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# THE PURPOSE OF A COMPANY

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ABSTRACT

*In Croatian law, it is commonly accepted that the directors should manage the company in the interest of the company itself. It has, however, rarely been discussed what is exactly the purpose of a company. In comparative legal systems, the question of corporate purpose is, somewhat simplified, often portrayed as a conflict between shareholder and stakeholder approaches. According to the first approach, the company should be managed primarily in the interests of its shareholders, while according to the latter it should be managed in the interests of all its stakeholders.*

*This paper reaches the conclusion that, in Croatian law, the shareholder approach should be given priority. Shareholders establish a company and bear the direct risk of their investment. On the other hand, the stakeholders are a diffuse notion, with diverse interests and no corporate mechanisms at their disposal. This enables the company directors to exercise wide powers and bear little responsibility.*

*The shareholder approach, however, does not mean that the directors have to follow the wishes of the current shareholder majority. The shareholders' interests are the objective interests of all shareholders, including those who will become shareholders in the future. The corporate purpose is, thus, to increase their long-term financial benefit.*

*Such interpretation does not have to be at the expense of the stakeholders. They should be protected on two different levels. One is top-down protection, where public regulations force companies to take minimum measures in the public interest. The other is bottom-up feedback from conscientious customers who demand that the company's conduct satisfies certain criteria.*

**KEYWORDS:** *company purpose, company interests, financial interests, corporate governance, shareholders, stakeholders, workers, takeover law*

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## 1. INTRODUCTION

One of the key issues of company law is the company's purpose. Unlike a natural person, which is free to pursue as many goals as he pleases, for a company it is essential to be organized behind a central purpose. It determines what is in the interest of the company and, thus, steers the directors, boards, and shareholders in the same direction.

In Croatian law, the importance of a purpose is evident already from the notion of a company[1]. A company is a legally recognized association of several persons, based on a contract, and directed towards a common purpose.[2]

However, in Croatian law, it is far from clear what is the company purpose. Although the Commercial Companies Act (hereinafter: CCA)[3] mentions the company purpose,[4] it does not provide a definition. It is also relatively rare that the articles of association state the overall purpose of the company, aside from listing the company activities.[5]

All the more so, it surprises me that the question of company purpose has been rarely analyzed in Croatian scholarly writing. Professor Jakša Barbić, who wrote more extensively on that subject, states that the purpose of a commercial company is to manage its enterprise.[6] Because of its commercial nature, a commercial company is usually, but not necessarily, oriented towards achieving profit.[7] However, the corporate governance of a joint stock company should take into account a wider net of stakeholders.[8] Thus, the directors have to pay heed to the interests of the shareholders, employees, and the general interests of society.[9] This reflects a worldwide debate that is, somewhat simplified, portrayed as a conflict between shareholder and stakeholder approaches.[10]

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1 Which, in a wider sense, encompasses not only companies with limited liability, but also partnerships.

2 Barbić, J.: *Pravo društava, Knjiga prva, Opći dio*, Zagreb, 2008, p. 133; High Commercial Court (hereinafter: VTS), Pž-4702/08-4 of 25 July 2012; VTS, Pž-2930/11-5 of 31 May 2011.

3 *Zakon o trgovačkim društvima*, NN No. 111/1993, 34/1999, 121/1999, 52/2000, 118/2003, 107/2007, 146/2008, 137/2009, 111/2012, 125/2011, 68/2013, 110/2015, 40/2019, 34/2022.

4 In Articles 227 (2), 420 (3) CCA.

5 Barbić, fn. 2, p. 150.

6 Barbić, fn. 2, p. 148, 150.

7 Barbić, fn. 2, p. 148; Barbić, J.: *Pravo društava, Knjiga druga, Društva kapitala, Svezak I., Dioničko društvo*, Zagreb, 2020, pp. 13-14.

8 Ibid., p. 753.

9 Barbić, fn. 7, p. 866.

10 To give a few examples, for US law, Bebchuk, L. A.; Tallarita, R.: *The Illusory Promise of*

According to the shareholder approach, the purpose of a company coincides with the financial interest of its shareholders. When managing the company, above all the directors have to endeavor to increase the company's profits and, thus, shareholder value.[11] According to the stakeholder approach, the purpose of a company reflects much broader interests, including those of the company's employees, creditors, suppliers, clients, local communities, economy, society, and the environment. When managing the company, the directors have to take into account all of those interests and find the right balance.[12] As long as the company stays sufficiently successful to avoid insolvency, the directors are free to forgo a part of the profit in exchange for other societal benefits. Especially in recent times, the stakeholder approach became intertwined with the ideas of corporate social responsibility (hereinafter: CSR), and environmental, social, and governance (hereinafter: ESG).[13]

Those two approaches will often lead to the same results since shareholders' and stakeholders' interests largely overlap. Stakeholders have an interest that the company's financially successful. Shareholders have an interest that the company and its products having a positive impact on the wider community and the environment.[14] However, that does not mean that the debate is entirely academic. Especially in borderline situations, the interests of different groups

*Stakeholder Governance*, Cornell Law Review, Volume 106 2020, pp. 91-176 and critical appraisal of that paper, e.g. Mayer, C.: *Shareholderism Versus Stakeholderism – a Misconceived Contradiction*, Cornell Law Review, Volume 106 2021, pp. 1859-1880; for UK law, Armour, J.; Deakin, S.; Konzelmann S. J., *Shareholder Primacy and the Trajectory of UK Corporate Governance*, British Journal of Industrial Relations, 41 (3) 2003, pp. 531-555; for German law, Fleischer, H. in: Fleischer, H. (ed.): *Handbuch des Vorstandsrechts*, München, 2006, § 1, paras. 26-33; Spindler, G. in: Goette, W.; Habersack, M.; Kalss, S. (ed.): *Münchener Kommentar zum Aktiengesetz*, München, 2019, § 76, paras. 64-115; Grigoleit, H. C. in: Grigoleit, H. C. (ed.): *Aktiengesetz*, München, 2020, § 76, paras. 19-30; for Swiss law, Von der Crone, H. C.; Beyeler, K.; Dédeyan, D.: *Stakeholder im Aktienrecht*, Zeitschrift für schweizerisches Recht, Vol. 122 2003, pp. 409-471; Daeniker, D.; Hertig, G.: Capitalist Stakeholders: Shareholder Stewardship in Switzerland, in: Katelouzou, D.; Puchniak, D. W. (eds.), *Global Shareholder Stewardship*, 2022, pp. 111-129.

[11] Brandt, F.; Georgiou, K.: *Shareholders vs Stakeholders Capitalism*, *Comparative Corporate Governance and Financial Regulation*, Paper 10, 2016, pp. 5-6.

[12] Ibid., pp. 6-8; Dörrwächter, J.: *Nachhaltigkeit und Gesellschaftsinteresse Zu den Pflichten des Vorstands im Zusammenhang mit ESG*, NZG, 2022, p. 1085.

[13] Cornell, B.; Shapiro, A. C.: *Corporate Stakeholders, Corporate Valuation and ESG*, European Financial Management, Volume 27 2021, pp. 196-207; Pollman, E.: Corporate Social Responsibility, ESG, and Compliance, in: van Rooij, B.; Sokol, D. D. (eds.): *The Cambridge Handbook of Compliance*, Cambridge, 2021, pp. 662-672; Dörrwächter, fn. 12, pp. 1083-1093.

[14] Bebchuk; Tallarita, fn. 10, pp. 108-109; Spindler, fn. 10, § 76. para. 73.

can contrast, even form a zero-sum game.[15] E.g., sometimes the only way for a company to increase its profits is by laying off part of its employees. Also, different groups can come into conflict over the question of change of control due to a company takeover.[16] The correct interpretation of the company's purpose is necessary to determine which of those interests should be given priority.

The prevalence of each approach depends on geographical and historical factors. Broadly speaking, the shareholder approach has been traditionally more dominant in the USA[17] and the UK[18]. On the other hand, the stakeholder model is more common in mainland Europe,[19] e.g. Germany[20] and Switzerland[21].

Irrespectively, the stakeholder approach became increasingly popular in the last couple of years on a global level. In 2019, CEOs of US major companies, associated with Business Roundtable, expressed a commitment to all their stakeholders, including customers, employees, suppliers, and communities.[22] World Economic Forum, in its Davos Manifesto 2020, stated that the purpose of a company is to "engage all its stakeholders in shared and sustained value creation".[23] Similarly, OECD published several Guidelines which promote stakeholder interests.[24]

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[15] Dobos, N.: *Shareholder Rights and Zero-Sum CSR: Strategies for Reconciliation*, in: Idowu, S. O. et. al. (eds.): *Corporate Social Responsibility and Governance*, 2015, pp. 255-267.; Spindler, fn. 10, § 76, para. 75.

[16] More on that issue in Section 4.

[17] Bebchuk; Tallarita, fn. 10, p. 103; Brandt; Georgiou, fn. 11, pp. 33-55

[18] Art. 172 Companies Act 2006 which arguably promotes so-called enlightened shareholder value approach; Armour; Deakin; Konzelmann, fn. 10, p. 531.; Grier, N.: *Enlightened shareholder value: did directors deliver?*, Juridical Review, 2014, pp. 95-111.

[19] For a historical development of the notion of company interest, primarily in German and French law, see Fleischer, H.: *Unternehmensinteresse und intérêt social: Schlüsselfiguren aktienrechtlichen Denkens in Deutschland und Frankreich*, ZGR, 2018, pp. 703-734.

[20] Spindler, fn. 10, § 76, paras. 64-80; Brandt; Georgiou, fn. 11, pp. 12-32. A number of scholars are, however, closer to shareholder approach, e.g. Grigoleit, fn. 10, § 76, paras. 19-30, Fleischer, fn. 10, *§ 1, paras. 27, 28, 30.*

[21] Daeniker; Hertig, fn. 10, pp. 117-119.

[22] Statement on the purpose of a corporation, of 19 August 2019, https://s3.amazonaws.com/brt.org/Business-RoundtableStatementonthePurposeofaCorporationwithSignatures.pdf accessed on 24/10/2022.

[23] Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution, https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/#:~:text=The%20purpose%20of%20a%20company,communities%20and%20society%20at%20large accessed on 24/10/2022.

[24] See OECD Guidelines for Multinational Enterprises, 2011 updated edition, https://www.oecd.org/daf/inv/mne/48004323.pdf accessed on 24/10/2022; OECD Due Diligence Guidance

The EU is also active in that direction.[25] In 2014 it enacted the Non-Financial Reporting Directive (hereinafter: NFRD), which requires corporate sustainability reporting from certain large companies.[26] The EU intensified its engagement within the framework of the European Green Deal. The EU Commission adopted a proposal for a Corporate Sustainability Due Diligence Directive (hereinafter: CSDDD),[27] which imposes extensive due diligence obligations on certain large companies, with the aim of protecting the employees, other individuals, groups, communities, or entities. The EU Commission also adopted a proposal to amend NFRD with a new Corporate Sustainability Reporting Directive (hereinafter: CSRD).[28]

Taking all of that into account, it could be argued that the pendulum of the debate swung towards stakeholder primacy. This paper will, however, steer away from such sweeping statements. Considering that, despite globalization, companies are still creatures of national law, it will analyze the shareholder and stakeholder approach from the perspective of Croatian law. Foreign legal sources and experiences will be used only inasmuch as they shed some light on the Croatian companies. Whether and to which extent the conclusions can apply to other legal systems is open to the reader's interpretation.

Company purpose will be primarily anal from the perspective of joint stock companies, (*dioničko društvo, d.d.*). In other Croatian companies, the company members (shareholders, partners) either manage the company (Art. 78, 136 CCA) or are authorized to give binding instructions to the company management (Art. 422 (2) CCA). Consequently, the shareholders have an efficient mechanism to impose their interests.

The paper primarily uses standard scholarly methods that focus on legal texts and provisions. Those methods include textual interpretation, as well as sys-

on Responsible Business Conduct, 2018, http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf accessed on 24/10/2022.

[25] Dörrwächter, fn. 12, p. 1088.

[26] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330, 15.11.2014, p. 1–9.

[27] Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and Amending Directive (EU) 2019/1937; COM/2022/71 final, 23 February 2022. On 30 November 2022 the Council of the EU adopted its negotiation position (general approach) on the Proposal for CSDDD, which amended a number of its provisions (https://data.consilium.europa.eu/doc/document/ST-15024-2022-REV-1/en/pdf accessed on 18/1/2023).

[28] Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, COM/2021/189 final, 21 April 2022.

temic, functional, and historic analysis. Besides legal methods, the paper also uses basic economic, political, and societal reasoning, which contextualizes legal provisions.

First, the paper contrasts the shareholder and stakeholder approach in Croatian company law (2). Second, the paper gives a more precise definition of shareholders' interests (3.). Third, the role of the company purpose is analyzed from the perspective of the takeover law (4). Finally, the conclusion summarizes the most important findings (5.).

## 2. SHAREHOLDER VS STAKEHOLDER APPROACH

The company purpose in Croatian law will be analyzed through the lens of shareholder and stakeholder approaches. The viability of these approaches will be examined through several key criteria – the notion of a company (2.1.), the distribution of corporate functions and powers (2.2.), the guiding principle for managing the company (2.3.), and the optimal allocation of risk and resources (2.4.).

### *2.1. THE NOTION OF A COMPANY*

As already mentioned, a company is considered an association of several persons, who enter into a contract, to achieve a common purpose.[29] Those persons are called company members or, in capital companies, shareholders. In other words, a company is created by and for its shareholders.

A joint stock company also falls under that definition.[30] To be more specific, a joint stock company is defined as a commercial company in which shareholders participate in the share capital, which is divided into shares (Art. 159 (1) CCA). Thus, a joint stock company is created and upheld by its shareholders.[31] The definition does not mention other persons, not even the company directors, much less different stakeholders' constituencies or the society at large. Consequently, the definition of a company favors the shareholders' approach.[32]

A different conclusion also cannot be drawn from the fact that the statutory provisions governing a joint stock company are mostly of a mandatory nature (Art. 173 (4) CCA). Such mandatory nature is, among other things, necessary

29 See fn. 2.

30 Barbić, fn. 7, p. 6.

31 Barbić, fn. 7, p. 7.

32 For German law, Fleischer, fn. 10, *§ 1, para. 30*.

to protect the capital market, i.e., new shareholders, from the potentially surprising provisions of the articles of association.[33]

Moreover, it does not particularly matter that the Croatian company law, including the law on joint stock companies, is mostly inspired by German law,[34] which is mostly stakeholder oriented.[35] Probably the main reason for such orientation is the historical concept of the "enterprise in itself" (*Unternehmen an sich*).[36] Inspired by Walter Rathenau's influential booklet "On the Nature of Shares" (*Vom Aktienwesen*),[37] the enterprise was understood as an amalgamation of the capital, work, and the public good, which has its interest, separate from the interests of its shareholders.[38] Such understanding left its mark on the German Stock Companies of 1937 (*Aktiengesetz 1937*), which stated that the management board manages the company in the interests of the business (*Betrieb*), its followers (*Gefolgschaft*), the whole nation (*Volk*) and the realm (*Reich*). Although the current Stock Companies Act from 1965 does not contain similar wording, its drafters thought that the company is managed in the interests of the enterprise (*Unternehmen*), shareholders (*Aktionäre*), employees (*Arbeitnehmer*), and the public (*Allgemeinheit*).[39]

Croatian law does not share a similar conceptual background. The notion of an enterprise was (re)introduced only in the 1990s, after the fall of the socialist legal system.[40] Although the enterprise is described, somewhat similar to German law, as a unity of work and capital,[41] it is primarily considered an asset through which the company appears in the market.[42] Considering that, unlike a company, an enterprise does not have a legal personality and it cannot have a legally recognized interest of its own.[43]

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[33] Barbić, fn. 7, p. 160.

[34] Barbić, fn. 7, p. 174.

[35] See fn. 20.

[36] Fleischer, fn. 10, *§ 1, para. 22*.

[37] Rathenau, W.: *Vom Aktienwesen*, Berlin, 1922.

[38] For a detailed explanation, Riechers, A.: *Das »Unternehmen an sich«, Die Entwicklung eines Begriffes in der Aktienrechtsdiskussion des 20. Jahrhunderts*, Tübingen, 1996, *pass*. Similar understanding can be found in the Swiss law, Daeniker; Hertig, fn. 10, pp. 118.

[39] Spindler, fn. 10, para. 64; Fleischer, fn. 10, *§ 1, para. 20*.

[40] Barbić, fn. 2, p. 217-223.

[41] Ibid., p. 226.

[42] Ibid., pp. 232-234; VSRH, Revr 154/08-2 of 21 May 2008; VTS, Pž 5613/2015-4 of 4 June 2018; VTS, Pž 8331/08-3 of 19 January, 2009.

[43] The idea of the interest of an enterprise is often criticised also in German literature (Spindler, fn. 10, para. 68, Fleischer, fn. 10, *§ 1, para. 25*).

Moreover, the EU instruments for the protection of stakeholders do not affect the purpose of Croatian companies. First, as stated by the Court of Justice of the EU in Daily Mail, companies are creatures of national law.[44] Second, the EU instruments usually do not address the company's purpose.[45] Even the most recent proposal for a Corporate Sustainability Due Diligence Directive (hereinafter: CSDDD)[46] primarily expands the company's compliance function. The companies covered by that proposal are required to implement a due diligence procedure, which ensures that they do not violate human rights and environmental conventions listed in the Annex.

In the proposal for CSDDD, there is one vague reference to company purpose. Art. 25 states that, when fulfilling their duty to act in the best interest of the company, the directors should take into account the consequences of their decision for sustainability matters. Even that, however, falls short of equating the best interests of the company with sustainability. It could equally be understood as an expression of the directors' duty to ensure the company's compliance with human rights and environmental standards.

In its recent negotiation position (general approach), the Council of the EU deleted the proposed Art. 25. The deletion was explained by the strong concerns expressed by Member States that it represents an inappropriate interference with national provisions regarding directors' duty of care and that it potentially undermines directors' duty to act in the best interest of the company.[47]

Furthermore, the EU references to sustainability are usually not sufficient to influence the company's purpose. E.g., Shareholder Rights Directive II mentions sustainability as a goal of the company's remuneration policy.[48] However, it talks about the "sustainability of the company" which is not contrary to the shareholder approach. It is no wonder that it was transposed in Croatian law under the term of "long-term development of the company"[49] (Art. 247.a (1) (1) CCA). Thus, it seems that, at least for the time being, the company's purpose is left exclusively to national company laws.

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44 Judgement of 27 September 1988, Daily Mail and General Trust PLC, C-81/87, ECLI:EU:C:1988:456, para. 19.

45 Differently suggests Mak, C.: *Corporate sustainability due diligence: More than ticking the boxes?*, Maastricht Journal of European and Comparative Law, Volume 22 2022, p. 303.

46 See fn. 27.

47 Para. 30 of the general approach, available at: https://data.consilium.europa.eu/doc/document/ST-15024-2022-REV-1/en/pdf accessed on 18/1/2023.

48 Art. 9a (4, 6) of Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, OJ L 132, 20.5.2017, p. 1–25.

49 In Croatian, „*dugoročnom razvoju društva*".

A reference to company purpose also exists in the Corporate Governance Code, issued by Zagreb Stock Exchange and Croatian Financial Services Supervisory Agency (HANFA).[50] It states that a company should be accountable not only to its shareholders but also to its stakeholders and society as a whole.[51] Further, the Code provides that, when assessing the interests of the company, the directors should take into account the interests of employees, shareholders (including minority ones), and other stakeholders.[52]

The effect of those provisions is questionable.[53] The code of corporate governance is a non-mandatory instrument that can only elaborate on the issues not settled in the statute.[54] CCA only requires that the companies whose shares are traded on a regulated market issue a statement about which code of corporate governance they apply (Art. 272.p). The choice of the code falls upon the management board. By choosing the Corporate Governance Code, the management board cannot depart from the company's purpose as set by the statute and the articles of association. Only shareholders have the mandate to set and consequently change, the purpose of a company. Consequently, the Corporate Governance Code cannot change CCA mandatory provisions relating to the authority of the shareholders' general meeting and the management board.

### *2.2. THE DISTRIBUTION OF CORPORATE FUNCTIONS AND POWERS*

It is a truism that a company interacts with many different persons and groups. Most of them, however, are not a part of the company's organization. In CCA they are covered by the umbrella term of "third persons".[55] Somewhat simplified, company law divides persons and entities into those who participate in corporate governance (corporate actors) and third persons.

This does not mean that third persons are somehow less worthy or irrelevant. One of the main principles of company law is that third persons' claims have priority over shareholders financial interests.[56] To be specific, the shareholders can receive dividends only if the value of the company's assets is higher than the sum of the company obligations and the share capital (Art. 220 (7, 8)

[50] Corporate Governance Code, 2019, https://www.hanfa.hr/media/4097/zse_kodeks_eng.pdf accessed on 26/10/2022.

[51] Introduction, The Purpose of the Code.

[52] Section 2, The Duties of Board Members, Principle D.

[53] For a similar conclusion in German law, Dörrwächter, fn. 12, pp. 1088-1089.

[54] Barbić, fn, 7, p. 758.

[55] E.g. Art. 35 (3), 37 (4), 41 (2), 48, 66, 90-96, 175, 234, 237, 337 CCA and many others.

[56] E.g. Barbić, fn. 7, p. 669.

CCA). Similarly, in liquidation or insolvency proceedings, shareholders can participate in the distribution of company assets only after creditors have been satisfied (Art. 380 CCA, Art. Insolvency Act[57]). The statutory provisions which protect third persons are mandatory, and they cannot be circumvented by the articles of association (Art. 173 (4) CCA). Moreover, third persons are protected by other areas of law, such as the obligations law, labor law, tax law, capital markets law, etc.

However, unlike corporate actors, third persons do not have a say on internal company issues. In other words, they do not hold any corporate functions or powers. Properly understood, they are protected from company actions precisely because they are outsiders without any influence over those actions.

In a joint stock company, the main corporate actors are company organs - the management board, the supervisory board, and the shareholders' (general) meeting.[58] Briefly, the general meeting appoints and removes the members of the supervisory board (Art. 244 CCA) and the supervisory board appoints and removes the members of the management board - directors (Art. 256 (1), Art. 259 (1) CCA). Thus, either directly or indirectly, the shareholders exercise an influence over both company boards.

At least in theory, the general meeting is not higher-ranking than the management or the supervisory board.[59] Each organ acts independently, pursuing the company's purpose within the strictly set statutory confines. The independence of the boards is supposed to be ensured by the personal independence of their members. The supervisory board can remove the directors only if there is an objectively important reason (Art. 244 (2) CCA). The general meeting can remove the members of the supervisory board only by a supermajority of 75% of votes (Art. 259 (1) CCA). Nevertheless, in practice, the board members will be deferential to the shareholders' majority.[60] Their term in office does not last more than 4 or 5 years (Art. 258, Art. 244 (1) CCA) and if they want to be reappointed, they have to be sensitive to shareholders' wishes. Even before the expiry of their term in office, the general meeting can refuse to grant them a discharge (Art. 244 (2), Art 276 CCA).

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[57] *Stečajni zakon*, NN No. 71/2015, 104/2017, 36/2022.

[58] Instead of the management and supervisory board, a joint stock company with one-tier (monistic) corporate structure can have only one organ, the board of directors (*upravni odbor*). Since this is a significantly less common option in Croatia, it is not separately discussed in this paper. Nevertheless, most of the conclusion for the management and supervisory board can analogously apply to the board of directors.

[59] Barbić, fn. 7, pp. 914-915.

[60] After all, this is the reason why the provisions on the group of companies have to protect the daughter company from the influence of the mother company (Art. 496 (1) CCA).

Consequently, not only are the shareholders important corporate actors, but arguably they have the strongest bargaining power. They are not appointed, and they got their position through an investment of capital. They cannot be removed,[61] which leaves them free to transfer their shares whenever they see fit. Through the general meeting, they exercise their right to be informed, to discuss, and to vote on the most important company matters, e.g., the payment of dividends, the amendment of the articles of association, the increase and decrease of the share capital, mergers and liquidation (Art. 287, Art. 275 (1), Art. 516 CCA). In certain situations, shareholders can also act outside of the general meeting. E.g., a shareholder can bring a lawsuit to avoid the resolutions of the general meetings (Art. 362 CCA). The shareholders who reach a threshold of 5% of the share capital can initiate the convening of the general meeting (278 CCA) or the appointment of special auditors (Art. 298 (2) CCA).

On the other hand, no other stakeholder's constituency exercises any real influence on corporate governance. The lenders, suppliers, clients, and consumers are connected to the company only through civil law contracts. They cannot vote on company matters, appoint or remove board members. Local communities, society at large and the environment do not even have a direct legal relationship with the company. Naturally, they can be affected by company actions, but the company law is not the proper vehicle to mitigate those risks. E.g., the state can order a company to behave in a certain way, but this is an issue of compliance with public law and not of a company purpose.

The company employees deserve special attention. They are not traditionally considered corporate actors. After all, their rights and obligations arising out of an employment contract and not company law.[62] However, it is impossible to ignore that they constitute the backbone of a company organization. They usually work for the company on a daily basis, unlike distant shareholders who gather only once a year. When third persons enter company premises, they usually see and deal with the company employees. This is why the employees represent the company within the scope of their usual tasks (Art. 43 CCA). In addition, one member of the supervisory board is a representative of the employees (Art. 164 Labour Act, LA[63]). In companies with twenty or more employees, the employees participate in the decision-making concerning their financial and social rights through the worker's councils (Art. 140 LA).

From a broader perspective, the employees are, at best, marginal corporate actors. First, they can neither appoint nor remove any other board members.

[61] Barring exceptional constellations, such as the shareholder squeeze-out (300.f-300.k CCA).

[62] Barbić, fn. 7, p. 1145.

[63] *Zakon o radu*, NN No. 93/2014, 127/2017, 98/2019.

Even in a supervisory board with a minimal number of members – three – the employee's representative is a minority. In larger supervisory boards, with e.g., 17, 19 or 21 members, the influence of the employee's representative is marginal. Workers council advises the company only on the decisions which are important for the position of the employees (Art. 150 LA). They can veto a company decision in cases of employee dismissal (Art. 151 LA). Consequently, employees have a right of co-determination only over the issues which immediately affect their status and not on the company's purpose and corporate governance.[64]

Equally important, employees are already protected by the provisions of labor law.[65] As to their claims towards the company, the employees are creditors par excellence. Their salary is not tied to the company's profit. Instead, it is an expense that is subtracted from the revenue. Thus, it reduces the company's profits. The employees also have priority claims in the insolvency proceedings (Art. 138 (1), 155 (1) (2), 156 (1) (5) Insolvency Act).

To conclude, apart from the shareholders, the only stakeholders who exert any corporate powers are the employees. It is questionable whether these powers can reflect on the company's purpose. Even if they can,[66] this does not translate to the other stakeholders who are not similarly intertwined with the company organization.

### *2.3. THE GUIDING PRINCIPLE FOR MANAGING A COMPANY*

The company's purpose is not an end in itself. Somewhat ironically, the company's purpose has to have its purpose. And its main purpose is to provide a benchmark for the behavior of all company actors, especially the management board.[67]

The principal duty of the management board and its directors is to manage the company with the care of a prudent businessperson (Art. 252 (1) CCA). If the directors breach their duty, they can be liable for damages (Art. 252 (1) CCA).[68] The statute, however, does not specify in which direction the management board should guide the company. It is accepted that such direction is set by the

[64] Barbić, fn. 7, p. 1146.

[65] Ibid., p. 1147.

[66] As suggested by Barbić, fn. 7, p. 1167.

[67] Thus, it is most often discussed in the context of the directors' duties (Barbić, fn. 7, pp. 865-866; for German law, Spindler, fn. 10, § 76, paras. 63-80; Grigoleit, fn. 10, § 76, para. 17-34.).

[68] For a more detailed discussion Barbić, fn. 7, pp. 974-1033.

company's purpose.[69] In other words, the management board and its directors should strive to achieve the company's purpose with a care of a prudent businessperson.

The same is true for the supervisory board. The members of the supervisory board have to act in the interest of the company (Art. 272 (1) CCA). Again, the interest of the company is to achieve the company's purpose. While acting in the company's interest, the members of the supervisory board should apply the care of a prudent businessperson (Art. 272 (1) CCA). Unlike the management board, the supervisory board does not manage the company but supervises the management. The duty of care and the company purpose is, however, the same.[70]

There are no statutory provisions that impose the duty of care on shareholders or the general meeting. However, among scholars and in the case of law it is accepted that shareholders owe a duty of loyalty to the company and each other.[71] The duty of loyalty arises out of the very notion of a company as an association between the persons who intend to achieve a common purpose. By accepting the articles of association, the shareholders impliedly undertook an obligation to contribute to the common purpose.[72] Naturally, the shareholders' duties are not nearly as comprehensive as those of the directors or the members of the management board. Shareholders do not have to attend the general meetings and they are in principle free to sell their shares to the highest bidder. However, apart from a situation involving the liquidation of the company, they should at the very least refrain from voting in a way that would go against the company's interest and purpose. Properly understood, the duty of loyalty is an important instrument in maintaining a balance between different shareholder factions and preventing the abuse of either majority or minority rights.[73]

Considering such a wide application, it is perhaps necessary that the company's purpose remains relatively general and abstract. Company organs and shareholders should be left with sufficient discretion to independently interpret the company's purpose in the context of their functions. On the other hand, the company's purpose should not be so vague that it becomes practically unidentifiable. After all, it is possible that the company or its creditors will sue the director for damages and the court will have to assess the director's actions.

[69] Ibid., p. 865.

[70] Ibid., p. 1137.

[71] Ibid., p. 591; VTS, Pž-5129/05-3 of 30 September 2005 which states that shareholders owe a loyalty to a joint stock company.

[72] Barbić, fn. 7, p. 591.

[73] Ibid., p. 592.

The company's purpose has to serve as a workable criterion against which it is possible to measure the director's behavior.[74]

In that respect, the shareholder approach is much more appropriate than the stakeholder approach.[75] It is true that there can be friction between different groups of shareholders, as well as between their short- and long-term interests.[76] Nevertheless, shareholders are an easily identifiable, relatively homogenous group with comparable financial interests. Generally, all shareholders want to increase the value of the underlying enterprise and maximize the company profits. Consequently, it is possible to determine whether the directors and the other corporate actors could have reasonably believed that they contributed to that goal.

On the other hand, stakeholder interests are notoriously difficult to define. The problem begins already with the notion of the stakeholder.[77] Apart from the shareholders themselves, there is a consensus that it includes company employees.[78] It should most probably encompass the company's contractual partners, such as the banks, the suppliers, and other creditors. It usually also includes the entire upstream and downstream chains, especially the consumers who use the company's products or services.[79] It can also encompass the whole society,[80] whether on a local, national or global level, as well as the environment. In other words, a stakeholder can be everyone who is, either directly or indirectly, affected by the company's actions.

If such a wide definition is accepted, the next question is how to reconcile all those diverse interests. Proponents of the stakeholder approach usually mention two main arguments. First, the company directors have discretion in managing the company, exemplified in the business judgment rule (Art.252 (1) CCA).[81] Second, the directors should balance those interests without giving priority to any single one of them.[82] However, none of these arguments are persuasive.

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[74] E.g. Ibid., p. 1138.

[75] For German law, Fleischer, fn. 10, *§ 1, para. 28*.

[76] For more details see Section 3.

[77] For US law similarly Bebchuk; Tallarita, fn. 10, p. 116.

[78] E.g. Corporate Governance Code, 2019, Section 2, The Duties of Board Members, Principle D; Barbić, fn. 7, p. 753.

[79] Similarly, Ibid., p. 753.

[80] Corporate Governance Code, 2019, Introduction, The Purpose of the Code.

[81] For US law Mayer, fn. 10, pp. 1863-1864; For Geman law Spindler, fn. 10, § 76. paras. 103, 112.

[82] Brandt; Georgiou, fn. 11, pp. 7, 11. For US law Bebchuk; Tallarita, fn. 10, pp. 114-115; Blair, M. M.; Stout, L. A.: *A Team Production Theory of Corporate Law*, Virginia Law Review, Volume 85 1999, pass.; For German law Dörrwächter, fn. 12, pp. 1084-105; Fleischer, fn. 10, *§ 1, paras. 19, 30*.

The discretion means that the directors have a wide margin of error when managing the company. Thus, the directors are not liable for the actions which eventually harm the company, as long as, at the moment when those actions were undertaken, it was reasonable to assume that they will be beneficial.[83] The discretion, however, does not say anything about the purpose that directors are supposed to achieve when they exercise their discretion. It is true that the boundary between those two notions is in practice often blurred. The directors who disregard the company's purpose might convince the court that the matter was within their discretion to ultimately realize such purpose. However, this is not the reason against, but the reason for defining the company's purpose as precisely as possible. Otherwise, there would practically be no criteria for the directors' liability, and they could indeed get away with almost anything.[84]

Furthermore, the popular idea of balancing different interests without prioritizing any of them, is, actually, meaningless. The very notion of balancing evokes an image of equally distributed weight, such as of balanced scales. However, weighing has a precise common denominator – mass, with an exact expression in grams, and kilograms. On the other hand, the interests of different stakeholder constituencies do not have a common denominator.[85] Even the very first step is vague. Should more weight be given to stakeholders who are closer to the company? In that case, the order would approximately be shareholders, employees, contractual partners, upstream and downstream business chains, local communities, a country or a nation, and, in the end, the whole planet. Or more weight should be given to those who have a greater need for the protections? E.g., if the directors are acutely aware of the environmental problems, should they primarily try to prevent pollution?

Perhaps an exaggerated example might be helpful. The directors of an extremely profitable company decide to allocate all of the company's surplus profit toward finding a cure for a severe disease. From the perspective of wider society, one could hardly find a fault. Few would prioritize shareholders' hefty dividends over saving millions of lives. However, what would happen if, universalizing such behavior, the directors of all companies begin to play the heroes? Shareholders would soon start to fear for their financial interests, which would discourage the investment. The national economy would most likely shrink, with far-reaching consequences, including for the investment in medical research. Even if other aspects are disregarded, it is difficult to say in which scenario it is more likely that the cure would be found.

[83] Barbić, fn. 7, p. 985-991.

[84] Similarly for German law Dörrwächter, fn. 12, pp. 1091-1092.

[85] For US law Bebchuk; Tallarita, fn. 10, p. 25.

As it can be seen, the problem exists even if directors are well-meaning, exemplary experts, thinking hard about what the optimal net outcome is. Making that kind of decision is not only about calculating the risks and predicting the future but also about values and policies. Should the directors prioritize shareholders who invested their money, the employees who put in their work, or the whole community? The directors have neither the abilities nor the shareholder's political mandate to make those choices.[86]

The problem is compounded if the directors have an unconscious bias or, even worse, if the unscrupulous directors collude with certain stakeholder constituencies at the expense of others. Barring explicit evidence of collusion, it would be very difficult to prove that the directors misused their "balancing" discretion. Consequently, the shareholder approach should be preferred as it provides clearer guidance for managing the company.

### *2.4. OPTIMAL ALLOCATION OF RISK AND RESOURCES*

The shareholder approach is often explained in the terms of the allocation of risk.[87] Shareholders are the investors who bear the risk of their investment. If the company is not successful, they do not receive dividends and its shares lose value. Therefore, the shareholders are sometimes portrayed as principals and the directors as their agents.[88]

This is countered by the observation that other stakeholders also bear risk in relation to the company.[89] The most obvious examples are the employees who "invest" their work and time. If the company becomes bankrupt, the employees who lose their jobs might be affected more than the shareholders who lose only a fraction of their diversified portfolio.[90] Other stakeholders can also be affected. A bankruptcy of a large, structurally important company can cause a chain reaction, spill over to other companies and destabilize the entire economy. As a rule – the larger a company, the larger the risk for the whole society.

Although the stakeholder approach claims to address all of these concerns, the problem is, again, its vagueness. There is no doubt that, ideally, every stake-

[86] As famously put by Friedman, M.: *The Social Responsibility of Business is to Increase its Profits*, The New York Times Magazine, September 13, 1970.

[87] For German law, Spindler, fn. 10, § 76. para. 72.

[88] Brandt; Georgiou, fn. 11, p. 6.

[89] For US law Anjier, J. C.: *Anti-Takeover Statutes, Shareholders, Stakeholders and Risk*, Louisiana Law Review, Voume 51 1991, p. 606; Spindler, fn. 10, § 76, para. 76.

[90] For US law Anjier, fn. 89, p. 606.

holder constituency should be protected from the adverse effects caused by a company. However, not all stakeholders face the same type of risk. Abstractly speaking, for each stakeholder constituency it would be better if it was protected by a tailor-made regulation that takes into account its unique position. After all, there are already many public and private law instruments designed specifically to protect various stakeholders' interests, and, if needed, it is possible to introduce new ones.

To give one example, the risk borne by the shareholders differs from the risk borne by company creditors, including its employees.[91] The shareholders' financial interests are directly tied to the success of a company. If the company is not sufficiently profitable, the price of its shares will decrease. On the other hand, the company has to pay its creditors' claims in full, no matter whether it is profitable or not. Creditors will only be affected if the company cannot meet its obligations. Thus, while the shareholders bear the risk of company profitability, creditors "only" bear the risk of company solvency.[92] Even if the company becomes bankrupt, the creditors can hope to receive a part of their claims. In other words, the creditors are much more protected than the shareholders by provisions of contract law, insolvency law, and labor law.[93] There is no need to fit an additional layer of protection into an already overloaded notion of company purpose.

Moreover, focusing on shareholders' financial interests could ensure the optimal allocation of societal resources and, thus, benefit all stakeholders. To be specific, shareholders' financial interests nudge the company to pursue the most profitable activity. The most profitable activity is the one the customers are willing to pay for. And customers are willing to pay for the products and services which they need or want the most. In other words, since the market ensures the optimal allocation of resources, following its impulses should favor not only the company shareholders but the whole of society.

This should not be understood as an expression of free market fundamentalism. The markets need to be regulated to a certain degree which should be determined through the political process. However, the company's purpose is not an appropriate vehicle for such regulation.[94] The companies have neither the duty nor the ability to make a correct assessment of the global picture.

91 For German law, Fleischer, fn. 10, *§ 1, para. 28*.

92 Ibid.

93 Ibid.

94 For US law Bebchuk; Tallarita, fn. 10, p. 69-73.

In short, it seems that it is better to protect the stakeholders by two mechanisms, none of which includes the company's purpose. First of them is a top-down mechanism in which the state introduces regulations intended to protect potentially weaker groups and the environment. Such regulation is found e.g., in the provisions of labor law, insolvency law, and even company law, since it protects third persons. The company and its directors have to abide by these regulations in the course of the company's regulatory compliance.[95]

The other is a bottom-up mechanism that originates from conscientious customers. E.g., if the customers cease to buy environmentally harmful products, the shareholders' interests might require raising the environmental standards. The latter approach is often called the enlightened shareholder approach.[96] However, the change of the production method often comes with a price tag, which is finally borne by the customers. Not every company has to choose that strategy. Instead, it may opt to retain the existing production methods, which do not go above the mandatory environmental protection. In return, the company will be able to offer cheaper products, thus catering to a different market segment. Not only that, similarly to natural persons, the companies should not be forced to realize their ethical maximum, but by offering affordable products they protect the interests of a different stakeholder constituency – less well-off people.

## 3. THE MEANING OF SHAREHOLDERS' INTERESTS

It remains to be seen how to properly define the shareholders' interests. That issue is best approached through four pairs of contrasted notions - financial vs non-financial shareholders' interests (3.1.), long-term vs short-term shareholders' interests (3.2.), the interests of a majority vs all shareholders (3.3.), and the interests of specific vs abstract shareholders (3.4.).

### *3.1. FINANCIAL VS NON-FINANCIAL SHAREHOLDERS' INTERESTS*

People have many interests and shareholders are no different. These interests do not have to be necessarily financial.[97] However, when shareholders participate in a company, it has to be presumed that they want to realize their

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[95] For German law Dörrwächter, fn. 12, pp. 1089-1090.

[96] For US law Bebchuk; Tallarita, fn. 10, p. 108; Mayer, fn. 10, p. 1860.; Jensen, M. C.: *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, European Financial Management, Volume 7, 2001, p. 298, for German law Fleischer, fn. 10, § 1, para. 31.

[97] Barbić, fn. 7, p. 13.

financial, and pecuniary interests. First, the joint stock company is a so-called commercial company (Art. 3 (3) CCA). A commercial company is always considered to be a "merchant", i.e., someone who acts in order to make a profit (Art. 3 (1, 6) CCA). Although commercial companies can also be established for other reasons, they are usually established for profit.[98] Second, because of the shareholders' limited liability, a company is a perfect vehicle for entrepreneurship. Therefore, in the absence of an indication to the contrary, the company's purpose covers only shareholders' financial interests.

The shareholders' financial interests should be understood broadly. They primarily consist of the shareholders' interest to receive dividends and to increase the market value of their shares. Sometimes, those two interests can conflict, e.g., when the payment of dividends would decrease the share value. If that is the case, the shareholders' overall interests depend on the net outcome, i.e., whether the decrease in the share value would cancel out the positive effects of the dividend. A regard is usually to be had to the likely effects on the long-term value of shares.[99]

The shareholders' financial interests generally coincide with the maximization of the company's profits and the value of the enterprise.[100] This should, however, not be equated with profit in the sense of the rules of accounting.[101] Shareholders have an interest in everything that increases the price of their shares. This includes the improvement of the company's future prospects, which cannot be fully expressed in the financial statements.

The articles of association can specify an additional or a different company purpose. That purpose can take into account shareholders' non-financial interests.[102] Those interests can directly benefit the stakeholders. This will often happen in the case of state-owned enterprises which perform a public service or a service of general (economic) interest. E.g., the articles of association could specify that the company's purpose is to ensure universal accessibility of a certain product or service.

[98] Barbić, fn. 2, p. 148.

[99] See Section, 3.2.

[100] For German law, Fleischer, fn. 10, *§ 1, para. 26*.

[101] For German law, Grigoleit, fn. 10, § 76, para. 26.

[102] Barbić, fn. 7, pp. 13-14. For Geman law, Dörrwächter, fn. 12, p. 1090.

### *3.2. LONG-TERM VS SHORT-TERM SHAREHOLDERS' INTERESTS*

One of the typical objections against the shareholder's approach is its alleged short-termism.[103] A usual counterargument is that the shareholders' interests should imply shareholders' long-term interests.[104] Properly understood, the temporal aspect of shareholders' interests depends on the period for which the company is established. The articles of association have to contain a provision on such a period (Art. 173 (3) (8) CCA). Although most companies are established with indefinite duration, their duration can also be limited to a certain event (e.g., the accomplishment of a project) or even with a fixed date.

If a company is established with an indefinite duration, the company purpose implies an indefinite gradual increase of shareholders' financial benefits. Although it is impossible to guarantee a such result, the directors should aspire towards that goal. Consequently, they have to forgo short-term profit if it would likely hinder long-term progress.[105]

One of the ways to ensure such long-term progress is to cultivate good relationships with stakeholders' constituencies. It is especially important to motivate employees and to create a loyal customer base. It is also useful to maintain a positive reputation and goodwill in a wider society. This can be achieved, among others, by caring about the environment and implementing sustainability policies and other ESG factors.[106] However, this is not an end in itself and the potential benefits should be carefully adjusted against the cost. The directors enjoy wide discretion, but they have to be able to provide a believable justification that a certain action had a reasonable chance to advance shareholders' financial interests.

Of course, the management board's choice of business strategy does not mean that the shareholders are not allowed to dispose of their shares, even if their primary aim is to enhance their own private short-term financial interests. A conclusion to the contrary would automatically lock shareholders in their given positions and thus directly contradict the fundamentals of both private and capital market law mechanisms.

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[103] For US law, Mitchell, L. E., *A Critical Look at Corporate Governance*, Vanderbilt Law Review, Volume 45 1992, pp. 1263-1318; Brandt; Georgiou, fn. 11, p. 58; For Geman law Fleischer, fn. 10, *§ 1, para. 27;* Dörrwächter, fn. 12, p. 1084.

[104] For Geman law, Spindler, fn. 10, §76, paras. 76-78; Dörrwächter, fn. 12, p. 184; for US law Babchuk; Tallarita, fn. 10, pp. 109-113; Brandt; Georgiou, fn. 11, p. 59.

[105] For German law, Grigoleit, fn. 10, § 76, para. 26.

[106] For German law, Dörrwächter, fn. 12, p. 1084.

### *3.3. MAJORITY VS ALL SHAREHOLDERS' INTERESTS*

Shareholders express their will through the resolutions of the general meeting. The resolutions are usually brought by a simple majority of votes (Art. 190 CCA)[107] or, in some cases, by a supermajority of 75% of votes or the share capital.

Those resolutions, however, do not express shareholders' interests within the meaning of the company's purpose. The company's purpose was set by the statute and the articles of association at the time when the company was established. Thus, the company's purpose could be changed only by an amendment of the articles of association,[108] or even by the consent of all shareholders.[109]

Even the articles of association could not stipulate that the company is managed in the interests of only certain shareholders or the majority of shareholders. Such a provision would go against the mandatory principle of the equal position of shareholders (Art. 211 CCA),[110] and would, thus, be null and void.

The practical consequence is that the management board manages the company independently, at its responsibility (Art. 240 (1) CCA). In managing the company, it is not bound by the resolutions of the general meeting.[111] It should try to create value for all shareholders and not just accommodate the wishes of the shareholders' majority.[112] Equally, when voting in the general meeting, the shareholders should vote in the interest of the company, i.e., all shareholders.

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[107] More votes for a resolution than against it Barbić, fn. 7, pp. 1371-1372.

[108] Barbić, fn. 2, p. 150, 152. The amendment of the articles of association requires a supermajority of three quarters of share capital and that the resolution is registered in the court register (Art. 301 (2), 303 (3) CCA).

[109] Better reasons speak for the opinion that the company purpose can be changed only with a consent of all shareholders. E.g. if the company purpose changes from profit to entirely non-profit, it alters the fundamental shareholders' expectations. This differs from some other structural changes decided by a supermajority, such as the resolution to liquidate the company or to merge it with another company. In those situations, the financial interests of shareholders are protected either by their participation in the remaining assets (Art. 380 CCA) or by receiving substitute shares and, if needed, an additional financial compensation (Art. 514, 532 CCA).

[110] Barbić, fn. 7, pp. 578-584; VTS, Pž-7385/05-3 of 13 May 2008.

[111] With certain exceptions, e.g. if the management board itself asks for the consent of the general meeting or when the management board is required by the statute to obtain such a consent (e.g. Art. 552 CCA).

[112] Barbić, fn. 7, p. 914.

### 3.4. SPECIFIC VS ABSTRACT SHAREHOLDERS' INTERESTS

This dichotomy partly overlaps with the dichotomy between the company's short-term and long-term interests and the one between the majority and all shareholders. Shareholders' interests concerning company purpose do not cover only shareholders who have shares at a specific moment in time, but also persons who will become shareholders in the future. More precisely, shareholders are treated as an abstract notion, irrespective of their personal characteristics and wishes.

This also means that the shareholder is treated as the same person even if the share changes hands. E.g., a current shareholder might want to receive a dividend before it sells its share. Vice versa, the acquiring shareholder might prefer that the dividend remains unpaid. However, when determining the interest of a company, they are seen as the same person. I.e., if the overall financial benefit to the abstract shareholder would be greater if the dividend is paid, the directors should propose the payment of the dividend. If, on the other hand, the benefit would be greater if the company retains its profit, the directors should act accordingly.[113] At least in the case of perfect competition, this should benefit everyone. Although the former shareholder might not get its dividend, it should be able to sell the share at a market price that would be higher than it would be if the dividend was paid.

Such understanding is especially important for the trading of shares in the capital market. Investors will feel comfortable investing in a company only if they can count that the company is managed in the objectively best interests of all shareholders. This is the principal reason why the management board manages the company independently from the instructions of the general meeting. Somewhat simplified, the management board protects abstract shareholders from specific shareholders. This is also the reason why the statutory provisions regulating joint stock companies are mostly mandatory.

In the following text, the purpose of the company will be analyzed by taking into account specific mechanisms pertaining to takeover law. An earlier analysis of Croatian company law will be used to demonstrate the inherent interconnection of company, takeover, and capital market law and their overall impact on the position of the management board of the target company.

[113] Similarly Barbić, fn. 7, p. 1564, when he mentions the criterion of commercial justification and commercial reasonability.

## 4. TAKEOVER LAW

Once analyzed from the perspective of takeover law, the somewhat elusive definition of a company's purpose takes on an additional layer, presenting the previously mentioned conflict between shareholders and stakeholders as a subtle issue of the inherent conflict between shareholders and the management board. This conflict, together with the interconnected issue of stakeholders' interests, is best shown in the example of the legislative process that led to the adoption of Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (hereinafter: Takeover Directive).[114] As the Takeover Directive was transposed into Croatian law, the reasons that led to the adoption of specific European solutions are, at the very least, instructive for the national legislator. To that extent, the Croatian Act on the Takeover of Joint Stock Companies (hereinafter: Takeover Act)[115] will primarily be used to analyze the notion of company purpose within the context of takeover law. At the same time, however, the analysis will be based upon the inherent interconnectedness of takeover and company law, which indicates that the determination of a company's purpose, as defined by national law, does not substantially change once the joint stock company becomes subject to takeover.

Analysis firstly highlights characteristics pertinent to takeover law, most notably the economic background of the market for corporate control and the effect it has on the position of the management board of the target company (4.1.). After that, the primacy of shareholder decision-making is analyzed by reference to legal arguments put forward in the legislative process which preceded Takeover Directive (4.2.). Finally, the analysis briefly evaluates the implementation of European solutions in the Croatian takeover law, with special emphasis on the purpose of the target company (4.3.).

### *4.1. MARKET FOR CORPORATE CONTROL AND THE POSITION OF THE MANAGEMENT BOARD*

Shareholders of the target company are at the central point of the takeover process. Conventional wisdom dictates that faced with a takeover offer and decision whether to sell their shares to the offeror, shareholders of the offeree company will be primarily guided by their short-term financial interests.[116] As

[114] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, OJ L 142, 30.4.2004, p. 12-23.

[115] *Zakon o preuzimanju dioničkih društava*, NN No. 109/2007, 36/2009, 108/2012, 90/2013, 99/2013, 148/2013.

[116] See Sections 3.1. and 3.2.

previously mentioned, shareholders are generally free to sell their shares.[117] After all, the offer is addressed directly to them and the mechanics of the takeover process largely lies on the premise that the price offered for the shares will be above the market one, as the offeror will try to provide an incentive in the form of a premium to the current market price.[118] Since shareholders are the main risk bearers[119] and have the legal title to shares, they are fully entitled to decide whether, and under what conditions, to dispose of them. Consequently, any interference with the takeover process (especially on behalf of the management board, trying to frustrate the offer by means of defensive measures) may weaken their position, ultimately robbing them of the possibility to dispose of shares in the manner they originally anticipated. Translated to the field of company law, this advances the argument that shareholders, deciding in the general meeting, should be primarily authorized to decide whether the takeover offer will be accepted or, alternatively, frustrated by means of defensive tactics.

The position of the management board of the target company seems to be somewhat different. Although it does not take away from directors' standard corporate fiduciary duties,[120] it has been repeatedly suggested that the takeover process may have serious and direct consequences in respect of their immediate behavior. More specifically, legal theory, with its origins in the field of law and economics, makes a persuasive link between corporate takeovers and agency costs by focusing on the market for corporate control and perceived economic values that are to be expected as the result of a successful takeover. Best explained in the words of its founder and one of its most prominent advocates, Professor Manne, "a fundamental premise underlying the market for corporate control is the existence of a high positive correlation between corporate managerial efficiency and the market price of shares of that company".[121] In other words, the fact that the company is inadequately managed inevitably

[117] See Sections 2.2. and 2.3.

[118] For factors that go into the quantification of premium, as well as an extensive analysis relating to premiums in European takeover law, McCahery, J. A.; Renneboog, L.; Ritter, P.; Haller, S.: *The Economics of the Proposed European Takeover Directive*, CEPS Research Report in Finance and Banking, No. 32 2003, pp. 25-42.

[119] See Section 2.4.

[120] See Section 2.3.

[121] Manne, H. G.: *Mergers and the Market for Corporate Control*, Journal of Political Economy, Vol. 73, No. 2 1965, pp. 112, 113. Professor Manne concludes that "the lower the stock price, relative to what it could be with more efficient management, the more attractive the takeover becomes to those who believe that they can manage the company more efficiently". For the sake of clarity, when discussing the issues relating to take over activities, he refers to three distinct mechanisms: proxy fights, direct purchase of shares, and the merger.

reflects on the price of its shares, which in turn makes that company a potential takeover target.[122] To that extent, the acquirer will have the incentive to change the management once it takes over the control of the company, as it will look to make a profit on subsequent appreciation of shares' value (which is expected to take place once the acquired company is managed more efficiently). The next step pertinent to this line of reasoning is that directors of the target company will have a strong motive to oppose the takeover and, if possible, fight against the change of corporate control by employing various defensive measures to disrupt the offer. It follows that those managerial decisions would not necessarily be driven by shareholders' interests, which then by implication means that they would also not be in line with the company's purpose. It is precisely these premises that form the basis of one of the most controversial issues in takeover law – the issue of whether the management board should remain neutral throughout the takeover process. Indeed, if the underlying purpose of a takeover is to create additional value by curing managerial shirking and consequently displacing inefficient directors, then (as a policy argument) one can convincingly argue in favor of the board neutrality rule.[123] At the very least, such a position would be in line with the above-outlined arguments in favor of shareholder decision-making, positioning the general meeting as the instance which has the primary say regarding the employment of defensive measures and consequent acceptance or rejection of a takeover offer.

However, if the application of the board neutrality rule ultimately depends on identifying who gets to decide on defensive measures (shareholders in the general meeting or the management board), it is only appropriate to further explore how and to what extent either of these options influences the shareholder v. stakeholder dilemma which, as previously explained, lies at the heart of the ongoing discussion relating to the purpose of the company.

Before exploring the specific European solutions introduced by the Takeover Directive, it must however be noted that both the problem and perceived solution(s), to a certain extent, rest on a presumption that the authority to decide on defensive measures somehow directly influences the ultimate position of stakeholders. Or to be more specific, the problem is often portrayed as a two-dimen-

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[122] Bainbridge, S. M.: *Mergers and Acquisitions*, Foundation Press, 2021, pp. 43-46; Easterbrook, F. H.; Fischel, D. R.: *The Economic Structure of Corporate Law*, First Harvard University Press, 1996, pp. 171-174; Mukwiri, J.: *The End of History for the Board Neutrality Rule in the EU*, 21 European Business Organization Law Review 2020, pp. 262-266.

[123] Board neutrality rule (sometimes also referred as the non-frustration rule) provides that the management board of the target company must remain neutral during the course of the offer and, unless given prior authorisation by the general meeting, restrain from taking any actions which may end in offer's frustration, thus enabling the shareholders to decide on its merits.

sional scenario in which the management board, once given the authority to decide on defensive measures, will almost inevitably do so by considering the "broader" purpose of the company, which then automatically includes protection of various stakeholders' interests (even if the managerial decision goes to the detriment of financial interests of shareholders).

Namely, the popular criticism of the model where the shareholders' general meeting has the authority to decide on whether the company should oppose a takeover argues that shareholders' motives are primarily financial. In other words, shareholders give precedence to their short-term financial interests, effectively foregoing long-term benefits that successful resistance to takeover may have for the company. In this scenario, the management board is, as a rule, in a better position to comprehensively analyze the benefits and drawbacks of the potential takeover. That is to say, the management board's decision will consider circumstances that shareholders, eager to sell their shares with the premium, will simply not deem relevant. The inherent danger is that, after the successful takeover, the new majority shareholder will look to maximize its profit with no, or very little, concern for stakeholders (primarily employees of the target company).

However, proper analysis of the argument shows that it rests upon an unsubstantiated premise that the purpose of the company, presumably followed by the management board when deciding on defensive measures, must favor stakeholders' interests by automatically making them part of the managerial decision-making process (up to and including the scenario where decisions are possibly taken to the detriment of shareholders' financial benefits). In other words, for this line of reasoning to work – one must embrace the idea that the company is primarily managed in the interest of its stakeholders, i.e. employees, creditors, customers, society at large, etc.[124] The argument thus does nothing in terms of solving the shareholder v. stakeholder dilemma, but only reinforces the above-outlined views advanced by one part of legal theory which argues against the shareholders (and in favor of stakeholders) model. In addition, it ignores convincing economic arguments specific to the position of the management board in takeovers. Namely, it does not address the inherent conflict between shareholders and the management board and ignores that members of the management board may have a motive to actively oppose the takeover on account of their interest to remain part of the company's management. Consequently, the argument does not only assume that the purpose of the company reflects broader stakeholders' interests but at the same time uncritically assumes that members of the management board will not have

[124] For summary of legal theories in support of such a proposition, see: Mukwiri, fn. 122, p. 263, 264.

self-serving interests to oppose takeovers. Unless one tries to argue that the takeover process somehow automatically changes the purpose of the target company (the view which should be rejected *a limine*, as it makes the purpose of the company dependent on the actions of specific shareholder(s), or even worse, third party looking to become majority shareholder), it must be defined within the constraints of national company law. As for the position of the management board of the target company, the text will show that its motives were rightfully addressed throughout the process of drafting the Takeover Directive, indirectly confirming previously analyzed elements pertaining to the purpose of the company.

### *4.2. PRIMACY OF SHAREHOLDER DECISION MAKING*

The primacy of shareholder decision-making, and its rightful role within the context of takeover law, will be analyzed by considering the legislative history of the Takeover Directive (4.2.1.), with special emphasis being given to the Report of the High-Level Group of Company Law Experts (4.2.2.). After analyzing legal arguments voiced during the drafting process, the text outlines specific solutions of the Takeover Directive (4.2.3.).

#### 4.2.1. LEGISLATIVE HISTORY AND MAIN OBSTACLES ON THE ROAD TO HARMONIZATION

In the laborious course of making the Takeover Directive (dating back to 1989 and its first proposal)[125], the board neutrality rule represented one of the main legislative challenges. At the core of the problem were differences between common and civil law legal traditions, accentuated by the fact that the first draft of the Directive followed the blueprint set forth by the London City Code on Takeover and Mergers which contained a set of rules and principles followed in one of the most active capital markets in EU at that time. Not surprisingly, Commission's 1989 draft (officially titled *Proposal for a Thirteenth Council Directive on Company Law concerning takeover and other general bids*)[126] recognized shareholders' primacy by expressly providing in its Preamble that, when joint stock companies are the subject of a takeover or other

[125] For legislative history of the Takeover Directive, see: Edwards, V.: *The Directive on Takeover Bids – Not Worth the Paper It's Written On?*, ECFR, Vol. 1, Issue No. 4 2004, pp. 418-431; Knudsen J. S.: *Is the Single European Market and Illusion? Obstacles to Reform of EU Takeover Regulation*, European Law Journal, Vol. 11, No. 4 2005, pp. 509-514.

[126] Proposal for a Thirteenth Council Directive on Company Law concerning takeover and other general bids, [1989] OJ C64/8; COM (88) 823 final.

general bid, *it is necessary to protect the interests of their shareholders*.[127] In addition, it opted for a solution which, in anticipation of possible hostility towards the takeover offer, provided that the management board must remain neutral unless given prior general meetings' authorization. To that extent, then Art. 8 (*Restriction of the powers of the board of the offeree company*) stated that after receiving the information relating to the offer and until the expiry of the period for accepting the bid, *the board of the offeree company shall not, without the authorization of the general meeting of shareholders, decide: (a) to issue securities carrying voting rights or which may be converted into such securities; (b) to engage in transactions which do not have the character of current operations concluded under normal conditions unless the competent supervisory authority has authorized them, giving its reasons for such authorization*.

Although it is quite clear that, when it comes to activities that may impede the offer, the proposed board neutrality rule gave precedence to the authority of the general meeting (the principle which will, although in a changed form, survive future textual iterations), the draft proposal also addressed the issue of stakeholders, namely employees of the target company. Specifically, the Preamble noted the obligation to inform, stating that, *taking into account the social policy of the Community, it is necessary that representatives of the employees of the offeree company be informed concerning the bid and that they should receive all the documents concerning that bid*. Consequently, the draft proposal provided for the offeror's obligation to draw up an offer document in respect of the offer stating, among other things, *the intentions of the offeror, explicitly expressed, regarding the continuation of the business of the offeree company, including the use of its assets, the composition of its board and its employees*,[128] and for an obligation on behalf of the board of the offeree company to communicate to its workers' representatives offer documents and other appropriate information.[129] Although the Parliament amended and approved the proposal, it was met with general disapproval. Among other things, provisions aimed at protecting employees' rights caused disagreements between Members States.[130]

[127] Preamble of the 1989 Proposal for a Thirteenth Council Directive on Company Law concerning takeover and other general bids.

[128] Art. 10 (1) (l) of the 1989 Proposal for a Thirteenth Council Directive on Company Law concerning takeover and other general bids.

[129] Art. 19 of the 1989 Proposal for a Thirteenth Council Directive on Company Law concerning takeover and other general bids.

[130] For amendments to the first draft and points of discord, Edwards, fn. 125, pp. 419, 420.

In its second 1996 draft proposal,[131] Commission tried to address several issues, primarily by realigning the text so that it would provide a workable framework and enable Member States to implement solutions characteristic to their legal systems.[132] Although the proposal, among its general principles, expressly stated that *the board of an offeree company is to act in the interests of the company as a whole*,[133] it did not substantially change the impact of the board neutrality rule. Quite to the contrary, it reaffirmed shareholders' position by stating that the management board of the offeree company must have a general meeting's prior authorization relating to any actions *which may result in the frustration of the offer, and notably from the issuing of shares which may result in a lasting impediment to the offeror to obtain control over the offeree company*.[134] However, Commission was careful to remove from the proposal's Preamble any mention of employees. Also, it limited their role by merely reiterating that the Member States will ensure that the offeror draws up and make public an offer document containing the information necessary to enable the addressees of the offer to reach a properly informed decision on the offer and that such a document must, among other things, state *the offeror's intentions concerning the future business and undertakings of the offeree company, its employees and its management*.[135] However, surprisingly enough, the issue of stakeholders was again put in the focus only a year later by the way of Parliament's amendments which clearly indicated that the future legislation is to encompass stakeholder protection.[136] In addition to bringing the issue back within

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[131] Proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids, [1996] OJ C 162/5; COM (95) 655.

[132] For criticism of the second 1996 proposal on behalf of UK, Netherlands, Germany, and Sweden; Edwards, fn. 125, p. 421, 422, including detailed references the author quotes.

[133] Art. 5 (1) (c) (*General principles*) of the 1996 Proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids.

[134] Art. 8 (*Obligations of the board of the offeree company*) of the 1996 Proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids underwent modifications inasmuch as it grouped board's obligations. Remodelled provision stated: "Member States shall ensure that rules are in force requiring that: (a) after receiving the information concerning the bid and until the result of the bid is made public, the board of the offeree company should abstain from any action which may result in the frustration of the offer, and notably from the issuing of shares which may result in a lasting impediment to the offeror to obtain control over the offeree company, unless it has the prior authorization of the general meeting of the shareholders given for this purpose; (b) the board of the offeree company shall draw up and make public a document setting out its opinion on the bid together with the reasons on which it is based.".

[135] Art. 6 (2) of the 1996 Proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids.

[136] 1997 Parliament's amendments to the Proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids, [1997] OJ C 222/20.

the Preamble,[137] Parliament proposed an amendment to the general principles. The board of an offeree company was still to act in the interests of the company as a whole, but this time also *included safeguarding jobs*.[138] In addition, Parliament reinstated the obligation of the board of the offeree company to inform the representatives of its employees or, where there are no representatives, employees themselves and to communicate the offer document.[139] Also, the offer document, drawn by the offeror to enable *the addressees of the bid to reach a properly informed decision on the bid*, among other things had to state *the offeror's intentions about the future business and undertakings of the offeree company, its employees and its management including any changes to the terms and conditions of employment and any envisaged dismissals*.[140] In a comparable manner, an obligation to disclose all information or documents (required in order to ensure that they are both readily and promptly available to the addressees of the offer) was amended to include the *representatives of the employees of the offeree company or, where there are no representatives, the employees themselves*.[141] Lastly, the Parliament amended the provision concerning the obligation of the management board of the offeree company to draw up and make public a document setting out its opinion on the bid together with the reasons on which it is based. The new provision provided that before finalizing this document *the board shall consult with representatives of the employees or, where there are no representatives, the employees themselves*.[142] Needless to say, amendments relating to the position of employees were regarded as particularly controversial.[143]

[137] Amendment 2 to Recital 9 of the 1997 Parliament's amendments to the Proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids.

[138] Amendment 11 to Article 5 (1) (c) of the 1997 Parliament's amendments to the Proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids.

[139] Amendment 14 to Article 6 (1) and Amendment 15 to Article 6 (2) of the 1997 Parliament's amendments to the Proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids.

[140] Amendment 16 to Article 6 (3), eight indent of the 1997 Parliament's amendments to the Proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids.

[141] Amendment 19 to Article 7 (2) of the 1997 Parliament's amendments to the Proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids.

[142] Amendment 21 to Article 8 (b) of the 1997 Parliament's amendments to the Proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids.

[143] For additional amendments to the role of employees made on behalf of Mr. Monti, Internal market Commissioner, and in particular his intervention to expand on the general principle requiring target boards to act in the interests of the company in a way which would expressly include the interests of employment, Edwards, fn. 125, p. 423.

After a substantial political compromise, a common position was adopted and the text was sent again to the Parliament.[144] In its second reading, Parliament once more proposed amendments, this time relating to both the board neutrality rule and the position of stakeholders. On German initiative, and with the presumed aim to ensure the level playing field with US takeover legislation, amendment proposed radical changes and opened the door for the management board to take defensive measures without prior authorization from shareholders.[145] And in line with German civil law tradition, it also gave stronger position to stakeholders by providing that the board, now free from the strict neutrality obligation, must (while considering the offer) consider future job availability and obtain employees' agreement prior to the actual acceptance of the offer.[146]

Gravity of the proposed amendments was at once recognized by both the Commission and the Member States. It was clear that the possibility that the board may unilaterally apply defensive measures without prior consultation with shareholders of the target company was unacceptable and would not find its way into the final text of the Directive.[147] Initial compromise which was agreed upon largely served the purpose of keeping the legislative process alive, with the rule on board neutrality remaining unchanged (but with an added option for Member States to postpone its application) and the right of employees to be informed about the effect the offer may have on jobs within the target company.[148] Nevertheless, the fact that the text ultimately failed to obtain a simple majority in the Parliament was a clear (if not ominous) reminder that individual Member States were still far from being ready to fully accept the ramifications of harmonized rules pertaining to takeover. Apart from accentuating the need to have rules which would consider specifics of US takeover regulation, the Parliament expressly noted that its rejection was motivated by the fact that the final text did not provide adequate answers relating to the position of shareholders and their authority to approve the employment of effective defensive measures (most notably, poison pills), which in turn led to the failure

[144] Ibid., pp. 424, 425.

[145] It has been suggested that legislative amendments were sponsored by German representatives in the wake of Germany's first hostile takeover, when UK Vodafone took over German Mannesmann, Ibid., p. 425.

[146] Legislative history suggests that German delegates were under intense pressure from both industry and union representatives, Ibid., pp. 425-427.

[147] For more details on the position of German delegation, Ibid., p. 426.

[148] Member states could postpose application of the board neutrality rule for maximum of one year after the deadline for its implementation, Ibid., p. 426.

to create a level playing field for target companies in the European market.[149] In addition, it stressed the importance of obtaining a future agreement on rules protecting the employees of the target company in a satisfactory manner.[150]

Despite the obvious legislative failure, the Commission continued with its efforts to work on a text of the future directive. The astonishing level of political compromise that followed, which ultimately led to the adoption of the Takeover Directive, goes well beyond the scope of the present paper. The effect of Article 12 Takeover Directive[151] and how optional arrangements undermined the proclaimed aim of integration did not go unnoticed.[152] However, the specifics of the legislative process that followed are indicative of the broader issues that are of utmost importance when analyzing the purpose of the company in European takeovers.

The focus of the following discussion considers the findings of the expert analysis prepared during the legislative process which, although largely undermined by the ensuing political compromise, outlined the key elements that future directive should have had to achieve proclaimed aims of integration. As will be seen from the following text, it not only gave precedence to the model of shareholder decision-making, but also reaffirmed that the interests of stakeholders do not justify specific legal solutions which would enable the management board of the target company to employ defensive measures to the detriment of shareholders' right to dispose of their shares.

### 4.2.2. REPORT OF THE HIGH-LEVEL GROUP OF COMPANY LAW EXPERTS

The decision to consult legal experts was made by the Commission before the last proposal failed to obtain Parliamentary approval, to obtain much needed

[149] Ibid., p. 427.

[150] Ibid.

[151] Art. 12 of the Takeover Directive provides for optional arrangements which give the Member States the right not to require companies to apply either the board neutrality rule from Art. 9 or breakthrough rule from Art. 11. Provision also provides for a reciprocity rule (Art. 12 (3)), which provides that Member States may, under the conditions determined by national law, exempt companies which apply board neutrality and breakthrough rules from applying them if they become the subject of an offer launched by a company which does not apply the same rules as they do, or by a company controlled, directly or indirectly, by the latter.

[152] Gatti, M.: *Optionality Arrangements and Reciprocity in the Takeover Directive*, 5 EBOR 2005, pp. 553-579; Gerner-Beuerle, C; Kershaw, D.; Solinas, M.: *Is the Board Neutrality Rule Trivial? Amnesia About Corporate Law in European Takeover Regulation*, LSE Working Papers 3 2011; Mukwiri, fn. 122, pp. 269-271.

feedback which could serve as a blueprint for future legislative activity. Despite obvious setbacks, Commission thus in 2001 formed a special group of legal experts, the High-Level Group of Company Law Experts, hereinafter: Expert Group) which one year later delivered its Report on issues related to takeover bids (hereinafter: the Report).[153] The fact that the political compromise ultimately led to the adoption of divergent solutions does not take away from the legitimacy of the legal analysis and arguments that Expert Group put forward in its Report.

Expert Group neither had a mandate to address the issue of the purpose of the company nor problems about the position (and potential protection) of stakeholders in takeovers. However, as its mandate did, among other things, encompassed the question of how to ensure the existence of a level playing field in the EU concerning the equal treatment of shareholders across Member States,[154] it was inevitable that both issues would have to be addressed in the Report itself.

Recognizing various obstacles standing in the way of the European integrated capital market, in particular those relating to different legal solutions that are in force in Member States,[155] Expert Group recognized the beneficial effects of mechanisms that facilitate takeover offers.[156] At the same time, however, it recognized the potentially detrimental conflict between the management board and shareholders of a target company, accentuating that takeover law plays an important role in terms of disciplining the management of listed companies.[157] It is along those lines that the principle of shareholder decision-making was recognized as one of two fundamental guiding principles which must be fol-

[153] Winter, J. et al.: The High Level Group of Company Law Experts: *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*, Brussels, 10 January 2002.

[154] Expert Group has been asked to consider the following three issues: (1) how to ensure the existence of a level playing field in the European Union concerning the equal treatment of shareholders across Member States; (2) the definition of the notion of an "equitable price" to be paid to minority shareholders; and (2) the right for a majority shareholder to buy out minority shareholders ("squeeze-out right"). Ibid., p. 70.

[155] Expert Group detected a number of general and company specific barriers standing in the way of achieving the level playing field in European takeover arena, taking into account that its mandate primarily relates to and encompasses company related factors. Ibid., pp. 18-20 and 74.

[156] It however also recognized potential detrimental effects it may have for shareholders of the offeror, placing these kinds of concerns firmly within the realm of general corporate governance principles applying to the offeror and outside of the scope of the Takeover Directive. Ibid., p. 19.

[157] For obvious reasons, Expert Group found this problem to be especially troublesome in listed companies with dispersed ownership. Ibid.

lowed by European takeover law regulation.[158] Expert Group's legal analysis considered the importance of shareholders' primacy on a level that is more substantial than the one encountered in contemporary debates. Departing from vague ethical concepts, it considered essential characteristics of companies whose shares are traded on a stock exchange and the importance of functioning capital markets, concluding that adherence to the principle of shareholder decision-making is crucial for securities markets, the capacity of European industry to finance itself, satisfactory level of investors' protection and overall integration of European securities markets.[159] At the same time, while clearly stating that the management board should not be allowed to either frustrate or facilitate (preferred) takeover offers, Expert Group outlined the role that management should have in takeovers. Namely, it recognized its importance in terms of utilizing its knowledge about the company to advise shareholders, giving them an expert opinion regarding the viability of the offer, and even searching for an alternative offer(s) which would be more beneficial for shareholders.[160] The usual counterarguments (e.g., pressure which is exerted upon shareholders by a takeover offer, presumed management board's ability to raise a premium, and the need to protect stakeholders) were found to be substantially unclear and linked with unacceptable costs and risk.[161] Finally, Expert Group's firm view that the management board should not be allowed to pre-empt shareholders' decisions was underlined by its recognition that the management board indeed has an inherent conflict of interest which must be recognized and properly weighed because it otherwise may lead to a market failure.[162] As clearly stated in the Report, managers' "interest is in saving their jobs and reputation instead of maximizing the value of the company for shareholders"[163], while "their claims to represent the interests of shareholders or other stakeholders are likely to be tainted by self-interest"[164].

Expert Group specifically analyzed the application of the principle of shareholder decision-making in the context of takeovers.[165] By recognizing the particularities of pre-offer and post-offer defenses, it reaffirmed the requirement

[158] The other is the principle of proportionality between risk bearing and control. Ibid., p. 21.

[159] Ibid., p. 23.

[160] Ibid., p. 20.

[161] Ibid., p. 21.

[162] Ibid., p. 22.

[163] Ibid., p. 21.

[164] Ibid.

[165] For the analysis of general application of both the principle of shareholder decision making and principle of proportionality between risk bearing and control, with special emphasis on the duty to disclose, Ibid., pp. 23-26.

that the management board stays neutral after the takeover offer is announced, extending the such obligation to the implementation of decisions that were taken before the announcement of the offer but not yet implemented.[166] Consequently, the management board should obtain prior authorization of the general meeting of shareholders before taking any action, other than seeking alternative bids, which may result in the frustration of the bid and notably before the issuing of shares which may result in a lasting impediment to the offeror's acquiring control of the offeree company.[167] Regarding decisions that were taken before the announcement of the offer, not yet partly or completely implemented, the general meeting of shareholders should be required if such a decision was made outside of the normal course of the company's business and if its implementation may result in the frustration of the bid.[168] Lastly, the importance of shareholder decision-making was underlined in course of the evaluation whether the management board could take actions that would frustrate a takeover offer in situations when a shareholders' general meeting has authorized such actions in a period of eighteen months before the offer.[169] Expert Group rejected such a possibility, highlighting shareholders' need to assess information at the time the offer is made, including general market conditions and the performance of the target company.[170] Their decision on whether the management board may frustrate the takeover offer should take into account all relevant and current information prevalent at the time the offer is announced.[171]

[166] Ibid., p. 27.

[167] The solution was retained in the final text of the Takeover Directive, see Art. 9 (2) Takeover Directive.

[168] The solution was retained in the final text of the Takeover Directive, see Art. 9 (3) Takeover Directive.

[169] This analysis referred to Art. 9 (2) of Takeover Directive Proposal, Annex 6 to the Report (*European Parliament and Council Directive on Company Law Concerning Takeover Bids: Joint Text Approved by the Conciliation Committee on 6 June 2001)*), Ibid., p. 80. It provided for the following solution: "Member States may allow the board of the offeree company to increase the share capital during the period for acceptance of the bid on the condition that prior authorization has been received from the general meeting of shareholders not earlier than 18 months before the beginning of the period of acceptance of the bid, with full recognition of the right of pre-emption of all shareholders as provided for in Article 29(1) of Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (OJ L 26, 30.1.1977, p. 1. Directive as last amended by the 1994 Act of Accession)".

[170] Winter, J. et al., ft. 153, pp. 27, 28.

[171] Consequently, Art. 9 (2) of Takeover Directive Proposal was not included in the final text of Takeover Directive. Compare with Art. 12 (5) Takeover Directive.

Turning back more specifically to the issue of stakeholders, it must be stated that the Expert Group recognized potential detrimental effects that may occur as a result of takeovers.[172] To that extent, it once again successfully bypassed the discussion concerning the viability of direct protection of stakeholders, underlining that the specific position of the management board in takeovers must be resolved precisely because the "discipline of management and reallocation of resources is in the long term in the best interests of all stakeholders, and society at large"[173]. Such indirect protection of stakeholders (in particular of employees of the target company, which are, as already explained, stakeholders who exert limited corporate powers)[174] undeniably recognized overarching company law setting in which management primarily acts as an agent of shareholders.[175] With its roots in economic theory, it served as a convincing background for Expert Group's conclusion that the interest of stakeholders „in itself does not justify defensive measures by the board which denies shareholders the opportunity to successfully tender their shares to a bidder who is willing to buy their shares"[176]. As the proposal, as well as the final text of the Takeover Directive, did provide for an obligation to inform the employees about the takeover process, Expert Group stated that further concerns for employees' interests should be addressed "by specific legislation providing for information and consultation of employees and their protection in the event of a bid leading to restructuring"[177], noting that many Member States already provided for these solutions in their legislation. Consequently, by stating that shareholders' decision to sell their shares "does not affect the legal protections afforded to employees and other stakeholders"[178], Expert Group reaffirmed previously suggested top-down mechanism as not only justified but also a viable method of stakeholders' protection. Finally, and in line with its previous view that the management board must nevertheless be tasked with specific obligations in takeovers,[179] Expert Group stressed its obligation to draw up and make public a document setting out its opinion on the offer, together with the reasons on which it is based, including its views on the effects of implementation on all the interests of the company, including employment, and on the offeror's strategic planning for the offeree company and its likely impact on jobs and locations as

[172] Winter, J. et al., ft. 153, p. 16.

[173] Ibid., p. 19.

[174] See Section 2.2.

[175] Winter, J. et al., ft. 153, p. 19.

[176] Ibid., p. 16.

[177] Ibid.

[178] Ibid., p. 17.

[179] See fn. 160.

set out in the offer document.[180] The board of the offeree company at the same time must communicate this opinion to the representatives of employees or, where there are no such representatives, to the employees themselves. Where a separate opinion of the employees' representatives on the effects of implementation on employment is made available to the board of the offeree company in sufficient time, it must be enclosed.[181] These rules were made to function in cohesion with the offeror's obligation to include in the offer document, among other things, its intentions with regard to the continuation of the business of the offeree company and, so far as affected by the offer, of the offeror company, and regarding the continued employment of their employees and their management, including any material change in the conditions of employment and in particular to the offeror's strategic planning for those companies and the likely impact on jobs and locations.[182]

Lastly, it should be stressed that Expert Group's legal analysis and proposed solutions must not be understood to represent a (political) compromise. After all, Expert Group was not tasked to propose a solution acceptable to (majority of) Member States, but rather because of the impeccable legal qualifications and expertise of its members.[183] In today's discourse where political agendas often aim to gain legitimacy by masking themselves as (more or less) convincing legal arguments, it seems useful to remind oneself that functional legal system primarily rests upon well thought norms, capable of producing desired legal effects once they are fully integrated in the existing legal framework. Ill-conceived and vague legal solutions that do neither follow nor complement legal architecture, which is already in place, will in the long run inevitably

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[180] Pursuant to Article 6 (3) (h) of Takeover Directive Proposal, Annex 6 to the Report (*European Parliament and Council Directive on Company Law Concerning Takeover Bids: Joint Text Approved by the Conciliation Committee on 6 June 2001)*), Winter, J. et al., ft. 153, p. 80, which provided for information which the offeror must include in the offer document. The solution was retained in the final text of the Takeover Directive, see Art. 9 (5) and Art. 6 (3) (i) Takeover Directive.

[181] The solution was retained in the final text of the Takeover Directive, see Art. 9 (5) Takeover Directive.

[182] The solution was retained in the final text of the Takeover Directive, see Art. 6 (3) (i) Takeover Directive.

[183] Members of the Expert Group were: (1) chairman Jaap Winter, Professor at the Erasmus University of Rotterdam and legal advisor Unilever, Netherlands, (2) José Maria Garrido Garcia, Professor at the University of Castilla-La Mancha, Spain, (3) Klaus J. Hopt, Geschäftsführender Direktor Max Planck-Institut, Germany, (4) Jonathan Rickford, Consultant for the Department of Trade and Industry, United Kingdom, (5) Guido Rossi, former President of the Italian stock exchange supervisory body CONSOB, Italy, (6) Jan Christensen, Professor at the University of Copenhagen, Denmark, and (7) Joëlle Simon, Legal Affairs Director, French Business Confederation - MEDEF, France.

prove to be impractical and ultimately harmful. To the extent that legal system reflects politically mandated views, responsibility of legal experts is indeed enormous, as they must (at least in democratic societies) resist the pressure to give legal justification to solutions which do not enjoy political consensus in the first place.

### 4.2.3. TAKEOVER DIRECTIVE

Expert Group's views relating to shareholder decision-making are (with minor modifications) part of the Takeover Directive. Subject to previously mentioned optional arrangements,[184] the board neutrality rule provides that the management board needs to seek shareholders' general meeting authorization before any actions which may frustrate the offer.[185] Although Takeover Directive does sporadically use language which might be considered ambiguous, and thus subject to interpretation, there is little doubt that precedence is given to shareholder decision-making.[186] The diffuse notion of stakeholders is reduced to include only the employees of the target company, and their interests are protected using provisions relating to disclosure and the right to be informed.[187] It

[184] See fn. 151.

[185] Art. 9 Takeover Directive.

[186] Clarke, B. *The EU Takeovers Directive: a shareholder or stakeholder model?*, in: C. A. Williams, C. A.; Zumbansen, P. (eds,), *The Embedded Firm*, Cambridge University Press, 2011, p. 233, 246-248.

[187] More specifically, company's employees or, failing that, employees directly, must be appropriately informed of the terms of the offer by means of an offer document (Point 13 of the Preamble and Art. 6 (1) Takeover Directive), and offeror is thus tasked with making a public document setting out its reasoned opinion of the offer, including its views on the effects of implementation on all the company's interests, and specifically on employment (Point 17 of the Preamble and Art. 6 (2) Takeover Directive). Mentioned offer document must, among other things, state the offeror's intentions with regard to the future business of the offeree company and, in so far as it is affected by the offer, the offeror company and with regard to the safeguarding of the jobs of their employees and management, including any material change in the conditions of employment, and in particular the offeror's strategic plans for the two companies and the likely repercussions on employment and the locations of the companies' places of business (Art. 6 (3) (i) Takeover Directive). Likewise, for the purpose of implementing the Takeover Directive, Member States must ensure compliance with general principle according to which shareholders of target company must have sufficient time and information to enable them to reach a properly informed decision on the offer and, where it advises the holders of securities, the board of the target company must give its views on the effects of implementation of the offer on employment, conditions of employment and locations of the company's places of business (Art. 3 (1) (b) Takeover Directive). Management board of the offeree company must thus both draw up and make public a document setting out its opinion of the offer and the reasons on which it is based, including its views on the effects of its implementation on all the

is thus primarily along those lines that one must interpret both the Preamble and specific provisions of the Takeover Directive. Namely, when Preamble provides that Member States are tasked to coordinate certain safeguards *for the protection of the interests of members and others*, this does not relate to the purpose of the company (as defined by national law) but rather indicates the intended scope of Takeover Directive. Likewise, when Takeover Directive provides that one of its general principles is that the management board of the target company *must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid*, this formulation is not an open invitation to reformulate the purpose of the target company but rather an indication that precedence is given to shareholders decision making, with full recognition that stakeholders' interests must not be uncritically employed to shareholders' detriment. One can thus rightfully expect that the Court of Justice of the European Union, should it ever be asked to interpret whether relevant provisions of the Takeover Directive reflect on the company's purpose, will answer in the negative and uphold the stand that definition of company's purpose is defined by national company law of Member States.

If one considers that board neutrality was perceived to be the rule, and optional arrangements provided for possibility to opt-out of an exception, it follows that Takeover Directive was mainly drafted along the lines of the traditional model which envisages that the purpose of the company aligns with financial interests of its shareholders. However, since the notion of the purpose of the company was not directly addressed by Takeover Directive, but rather left to national law, the scope of the board's decision-making may differ according to the national corporate law setting.

It is obvious that national company law can define the purpose of the company in a manner that relates to various stakeholders' interests. Although, as out-

company's interests and specifically employment, and on the offeror's strategic plans for the offeree company and their likely repercussions on employment and the locations of the company's places of business as set out in the offer document in accordance with Article 6 (3) (i) Takeover directive (Art. 9 (5) Takeover Directive). The board of the offeree company must at the same time communicate that opinion to the representatives of its employees or, where there are no such representatives, to the employees themselves and where the board of the offeree company receives in good time a separate opinion from the representatives of its employees on the effects of the offer on employment, that opinion must be appended to the document (Art. 9 (5) Takeover Directive). National law is deemed applicable to issues of disclosure of information to and the consultation of representatives of the employees of the offeror and the offeree company, and the employees of the companies concerned, or their representatives, must be given an opportunity to state their views on foreseeable effects of the offer on employment (Point 23 of the Preamble and Art. 8 Takeover Directive.

lined above, such an approach raises legitimate concerns (primarily due to the vagueness of the notion of stakeholders and problems which are to be expected once stakeholders' interests are weighed against each other),[188] there should be no doubt that national legislators can opt for such an intervention. If that is the case, and if Member State takes advantage of Art. 12 Takeover Directive optional arrangements, it follows that the management board of the target company can decide on defensive actions without prior authorization of the shareholders' general meeting. However, while deciding on those actions, the management board of the target company would not only be free but also obliged, to decide by considering the purpose of the company, as defined by national company law. However, if Member State excludes the application of the board neutrality rule by virtue of optional arrangements in Art. 12 Takeover Directive, but still defines the company purpose in line with the shareholder model, the management board of the target company would not have the mandate to introduce defensive actions by considering interests of all stakeholders. The previously mentioned general principle according to which the management board "must act in the interests of the company as a whole" would then merely indicate the board's obligation to act by relying on company purpose, as that notion is defined by national company law. Lastly, one could also envision a situation in which national company law defines the purpose of the company in line with the shareholder model, but then directly provides for a stakeholder model in takeover law. Aside from the fact that previous analysis clearly showed that this was not the intended purpose of the Takeover Directive, national courts would have to use two different models as takeover law would appear to have a *lex specialis* effect. However, this option is not expected to be common as it is hard to imagine a convincing setting where national legislator deliberately provides two different definitions of the purpose of the company. As far as European law is concerned, the such scenario would most likely be attributed to a legislative oversight, which in turn highlights the overarching need to fully understand and appreciate the intended scope and meaning of relevant European legislation (here, Takeover Directive) in the process of its implementation in national law.

### *4.3. CROATIAN TAKEOVER LAW*

Various problems relating to the implementation of the Takeover Directive in the Croatian Takeover Act have been recognized in legal theory.[189] Not surpris-

[188] See Section 2.3.

[189] Ivkošić, M.: *Obrana dioničkog društva od neprijateljskog preuzimanja*, doktorska disertacija, Pravni fakultet Sveučilišta u Zagrebu, 2013; Ivkošić, M.: *Pravilo neutralnosti upra-*

ingly, this primarily relates to the application of the board neutrality rule and the national legislator's omission to take advantage of Art. 12 Takeover Directive optional arrangements in order to adjust takeover law mechanisms with its corporate legal framework and capital market characteristics. With strong indications that much-needed overhaul of the Takeover Act will take place,[190] the existing model of board neutrality rule dictates that the management board of the target company must obtain prior authorization of shareholders' general meeting to: (1) increase equity capital, (2) enter into transactions outside the regular business operations of the target company, (3) act in a manner that could seriously threaten further operations of the target company or enter into transactions that could seriously threaten further operations of the target company, (4) decide on the acquisition and disposal of treasury shares of the target company or securities conferring rights to these shares, and (5) act in a manner which might result in an impediment to or frustration of the takeover offer.[191] Additionally, and in line with Takeover Directive, Takeover Act provides for the protection of only one group of stakeholders, the employees of the target company, prescribing appropriate disclosure mechanisms as well as provisions intended to safeguard their right to be informed about the takeover.[192]

Croatian takeover law thus unequivocally gave precedence to shareholder decision-making, aligning itself with not only Takeover Directive's intended purpose but also with specific solutions contained in its national company law. To that extent, one of the general principles which must be respected by takeover participants (both during the takeover process and in terms of exercising their respective rights and obligations) is that management and supervisory board of the target company must, during the takeover process, act in the best interest of the target company.[193] What is in *the best interest of the (target) company* is defined in line with company law (CCA), which in turn furthers the originally

*vljačke structure u hrvatskom pravu preuzimanja*, Zbornik Pravnog fakulteta Sveučilišta u Splitu, Volume 50, Number 5 2013; Ivkošić, M.; Šumanović, I.: *Položaj organa ciljnog društva u postupku preuzimanja*, Pravo u gospodarstvu 5 2020; Jurić, D.; Zubović, A.: *Protupreuzimateljske mjere i položaj uprave ciljnog društva u postupku preuzimanja dioničkog društva*, Zbornik Pravnog fakulteta Sveučilišta u Rijeci, Volume 30, br. 1 2009; Miladin, P.: *Protuponuditeljske mjere prema Nacrtu Zakona o izmjenama i dopunama Zakona o preuzimanju dioničkih društava*, Zbornik Pravnog fakulteta Sveučilišta u Rijeci, Volume 39, br. 3 2018.

[190] Ministry of Finance in 2016 formed Task Group to analyse potential amendments to Takeover Act. Although its work was delayed (especially during COVID pandemic), Task Group is expected to continue with its work and propose number of substantive changes to existing legislation.

[191] Art. 42 (1) Takeover Act.

[192] Art. 11 (2), Art. 22 (1) (15), Art. 41 Takeover Act.

[193] Art. 3 (1) (3) Takeover Act.

envisaged shareholder model. Consequently, both boards must render their respective decisions with the primary aim of furthering shareholders' financial interests which relate to the increase of the company's profits and, by implication, the value of the company's shares. As previously explained, shareholders' interests (defined concerning the purpose of the company) relate to abstract shareholders, i.e. both present and future shareholders of the target company.[194] In other words, company purpose, as defined by CCA and analyzed in the previous text, does not change once the joint stock company becomes the subject of a takeover.

## 5. CONCLUSION

The debate of whether company purpose should be interpreted as to reflect shareholders' or stakeholders' interests can hardly be solved on an abstract level, detached from specific social, historical, and geographical factors that helped shape various national company laws. Although the proponents of each model seem to be sharply opposed, perceived dichotomy will often lead to the same results. Nevertheless, when defining company purpose, one must be careful not to try to extensively interpret the notion by detaching it from the underlying meaning it has in a specific national company law. Leaving aside the ethical undertones, often associated with the stakeholder model, a legal analysis must always be grounded within the boundaries of the national legal framework.

As for Croatian law, the analysis showed that relevant company law provisions provide for the primacy of the shareholder model. Such a conclusion follows from the notion of the company itself as well as several specific CCA provisions pertaining to functions and powers of corporate actors (management board, supervisory board, and general meeting). It is along those lines that the paper further analyzed the notion of shareholders' interest, recognizing its primary long-term financial component which is ultimately reflected through an increase in price of the company's shares which benefits all (existing, as well as future) shareholders. This is not to say that shareholders do not have the authority to depart from the statutory meaning of company purpose. However, should they choose to do so, the proper way would be to insert the specific intended purpose in the articles of association. Without such an intervention, which indicates shareholders' intent that the company is run by taking into account the interests of (preferably well-defined) group of stakeholders, neither management nor the supervisory board of joint stock company have the

[194] See Sections 3.4.

mandate to neglect fundamental statutory elements which define the notion of company purpose.

Company purpose was further analyzed in reference to the Croatian takeover law. As Croatian Takeover Act was modeled upon Takeover Directive, the analysis took into account a variety of legal arguments put forward in the drafting process preceding its adoption. Although the company purpose *per se* was not in the drafters' focus, the particularities of takeovers indirectly reflected on the notion, primarily by recognition of the specific position of management boards of target companies. Although the question of the authority to decide on defensive measures (and whether it should lie with shareholders' general meeting or the management board), most likely, influenced the ensuing debate which encompasses the need to protect stakeholders' interests, the analysis showed that there is no legal justification for an overly extensive interpretation which would ultimately go against shareholders right to either accept or reject the takeover offer. In addition, Takeover Directive recognized only one group of stakeholders (employees) and appropriately afforded them protection using disclosure mechanisms and the right to be properly informed about the takeover offer. Other issues were left to be dealt with within the framework of national law. Croatian Takeover Act consistently followed the solutions of the Takeover Directive and also reflects primacy of the model of shareholder decision-making. The notion of company purpose must be afforded the meaning it has in CCA, and neither Takeover Directive, nor Takeover Act, can be used to later change (much less broaden) it.

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