its disposal to interfere with company affairs.¹⁰⁵

Not only does the French government's relational investing address the corporate agency problem in state-owned companies, but the background and formation of company executives create a continuity of interests between the state-owner and managers. Executives in French state-owned companies have traditionally come, not from the ranks of entrepreneurs or from a progression up the career ladder inside the company, but from a small select group.¹⁰⁶ This group consists of individuals trained in elite schools of public administration or commercial affairs, such as the École Nationale d'Administration and Hautes Études Commerciales.¹⁰⁷ The managers have nearly all worked in a ministry or a branch of public administration before assuming a high executive position in a company.¹⁰⁸

104. *See id.* at 90.

105. *See id.* at 91-92. This model of State relational investing resembles other main French corporate governance situations. Another prominent ownership structure in France is family control of corporations. *See Wymeersch, supra* note 18, at 9-10 ("Correspondingly, in Belgium, the Netherlands, and France one predominantly finds companies that, although listed on the stock exchange, are closely held and often minority controlled, whether by the founding family, by financial holdings, or by other interests acting together. Ownership and control can often be traced back to an identifiable person or group of persons."). In this family or "close corporation" structure, management is often given free reign to pursue strategies with periodic review by family owners.

106. *See* OXFORD ANALYTICA LTD., BOARD DIRECTORS AND CORPORATE GOVERNANCE: TRENDS IN THE G7 COUNTRIES OVER THE NEXT TEN YEARS 96 (1992) (discussing how French state-owned companies have almost uniformly preferred high ranking career civil servants for executives at the expense of entrepreneurs or company insiders); *see also* MICHEL BAUER, LES 200: COMMENT DEVIENT-ON UN GRAND PATRON? (1987).

107. *See* ECK, *supra* note 81, at 29; KERNINON, *supra* note 94, at 80.

108. *See* KERNINON, *supra* note 94, at 80 ("La position des dirigeants est d'autant plus solide qu'ils satisfont à certains critères de légitimité, tels que l'appartenance à un grand corps de l'Etat, une expérience acquise au sein de cabi-

They are thus likely to share the views of government officials, generally their former colleagues, and to accept the current view of French government intervention in, or regulation of, the economy. In economic parlance, the government-owner has already made "bonding" expenditures to ensure that its manager-agents will act in accordance with its interests.¹⁰⁹

3. Non-Controlling Shareholders

As a final feature of this review of French corporate governance in state-owned, globally competitive companies, it is useful to consider the position of shareholders, who are often natural persons with no state affiliation or state purpose behind their investment (e.g., are not also state-owned or controlled).¹¹⁰ That nationalized companies have private shareholders may seem something of a contradiction. These shareholders were occasionally a holdover from prenationalization days or, at times, arose from a policy of opening the capital of

nets ministériels ou à la tête d'une direction d'administration centrale, des responsabilités déjà assumées au sein de grandes entreprises publiques ou privées.").

109. In some cases, however, executives of French government-owned companies have shown considerable independence from the state with respect to business strategy and other matters. This independence does not necessarily contradict the unity of interests between the government and company management. If, as explained above, the government wants its companies to be able to compete in international markets, it must give a certain freedom to managers. It is likely that managers, who are judged on the competitive success of their company, will pursue this success and resist government interference that detracts from it. See KERNINON, *supra* note 94, at 80 ("Cette émancipation des dirigeants n'est pas fortuite. Elle se trouve liée à la vocation capitaliste assignée aux entreprises publiques, et tout spécialement aux entreprises industrielles ou de services du secteur concurrentiel.").

French executives are also generally acknowledged to be highly motivated and concerned about their reputation in the relatively small circle of elite civil servants and company managers. This concern helps to counter self-interested behavior on their part. However, there have recently been scandals in management of French world-class companies, including those that are state-owned, which involve mismanagement or personal management corruption. These scandals call somewhat into question the success of the state's relational investing. See, e.g., Alice Rawsthorn, *Last Chapter in a Stormy Career: Jean-Yves Haberer is Unlikely to Go Quietly*, FIN. TIMES, Mar. 31, 1994, at 18 (discussing mismanagement at the state-owned Crédit Lyonnais by Jean-Yves Haberer, who, after being relieved of his duties as PDG (*président directeur général*) at Crédit Lyonnais, was made PDG of another state-owned bank, Crédit National (from which position he has since been removed)).

110. See *infra* note 111.

these companies to the capital markets, thus relieving the state of complete responsibility for their financing.¹¹¹

The weak position of the small shareholder is the natural counterpart to the dominance of company management. By all accounts, French company management, particularly the chief executive officer (in French, the *président directeur général* (PDG)) completely controls a corporation and regards it as his own domain.¹¹² A PDG does not place the interests of noncontrolling shareholders above his own strategic plans, and, he may even be relatively independent of the state. Perhaps this lack of attention to small shareholder interests has naturally arisen in a market of small capitalization, where investors with other than controlling stakes have been neither significant nor numerous.¹¹³ Moreover, small shareholders have traditionally had limited interests (*i.e.*, steady receipt of dividends with little concern about control), and thus have not pushed for a corporate governance role.¹¹⁴

111. See KERNINON, *supra* note 94, at 39-42 (discussing the opening of state-owned companies to private capital, particularly in the form of "special" instruments, such as *titres participatifs* and *certificats d'investissement*, which generally do not give the holders any voting rights). Because the position of the "small" shareholder in a state-owned company is not so different from that in a company completely owned by nongovernment shareholders, the following remarks could equally apply to French corporate governance in all large French companies.

112. See OXFORD ANALYTICA, *supra* note 106, at 118 (discussing the dominance that French management typically has in a company, even over the board of directors); Gordon, *supra* note 76, at 99-100 ("This power [concentration] is reinforced by the role of the boards and their chairmen. General meetings of shareholders have virtually no teeth and the board is only formally answerable to its shareholders. In their turn, members of the board are only there to back up the chairman (*le président*). The system is almost a carbon copy of the French parliamentary system, with extensive powers vested in the state President. Some have called it management by divine right with chairmen not answerable to anyone—votes are rare and, indeed, if a proposal is put to the vote, it is seen virtually as a sign of no confidence in the chairman and time for him to resign.").

113. Commentators acknowledge the continuing decline in the number of individual shareholders in the French market. Cf. ALICE PEZARD, DROIT DES MARCHÉS MONÉTAIRE ET BOURSIER 260 (1994) (noting the decline in small shareholders since 1987). The number of small shareholders in France may be increased by the recent privatizations. But see Michel Bauer, *The Politics of State-Directed Privatisation: The Case of France, 1986-88*, in THE POLITICS OF PRIVATIZATION IN WESTERN EUROPE, *supra* note 34, at 58 (observing that many small shareholders who had purchased shares in the privatizations beginning in 1986 quickly resold their shares).

114. Some French market authorities believe that small shareholders in France have traditionally viewed equity almost as they view bonds, *i.e.*, as an instrument paying a steady return, and have not been concerned about issues of control or

Certain features of French corporate governance emphasize the powerlessness of small shareholders. They cannot count on the board of directors because board members represent controlling shareholders and are otherwise dominated by management.¹¹⁵ Moreover, even if board members are "outside" directors in United States parlance, no strong legal duties compel them to protect all the corporation's shareholders and to avoid conflicts of interest.¹¹⁶ One sign of this lack of concern about these shareholders by directors and management is the infrequent recourse to directors' and officers' insurance.¹¹⁷

even capital appreciation. Interview with Mr. Francois Champarnaud, Chef du Service des Études et du Développement du Marché, Commission des Opérations de Bourse, in Paris, France (July 1, 1994).

115. Independent directors do exist in French companies, but a board is usually composed of directors selected by management or represents controlling shareholders. See INSTITUTIONAL SHAREHOLDER SERVICES, INC., PROXY VOTING GUIDELINES: FRANCE 10 (1993).

116. Cf. Arnaud Leparmentier, *Bourse: Les Petits ont toujours tort*, LE NOUVEL ÉCONOMISTE, June 10, 1994, at 63 ("En France, aucune disposition légale ne peut priver certains administrateurs de leurs voix délibératives en raison d'éventuels conflits d'intérêts.") (quoting Jean-Claude Sarazin, PDG of La Redoute). In addition to an obligation not to violate the law or to cause the company to act in an *ultra vires* manner, a member of the board of directors of a French company has a weak duty of "due care." As explained by Professor Jeantin:

Les dirigeants sont responsables, envers les sociétés et envers les tiers de toute infraction aux lois et règlements applicables aux sociétés, de toute violation des statuts ainsi que de toute faute de gestion. La loi ne définit nullement la faute de gestion; il s'agira soit d'un acte contraire à l'intérêt social, soit d'un acte excédant l'objet social, soit encore d'une décision dont les conséquences se sont révélées malencontreuses pour la société.

JEANTIN, *supra* note 95, at 140; see also ROMANO, *supra* note 14, at 134-35 (describing how duty of loyalty is not well developed in France and that there is also no corporate opportunity doctrine) (referring to André Tunc, *Corporate Law*, in EUROPEAN BUSINESS LAW: LEGAL AND ECONOMIC ANALYSIS ON INTEGRATION AND HARMONIZATION, *supra* note 5, at 199, 211-12).

117. Although increasingly prevalent in France, as well as in the rest of Europe, this kind of insurance has generally been used to protect directors from a legal liability to cover the debts of a bankrupt company that was brought to insolvency by the director's wrongdoing. See Rachid Safa, *Directors' and Officers' Liability Insurance and the Theory of Abuse of Corporate Assets Under French Law*, 21 INT'L BUS. LAW. 365 (1993). For a discussion of this liability, see JEANTIN, *supra* note 95, at 140-41. Market professionals predict that suits for general director negligence outside the insolvent company situation will likely increase. See Leparmentier, *supra* note 116, at 63 ("D'ici à cinq ans, on va assister aux premiers procès contre des administrateurs déficients.") (quoting Alain Minc, former director and PDG).

Moreover, a shareholder in large non-state-owned companies will generally find that the company has significant antitakeover protection, whether through French law or by way of the company's charter. French law requires disclosure to

Just as most commentators of French corporate governance agree that French company management has significant power, often at the expense of noncontrolling shareholders, many believe that the situation is changing, albeit gradually. In recent years, organizations of small shareholders have sprung up that are challenging in the courts management's decisions or other corporate actions having adverse effects on them.¹¹⁸ Moreover, organizations also exist to aid shareholders that have significant minority stakes in companies.¹¹⁹ As discussed above, these organizations often increase their power by forming alliances with non-French institutional shareholders. This small shareholder "activism" is one of several phenomena that may lead to change in French corporate governance.

the company and, in certain cases, market authorities by purchasers (or parties acting in concert) of acquisitions of listed shares at various thresholds: 5%, 10%, 20%, 33 1/3%, 50%, 66 2/3%. Penalties for failure to disclose such acquisitions include loss of voting rights on the shares in excess of the thresholds for a minimum of two years. See Keith D. Nunes et al., *French & SEC Securities Regulation: The Search for Transparency and Openness in Decisionmaking*, 26 VAND. J. TRANSNAT'L. L. 217, 242 (1993). Company charters can reduce the threshold to 1/2%. See Yves Guyon, *Les Investisseurs Institutionnels en Droit Français*, in INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE 385, 391 (Theodor Baums et al. eds., 1994). French public companies have also been known to limit the number of votes that any one shareholder can cast. See ALCATEL ALSTHOM, PROSPECTUS 55 (1992) (describing limitation of votes of any shareholder to 8%).

118. These organizations include "Anaf" (*l'Association nationale des actionnaires de France*) and "Adam" (*l'Association de défense des actionnaires minoritaires*), the latter operated by Colette Neuville. Most recently, Adam was active in challenging the merger terms in the Pinault acquisition of La Redoute. See Guyon, *supra* note 117, at 387 (discussing how the goals of institutional shareholders and smaller shareholders may be different); Leparmentier, *supra* note 116, at 61.

119. Such organizations represent (for a fee) shareholders that, while having a minority position, have a significant enough position to make it economically reasonable to contest actions that harm their economic interest. In France, a good example of such an organization is Déminor, also known as the *Société de défense des actionnaires minoritaires*. The "objectif" of Déminor is as follows: "d'assister et/ou de représenter l'actionnaire minoritaire d'une société, depuis sa prise de participation jusqu'à la cession éventuelle de celle-ci, en passant par la défense de ses intérêts pendant la détention de cette participation." See DÉMINOR, SOCIÉTÉ DE DÉFENSE DES ACTIONNAIRES MINORITAIRES (bulletin describing organization). Déminor is reported to have had significant success in several cases, including a takeover of the Wagon-Lits company by Accor. Interview with Marie-Sophie Hélias, Associée, Déminor, in Paris, France (June 16, 1994). Ms. Hélias has just founded another company in Paris, Franklin Global Investor Services, with a similar purpose. *Id.*

B. Capital Market Pressures

The preceding section outlined major features of French corporate governance in the large, state-owned companies and also suggested that the system is under pressure to change. This section explores other related pressures on French corporate governance that push in directions potentially incompatible with the present system. They are (i) French capital market developments and (ii) developments in the European Union (EU), of which France is a member.

1. French Capital Market Developments

The French capital market is a relatively small one.¹²⁰ This size is understandable because most corporate financing has come from the state, state-owned or -controlled financial institutions or large, often family-owned industrial groups. Because the French government has encouraged state-owned companies to turn more to the capital markets for financing, the capitalization of the French market should increase in size as more shares are listed on it.¹²¹ However, development of the French capital market and its increased capitalization also depend upon creation of an efficient, low-cost, and honest market, which will be attractive to investors, given that investors, whether domestic or foreign, have investment alternatives.

In recent years, French government, market, and business authorities have all made concerted efforts to improve the depth, liquidity, and quality of the French capital market so that Paris would become an important European financial

120. In terms of market capitalization, the Paris stock market, or Bourse, ranks fifth behind stock exchanges in New York, Tokyo, London and Germany. In addition, Paris ranks below the above as well as below markets in Korea, Switzerland and Taiwan in volume of transactions. See COMMISSION DES OPÉRATIONS DE BOURSE, 26^e RAPPORT AU PRÉSIDENT DE LA RÉPUBLIQUE, ANNEXES 43-44 (1993) [hereinafter COB]. See also Joel Seligman, *Another Unspecial Study: The SEC's Market 2000 Report and Competitive Developments in the United States Capital Markets*, in AMERICAN BAR ASSOCIATION, *supra* note 32, at 1, 17 n.43 (1994) (presenting statistics based upon DIVISION OF MARKET REGULATION OF THE SEC, MARKET 2000: AN EXAMINATION OF CURRENT EQUITY MARKET DEVELOPMENTS (1994)).

121. Market capitalization has in fact significantly increased from 1992 to 1993 (by approximately 40%), after a slight decline from 1991 to 1992. The amount of market transactions similarly increased during the same period. However, the number of companies listed on the Paris exchanges has steadily declined for this period. See COB, *supra* note 120, at 36.

center to rival London's dominance.¹²² These efforts have resulted in a complete overhaul and modernization of France's securities markets. The seven separate French stock exchanges (Paris and six regional centers) have all been placed into a national market system, with most activity taking place on the Paris Bourse. Developments include a computerized trading facility for the routing and execution of orders, a similarly computerized settlement facility and a depositary system using entirely dematerialized securities (*i.e.*, securities are represented no longer by certificates but by accounts in a central account mechanism.)¹²³

French authorities have also improved the quality of the

122. See Gordon, *supra* note 76, at 86 (describing the aim among French authorities to "attract back" to France securities business that "leaked" to London). The main competitor to the French capital market is the London Stock Exchange (known as the International Stock Exchange of England and the Republic of Ireland), particularly with its SEAQ international system, an automated system where market makers provide quotations in stock of non-U.K. companies. Traditionally, this system has attracted trading of stock of major French companies because of liquidity problems on the Paris Bourse. See NORMAN S. POSER, *INTERNATIONAL SECURITIES REGULATION: LONDON'S "BIG BANG" AND THE EUROPEAN SECURITIES MARKETS* 379-83 (1991 & Supps. 1991, 1992). With a more developed market comes potential growth in the French securities industry. French market participants, such as banks, securities brokers, and clearance systems, develop expertise, become more sophisticated and are better equipped to compete in the global securities markets.

123. The reforms of the French capital markets (known as the "Little Bang", after the "Big Bang" reference to the transformation of the London markets) is described in detail in POSER, *supra* note 122, at 379-92, 92-103 (Supp. 1991), 102-15 (Supp. 1992); see also Leslie Goldman, *The Modernization of the French Securities Markets: Making the EEC Connection*, 60 *FORDHAM L. REV.* S227 (1992). For a description of (i) how a price for a given stock is established on the Bourse, (ii) how orders are fed for execution into the computerized quotation system (*i.e.*, the C.A.C. or "*cotation assistée en continu*") and (iii) how the orders are settled through the Relit (*règlement-livraison des titres en France*) system, see GROUP OF THIRTY, *CLEARANCE AND SETTLEMENT PROJECT: FRANCE, YEAR-END 1990 STATUS REPORT* (1990) (description of Relit system); PEZARD, *supra* note 113, at 120-30; POSER, *supra* note 122, at 105-06, 109 (Supp. 1992). The central "depositary" of French shares, SICOVAM (the "*Société Interprofessionnelle pour la Compensation des Valeurs Mobilières*"), maintains accounts for companies or for accredited parties (*i.e.*, banks or brokers), to which securities are credited. Shareholders indirectly hold their securities through these accounts. See Richard Vilanova, *Clearing and Settlement in France* (1991) (unpublished paper submitted to the International Bar Association Conference in Hong Kong 1991; on file with author) (describing legal background to dematerialization); Martin Gdanski, *Dematerialization of Securities in France* (May 17, 1991) (unpublished paper submitted to the International Bar Association Eighth Annual Seminar on International Financial Law; on file with author).

major market participants, the French brokers. These market participants are particularly important for increasing the liquidity of the market, a characteristic of chief importance to investors.¹²⁴ They provide this liquidity by purchasing securities for their own account as dealers at a time when a market cannot absorb all the trading volume, thus creating an orderly market. Traditionally, French brokers (known as *agents de change*) could not deal in securities and thus could only match buy and sell orders.¹²⁵ Moreover, they were a closed fraternity whose members did not include foreigners. Reforms of the Bourse beginning in 1987 changed this situation: the brokers became incorporated member firms (*sociétés de bourse*) that could act as dealers and do other services. In addition, they could be 100% foreign-owned. This reform resulted in the acquisition of French brokers by large French banks, as well as by foreign banks and investment firms. In addition, it added capital to brokers and thus liquidity to the Bourse.¹²⁶

A market subject to significant abuses, such as insider trading or market manipulation, is unlikely to attract investors that have many other investment possibilities around the globe.¹²⁷ In recent years, the French government and French market authorities have significantly improved the integrity of the French financial markets. Much of this effort has been devoted to enhancing the status and powers of the Commission des Opérations de Bourse (COB), a government agency responsible for regulating the French markets.¹²⁸ Because of chang-

124. See PEZARD, *supra* note 113, at 117 ("L'investisseur sur le marché secondaire des actions peut facilement et rapidement récupérer ses fonds investis puisqu'il peut à tout moment vendre ses titres sous réserve des plus ou moins-values réalisées depuis l'investissement.").

125. See POSER, *supra* note 122, at 381-83.

126. See *id.* at 383-84 (describing the transformation of the *agents de change*); see also PEZARD, *supra* note 113, at 201-16.

127. See Richard C. Breedon, *The Globalization of Law and Business in the 1990s*, 28 WAKE FOREST L. REV. 509, 515 (1993) ("The integrity of the market is one of the United States' most important competitive advantages. Some maintain a nation maximizes its competitiveness by the elimination of regulation. While I agree that many regulations inhibit rather than strengthen the market, few investors of any nationality wish to invest their hard-earned savings only to have them promptly stolen.").

128. See PEZARD, *supra* note 113, at 427-47; POSER, *supra* note 122, at 386-88. In addition to the COB, there is the Conseil des Bourses de Valeurs (the "CBV"), which is a self-regulatory organization of stock exchange firms, and the Société des Bourses Françaises (the "SBF"), which is a self-regulatory organization for the

es in French financial laws, the COB has received greater powers, particularly in the area of investigating and penalizing market abuses.¹²⁹ As a result, it resembles the United States Securities and Exchange Commission, with which it has a Memorandum of Understanding.¹³⁰ The COB can address insider trading abuses by subjecting defendants to significant civil liabilities, in addition to criminal liabilities.¹³¹ Moreover, French takeover laws have been continually amended to improve the situation of noncontrolling investors.¹³²

Although reforms to the French capital markets increase their size, liquidity, and quality, such reforms may prove incompatible with a corporate governance system of state, or state-controlled financial institution financing, and of a small, closed market favoring controlling interests.¹³³ As state-owned companies turn to capital market financing (with an ultimate goal of complete privatization), the role of state financing, or financing through state financial institutions, diminishes. Capital market investors, generally focused on total investment return and hostile to noneconomic purposes,¹³⁴

stock markets.

129. See POSER, *supra* note 122, at 110-12 (Supp. 1992); COB, *supra* note 120, at 181-211.

130. See Understanding with France, International Series, Release No. 116 (Jan. 12, 1991), available in LEXIS, FEDSEC Library, SECREL File. Generally, this memorandum provides that each agency will supply the other with information in its possession to counteract market abuses in each jurisdiction.

131. See POSER, *supra* note 122, at 111 (Supp. 1992). On the development of French insider trading laws, see Robert B. Irving, *French Insider Trading Law: A Survey*, 22 INTER-AM. L. REV. 41 (1990); Carol Umhoefer & Alain Pietrancosta, *Le Délit d'Initié: Insider Trading Law in France*, 30 COLUM. J. TRANSNAT'L L. 89 (1992).

132. Thus, if a buyer purchases one-third of the shares of a listed company, it must make an offer for the remaining two-thirds of the shares. See PEZARD, *supra* note 113, at 321 (noting that this law conforms with the European Union's proposed Thirteenth Directive on Takeovers). On this Directive, see Roberta S. Karmel, *Securities Law in the European Community: Harmony or Cacophany?*, 1 TUL. J. INT'L COMP. L. 3, 18 (1993).

133. See *supra* note 17 and accompanying text.

134. See François Morin, *La Privatisation de la BNP et la formation d'un nouveau pôle financier*, 28 REV. ECON. FIN. 121, 127 (1994) ("Le modèle du marché financier est un système dans lequel l'État n'intervient que faiblement; celui-ci règle cependant, par la réglementation, son fonctionnement global. Dans un tel environnement, les grandes firmes ont des caractéristiques bien particulières. Elles ont le plus souvent un actionnariat dispersé, et le but des actionnaires est de valoriser au mieux leurs placements, ce qui en général les oppose aux dirigeants, qui eux sont rarement titulaires de façon significative de titres de la firme.").

should rise in importance as the state's role recedes. Moreover, capital market financing is arguably cheaper and more flexible than state or state surrogate financing, which could improve the competitive position of French companies using it.¹³⁵

Given the decline in the number of individual investors, a transformation to full capital market financing would require funds from domestic investors other than the state or its proxies. Such investors exist in the form of mutual funds¹³⁶ and incipient pension funds,¹³⁷ but do not by any means dominate the French market. Existing French funds have so far been quiet on corporate governance issues. However, to compete

135. The argument would go something as follows: Large French companies increasingly compete in global product markets. To be a viable global competitor a company must be able to raise large amounts of capital as inexpensively and flexibly as possible. One of the most flexible, and often the cheapest, means of financing is in the capital markets, as opposed to specialized financing through financial intermediaries. A company with access to the capital markets will have a competitive advantage over one that does not have such access. Moreover, a company may particularly be in a favorable position if its local capital market is a "deep" and developed one. See Mark Ramseyer, Remarks at the Japan Society Conference: For Whom the Corporation? Corporate Governance in Japan, the U.S. and Europe, *supra* note 8.

136. The French mutual fund falls under the general category of "Les organismes de placement collectif en valeurs mobilières" or O.P.C.V.M. . A common kind of mutual fund is the S.I.C.A.V. ("SICAV") or "Société d'investissement à capital variable," whose purpose is to invest in financial instruments. See PEZARD, *supra* note 113, at 239-42. The SICAV and similar funds are generally restricted in the kinds of securities in which they can invest and have a diversification requirement. See Guyon, *supra* note 117, at 388-89. The French mutual fund industry is one of the biggest in the world amounting to two trillion French francs in November 1993. *France: SICAVS Increases Investment in Top 100 Shares*, LES ECHOS, Mar. 14, 1994, available in LEXIS, Europe Library, TXTWE File. This represented 22% of French household assets. *Tomorrow the World*, ECONOMIST, Nov. 27, 1993, at 20. The primary underlying investments of the funds, however, are bonds and money market instruments.

137. There are no public or private pension funds in France in the U.S. sense, because pension obligations are covered by the state and funded by contributions from employers and employees. See Alice Pezard, Pensions in France (Feb. 18, 1992) (unpublished manuscript, on file with the *Brooklyn Journal of International Law*). However, legislation permitting companies to create private pension funds (*fonds de pension*) has been proposed. See PEZARD, *supra* note 113, at 266-67 (discussing recent proposed legislation in the Senate to establish pension funds). Moreover, French citizens are being encouraged to save for their retirement by means of tax benefits for investing in a stock portfolio. See *id.* at 261-62. French politicians are increasingly recognizing that private pension funds must assume a significant role in covering retirement expenses of its citizens, given the weight such expenses now place on the French companies and the public budget. Cf., Gordon, *supra* note 76, at 71-72 (discussing the high level of social taxes and charges placed upon French citizens and companies).

with the foreign funds that will increasingly be marketed in France, French funds must emphasize "bottom line" total return and will be by definition at odds with any corporate governance system based upon noneconomic purposes and favoring controlling shareholders.¹³⁸ In sum, French capital market developments point to the emergence of corporate governance à l'américaine; governance with dispersed shareholdings and American-style institutional investors.

2. European Union Developments

The European Union, of which France is a member, is also placing significant pressure on French corporate governance. The EU is creating a single European market with an economically liberal orientation.¹³⁹ As a way of achieving this goal,

138. The apparent reason for this lack of "activism" on bottom line issues is that French funds are often sponsored and managed by French banks, which have other relationships with issuers whose stock is owned by the funds. This conflict can lead to silence by the funds in situations that might otherwise call for activism. See Leparmentier, *supra* note 116, at 64 (discussing how such conflict leads to passivity on the part of funds); cf. Guyon, *supra* note 117, at 387. Whether such passivity can continue in the face of competition from non-French funds, which are established in other EU countries but can be marketed in France, remains to be seen. See Karmel, *supra* note 132, at 10, 16 (discussing the potential of the directive on UCITS (Undertakings for Collective Investment in Transferable Securities) to produce a new breed of institutional investor in Europe); Nunes, *supra* note 117, at 235-36 (discussing how France has harmonized its law in line with the directive and has authorized non-French funds to be marketed in France).

139. This orientation has its origins in the Treaty of Rome, which has as its goal the free movement of goods, persons, services and capital through the (then) European Community. This goal has been further promoted in the White Paper of 1985, which established a program for a single European market where resources flow freely to the most economically worthy end users. See Karmel, *supra* note 132, at 3-4; M.J.G.C. Raaijmakers, *The Harmonisation of Company, Stock Exchange and Securities Law in Europe and the United States*, in HARMONISATION OF COMPANY AND SECURITIES LAW: THE EUROPEAN AND AMERICAN APPROACH 1, 2-3 (1989); Manning G. Warren III, *Global Harmonization of Securities Laws: The Achievements of the European Communities*, 31 HARV. INT'L L.J. 185, 195-97 (1990) [hereinafter Warren, *Global Harmonization*]; Manning G. Warren III, *The European Union's Investment Services Directive*, 15 U. PA. J. INT'L BUS. L. 181, 191 (1994) [hereinafter Warren, *Investment Services Directive*] (discussing economic benefits arising from unification of the European financial markets). As Geoffrey Fitchew (Director-General, Directorate-General XV, Financial Institutions and Company Law, Commission of the European Communities, Brussels) has explained the benefits:

The diagnosis made by the Commission which entered office in 1985 was that Europe had been falling seriously behind the United States and Japan in both economic performance and potential and that this gap

the EU is harmonizing laws among its member states dealing with corporate governance, the securities markets, and other matters that would have an impact upon corporate governance.¹⁴⁰ So significant is the EU pressure that some French authorities believe that it is the most likely source of change to French corporate governance.¹⁴¹

Most importantly, the EU is weaning its member states off the practice of providing state financing to companies, often resorting to sanctions in the process.¹⁴² If member states are not the primary source of company capital, companies have no choice but to look to the capital markets, with the accompanying loss of state control.¹⁴³ As less state aid is forthcoming,

could not be bridged unless remaining barriers to the freedom of movement of *goods, services, capital and persons* (both natural and legal) were removed

The clear expectations of the White Paper are that the removal of these barriers will lead not only to sharper competition and hence to a general improvement in factor productivity, but ultimately to increased investment by industry and services in order to take advantage of the economies of scale offered by a genuinely unified market.

Geoffrey Fitchew, *Political Choices*, in *EUROPEAN BUSINESS LAW: LEGAL AND ECONOMIC ANALYSIS ON INTEGRATION AND HARMONIZATION*, *supra* note 5, at 4.

140. See generally Richard M. Buxbaum & Klaus J. Hopt, *Legal Harmonization and the Business Enterprise Revisited*, in *EUROPEAN BUSINESS LAW: LEGAL AND ECONOMIC ANALYSIS ON INTEGRATION AND HARMONIZATION*, *supra* note 5, at 391-412; *LEGAL HARMONIZATION AND THE BUSINESS ENTERPRISE*, *supra* note 5.

141. Interview with Alice Pezard, Magistrat, Conseil Juridique du Directeur, Direction du Trésor, Ministère de l'Économie, in Paris, France (June 27, 1994).

142. See KERNINON, *supra* note 94, at 93-94 (discussing Articles 91-93 of the Treaty of Rome that limit aid that a member state can give to a company). As Kerninon explains:

La Commission est en vérité animée par la volonté de combattre tout ce qui, à l'intérieur de la Communauté, peut entraver l'épanouissement de la concurrence, tenue pour la source principale de l'efficacité économique. A ce titre, la survie de firmes artificiellement assurée par le canal d'aides étatiques apparaît nuisible et génératrice d'un inutile gaspillage de ressources publiques.

Id. at 96. See, e.g., Beverley Head, *France: French Cut Losses as Cash Injection Does Not Compute*, *AUS. FIN. REV.*, Mar. 11, 1994, available in LEXIS, Europe Library, ALLEUR File (describing European Commission's deliberations over whether to permit further French government investments in Bull). See generally Tony Prosser & Michael Moran, *From National Uniqueness to Supra-National Constitution*, in *PRIVATIZATION AND REGULATORY CHANGE IN EUROPE* 145, 150-51 (Michael Moran & Tony Prosser eds., 1994).

143. See KERNINON, *supra* note 94, at 96 ("Le marché financier doit donc être le pourvoyeur naturel de capitaux pour les entreprises qui, publiques ou privées, se voient contraintes de faire en sorte que l'équilibre de leur gestion ne dépende pas de concours émanant de l'État.").

company management has no choice but to look to capital market financing. It must thus demand more management autonomy from the state and it should encounter shareholder-owners with pure economic purposes.¹⁴⁴

Equally significant is pressure arising from relevant EU directives dealing with corporate governance and capital market issues. I have already mentioned the Undertakings for Collective Investment in Transferable Securities directive, which may expand the class of European institutional investors, and the Thirteenth Directive dealing with tender offers—both already implemented in national legislation by France. Many of the other relevant directives, both already passed by the European Council and proposed, but not enacted, would produce a more competitive market environment and are thus incompatible with a closed system of corporate governance.¹⁴⁵

3. Summary

French corporate governance is feeling pressures to change. French government, market, and business parties are creating a modern liquid market system that presents corporate financing possibilities potentially incompatible with state control. Moreover, the EU has made it increasingly difficult for France to provide financing to state-owned companies, thus turning these companies to the capital markets, and it is attempting to create a unified capital market and company structure. Therefore, when we consider the involvement of United

144. *See id.* at 98-99. Given this EU pressure, it is understandable that European governments are now taking the ultimate step of pushing companies to an entire dependence upon the capital markets (*i.e.*, privatization).

145. For a listing and description of the relevant directives, see Karmel, *supra* note 132, at 6-10; Andreas J. Roquette, *New Developments Relating to the Internationalization of the Capital Markets: A Comparison of Legislative Reforms in the United States, the European Community, and Germany*, 14 U. PA. J. INT'L BUS. L. 565, 587-99 (1994); Warren III, *Global Harmonization*, *supra* note 139, at 197-224. A particularly significant Directive is the Investment Services Directive, which establishes prudential standards for broker-dealers and introduces the important concept of recognition of a broker-dealer organized and located in one home state by other member states, where such broker-dealer would be permitted to conduct business. *See* Warren III, *Investment Services Directive*, *supra* note 139, at 198-217; *see also* Norman S. Poser, *Automation of Securities Markets and the European Community's Proposed Investment Services Directive*, 55 LAW & CONTEMP. PROBS. 29 (1992).

States institutional investors in the recent wave of French privatizations beginning in 1993, we must understand that French corporate governance is at a crossroads.

V. FRENCH PRIVATIZATION AND UNITED STATES INSTITUTIONAL INVESTORS

This final part examines the transformation of French corporate governance revealed in, and to an extent caused by, the 1993 privatizations and the place of United States institutional investors in the transformation. It first outlines the history of recent French privatization and overall privatization mechanics. It next examines the transformation of French corporate governance as occasioned by the French privatization. This part then reviews the investment and corporate governance activity by United States institutional investors in the French privatization. Finally, it draws several conclusions about the role of these investors in French corporate governance.

A. *French Privatization*

1. History

French privatization began in 1986 with the resumption of parliamentary power by the French Right.¹⁴⁶ French right parties allied themselves and obtained a majority in the French National Assembly, which enabled them to form a government.¹⁴⁷ They shared power with François Mitterand,

146. The French Right was basically represented by two political parties, the *Rassemblement pour la République* ("RPR"), a party with its origins in the approach of General de Gaulle and headed by Jacques Chirac, and the *Union pour la Démocratie Française* ("UDF"), headed by the former French president, Valéry Giscard d'Estaing (1974-1981). The 1986 legislative elections gave a union of right-wing parties a bare majority in the French National Assembly. JEAN-JACQUES BECKER, *HISTOIRE POLITIQUE DE LA FRANCE DEPUIS 1945*, at 179-80 (1992).

Although privatizations started in 1986, in the early 1980s Socialist governments, recognizing the difficulty in government financing of state-owned companies, permitted the companies to turn to financial markets to raise some equity capital. See DURUPTY, *supra* note 93, at 25-29; KERNINON, *supra* note 94, at 40.

147. For a discussion of the French political system, see JEAN ROSSETTO, *LES INSTITUTIONS POLITIQUES DE LA FRANCE* (1992). Under the Constitution of the French Fifth Republic, the president has the power to select the prime minister, the chief government executive. However, he generally must select this minister from the party or parties controlling the National Assembly. *Id.* at 68-69. The

a Socialist president whose term had not yet expired.¹⁴⁸ A major plank in the platform of the new government was the privatization of publicly-owned companies, both those nationalized by the Socialists in 1982 and those whose nationalization dated to the immediate post-War years.¹⁴⁹

A neo-liberal economic belief that companies would function more efficiently in the private market, *i.e.*, that the market would direct resources to the most efficiently operated enterprises, inspired the 1986 privatization. However, as Professors Graham and Prosser have explained, this liberal account fails to explain fully the privatization movement.¹⁵⁰ Many of the companies on the privatization "list" were in good financial condition and were major global competitors.¹⁵¹ Thus, these companies were already subject to market discipline. More importantly, the French government privatized companies because, with a growing budget deficit, it could not provide them with the funds necessary to enable them to compete in the global marketplace and because proceeds of their sale helped to fill this deficit.¹⁵²

In addition, through privatization, the French government intended to contribute to a goal of developing the Bourse by increasing its small capitalization and its liquidity.¹⁵³ Individual French citizens were encouraged to invest in the

prime minister in turn proposes to the president a list of other government officials or ministers. *Id.* at 90.

148. This period in which a Socialist president co-existed with a Rightist prime minister (Jacques Chirac) was known as the first "*cohabitation*."

149. See DURUPTY, *supra* note 93, at 32.

150. COSMO GRAHAM & TONY PROSSER, *PRIVATISING PUBLIC ENTERPRISES* 26-36 (1991); Michael Moran & Tony Prosser, *Introduction: Politics, Privatization and Constitutions*, in *PRIVATIZATION AND REGULATORY CHANGE IN EUROPE*, *supra* note 142, at 1-13.

151. See Bauer, *supra* note 113, at 51 ("From a strictly economic point of view the liberal *credo* was very watered down: the French remained faithful to the practice of 'nationalising losses and privatising profits.'").

152. See ROLAND LASKINE, *LES PRIVATISATIONS: ENJEUX STRATÉGIQUES ET OPPORTUNITÉS BOURSIÈRES* 11 (1993) ("Le manque de moyens financiers de l'État est à l'origine d'un déficit chronique de fonds propres de nombreuses entreprises publiques. Soit l'État dispose de la totalité du capital, et le coût financier d'une augmentation de capital de grande ampleur n'est pas à sa portée. Soit il ne dispose que de 50% des actions et il s'oppose à toute augmentation de capital qui pourrait lui faire perdre la majorité."); DURUPTY, *supra* note 93, at 33.

153. See DURUPTY, *supra* note 93, at 34 ("Le but de la privatisation est de donner à la France les moyens d'attirer les investissements internationaux et de changer en conséquence les dimensions de notre marché financier.").

privatizations so that they would have an economic stake in the process (and would be reluctant to agree to a renationalization).¹⁵⁴ Because privatization would involve large public sales of stock, French banks and brokers would gain experience in this complex area, which would improve their own global competitiveness.¹⁵⁵

In 1986, the French government proposed, and the French National Assembly passed, several privatization laws. The law of 1 July 1986 established the general framework for the process and included as an annex a list of the companies to be privatized.¹⁵⁶ The law of 6 August 1986 established actual privatization procedures after the Socialist President Mitterand made clear his unwillingness to cooperate in the privatization process.¹⁵⁷ Although opponents challenged the

154. See GRAHAM & PROSSER, *supra* note 150, at 26; Bauer, *supra* note 113, at 54. As Professors Graham and Prosser observe, this reliance upon individual shareholders was risky because it meant that the privatization had to succeed economically and thus that privatized enterprises could not fail. "To a government disposed to increase the number of such shareholders the incentives will be strong to limit the vulnerability of an enterprise to market forces in order to maximize new shareholdings; in this sense the ideological and the more directly political considerations may run counter to each other." *Id.*

155. See *id.* at 31 ("In addition, the prominent role of the nationalized banks provided a further set of arguments for their privatization in view of the internationalization of capital and increasing bank competition in Europe.").

156. Under this law, legislative authorization was required for any transfer to the private sphere of (i) companies where the State directly controlled more than 50% of the capital ("*entreprises publiques de premier rang*") or (ii) companies that entered into the public sector as a result of a particular legislative action (*i.e.*, nationalization), whether or not controlled at 50% directly by the state. A list of 65 companies was established in this annex and included industrial companies (Péchiney, Thomson, Rhône-Poulenc, Saint-Gobain, CGE (now Alcatel-Alsthom), Matra, Compagnie des Machines Bull, Compagnie Générale de Constructions Téléphoniques), two financial companies (Compagnie Financière de Suez (now Compagnie de Suez) and Compagnie Financière de Paribas), banks (Société Générale, Crédit Lyonnais, Banque Nationale de Paris) and insurance companies (Union des Assurances de Paris, Assurances Générales de France). Left to administrative decision was the privatization of companies not falling in the above categories or the sale to private parties of shares in state-owned companies in cases where the state maintained control. For general descriptions of this law, see DURUPTY, *supra* note 93, at 36-45; GRAHAM & PROSSER, *supra* note 150, at 85-88; Olivier d'Ormesson & Didier Martin, *L'élaboration des lois de privatisations: Présentation générale du cadre juridique*, 13 DROIT PRATIQUE COMMERCIALE INTERNATIONALE [D.P.C.I.] 405, 412-17 (1987).

157. President Mitterand refused to facilitate privatization by signing an administrative order. The August law enumerated the ways in which privatization could be effected (*e.g.*, by public sales), the procedure to follow for establishing a price and determining purchasers and the manner in which administrative authori-

privatization on constitutional grounds, the Conseil Constitutionnel upheld them as constitutional with some modifications.¹⁵⁸

The privatizations planned by these laws, which established a deadline of 1991 for their completion, was an economic and political success. Within one year, a third of the planned privatizations had been carried out and included such companies as Alcatel-Alsthom, Crédit Commercial de France, Havas (communications group), Paribas, Saint Gobain, Société Générale, Suez, TF1 (television station), as well as numerous smaller companies.¹⁵⁹ The 1987 world stock market crash slowed the privatizations; the 1988 French legislative elections, where the Socialists returned to power in the National Assembly, completely stopped them.¹⁶⁰ Following the elections, President Mitterand announced that there would be neither more privatizations nor more nationalizations.¹⁶¹ However, the Socialist government continued the process of "opening" the capital of state-controlled companies to private capital market investors.¹⁶²

Privatization recommenced with the return of the right-wing coalition to power in the spring 1993 legislative elections. Not only did this coalition simply return to its privatization program,¹⁶³ but it felt economic pressures that made privat-

zation would be granted for sales of companies not falling into the *premier rang*. See DURUPTY, *supra* note 93, at 50-58; d'Ormesson & Martin, *supra* note 156, at 426-55.

158. The Conseil Constitutionnel, which reviews for constitutionality laws promulgated by the French National Assembly, ROSETTO, *supra* note 147, at 171-79, determined in its decision of June 25, 26, 1986 that the draft privatization laws were constitutional subject to three general limitations: (i) a company that constituted a "service public national" (e.g., education, social security) could not be privatized; (ii) nor could a company that occupied a "monopole de fait" (e.g., gas and electricity); and (iii) the State had to receive "une indemnisation juste et équitable" in the privatization (i.e., company had to be sold at a price not less than its value determined in accordance with proper valuation methods). See DURUPTY, *supra* note 93, at 45-50; GRAHAM & PROSSER, *supra* note 150, at 98 (generally discussing constitutional limitations on French privatization); d'Ormesson & Martin, *supra* note 156, at 419-25.

159. See Bauer, *supra* note 113, at 51 (noting that such companies included those recently nationalized in 1982 and those nationalized following the War).

160. KERNINON, *supra* note 94, at 42.

161. *Id.*

162. See LASKINE, *supra* note 152, at 23. These partial sales included that of Elf in 1990, Total in 1992 and Rhône-Poulenc in 1993.

163. See ECK, *supra* note 81, at 52.

ization absolutely necessary. Because of high unemployment partly owing to the recession in the early 1990s and increasingly large financial burdens due to social welfare spending, the French government was running a significant budget deficit. Receipts from privatization sales helped fill this deficit.¹⁶⁴ These receipts were intended to be used to prepare other companies for privatization (e.g., by giving them additional capital or removing significant liabilities from their balance sheets).¹⁶⁵

Because the law identifying the companies to be privatized was no longer in effect, the French National Assembly passed new privatization laws modeled upon the old, with some differences with respect to the manner of privatization.¹⁶⁶ The laws established a list of companies to be privatized that included those on the 1986 list that had not been privatized and new additions, such as Renault.¹⁶⁷ The program, which is now entering its second year of operation, has several major privatizations to its credit and others currently planned.¹⁶⁸

164. See LASKINE, *supra* note 152, at 16-17.

165. It has been reported that, in 1993, the French government obtained 47.6 billion French francs from privatization sales. Of these, 19 billion were used to improve the financial condition of state-owned companies; 9 billion went to help address unemployment; and 18 billion was used to address the deficit. See *France 1993 Privatization Raised 47.6 Bln Francs*, Reuters, Mar. 16, 1994, available in LEXIS, Europe Library, ALLEUR File.

166. The new law provides that companies included on an annex, or any companies whose principal purpose is to own shares of the listed companies, are eligible to be privatized. It basically amends the law of August 6, 1986. Loi No. 93-923 du 19 Juillet 1993 [Law No. 93-923 of July 19, 1993], art. 2, *Journal Officiel de la République* [J.O.], July 21, 1993, at 10255, 1993 Dalloz-Sirez, *Législation* [D.S.L.] 396.

167. The list included the following 21 companies (9 of which had not been on the 1986 list): Aérospatiale (new), Société Nationale Industrielle, Compagnie Nationale Air-France (new), Banque Hervet, Banque Nationale de Paris, Caisse Centrale de Réassurance (new), C.N.P. Assurances (new), Compagnie des Machines Bull, Compagnie Générale Maritime (new), Crédit Lyonnais, Pêchiney, Régie Nationale des Usines Renault (new), Rhône-Poulenc, Assurances Générales de France, Groupe des Assurances Nationales, Union des Assurances de Paris, Société Nationale d'Exploitation Industrielle des Tabacs et Allumettes (new), Société Marseillaise de Crédit, Société Nationale d'Étude et de Construction de Moteurs d'Aviation (new), Elf-Aquitaine, Thomson S.A., Usinor Sacilor (new). PEZARD, *supra* note 113, at 358.

168. The French government has so far proceeded with five privatizations through public sales of securities on French and international securities markets. Of these, four have involved some of the strongest economically of the 21 companies, two of whose shares (Rhône-Poulenc and Elf) had already been sold to the public in France and internationally. See Arrêté du 4 Octobre 1993 [Order of Oct.

2. The Privatization Process

French constitutional constraints determined the privatization structure. As noted above, the Conseil Constitutionnel stated that, under French constitutional law, the government had to receive adequate compensation for the sale of state-owned companies (just as private parties had to be adequately compensated in the original nationalizations).¹⁶⁹ Accordingly, both the earlier and later privatization laws established an independent Commission to oversee the privatization process.¹⁷⁰ The Commission evaluated a state-owned company that the government proposed to sell and established a "floor" price below which the company could not be sold.¹⁷¹ This legal requirement posed a potentially difficult practical problem, because, if the floor were set too high, the potential buyers

4, 1993], J.O., Oct. 5, 1993, at 13808, 1993 D.S.L. 514 (Banque nationale de Paris); Arrêté du 15 Novembre 1993 [Order of Nov. 15, 1993], J.O., Nov. 16, 1993, at 15801, 1993 D.S.L. 544 (Rhône-Poulenc); Arrêté du 2 Février 1994 [Order of Feb. 2, 1994], J.O., Feb. 3, 1994, at 1870, 1994 D.S.L. 175 (Elf-Aquitaine); Arrêté du 25 Avril 1994 [Order of Apr. 25, 1994], J.O., Apr. 26, 1994, at 6107, 1994 D.S.L. 262 (Union des Assurances de Paris); Arrêté du Feb. 6, 1995, J.O., Feb. 7, 1995, at 2084, __ D.S.L. __ (Société Nationale d'Exploitation Industrielle des Tabacs et Allumettes (SEITA)). The government has also sold a minority share of the automaker Renault in a public offering. See Arrête du 2 Novembre 1994 [Order of Nov. 2, 1994], J.O., Nov. __, 1994 at 15610, 1994 D.S.L. __. The government has also announced that it intends soon to privatize fully, through public sales, the Société Centrale Assurances Générales de France, see Décret No. 94-195 du 8 Mars 1994 [Decree No. 94-195 of Mar. 8, 1994], J.O., Mar. 9, 1994, at 3732, 1994 D.S.L. 224.

169. See GRAHAM & PROSSER, *supra* note 150, at 20 (discussing decision of Conseil Constitutionnel on this matter).

170. Article 3 of the 1986 law had established a Commission d'évaluation des entreprises publiques. Loi no. 86-912 du 9 Août 1986 [Law No. 86-912 of Aug. 6, 1986], art. 3, J.O., Aug. 7, 1986, at 9695, 1986 D.S.L. 430. The 1993 law amended this article by organizing a Commission de la privatisation. Loi no. 93-923 du 19 Juillet 1993 [Law No. 93-923 of July 19, 1993], art. 4, J.O., July 21, 1993, at 10255, 1993 D.S.L. 396. In both cases, the Commission was composed of seven members, who, during their five-year term, were barred from any company management or membership on a board of directors. Moreover, for five years following their term, they were barred from similar activities with any company that had purchased a formerly state-owned company.

171. As stated in the 1993 law, the Commission was to "déterminer la valeur des entreprises." Loi no. 93-923 du 19 Juillet 1993 [Law No. 93-923 of July 19, 1993], art. 4(I)(1), J.O., July 21, 1993, at 10255, 1993 D.S.L. 396. In the case of a sale other than through a large public offering, the Commission would also evaluate "le choix de l'acquéreur". *Id.* art. 4(2). In addition, the 1993 law requires the transaction to occur within 30 days of the date when the Commission gives its opinion. See *id.* art. 4(VI).

would be deterred from purchasing shares of the company.¹⁷²

Both the 1986 and 1993 laws gave the government considerable flexibility in structuring a sale, with the major form being public sales on stock markets.¹⁷³ These public sales involved several separate offerings. Because of the political goals of the privatization, the primary and largest one was a public offering to French retail investors.¹⁷⁴ There was also an ac-

172. Professors Graham and Prosser identify the conflict generated by this requirement. The state needs to raise as much funds as possible and to meet the constitutional constraints, which argues that it should set a high a price as possible. However, in order to attract many small investors to the process and to the stock markets, and to fulfill the ideological goals of the privatization, the privatizations must be priced low. GRAHAM & PROSSER, *supra* note 150, at 98.

For example, in the Elf privatization, the floor price was set at FF 376.4, and shares were sold to the French public at FF 385. The highest share price of Elf was in the neighborhood of FF 434 before the privatization. ELF, *supra* note 50, at 20, 22; see e.g., *Paris: Elf and Fitness in the French Sell-Off Spree*, OBSERVER, Feb. 27, 1994, available in LEXIS, Europe Library, OBSRVR File.

173. See Loi no. 93-923 du 19 Juillet 1993 [Law No. 93-923 of July 19, 1993], art. 2, J.O., July 21, 1993, at 10255, 1993 D.S.L. 396 (referring to procedures established in Loi no. 86-912 du 6 Août 1986 [Law No. 86-912 of Aug. 6, 1986], J.O., Aug. 7, 1986, at 9695, 1986 D.S.L. 430).

174. It must be remembered that the French privatization is primarily an internal political affair that demands a successful placement among French citizens. The key aspect of a public sale is thus the *offre publique de vente* in France to French citizens and residents. In order to encourage these persons to participate in the privatizations, the French government widely advertized the privatizations and gave investors tax benefits. See LASKINE, *supra* note 152, at 47 (discussing the *Plan d'Épargne en Action*, where French citizens can set up a plan to purchase shares in French companies without taxation of dividends or capital gains). Moreover, success of an offering in the domestic French market is a key to success in the international markets because international investors are encouraged by this domestic success. *France: Elf Sale Was a Success*, CROSSBORDER MONITOR, Feb. 23, 1994, available in LEXIS, Europe Library, ALLEUR File.

In the Banque Nationale de Paris offering, 37,507,489 of the 72,129,786 shares offered were offered to French retail investors. See BANQUE NATIONALE DE PARIS, OFFERING CIRCULAR 8 (1993) [hereinafter BNP]. For Rhône-Poulenc, it was 52,330,983 out of 88,099,298. See RHÔNE-POULENC, PROSPECTUS 9 (1993). For Elf-Aquitaine, it was 38,641,489 out of 67,085,918. See ELF, *supra* note 50, at 7. For UAP, it was 54,402,978 out of 105,126,529. See SOCIÉTÉ CENTRALE UNION DES ASSURANCES DE PARIS, PROSPECTUS 7 (1994) [hereinafter UAP]. For SEITA, it was 16,616,912 out of a total of 45,338,792. See Arrêté du Feb. 6, 1995 [Order of Feb. 6, 1995], J.O., Feb. 7, 1995, at 2084, — D.S.L. —; Arrêté du Feb. 17, 1995 [Order of Feb. 17, 1995], J.O., Feb. 18, 1995, at 2665, — D.S.L. —. In certain cases, additional shares were sold in the retail offering after being "clawed back" from the institutional offering (Rhône-Poulenc's 52,330,983 includes 4,757,362 shares "clawed back" from the international offering). In nearly every case, the offering price to French retail investors was lower than that to other buyers (except for employees): in BNP, the offering price was the same, FF 240; in Rhone-Poulenc, the retail offering price was FF 135, as opposed to an institutional price of FF 146; in Elf,

companying sale to institutions, both in France and internationally, primarily to place stock that could not all be absorbed by the French retail market.¹⁷⁵ In addition, the public offering process also included offerings to employees of the privatized company, or of its subsidiaries,¹⁷⁶ and a private sale to certain large, strategic investors.¹⁷⁷

B. Corporate Governance

A significant part of the French privatization program, both as designed and as implemented, involved corporate governance of the newly privatized companies, and, in fact, indicated the transformation of French corporate governance. French privatization treated corporate governance in two respects: (i) the continued ownership and control of privatized companies by the French government and (ii) creation of a

the retail price was FF 385, against an institutional price of 403; and in UAP, the retail and institutional offering prices were close—FF 152 to FF 155; and in SEITA, the retail price was FF 129 to an institutional price of FF 133. The reason for the same price in the BNP retail and institutional offerings is that the government wanted to ensure that its first privatization would be a national and international success. See *French Privatisation*, FIN. TIMES, Oct. 8, 1993, at 20. Although all the offerings have been popular so far, their popularity, measured by the rate of domestic oversubscription, may be declining. BNP was 5 times oversubscribed, Rhone-Poulenc was 4.4 times oversubscribed, Elf was only 3 times oversubscribed, UAP was 2.5 times oversubscribed and Renault was 1.4 times oversubscribed.

175. The institutional offerings comprised a significant amount of the overall offering, subject to a legal limitation imposed by Article 10 of the 1986 law (as amended by Article 8 of the 1993 law) that no sale to foreigners could exceed 20% of the *capital* of the company. Although the BNP offering had separate tranches for French institutions (12,117,804 shares) and for institutions outside France (22,504,493), BNP, *supra* note 174, at 8, the other offerings simply combined the shares sold in the international offering. For Rhône-Poulenc, it was 26,958,385, RHÔNE-POULENC, *supra* note 174, at 8; for Elf, 21,735,837, ELF, *supra* note 50, at 7; for UAP, 40,210,898 shares, UAP, *supra* note 174, at 7; for Renault, 11,578,500 shares; and 10,643,682 shares for SEITA.

176. Under the privatization law, up to 10% of a public offering of shares of a privatized company must be reserved for employees of the company or of its subsidiaries. See Loi no. 86-912 du 6 Août 1986 [Law No. 86-912 of Aug. 6, 1986], art. 6, J.O., Aug. 7, 1986, at 9695, 1986 D.S.L. 430. Any individual employee could take shares whose total value was not in excess of five times the annual ceiling for social security payments. In addition, employees could receive a reduction in the offering price up to 20% less than the price proposed to the public, as well as possibilities of deferred payments and of receiving "bonus" shares. In each privatization, therefore, a significant portion of the shares (*i.e.*, 10%) were set aside for employees.

177. See *infra* subpart V.B.2.

stable network of shareholders for these companies.

1. Continued Government Ownership and Control

The French government's continued involvement in privatized companies would appear to be relatively simple. In many, if not most, cases, the government was completely divesting itself of direct or indirect ownership of the companies. However, both the 1986 and 1993 privatization legislation gave the government one obvious opportunity to retain control of privatized companies. In the 1993 law, the French government had only to retain one share in the privatized company and, by decree, have it transformed into a "golden share" or "*action spécifique*."¹⁷⁸ By means of this share, the government would have one or more of the following rights: (i) prior authorization by the Minister of the Economy for the acquisition, by any person (or group of persons acting in concert) of share capital or voting rights in a privatized company beyond certain limits established by the decree; (ii) the right to place two nonvoting state representatives on the board of directors; and (iii) the right to oppose any sale or other disposition of assets if such transaction adversely affected national interests.¹⁷⁹ If a person purchased shares in violation of any restriction pursuant to (i) above, it would lose any voting rights as to shares in excess of the given threshold and be compelled to sell these shares within three months.¹⁸⁰ Unlike the 1986 law, the 1993 laws did not place a term on the golden shares.

The statutory language providing for the "golden share" is vague, speaking of its use to protect national interests: "*si la protection des intérêts nationaux exige*."¹⁸¹ This vagueness

178. The concept of the "golden share" was borrowed from U.K. privatizations. See LASKINE, *supra* note 152, at 85.

179. See Loi no. 93-923 du 19 Juillet 1993 [Law No. 93-923 of July 19, 1993], art. 7, J.O., July 21, 1993, at 10255, 1993 D.S.L. 396. See also PEZARD, *supra* note 113, at 386 (discussing the "golden share"); Jean-Luc Delahaye, *La Golden Share à la française: l'action spécifique*, 13 D.P.C.I. 579 (1987) (discussing use of golden share in 1986 privatizations).

180. This penalty is similar to those imposed on purchasers who pass thresholds set either by French law or by the certificate of incorporation of a particular company.

181. These "national interests" must be in addition to those specifically recognized by EU law, for the second section of Article 10 of the August 1986 law, as revised by the 1993 law, provides that, pursuant to EU law, the Minister of the

has not posed problems in the 1993 privatization because the golden share has been used only once, in the privatization of Elf-Aquitaine, the world-class oil and gas company. In fact, its use with Elf suggests some coherent meaning to the terms "intérêts nationaux" and "indépendance nationale"—they deal with the protection of French strategic resources, such as energy.¹⁸² Unlike in the other three complete privatizations sold on the public markets, in Elf, the French state continues to hold indirectly 13% of the share capital and voting rights. Moreover, its golden share gives it all of the above rights provided by the privatization law and is of unlimited duration.¹⁸³

It would appear then, that continued state involvement in ownership and control of privatized companies would be easy to detect: either the French government maintains a direct or indirect interest and/or veto through a golden share, or it does not. One would assume that if such indicia of ownership or control are not present, then the French government's involvement in the corporate governance of these companies would be at an end. That the privatized companies are generally in competitive industries (*i.e.*, not providing essential services such as electricity) and thus not demanding of special government regulation supports this view. However, given the tradition of *colbertisme* and the recent history of strong state involvement in the economy, as well as the tradition of the state career for company executives, the state may try to maintain some indirect influence over privatized companies through another privatization technique, as discussed in the following subsection.

Economy can limit to 5% holdings by non-French parties (including those from other EU states) in companies dealing with certain sensitive sectors, such as health, security and defense. Loi no. 93-923 du 19 Juillet 1993 [Law No. 93-923 of July 19, 1993], art. 7, J.O., July 21, 1993 at 10255, 1993 D.S.L. 396. See PEZARD, *supra* note 113, at 387-88. Confusion arises because a further provision of the privatization law states that, if the "*indépendance nationale est en cause*" (emphasis added), the golden share cannot be transformed into an ordinary share.

182. Mme. Pezard suggests that the term "indépendance nationale" is much more restrictive than "intérêts nationaux" in that its focus is on protecting activities necessary for national sovereignty. In her view, providing certain forms of energy clearly falls into this category. See PEZARD, *supra* note 113, at 388.

183. The acquisition thresholds requiring prior approval of the French Minister of the Economy are 10%, 20% and 33.33%. Government approval is needed for the sale or pledge of specific important subsidiaries of Elf. See ELF, *supra* note 50, at 17.

2. Stable Shareholders

A more significant phenomenon than the golden share with respect to corporate governance of French privatized companies is the creation of a small group of stable shareholders, or, in French, the *noyau dur*. This phenomenon is most developed in the French corporate structure, although it is being copied in Spain, and Italy. The 1986 privatization law permitted the Minister of the Economy to privatize a company by finding purchasers other than through a public sale, i.e., by private sales. The 1993 privatization law modified this procedure by addressing the issue of the secrecy of the process and accompanying suspicion that the Minister selected purchasers for political reasons.¹⁸⁴ However, even the 1993 law gives no intended purpose for the Minister's exercise of this power, other than the general privatization goal.¹⁸⁵

In practice, the Minister has used the stable shareholder structure to ensure that a controlling block of the capital (and voting rights) of a privatized company are put in the hands of a relatively small group of other companies, particularly financial institutions. This result is accomplished in two ways. First, one or a few large shareholders are established for a privatized company;¹⁸⁶ invariably some or all of such shareholders are affiliated financial institutions whose collective ownership of the privatized company reaches approximately 15-20%. At a second level, there is formed a slightly larger group of other

184. The 1993 law stipulates that the Minister fix the choice of private purchasers and the conditions of the transaction based upon the advice of the Privatization Commission. See Loi no. 93-923 du 19 Juillet 1993 [Law No. 93-923 of July 19, 1993], art. 5, J.O., July 21, 1993, at 10255, 1993 D.S.L. 396. A decree of the Conseil d'Etat in turn establishes rules concerning the solicitation of offers from private parties for participation in the *noyau dur* of a given company. This decree states that, upon publication of a solicitation of offers in the *Journal Officiel*, potential buyers have 15 days within which to submit their offer as well as their financial qualifications. This information is forwarded to the Privatization Commission for evaluation. See Décret no. 93-1041 du 3 Septembre 1993 [Decree No. 93-1041 of Sept. 3, 1993], art. 1, J.O., Sept. 5, 1993, at 12501, 1993 D.S.L. 497. See generally PEZARD, *supra* note 113, at 371-73.

185. See Bauer, *supra* note 113, at 55 (discussing the flexibility given to the Minister of the Economy with respect to these transactions).

186. The privatization law generally prohibits any purchaser from acquiring more than 5% of a company at the time of the privatization. *Id.* Thus, these larger shareholders usually already have significant stakes in the privatized companies and add to their holdings through the current privatization.

institutions holding stock in the company, with this second group together having approximately 20% of the capital (and votes).¹⁸⁷ Thus, once the *noyau dur* for a privatized company is set, other companies selected by the Minister with the advice of the Privatization Commission hold 30-40% of its capital (and votes).

The formation of *noyaux dur*, in the related privatizations of the Banque Nationale de Paris (BNP) and the Union des Assurances de Paris (UAP) (one of the largest insurance companies in France), shows the result of this process. These privatizations are related because BNP and UAP are each the major investor in the other, a respective position enhanced by the privatization process. In 1990, BNP and UAP formed a cross-shareholding arrangement that was part of joint efforts in the development of the marketing of insurance products through banks.¹⁸⁸ In BNP's privatization, UAP's shareholding went from 9.8% to approximately 15%; in UAP's privatization, BNP's ownership of UAP remained the same, at 19%, although agreements had been reached to lower the bank's holding to 15%.¹⁸⁹ At a second level, Dresdner Bank owns 10% of BNP as a result of the privatization.¹⁹⁰ In UAP's case, the second level comes from a cross-holding with the Suez Group, a large financial and industrial conglomerate, where each side holds approximately 5% of the other.¹⁹¹ Finally, other companies collectively control a significant percentage of each company. In BNP's case, this group owns approximately 15%; in UAP's case, the ownership is 11%.¹⁹² Thus, following privatization,

187. One can think of these various shareholders in circular terms, with an inner circle representing the large shareholders and circles with steadily larger diameters representing the second group of institutions. François Morin, of the Laboratoire d'études et de recherches en économie de la production ("LEREP") of the Université de Toulouse-1, has made vivid graphs of cross-shareholdings in privatized companies. See Morin, *supra* note 134 (describing cross-shareholdings in BNP); François Morin, *La recomposition du pouvoir économique: Les trois pôles du coeur financier*, LE MONDE, Mar. 8, 1994, (L'économie section), at II. See generally FRANÇOIS MORIN & CLAUDE DUPUY, *LE COEUR FINANCIER EUROPÉEN* 47-54 (1993).

188. See BNP, *supra* note 174, at 35 (describing cross-shareholding between BNP and UAP); UAP, *supra* note 174, at 63 (describing how certain sales in the health, homeowners' and automobile insurance is made through BNP branches).

189. See BNP, *supra* note 174, at 53-54; UAP, *supra* note 174, at 19.

190. *Id.*; see also Morin, *supra* note 134, at 128-29 (observing that, pursuant to agreements between Dresdner and BNP, cross-shareholdings will rise to the 10% level).

191. See UAP, *supra* note 174, at 19-20 (discussing cross-shareholding).

192. In BNP's case, some of these companies are involved in cross-

stable shareholders own approximately 40% of each of BNP and UAP's capital.

Two of the privatized industrial companies, Rhône-Poulenc and Elf, exhibit a somewhat similar structure. However, these companies do not have significant cross-shareholdings with one or more financial institutions; rather, financial institutions simply number among their owners. These companies are less important in the examination of the transformation of French corporate governance because the state remains a significant direct or indirect shareholder of them. Thus, Rhône-Poulenc's two major investors, Crédit Lyonnais and AGF, are both financial institutions and government-owned (albeit on the list for privatization), and together control approximately 14% of Rhône-Poulenc.¹⁹³ The government also continues to own 13% of Elf. In both companies, a small group of other companies together owns 10% of their capital and votes.¹⁹⁴

shareholdings. Thus, Saint-Gobain (a company privatized in 1986) owns approximately 1.8% of BNP, which owns approximately 3% of Saint-Gobain. Similar cross-holding occurs in Pechiney (State-owned), Rhone-Poulenc (privatized in 1993), Générale des Eaux (private), and Saint Louis (private). Other members of the group include two Kuwaiti investment funds, General Electric Investment Corporation, Elf, Dassault, Peugeot Citroen, Renault, BAT and Hoffman Laroche groups. BNP, *supra* note 174, at 10; Morin, *supra* note 134, at 128.

There are fewer cross-holdings in UAP, but this third level of company-owners includes some of the same companies as are in BNP's group (e.g., Générale des Eaux, Saint-Gobain, Peugeot group company). It also includes the Caisse des Depots et Consignations (state financial company), Crédit Local de France, a company in the Albert Freres group, Meiji Mutual Life, and Westdeutsche Landesbank. See BNP, *supra* note 174, at 10.

193. See RHÔNE-POULENC, *supra* note 174, at 19. AGF and Crédit Lyonnais are linked in a cross-shareholding arrangement and, as François Morin has remarked, they, together with Paribas, present another center of financial power in juxtaposition with that of the BNP-UAP-Suez group. See MORIN & DUPUY, *supra* note 187, at 50; Morin, *supra* note 134, at 131; Morin, *Les trois pôles*, *supra* note 187, at II. Given various (highly publicized) troubles with investments it has recently experienced, Crédit Lyonnais will likely not be privatized in the near future. See Peter Gumbel, *France's Bureaucracy Finds it Hard to Stop Meddling in Industry*, WALL ST. J., June 20, 1994, at A1. By contrast, AGF's privatization has been approved by the government, but no timetable for it has been set. See David Buchan, *Balladur Pledge on Renault Sell-Off as Profits Rise 125%*, FIN. TIMES, Sept. 3, 1994, at 22 (speculating that delay is due to AGF's recent adverse financial results).

194. For Rhône-Poulenc, this group includes Société Générale, BNP, the insurance company AXA, Credit Suisse and a company in the Fiat Group. RHÔNE-POULENC, *supra* note 174, at 19. The Elf stable shareholder group consists of UAP, BNP, Société Générale de Belgique, Société financière pour l'Expansion de l'Industrie, AXA, Paribas, Caisse Nationale de Crédit Agricole, Compagnie

What, then, are the purposes and effects of this stable shareholder structure?¹⁹⁵ First, a pure market discipline or market for corporate control cannot affect, without hindrance, these privatized companies. If one or two investors own 15-20% of a company, and if a slightly larger group owns an additional 10-20%, with the rest of the shares dispersed among small shareholders,¹⁹⁶ a buyer will experience great difficulty obtaining control of the company through open market purchases and a hostile takeover. This difficulty will be enhanced by the fact that many of the companies, whether in the "inner" or "outer" group of stable shareholders, are linked to the target company by cross-shareholdings. In addition, members of the *noyau dur* customarily enter into agreements generally providing that, for the first several years, its members are free to sell only a small percentage of their shares, and also, up to five years following the purchase, other *noyau dur* members have a right of first refusal as to offered shares.¹⁹⁷ Given that man-

Nationale à Portefeuille and the Union des Banques Suisses. ELF, *supra* note 50, at 18. Arguably, both companies could fall within UAP-BNP-Suez's group of industrial companies.

Given that the French government has only partially privatized Renault, I do not include it in the above *noyau dur* analysis. As in Elf, the French government retained a significant share position. See *France*, in PRIVATISATION INT'L, Feb. 1, 1995, available in Westlaw, PRVINT Database.

195. This consideration is significant in the 1993 privatizations because, unlike the 1986 privatizations, many stable shareholders are no longer under government control. The full effect of the stable shareholder mechanism on French corporate governance is only now beginning to be seen because fewer and fewer large companies, particularly banks, who belong to stable shareholder groups are remaining under the control of the state. In the 1986 privatization, by contrast, arguably state control continued in many cases despite the privatization because of the state ownership of members of the stable shareholder group.

196. Some of the publicly-held shares are in fact owned by employees of the privatized company or of its subsidiaries and are thus in friendly hands. Other shareholders that would likely vote to oppose a takeover would include SICAVs managed by banks belonging to the dominant financial shareholders.

197. For example, the stable shareholder agreement in Rhône-Poulenc is described as follows:

These investors will adhere to, and a certain number of existing shareholders (collectively, the "Stable Shareholders") have entered into, an agreement (the "*protocole*") with the intention of assuring the cohesion and stability of the shareholder base of the Company. The parties to the *protocole* have designated the Company to manage the *protocole* in order to assure that each party complies with its terms. According to the *protocole*, each Stable Shareholder is required to keep the Shares subject to the *protocole* held by it for at least three months, and to keep at least 80% of such Shares for a further 15 months, beginning on November 26,

agement of privatized companies is rumored to have a "say" in the composition of the stable shareholder group, and given the dominant position of management in French companies, the purpose of the stable shareholder structure could be a management entrenchment device.¹⁹⁸

In response to suggestions that the core shareholder structure entrenches management, some have argued that it is needed in a market of traditionally small capitalization and one relatively lacking in domestic institutional investors similar to United States pension funds. In other words, because individual investors are still not regularly in the French capital market and because French institutional investors, such as SICAVs and pension funds, are only gradually increasing their investments, the French government and company management must turn to existing companies for the bulk of company financing.¹⁹⁹ This structure should not be an obstacle to full market liberalization because the stable shareholder agreement is for a set term.²⁰⁰

1993. Following the expiration of such period of 18 months and for a further period of three years, transfers of 80% of such Shares by any Stable Shareholder will be subject to a right of first refusal in favor of the other Stable Shareholders.

RHÔNE-POULENC, *supra* note 174, at 18.

198. See Bauer, *supra* note 113, at 59 ("Lastly, there is the fact that, in choosing the members of the 'stable nucleus,' the Minister of Finances was very sensitive to the wishes of the management of the privatised firms."). Occasionally, the selection of a PDG for a privatized company occurs shortly before the actual privatization. See BNP, *supra* note 174, at 52 (Michel Pebereau was selected as PDG of BNP approximately 5 months before its privatization). Nonetheless, it is likely that new management would especially have a say in the identity of the core shareholder group.

199. See, e.g., *France Will Keep Some 13 Percent of Elf After Sale*, Reuters Eur. Bus. Rep., Jan. 7, 1994, available in LEXIS, Europe Library, ALLEUR File (the structure gives companies time to adjust to life in the market); John Ridding, *Hard Core or Soft Centre*, FIN. TIMES, Feb. 10, 1994, at 21 (citing French market officials who explain that the structure is necessitated by the absence of U.S.-like institutional investors in France). See also GRAHAM & PROSSER, *supra* note 150, at 155 ("What was the purpose of the hard cores? Their presence was ostensibly a reflection of the lack of large institutional shareholders in France in comparison with the United Kingdom.").

200. See Ridding, *supra* note 199 (pointing out the limited term of the agreements). But see ELF, *supra* note 50, at 18 ("Such additional three-year period [for right of first refusal] will be thereafter automatically renewed for an unlimited number of periods unless a Stable Shareholder gives written notice to the Company by registered mail, at least three months prior to the end of any such period, stating such Stable Shareholder's intention to cease to be a party to the *protocole*."). It has been pointed out that the percentages owned by many of the

If the stable shareholder structure constitutes only a stage on the way to full market liberalization, one would expect to see the ownership of non-core investors gradually increase. The evidence, however, is to the contrary, and much remains to be done to encourage increased non-core shareholder involvement in the market.²⁰¹ Thus, privatized companies arguably remain free from capital market competition and their managers from the monitoring of owners other than members of the stable group. Because privatized companies are often in turn members of stable shareholder groups of their own core shareholders, privatization may have reproduced, at a favorable price,²⁰² an oligarchy of companies, somewhat reminiscent of

stable shareholders are so small (e.g., between .5% and 2.5%) that no one shareholder had enough control or incentive to present effective resistance to an unwanted hostile takeover. See KERNINON, *supra* note 94, at 43; see also Guyon, *supra* note 117, at 395 (discussing the established legality of shareholder agreements among the core group and observing that "il est conforme à l'intérêt social que des pactes conclus entre les principaux actionnaires, dont font souvent partie les investisseurs institutionnels, confèrent une certaine stabilité au conseil d'administration afin de permettre la réalisation d'objectifs à long terme.").

201. Michel Bauer observed that, in the 1986 privatizations, apart from the possibility of receiving bonus shares if purchased shares were held for a set period, small shareholders were not encouraged to remain shareholders. He explains that "[s]mall shareholders were allowed to provide important new financial resources but were unable to exert any influence on the privatised firms." Bauer, *supra* note 113, at 54. Accordingly, many small shareholders resold their shares to take advantage of the offering discount, and many core shareholders increased their holding. See *id.* at 58; see also KERNINON, *supra* note 94, at 42 n.66 ("Ils [statistics] témoignent que le rachat de titres cédés par les petits porteurs a permis aux membres des groupes d'actionnaires stables qui en ont eu la volonté d'assurer véritablement leur emprise sur les firmes concernées, en donnant par là même toute sa signification à leur présence."); LASKINE, *supra* note 152, at 18 (discussing failure of past privatizations to maintain small shareholders in capital of company). Although French market authorities have directed much effort at having small shareholders maintain their shareholding positions, and although privatizations have been generally popular, reports are that a large percentage of purchasers continue to resell quickly to take advantage of the discount. See *France: French Sell-offs to Quicken After Elf's Runaway Success*, EUROWEEK, Feb. 18, 1994, available in LEXIS, World Library, TXTLNE File.

202. Core shareholders pay a "control" premium for their shares, and thus their price generally exceeds that of shares offered to the public and to international investors. However, the price has still been under the current market price for the shares. For example, in Elf, the last reported market price before the offering was FF 415 per share, while the core shareholders paid FF 411 per share. See ELF, *supra* note 50, at cover, 18. This discount may be compensation for the lack of liquidity for the purchased shares. Moreover, the Privatization Commission and the Minister of the Economy do not necessarily take the best offers, as opposed to those offering strategic advantages. See Morin, *supra* note 134, at 129 (explaining how, from the evidence of the BNP's privatization, the government opted for a

the pre-World War trusts, that produce benefits primarily for its members and locks French capitalism into a small circle of companies and owners.²⁰³ This oligarchy is reinforced by the elitist training and background of the managers and directors.²⁰⁴

A critical question in French corporate governance today is whether the stable shareholder and cross-holding structure must result in an oligarchy controlling a large segment of the French economy. The structure may simply suggest a different kind of corporate governance that does not exclude the market and its discipline. In this view, as a result of the privatizations, coalitions of large, formerly state-owned financial institutions replace the state as the primary relational investors for industrial companies.²⁰⁵ In contrast to traditional practices, these financial institutions do not simply provide equity capital to the industrial firms in an effort to become the primary lender and investment bank for the companies. Rather, their role as significant shareholders offers benefits to both sides: (i) the financial institutions develop a source of return, both from the investments and from fees from financial advice, and (ii) the companies receive this investment and advice, as well as other services provided by the institutions, and can develop long-range plans with the strategic guidance of the banks.²⁰⁶ These financial institution-industry links do not

strategic use of the stable shareholder group, rather than using a market viewpoint of taking the highest bidders).

203. See Bauer, *supra* note 113, at 59 ("France is a long way from the free market: it has reconstituted between 1986 and 1988, in many cases in identical fashion, the traditional structures of French capitalism: 'a capitalism without capital and without sanctions.'").

204. See *id.* at 59-60.

205. See Morin, *supra* note 134, at 126-27. In Morin's view, the financial institutions that provide the relational investing are not single banks, but related groups of world-class financial institutions. Thus, he sees that, as a result of the 1993-1994 privatizations, a group centered around BNP and UAP has been formed, with a further involvement of the Compagnie de Suez, a financial conglomerate privatized in 1987 (which also includes the large Indosuez banking group). See *id.* at 126-31. Juxtaposed with this group are other emerging groups: the Cr dit Lyonnais-AGF-Paribas group, whose emergence is hindered by state ownership of the first two prongs; and a group formed around Soci t  G n rale. For a discussion of the concept that this financial group structure constitutes another kind of capitalism, see MICHEL ALBERT, CAPITALISME CONTRE CAPITALISME (1991); OLIVIER PASTR , LES NOUVEAUX PILIERS DE LA FINANCE (1992).

206. See ALBERT, *supra* note 205, at 126-27; MORIN & DUPUY, *supra* note 187, at 3. In fact, the equity involvement by banks is almost a necessity for survival in

prevent companies from going to capital markets; in fact, much of their financing may come from such sources. Thus, although a company's strategy will be formed in conjunction with the financial institutions' oversight, the capital markets would provide the ultimate check that even banks could not ignore if capital market investors turned to other, more productive uses of capital.²⁰⁷

It may then be a natural, and understandable, step from state ownership and relational investing to similar ownership and investing on the part of newly privatized large financial institutions bound in elaborate networks of cross-ownership with industrial companies. However, concerns (in addition to the worry about the creation of a financial oligarchy) have surfaced. There is little political legitimacy for the new control structures, especially given that they are replacing a framework sanctioned by a democratic process.²⁰⁸

More significant from the French domestic economic perspective is whether the structures will lead to a lack of competition and innovation, due to a too great reliance on strategic advice and financing provided in the closed networks. The danger from these closed networks is that industry will be forced to return to state ownership because of economic crises partly brought on by this closed vision.²⁰⁹ The potential lack

an economic environment where banks' profitability from its traditional lending activity is decreasing. See Jean-Michel Paguet, *Les Conglomérats Financiers en Europe, Stratégie et Concurrence*, 28 REVUE D'ÉCONOMIE FINANCIÈRE 7 (1994) (discussing the reasons for the creation of large financial conglomerates in Europe). The structure provides a company with shareholders who will allow management's long-term plans to develop and who must look to the long term for their return. See, e.g., Gail Counsell, *A Very Private Privatisation; Gail Counsell Reports on the Nationalistic Nature of the French Sell-Off*, INDEPENDENT, July, 21, 1993, available in LEXIS, Europe Library, INDPNT File (quoting Jean-Pierre Tirouflet finance director of Rhône-Poulenc) ("In our mind it is not a means of protection, it's more like a mirror, someone you can discuss with, have a dialogue with, and share your strategy and make decisions with. I feel that is very important to us. It is in that way we feel a group of permanent shareholders can be very useful to us.").

207. Cf. MORIN & DUPUY, *supra* note 187, at 3-4 (explaining that French capitalism is between the two systems of capital market and bank financing). Moreover, product market competition would similarly discipline the companies.

208. See Morin, *supra* note 134, at 131 ("mais le pilotage de ce coeur [financier] ne s'annonce-t-il pas d'ores et déjà fragile, voire contestable, en raison du manque de légitimation claire de ses principaux responsables?"); Morin, *supra* note 187, at II ("La démocratie pourra-t-elle se montrer longtemps indifférente aux formes redoutables de ce nouveau pouvoir économique?").

209. See DURUPTY, *supra* note 93, at 131 ("Ainsi, la dimension assez réduite du

of accountability of participants in this closed structure could lead to abuses, such as the ones that seem to be reported weekly in the recent French press, that would undermine confidence in French corporate governance and injure the reputation of France's capital market.²¹⁰ These issues are all significant, because given the stable shareholder structure, corporate governance dominated by financial institutions is prevailing over a system of capital market discipline, although the issue is far from resolved.

C. United States Institutional Investors and French Privatization

Did United States institutional shareholders, with their market orientation and activism, have any effect on corporate governance in recent French privatization? Were they at all interested and successful in forcing the French corporate governance to choose between the two paths available to it; financial institution or capital market monitoring? Let us consider answers to these questions, after first briefly reviewing the

capitalisme français peut renforcer la concentration financière et le pouvoir économique de quelques groupes, tout en débouchant sur les défauts antérieurs aux nationalisations de 1982: recours excessif à l'État-providence et insuffisance de la politique d'investissement."); Morin, *Les trois poles*, *supra* note 187, at II (speaking of the potential "ossification" of the groups); Paguet, *supra* note 206, at 23 (discussing how groups could lessen competition by preventing advantageous financing to companies outside their sphere).

210. The recent series of abuses in France among company officials, often in connection with political bribery and personal benefits, has raised the question concerning the lack of accountability of corporate management. It may point to inherent problems with a closed system in itself, as well as one that retains "hidden" connections with the government. See, e.g., Thomas Kamm, *Latest in Wave of French Scandals Puts Pressure on Industry Minister to Resign*, WALL ST. J., Sept. 21, 1994, at A11 (describing numerous scandals in management of large French public companies, many of which are related to political bribery); Alice Rawsthorn, *French Business Chiefs 'Suspect Corruption Rife'*, FIN. TIMES, Sept. 8, 1994, at 12 (describing poll of French company chairmen in which "[t]wo out of three executives suspect that illegal practices are rife in many companies").

As both Morin and Paguet suggest, the financial networks do not limit their reach to France; they have formed connections with other European countries (e.g., BNP-Dresdner). Thus, the question arises whether the market will police such conglomerates or whether the conglomerates will distort the structure of the markets. See Paguet, *supra* note 206, at 18-26 (inquiring whether the growth of European financial conglomerates could injure product market competition in industry and enhance systemic risk to payment systems).

investment of United States institutional investors in French privatized companies.

1. Sales to United States Institutional Investors

By most reports, the initial privatizations following the 1993 legislation met with a warm reception among United States institutional investors.²¹¹ This may have been due to attractive sales price (*i.e.*, prices under the market valuation for shares). Moreover, United States institutional investors were not offered an unlimited supply of shares. Because most shares were offered and sold to French retail investors, only approximately 5% of the shares in any given privatization have ever been offered to United States institutions.

In the BNP privatization, shares were sold in the United States, only to United States institutional investors in a Rule 144A offering, at a discount of approximately FF 37 per share, with such investors reported to have purchased approximately \$147 million in shares.²¹² The discounts in the next offerings, Rhône-Poulenc and Elf, were not as significant (FF 4 and FF 12 per share, respectively), and in each case United States investors were sold approximately 20% of the portion of the shares offered to international investors.²¹³ The UAP offering had an even smaller discount (FF 3 per share) and, as in BNP, the United States offering was restricted to United States institutional investors.²¹⁴

211. See, *e.g.*, *U.S. Fund Managers Plan to Boost Foreign Investment*, *supra* note 49 (discussing Broadgate consultants survey results that American fund managers wish to participate in French privatizations). See also *France—Foreign Economic Trends*, MARKET REP., Dec. 20, 1993, available in LEXIS, Europe Library, ALLEUR File (reporting that U.S. investors are the largest foreign investors in France).

212. See Susan Scherreik, *Stocks: Only Funds Get Shot at Hot French Offerings*, N.Y. TIMES, Oct. 9, 1993, at A38.

213. See *France: Foreign Shareholders Hold Between 20% and 25% of Elf's Capital*, AGENCE EUR., Mar. 1, 1994, available in LEXIS, Europe Library, TXTWE File (discussing Elf); Rosie Shepperd, *France: Rhône-Poulenc Float Reaches Triumphant Finale; Jumbo Elf Offer Starts to Warm Up*, EUROWEEK, Nov. 26, 1993, available in LEXIS, Europe Library, ALLEUR File (discussing Rhône-Poulenc offering).

214. See UAP, *supra* note 174, at cover (for French public offering price and price to international investors). American institutional investors purchased 2.7% of the 54.4 million offered UAP shares. U.S. investor demand was characterized as "unenthusiastic." *CNP to Follow UAP Success and AGF*, PRIVATISATION INT'L, July 1, 1994, available in Westlaw, PRVINT Database. U.S. institutional investors pur-

2. United States Institutional Investors' Concern With, and Effect on, French Corporate Governance

The simple fact of the limited need for United States institutional investor funds perhaps explains why, so far at least, they have had little effect on the transformation of French corporate governance. Available evidence suggests that United States institutional investors were concerned about the ownership structure of the privatized companies and about the possible adverse effects on corporate governance resulting from this structure.²¹⁵ They liked neither the continued French government share ownership and the golden share, nor the domination of privatized companies by French financial institutions through the stable shareholder group.²¹⁶ In their view, these corporate governance techniques weakened their own position as shareholders because they made more likely negative externalities for non-controlling shareholders (*e.g.*, the company would serve the purposes of the French government and the stable shareholders, or those of management, at the expense of other shareholders).

chased 10.6% of Renault shares recently offered in its partial privatization. *France*, *supra* note 194.

The privatization law limits sales to foreigners in any offering to 20% of the capital of the company in question. Loi no. 93-923 du 19 Juillet 1993 [Law No. 93-923 of July 19, 1993], art. 8, J.O., July 21, 1993, at 10255, 1993 D.S.L. 396. Given the large size of this limit and the focus of the offerings on the French retail market (as well as private sales to stable shareholders), practically it does not restrict sales to U.S. institutional investors. Moreover, it applies only upon initial sales; it does not affect purchases by international investors in the secondary market.

Although the above statistics give a rough idea of sales to U.S. institutional investors in the initial privatizations, they are incomplete (*e.g.*, such investors could purchase shares in the secondary market, as well as through overseas subsidiaries in the primary market).

215. See, *e.g.*, *U.S. Fund Managers Plan to Boost Foreign Investment*, *supra* note 49 (discussing Broadgate consultants' report of a concern among fund managers of corporate governance issues in French companies); *USA: Seminars for French Privatisation Programme*, AGEFI, July 12, 1993, available in LEXIS, Europe Library, ALLEUR File ("It would appear some of the large U.S. institutional investors are now voicing their dissatisfaction with the way they feel they are being treated as shareholders in French companies.").

216. See, *e.g.*, Resener, *supra* note 23, at 50 (referring to the opposition of Richard Koppes, general counsel of CalPERS, to use of the "golden share" technique); see also L'Interview: Howard D. Sherman, BULLETIN DE L'AGENCE FINANCIÈRE DE NEW YORK [B.F.N.Y.], Jan. 1995, at 2, 3 (in an interview with French embassy officials in New York, Mr. Sherman of ISS refers to institutional investors' hostility to the golden share and stable shareholder groups).

United States institutions had global proxy and investor information specialists examine French privatization and identify problems in it. For example, the IRRRC conducted numerous seminars for United States institutional investors on French privatization.²¹⁷ Moreover, certain investors commissioned the IRRRC to prepare a report on the privatization, with a special focus on corporate governance issues. In preparing the report, IRRRC personnel, with the help of Déminor, met with Government and company officials to discuss United States institutional investor concerns.²¹⁸

Certain institutional investors took the additional step of speaking directly with French government and company authorities. Professor John C. Coffee's observation that public pension funds are likely to take the lead in any activism again rings true. CalPERS' Richard Koppes, accompanied by Global Proxy Services Joseph Lufkin, traveled to France before the first privatization was launched specifically to see management of companies on the privatization list and to discuss corporate governance matters with French government authorities.²¹⁹

Despite efforts by some United States institutional investors (*i.e.*, an occasional protest from CalPERS), these investors, as a whole, had little influence on corporate governance in the French privatization, particularly on the stable shareholder structure.²²⁰ French government and company officials occa-

217. See, *e.g.*, Lisa R. Gerson, *Foreign Investors Buffeted by French Privatization*, ISSUE ALERT, Feb. 1994, at 5 (in this Institutional Shareholder Services publication, author describes corporate governance problems in French privatization); *USA: Seminars for French Privatisation Programme*, *supra* note 215 (referring to IRRRC seminars); see also INSTITUTIONAL SHAREHOLDER SERVICES, INC., GLOBAL PROXY REVIEW: 4TH QUARTER 1993, at 29 (1994); INSTITUTIONAL SHAREHOLDER SERVICES, INC., GLOBAL PROXY REVIEW: 3RD QUARTER 1993, at 40 (1993); INSTITUTIONAL SHAREHOLDER SERVICES, INC., GLOBAL PROXY REVIEW: 2ND QUARTER 1993, at 22 (1993) (highlighting issues related to various French privatizations).

218. Telephone Interview with Robin Meszoli, *supra* note 64. The IRRRC report, which was a collective project with Deminor, is not publicly available. However, Ms. Meszoli reports that it includes a description of the current privatization, a review of key corporate governance issues, a summary of key accounting differences between French and U.S. companies and a profile of the companies on the privatization list.

219. Lufkin Interview, *supra* note 60. In Mr. Lufkin's view, only the largest U.S. institutional investors can hope to have any influence on corporate governance of non-U.S. companies. He adds that, even in sophisticated institutions such as CalPERS, there may be little familiarity with foreign corporate governance.

220. Both Mr. Lufkin and Ms. Meszoli report that government officials did not seem particularly receptive to U.S. institutional shareholders' corporate governance

sionally attempted to explain that corporate governance structures, such as the *noyau dur*, were temporary, as if to mollify the United States institutional investors.²²¹ However, these investors did not shun the privatizations. Perhaps this suggests that given the offering discount and the economic fundamentals of the companies,²²² the deals were too good to pass up for the institutions despite any corporate governance concerns.²²³ In fact, one United States institutional investor, the General Electric Investment Corporation, even became a member of BNP's stable shareholder group.²²⁴

D. Concluding Remarks

It is perhaps no surprise that United States institutional investors have so far had little influence on corporate governance in French privatization. Numerous economic and cultural factors deflect their impact in France. Despite the recent

concerns. Recently, however, French government and market authorities are showing more interest both in the concerns of U.S. institutional investors and in corporate governance generally. See, e.g., MARIE-NOËLLE DOMPE & ALAIN DORISON, QUATRIÈME TABLE RONDE: MARCHÉS 2001: ENTRETIENS DE LA COB (1994) (discussing corporate governance in U.S., U.K. and France); L'Interview: Howard D. Sherman, *supra* note 216, *Les placements des investisseurs institutionnels aux États-Unis*, B.F.N.Y., Jan. 1995, at 3; *Les marchés financiers*, B.F.N.Y., Jan. 1995, at 10 (entire issue devoted to U.S. institutional investors).

221. See Ridding, *supra* note 199 (discussing views in France that, in time, French markets would more likely evolve into an Anglo-Saxon market for corporate control).

222. Telephone Interview with William Wright, Principal, Morgan Stanley & Co. Inc. (Mar. 9, 1994) (explaining that institutional investors often made a decision to "buy the country" and were thus motivated to purchase based upon economic fundamentals).

223. According to Joseph Lufkin, one should keep in mind that personnel in U.S. institutional investors who are responsible for making the investments are generally not the same people responsible for following corporate governance matters. Thus, in his view, investments are generally made in these institutions purely on the basis of economic fundamentals, with little attention given to corporate governance that might be of more concern to those who oversee proxy voting. Thus, liquidity and return are of central concern to these decision makers. A critical question is whether *legally* U.S. institutional investors can continue to ignore corporate governance when making an initial investment. Lufkin Interview, *supra* note 60.

224. In the BNP privatization, the General Electric Investment Corporation (for the account of the trustees of the General Electric Pension Fund, of Elfund Trusts and of Elfund Global fund) became a member of the stable shareholder group and purchased about .75% of BNP's shares (or 1,391,473 shares). See BNP, *supra* note 174, at 10.

increased emphasis placed in the French economy and French companies on global competitiveness, nearly fifty years of active state economic domination does not end overnight. Moreover, the tradition of a relatively closed circle of ownership of large companies is an old one in France, and this tradition, which may be reappearing as financial institutions replace the state as the center of corporate financing and strategic direction, runs counter to the market orientation of United States institutional investors. In addition, the shared background, training and culture of French executives and board members reinforce this tradition, as well as serve to maintain connections with a state that, despite the privatization, could continue to exert some macroeconomic influence over the privatized companies.

United States institutional investors have also so far not been in a position of economic strength in France. Their funds made the initial privatizations successful, but were not *essential* in a process relying upon domestic and other European investors. In addition, the differing interests among United States investors mean that they can often be "sold" on a privatization because of a price discount, or economic fundamentals, regardless of potential corporate governance problems. In fact, considering the domestic focus of the French privatizations and the lack of unity among United States institutional investors, it would have been a surprise if they *had* influenced French corporate governance through the process.

At this stage in French privatization, therefore, the investigation into United States institutional investor influence on French corporate governance is somewhat premature. Because the "best" companies on the privatization list were sold in the first round, future privatizations may likely involve some companies that may not be as financially attractive.²²⁵ Accordingly, institutional investors may be in a stronger bargaining position when their funds are solicited, especially if French

225. For example, weekly press reports describe restructuring and other problems with major companies on the French government's privatization list. See Buchan, *supra* note 193, at 22 (describing AGF's "inopportune drop in first half net profits"); Martin du Bois, *Péchiney Emerges as Test of France's Will to Privatize*, WALL ST. J., Aug. 17, 1994, at B4 (describing how privatization of this company must await "lower[ing] costs, reduc[ing] a mountain of debt, possibly divest[ing] underperforming assets and expand[ing] the company's reach to growth markets in Asia and Latin America."); Rawsthorn, *supra* note 109.

retail interest in privatization falters.²²⁶ Moreover, with the help of groups such as IRRC, ISS, Global Proxy Services, Déminor, and Franklin Global Investors, United States institutional investors may become educated about foreign investments so as to insist that corporate governance matters be part of the investment decision.²²⁷ This education could lead to some form of collective action on their part, perhaps under the leadership of a public pension fund.

However, my suspicion is that even in the circumstances outlined above, United States institutional investors will not be the agents for significant changes in French corporate governance. The changes, if they are to come at all, would originate from complex French and European cultural, social and political forces, either compatible with a movement to a market capitalism and a market for corporate control, or with the continued emergence of a capitalism of financial institution centers. The activism of French groups of small shareholders and organizations for significant minority shareholders may contribute to the change. More importantly, if French authorities continue to develop the Bourse as a rival to London's capital market, the success of this market could undermine a domination of companies by large financial institutions that relegate other shareholders to a second class position.²²⁸ And, as Professor Karmel has observed in another context, the strongest factor for change could be the growth of local, or regional, institutional investors more concerned about total *investment* return than other kinds of profits arising from an institution's

226. See France: *Elf Sale was a Success*, *supra* note 174 (questioning whether the French public's enthusiasm for privatization is waning).

227. It is interesting to note that the new chief executive at CalPERS has stated that he plans to extend the fund's corporate activism to Europe and Japan. See Ralph T. King, Jr., *CalPERS Names Burton to Succeed Hanson as Chief*, WALL ST. J., Sept. 19, 1994, at B2; Eric Schine, *CalPERS' New Chief: Same Fire, Less Flash*, BUS. WK., Oct. 3, 1994, at 114 (describing Burton's hiring of a chief investment officer who is "busy arranging trips to Europe and Japan to bring religion to boards of overseas corporations, where a growing portion of CalPERS' assets are invested.").

228. This statement is subject to qualification. If the "second class" position ensures a steady total return, it may be that even new French institutional investors (many of whom will have organizational allegiance with the dominant financial institutions) would be content with this position. After all, investors in Japanese markets, admittedly dominated by large financial concerns, have not always suffered from their investments.

relationship with a company.²²⁹ In this respect, the European Union, with its liberal, free market orientation, could place significant pressure upon a closed ownership structure for French privatized companies.

Thus, if these influences lead to change in French corporate governance, United States institutional investors' activism could provide support. Generally, this supporting role would likely resemble what occurs today in isolated disputes with French corporate management and is the path preferred by the investors themselves. Moreover, without a local French interest to follow, the United States investors always run the risk of provoking a nationalist reaction to their activism.

However, the triumph in France of an American-style market capitalism and a market for corporate control is by no means certain. With all of the cultural and historical factors weighing in its favor, the capitalism of financial institution "poles" or centers appears to be emerging as the dominant form in France with a subsidiary capital market. If this capitalism were to evidence its benign face—a long-term focus, steady investment returns and lack of management abuse,²³⁰ as opposed to the current malevolent face that has recently appeared, then United States institutional investors may well be content to support it and occupy a subsidiary role, so long as they have a liquid market for their investments. They might even be attracted to this capitalism because of its long-term focus. Like the General Electric Investment Corporation, they may increasingly join forces with French financial institutions in a capitalism defined by its opposition to complete capital market discipline.

229. See Roberta S. Karmel, *supra* note 132, at 3, 16 ("The creation of large private pension funds in France and Italy, where there is serious government interest in supplementing retirement savings this way, could similarly lead to the development of a constituency favoring investor interest.").

230. This is the capitalism described by Michel Albert (PDG of AGF and board member of numerous other French companies) in his *CAPITALISME CONTRE CAPITALISME*, *supra* note 205, at 117-46. In his view, with the defeat of communism, the economic world is now engaged in a struggle between two forms of capitalism, Anglo-Saxon market-based capitalism against bank-financing capitalism typical of the Continent and Japan.

VI. CONCLUSION

As corporate law scholars have become interested in the role of institutional investors in corporate governance, they have looked to activities of similarly situated investors in other countries. As Reinier Kraakman has observed, this comparative corporate governance research first led scholars to observe forms of institutional activism present abroad and to speculate on whether these forms could be used in the United States. In the course of this analysis, scholars came to appreciate that a particular foreign solution to the Berle-Means corporate agency problem is invariably a product of, and deeply imbedded in, a given cultural, historical and political context. Comparative corporate governance studies thus help explain the complexity of a foreign corporate governance system and of its answers to the agency problem, while providing a warning that these solutions are not readily transferable.

Yet these very institutional investors that inspired scholars to look abroad for models for United States institutional investor activism are now keeping attention focused upon foreign corporate governance. An increasing percentage of their investments is devoted to non-United States companies. In the globalization of their portfolio, they are only following the dictates of a portfolio theory that demands a global diversification of assets. In ever increasing numbers, foreign markets are proving efficient and providing the liquidity desired by these investors. Moreover, an increasing number of countries and companies, many of Western European origin, that are engaged in ambitious privatization programs are soliciting their funds.

The focus on foreign corporate governance that results from present United States institutional foreign investment is raising new issues, such as the impact of their activism in a complex foreign context. That corporate governance is even an issue in their foreign investment owes much to evolving legal standards for money management that increasingly mandate attention to this subject. United States institutional investors are also finding that their participation in foreign corporate governance is becoming less costly. Moreover, a "global proxy" industry has arisen to serve them in their foreign activism.

Because of this investment strategy by United States institutional investors, scholars are thus drawn to explore foreign

corporate governance in considerable detail. As I have shown in this Article from a consideration of French corporate governance, this exploration cannot satisfactorily be limited to an economic account. Rather, we have seen that French government ownership and control of large public companies belongs to a long tradition of state involvement in the French economy as well as owes its recent manifestation to a response to the economic devastation caused by World War II. This ownership in turn led to various solutions to the corporate agency problem, from state domination of management to a collaboration between the state and management on long-range goals for a company. Moreover, the tradition of state control has been solidified, and the relationships between the various human actors "bonded," by the common background, training and professional careers of the high civil servants and company executives.

This examination has also revealed that French and European pressures may change French corporate governance. A resurgence of a liberal market orientation and the financial inability of the French state to fund private companies are leading to a gradual abandonment of the French state from its role in the system. In addition, a desire by the French government and market authorities to develop a capital market competitive with any in Europe arguably runs counter to domination of public company financing by the State. Finally, there is the ever present and ever increasing pressure from the European Union, with its economically liberal orientation in capital and other markets.

Privatization highlights that French corporate governance is at a critical juncture. Although heralded as a movement in some ways designed to promote capital markets and a market orientation, we have seen that French privatization, in certain instances, did not mean that the state would completely abandon its control of industry. More importantly, French privatization is arguably transforming French corporate governance from one dominated by the state to one controlled by centers of financial institutions, linked together and with a group of industrial companies in elaborate cross-holdings. Whether such a system, which some have suggested represents a different form of capitalism, will prevail in France and whether it will be compatible with the market-based capitalism and market for corporate control that characterize United States markets and,

to a great extent, the perspective of United States institutional investors remain to be seen.

A consideration of the results of the contact of the United States institutional investors with French corporate governance in the privatization suggests that nothing of significance has so far emerged from this contact. The United States investors participated in the transactions, generally because the prices were favorable, with occasional complaints about an emerging French corporate governance of financial institution dominance. Although United States institutional investors may become more important in France if there were an increased need for United States institutional investor funds and if these investors acted as a coherent group at the structuring phase of a privatization, the transformation of the French system will continue to be dominated by French and EU pressures. Moreover, the United States institutional investors may themselves be "transformed" in the process to accept a role in emerging financial institution-dominated, French corporate governance.

In sum, United States institutional investors' worldwide investments are forcing us to educate ourselves about foreign corporate governance. Given the likelihood that these investments will continue, we have little choice but to follow these investors if we want to understand developments in global corporate finance. This orientation is a welcome one. Given the increasing global nature of the capital markets and investing, these are changes that we should study as closely as those occurring in the United States.

