

'THE EUROPEAN COMPANY STATUTE - HOW WILL IT BETTER PROTECT MINORITY SHAREHOLDERS?'

By

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ABSTRACT

This paper examines the European Company Statute, which came into force on 8th October 2004 and contains an analysis of minority shareholders with the present company law in three major member states. In examining the level of shareholder protection in the three member states, it must be remembered that there is a common perception that different legal systems have different levels of shareholder protection and different levels of risk against fraud. One would therefore expect to see different levels of shareholder protection in Germany and the UK, these being a civil legal system and a common law system respectively. But analysis indicates that despite differences in the common law legal systems and civil law systems, member states' company law has been converging, largely due to outside forces. of ongoing process of globalisation of financial regulation, the European Union's directives to harmonise member states , the O E C D's internationally agreed code of corporate conduct, 'Principles of Corporate Governance', international accounting standards and electronic fraud,. The International Accounting Standards

is an important factor since a random sample of one hundred and fifty companies , fifty each registered in UK, France and Germany show that 45 % of these have operations in the USA, 43% in Asia, 26% in South America, 19% in Africa and 12% in Australia and New Zealand.

Apart from giving businesses another choice of formation, the SE('societas europaea') gives employees, whether they are minority shareholders or not, the power to appoint the supervisory board , with management's co-operation. This means that minority shareholders who are employees can appoint and remove the management board through their appointed supervisory board. . But they already have this power under UK, French and German company law. It is in SE's that have outlets in non-EU countries that shareholders would worry about. Employees in the USA, Asia, South America, Africa and other parts of the world will have control of the SE in their power to appoint the supervisory board which might not always understand the psychology, cultural and ethnic background of some employees By appointing the supervisory board which has the power to appoint and remove directors, an SE can be forced to change structure, articles and direction even without shareholders consent.

It is not surprising therefore, that to date, only Belgium, Austria, Denmark, Sweden, Finland and Iceland have taken steps to have European Companies formed on their territory.

INTRODUCTION

This paper builds on the contributions of Coase (1960) ^[1], Hayek (1973) ^[2], North (1990) ^[3] and Williamson (1988) ^[4] in the analysis of law from an economic perspective. The study is part of a study of law and legal institutions and their contribution to economic growth through compliance to detect and prevent risks. It acknowledges the contributions of the descriptive and historical studies of European company law by Horn (1979) ^[5] and Coing (1982) ^[6]. The paper shows that there is globalisation of law and regulation that is occurring even at a regional level, for example, Basel 11/CAD 3 Accord which seeks to regularise and put in place capital adequacy, supervisory review and market discipline across the EU member states, the ultimate goal being to mitigate risk ^[7] through fraud, incompetence and inefficiency.

The new type of company formed by the European Company Statute ^[8] (ECS) is now available to commercial organisations with operations in more than one business state and serves as an extra choice for businesses. An SE may be created either through a merger of public companies, formation of a holding company or subsidiary, or conversion of an existing public company. It

will be a European public limited-liability company with a minimum share capital of 120,000 Euros.

There will be options on rules on board structure, rules on enhanced creditor and minority shareholder protection, currency of capital and currency in which accounts are to be drawn up. One currency will be used but it can be the Euro or another, not both and there is no restriction on its profit-making capacity nor on the number of employees it may have.

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Other costs to be saved will be administrative costs and taxation. Only the tax rules of the member state in which the SE is registered will apply, which will mitigate certain national taxes such as capital gains tax on cross-border re-structuring. Also, the Interest and Royalties Directive (2003/49/EC), which provides relief from withholding tax on interest, and royalty payments made between associated companies of different member states will be extended to the SE. There is one factor that commentators have not discussed with regard to tax and other operational considerations and that is that nearly all of companies in the UK, France and Germany have outlets in Asia, Africa, USA, South America, Australia and New Zealand.

UNITED KINGDOM COMPANIES - SUBSIDIARIES IN NON-EU COUNTRIES

<i>Asia</i>	<i>Africa</i>	<i>USA</i>	<i>South America</i>	<i>Australia & New Zealand</i>
53%	40%	53%	40%	13%

GERMAN COMPANIES - SUBSIDIARIES IN NON-EU COUNTRIES

<i>Asia</i>	<i>Africa</i>	<i>USA</i>	<i>South America</i>	<i>Australia & New Zealand</i>
45%	0%	45%	18%	0%

FRENCH COMPANIES - SUBSIDIARIES IN NON-EU COUNTRIES

<i>Asia</i>	<i>Africa</i>	<i>USA</i>	<i>South America</i>	<i>Australia & New Zealand</i>
53%	40%	53%	40%	14%

This must have a significant impact on the way the companies are reported at least and the necessity for implementation of International Accounting Standards is obvious.

There is an Employee Involvement Directive attached to the SE which will require that each SE must have a negotiating body made up of managers and employees and which will enable all employees of the SE to adopt the highest standards of that SE's employees. So, for example, if the SE has an office in the UK and one in Latvia, the Latvian employees must have the same employment rights as the UK workers of the SE. A factor that managers will be worried about is the potential for demands for European-wide collective bargaining, notwithstanding those employees in the United States of America, South America, Asia, Africa and Australia. How internal corporate structures in these other common law countries shape themselves may well be different to the formal corporate structure.

SHAREHOLDERS' RIGHTS IN UK COMPANIES

The UK has a common law legal system and its company law vests control of the company primarily with company shareholders. Since 1844 the UK has had codified company law. Since 1862 the UK has also had the London Stock Exchange, which has played a role in regulating the financial market and ensuring shareholder primacy. Entry requirement is by the registration system. The law sets broad limits for the allocation of control rights and left it to shareholders to

[\[10\]](#) change them within these limits. Shareholders rights are very important in achieving corporate transparency. There is common law protection for minority shareholders if fraud occurs

[\[11\]](#) and there is statutory protection by company law.

A shareholder has an interest in the company and a right to uphold its constitution. Various classes of shareholders enjoy different rights, usually set out in the articles of association of the company and there are strict rules to be complied with when a company wishes to alter the rights of any of the classes of shareholders. Since the publication of the OECD's Codes of Corporate Governance in 1999, it has been agreed globally that all shareholders of major corporations must have the minimum rights of receiving the company's annual reports, market sensitive information from the company, to attend general meetings and question the executive team without giving prior notice, independent non-executive directors on the board, consultation on take-over bids, non blocking of bids by the Board, voting rights in each class of share, to vote on appointment of individual directors, on the adoption of the annual report and accounts, on changes to the articles of association and on major changes in the activities of the company.

Ordinary shareholders are entitled to receive dividends when they are declared and to be paid a proportion of the company's assets after payment of creditors, when the company is wound up, proportionate to the size of his shareholding. An ordinary shareholder will not normally have the right to exercise one vote for each share he holds at the general meetings of the company. For example, if a company alters its articles to insert a variation clause a shareholder can apply to the court to have the variation cancelled but only if the holder has more than 15% of the issued shares of the class of shares whose rights are being varied. The rules are strict and application to the court must be made within 21 days of the variation and by one of the shareholders who must be [\[12\]](#) appointed in writing. [\[13\]](#), although case law has made it possible for holders of less than 15% of the shares to apply to the court if the variation was not made in good faith. There has always been litigation on company law issues and the UK has a fine body of case law, developed over many years.

Minimum corporate capital and mandatory pre-emptive rights only became law later in the 1985 [\[14\]](#) Company Law Act in response to the EU directive. . The EU First Directive in 1968 provided a system of publicity for all companies of member states by ensuring disclosure of the memorandum and articles, officers of the company, paid up capital, Balance Sheet and Profit and Loss Account, winding up and appointment of Liquidators [\[15\]](#) .

Recently, there has been consolidation of financial regulation and the Financial Services Authority is the financial regulating body of the UK. In an attempt to identify best legal practice

the FSA is overseen by the International Monetary Fund, IMF, which is due to investigate its processes at regular intervals to advise on shortfalls in compliance areas.

GERMANY - CORPORATE LAW

Germany is a civil law country and has a formal legal system, a General Commercial Code since 1861. It has developed its financial market largely internally with very little borrowing. Entry requirement is by the registration system. As to legal rights in company law, Germany leaves that to the law and not to the shareholders and company law dictates the rights and obligations of shareholders. There have been corporate governance rules in place well before other developed countries. There is modest company law litigation in Germany but the shareholder must first make a formal complaint to the supervisory board and not unless the matter is unresolved can it go to expensive litigation. Shareholders cannot litigate on behalf of the company, for example they cannot file a lawsuit against the Baffin regulatory body. Nevertheless Germany has much company case law for closed corporations.

German companies must have legal capital. The provision of legal capital is a big issue worldwide and regulation now stipulates minimum legal capital. especially for banks.

The European Union's Takeover Bid Directive 2003 will be enacted in Germany in March 2006. The Directive protects at European level minority protection principles in that there is to be equal treatment of the target shareholders and this applies to all bids, voluntary and mandatory. All target shareholders of the same class must be afforded equal treatment. Shareholders are to be given adequate time and full company information in order to consider any offers. The German system consists of highly concentrated share ownership and a straight- forward practice of proxy

voting. This at present allows for many challenges to the majority and in 85% in cases challenged, there is consensual settlement that can be very expensive, not least because cases end up in court and shareholders are given even wider scope when the courts rescind corporate

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decisions. It has been proposed by the German Lawyers Conference that there should be reform of German company law, requiring that there must be a quorum requirement, a minimum amount of shares held for a minimum time period, before a case can go to court. This is not a viable proposal, in light of the Take-over Directive, which gives minority shareholders more

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rights than at present, those shareholders are in a very strong position , not unlike those in the UK.

FRANCE - CORPORATE LAW

France, like Germany, has a civil law system and had its code de commerce, including a code on corporations, since 1807. Entry requirement is by the registration system and in France its highly mandatory company law determines the allocation of control rights. As well as stipulating the requirements for disclosing annual reports to company shareholders and the rights and responsibilities of shareholders.

There is little company law litigation in France, although shareholders can file lawsuits on behalf of the company. Recent shareholder activism illustrates the change in attitude and rise of shareholder democracy in the proxy contests in ousting the Euro-tunnel Board. They used recent legislation to allow a shareholder with 5% ownership to be able to request that a court

convene a general assembly. Furthermore any shareholder may put written questions to the Board, which must be answered during the AGM, a real convergence of shareholder power like those of UK companies.

The form those activist minority shareholders' actions take today hold in check the risks that trans-national corporations might take with the environment, for example, for the sake of profit.

Investors often choose ethical companies to invest in and companies are aware of the power of this. Minority shareholders in fact act to regulate companies that will take risks with the environment and health and stop them from exporting their environmental pollution to helpless poorer countries. The International Monetary Fund, in a supervisory investigation of France, noted that foreign equity portfolio investment in France in 2002 was \$290 billion of which nearly

[\[18\]](#)

half was from the UK and USA.

Since France has opened up its market, in 2003, 37% of French market capitalisation is held by overseas shareholders. This is because France has Monetary and Financial Codes include a new regulation to allow unfettered distribution of non-OECD securities into France without having to apply to the Treasury. This is bound to change shareholder behaviour as France now has shareholders who are not French and who come from different legal systems and cultures.

CONCLUSION

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Osugi (2000) put forward a theory that the English and American method of financial

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regulation is by 'monitoring by capital markets' whilst the European method of financial

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regulation is by 'monitoring by block-holders' , there being a "slow convergence between these systems in developed economies over the last two decades".

Germany can be seen to use the 'monitoring by block-holder' system. In Germany, there is prohibition of shares with multi-voting rights for a listed or publicly -held company. If such shares were allowed, insiders would hold them. The German Stock-Company Act was reformed to prohibit multi-voting shares. Most German companies are monitored by banks, which loan money. So the German system is monitored by banks rather than by large equity holders or by securities markets.

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In summary form, the similarities in company law between the UK, France and Germany,

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show that the high levels of minority shareholder protection in the UK were not present at the time of first incorporation but were enacted much later, starting in 1948 and that there are now few differences in company law, giving Osugi's theory much credence. The formation of a European company is but another step in achieving regulation and enforcement against fraud and risk. The choice between two models is there. The two-tier structure of the SE consists of a management board composed solely of insiders, responsible for the company's daily business activity, and the supervisory board, supervising its activity, with general oversight functions. It allows directors to supervise and take action completely independently of the management. This two-tier company will create institutional and personal separation of monitoring and management. The management plus the employees have the power to appoint the supervisory board. Since companies in Europe have outlets in USA, Asia, South America, Africa and

Australia, it may well be that employees may elect to have the management board composed of people from their countries, depending on the company. This could have serious consequences for a European supervisory board that may not always understand the psychology, cultural and ethnic background of some of their workers, although the supervisory board may not represent the company in transactions with third parties. In turn the supervisory board has the power to appoint and remove the management board.

If the single tier SE is chosen, there is just one administrative board, which manages the SE. Members are appointed and removed by the general management unless minority shareholder rights under national law or model employee participation rules dictate otherwise. A chairman will be elected among the members but if employees elect half of the members, only a member appointed by the GM may be chosen.

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It has been said that management structure is dictated by the culture of the member state. But this can be disputed when the management culture reflects the international element of most countries. For example, the UK is so entrenched in minority shareholder rights that the management board might feel unconscious allegiance to shareholders and so the two-tier system of European Company formation would not succeed.

The ECS does provide some protection to minority shareholders. Under Articles 55 and 56, 10% of shareholders of a subscribed SE may request a general meeting and they may also put items on the agenda. If such meeting as requested by these shareholders is not convened in time, these minority shareholders may ask the court to order that such general meeting be held within a stipulated time. This is a major step towards harmonisation. With the implementation of the

OECD's Principles of Corporate Governance, it is questionable whether this would bring a level of harmonisation within which companies can operate smoothly.

END

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TABLE 1 - (ANY) SHAREHOLDERS RIGHTS UK COMPANY LAW

Right to ask court to call EGM	CA1985 s 371
Right to restrain ultra vires	CA1985 s 35(2)
Right not to be unfairly prejudiced	CA1985 s 459
Right to have company wound up provided this is just and equitable	Insolvency Act 1986 s122 (1)(g)
Right to vote	CA1985 s370
Right to receive notice of general meeting	CA1985 s 370
Right to declared dividend	Table A Article 104
Right to inspect register of directors interests	CA1985 s 318(1)
Right to share certificate	CA1985 s 185
Right to name on register of members	CA1985 s 362
Right to copy of annual accounts	CA1985 s 240
Right to attend AGM	CA1985 s 366
Right to inspect minutes of general meeting	CA1985 s 382A

Right to prevent introduction to elective regime	CA1985 s 379A
Right to inspect register	CA1985 s 356(1)
Right to copy of register	CA1985 s 356(3)
Right to inspect books of company at Companies House, these being register of directors and secretaries, register of members, register of directors' interests and minute books.	SI 1991 No.1998 3(2)

Writer's table compiled from textbooks such as Walmsley. K, (2002), 'Company Law Handbook, Butterworths.

TABLE 2 - STATES' RESPONSES TO EU DIRECTIVES AND OTHER OUTSIDE FORCES

Company Law Amendments in UK, France and Germany

	FR	GM	UK	LAWS	EU DIRECTIVES
1	1807			Code de Commerce	
2		1861		General Commercial Code.	
		1883		Stock Market Crash	
3			1900	Companies Act	
4			1929	Major Revision of Company Law	
5			1948	Proxy by mail	
6	1966.		1980	Shareholder can sue France's first company law	
7	1981				
8	1972	1972			EU First Directive (OJ 1968)

9	1984			Pre-emptive rights; Minimum sub share cap	
10			1985	Section 35 CA Memorandum, articles, paid up capital, etc disclosure	EU Second Directive (OJ 1977 L26/1)
11	1989			CA Part VII Companies (Merger & Divisions) Reg 1987(SI 1987) No1991	First EU Directive (OJ 1968 spec ed 41-5)
12	1978	1978			EC Fourth Directive (OJ 1978 L222/11) EU Third Directive (OJ 1978 L295/36) and Sixth Directive (OJ 1982 L378/47)
13				CA 1986 s 35 CA 1989 s 108	First Directive (OJ 1968 spec ed 41-5)
				Part VII, CA1985 CA1980; CA1981.	Fourth Directive (OJ 1978 L222/11)
				Companies (Mergers & Divisions) Regulations 1987 (SI 1987, No. 1991)	Third Directive (OJ 1978 L295/36)
14				Companies (Mergers & Divisions) Regulations 1987/	Sixth Directive (OJ 1982 L378/47)
15	1983	1983		CA 1989	Seventh Directive (OJ 1983 L193/1)
16			1992	Companies (Accounts of small and medium sized enterprises and publications of Accounts in ecu) Regulations 1992	Amendments to Fourth & Seventh Directives
17			1992	Overseas Companies and Credit Financial Institutions (Branch Disclosure) Regulations 1992	Eleventh Directive (OJ 1989, L395/36)
18			1992	Companies (Single Member Private Limited Companies) Regulations 1992	Twelfth Directive (OJ 1989, L395/40)
19					Fifth Directive

20	1998		1994	Criminal Justice Act 1993	Insider Dealing Directive (OJ 32 L334/30)
21			2005		Thirteenth Directive (OJ 32 C64/8)
22	2003 (BaFIN)	2003 (AMF)	2003 (FSA)	Criminal Justice Act 1993 and The Money Laundering Regulations 1993, SI 1993 No.1933.	Money Laundering Directive (OJ 1991 L166/77)
23			2005		European Company Statute (OJ 1991 C176/1)
24	2004	(2004) German Securities Trading Act and Investment Modernisation Act	2004		Market Abuse Directive 2003/6/EC
25	2006	2006	2006		Financial Markets Directive 2004

Writer's Table composed from: Annual Reports of FSA, AMF, BaFin; and Dine.J, (2001), 'Company Law', Palgrave

TABLE 3--SHAREHOLDERS IN FRANCE, GERMANY and THE UK

	FRANCE	GERMANY	UK
Bearer Bonds	Common	common	NOT common
ordinary shares	Yes	Yes	Yes
Preference shares	Yes	Yes	Yes
Cumulative shares	Yes	No	Yes
Redeemable shares	No	No	Yes
Convertible shares	No	No	Yes
Non-voting shares	Yes	Yes	Yes
Transfer restrictions	Yes	Yes	Yes
Founder shares	No	No	No
Shares with more than 1 vote	Yes	No	No
Deferred shares	No	No	Yes
Other types of shares	No	No	No
Cross share-holding	Not allowed	Limited to 10%	Not allowed

Golden shares	No	No	Yes
Appointment auditors	Yes	Yes	Yes
Appoint or remove director	Yes	Yes	Yes
Amend articles	Yes	Yes	Yes
Distribute profits	Yes	Yes	Yes
Adopt annual acs	Yes	No	Yes
Merger & transformation	Yes	Yes	No
Co. dissolution	Yes	Yes	Yes
Ratify monument acts	Yes	Yes	Ratify breach of duty
Capital anchor decreases	No	Yes	Yes
Profit transfer	Yes	Yes	No
Change co. name	No	No	Yes
Call meeting	Only after takeover	If 5%	If 10%
min.time limit for meeting	30 days	1 month	21 days
Information provided	All usual	Only own data can be viewed on shareholder register	All usual
Voting method	All usual	No mail or electronic voting	No mail or electronic

Writer's Table composed from APCIMS and other fact sources.

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[10]

La Porta .R, (1997), 'Legal determinants of external finance', Journal of Finance Lii(3): 1130-1150. Study that minority shareholder protection in common law systems such as the UK's is better than that in civil law systems.

[11]

See table 1 for any shareholder's rights in UK company law.

[12]

Companies Act 1985, section 127(3).

[13]

Carruth v ICI [1937] AC 707.HL. The company had a large class of ordinary shares and a small class of deferred shares. A variation of the rights of the deferred shares was proposed as part of a reduction of capital scheme whereby the deferred shares would be consolidated with the ordinary shares and lose their preferential rights to surplus assets in a winding up. A separate class meeting of the deferred shareholders was called as per Companies Act, section 125. But 80-% of deferred shareholders was also ordinary class shareholders with more ordinary shares than deferred shares. They approved the variation, which benefited them, and the minority members of the deferred class challenged the fairness of this.

[14]

Table 2 shows company law changes in the 3 members states and EU directives.

[16]

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See also Donnelly.S et al, (2001), 'The Public Interest and the Company in Germany and Britain', Anglo-American Foundation.

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[\[20\]](#)

'Monitoring by capital markets' requires legal rules of equality among shareholders and curtailing outsider's rights and enlarging insiders' rights must both be restricted.

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Monitoring by block-holders works when there are statutes that allow outside block-holders to contract with the company such extra rights that are useful in the supervising of their managers.

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See Table 3, Shareholders rights in France, Germany and the UK as at 2003.

[\[23\]](#)

The protection of minority shareholders is the 2nd principle of the OECD's Principles of Corporate Governance, the 4th being the need for transparency, which prohibits fraud.

[\[24\]](#)

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