CHAPTER 1

COMPARATIVE CORPORATE LAW: THE BUILDING BLOCKS

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WHY STUDY COMPARATIVE CORPORATE LAW?

The question mark at the end of the title of this section should probably not be there. The reasons to learn about comparative corporate law should be self-evident, and they are both practical and theoretical.

On the one hand, there are practical reasons. "Globalization," to employ an abused term, has blurred national boundaries: international commerce, multinational corporations, cross-border transactions are growing and dominate the economy. In this scenario, most lawyers, businesspeople, economists, judges, regulators, and legislatures deal regularly with corporate activity that has an international dimension. Unfortunately, both in the U.S. and in other countries, there is still a lot of ignorance of foreign legal systems. This is partially due to the traditional "local" and "domestic" dimension of most legal professions. If on the one hand it is essential for jurists to know their own systems like the back of their hand, we can no longer afford to ignore at least the basics of corporate law in different legal systems. Of course none can be an expert in corporate law in all legal systems, and when dealing with complex transactions or litigation, local legal counsels are not only legally and ethically required, but also necessary as a matter of fact. Legal scholars, lawyers, executives, judges, policy makers, should however be able to interact intelligently with their foreign counterparties, to understand what the key issues are, and to be able to ask the important questions. The goal of this book is to offer a general framework and some specific technical insights about different corporate law systems that should help you, when facing an international problem, to understand where the "red flags" could be. We will explain and discuss specific rules and approaches in a quite technical and detailed fashion, also putting them in their economic and socio-political context, but most importantly we will try to offer a methodology, a way of looking at business problems that should enrich your ability to operate internationally. Imagine you are negotiating an international merger, litigating a case involving directors' liability in a multinational corporate group setting, sitting on

the board of directors of a foreign corporation, drafting new legislation in the area of takeovers: familiarity with different legal systems can certainly make you more effective.

This book and a comparative corporate law course have however also theoretical and pedagogical goals. To study different legal systems, to understand why they regulate similar economic phenomena differently, and to question the rationale of precedents and of statutory and regulatory provisions from different jurisdictions, are unique ways to both understand better your own system, and to think "out of the box" and not take anything for granted. It expands your "mental library" of cases and rules that might be useful to think creatively or advocate more effectively. A Japanese case, for example, might offer you an idea if you are involved in regulatory reform in Mexico; a provision of the German Corporation Law might suggest to you how to frame an argument in a trial in the U.S.; an insight of a French scholar might be useful to lobby for legal reform in Singapore, and so on.

Interestingly enough, if you think about it, even in the basic course on Corporations there is almost always an element of comparative law. This is for sure the case in the United States: corporate law is regulated by the states, and only partially by the federal government, with the consequence that there are 50 different corporate law systems. Of course the differences among them are not extremely profound, also because several states follow the Model Business Corporation Act, and of course there are some particularly important jurisdictions, such as Delaware, New York, and California on which often the course focuses. But some differences exist and when you study corporate law in the U.S. (as well as with many other courses) you are, in a way, already engaging in a comparative exercise. Similarly, in the European Union, corporate law is regulated at the state level, but it has been partially harmonized through several European directives. In addition, regulatory competition and imitation determine the circulation of legal rules and models also in Europe. It is inevitable also in these systems to consider, at least occasionally, foreign law. This book expands this approach giving it an even more global dimension.

Some scholars have in fact argued that comparative corporate law should be included also in any basic corporate law course. It can be discussed if this is desirable, or if it is preferable to dedicate an upper-division course to comparative corporate law, but the reasons they offer contribute to clarify the relevance of comparative corporate law for anyone dealing professionally with business law issues, as you can gather from the following excerpt.

LAWRENCE A. CUNNINGHAM, COMPARATIVE CORPORATE GOVERNANCE AND PEDAGOGY

34 Ga. L. Rev. 721 (2000)[1]

"Comparative corporate governance" [. . .] is the collection of mechanisms in use in selected parts of the world to regulate those in control of business organizations, with attention to the origins and durability of the differences between countries or regions. The United States is commonly compared to countries such as the United Kingdom and those in continental Europe, in Asia (chiefly Japan), and to a lesser extent Australia, Canada, Israel and South Africa.

Comparisons of these models typically emphasize their finance characteristics. In the United States and the United Kingdom, capital traditionally has been supplied by debt financing offered by banks and other financial institutions while equity financing is offered by public investors in organized stock markets and private placements (characteristics that may be changing). In Germany and other European nations capital historically has tended to be supplied by banking institutions that offer both debt and equity financing for their industrial clients. Ownership of industrial companies therefore tended to be fragmented in Anglo-Saxon countries and concentrated on the Continent.

Corporate governance regimes in these countries differed substantially as a result of this relative fragmentation or concentration, at least in the abstract. United States and United Kingdom managers were to focus on the shareholder interest according to a complex system of checks and balances intended to compel them to put shareholders first. German and other European corporations were to operate not by putting shareholders first but by commanding corporate boards and managers to operate the firm in the best interests of all its constituencies.

The traditional Japanese model is different yet again, with the system of lifetime employment and interlocking corporate ownership (*keiretsu*) contrasted to the Anglo-Saxon tradition of employment-at-will and the United States aversion to concentrations of power (which also may be waning). The list of potential comparative countries is increasing as privatization breaks out the world over, and could go on to include countries in economic and political transition such as former republics of the Soviet Union, former members of the Soviet Union's Council for Mutual Economic Assistance (COMECON), and former republics of Yugoslavia.

As these transitions go forward, new variations on governance approaches are emerging, often blending aspects of the models usually treated as polar. Those polar models may also be seen to be converging

[1] Footnotes omitted.

with one another as transnational corporations increasingly dominate global capital, labor and product markets. Indeed, one of the most important recent corners of corporate-law scholarship has been the question of such convergence and the challenge it seems to pose to the abstract conception of modular polarity.

[. . .]

An assessment of the benefits of introducing comparative corporate governance in the basic course calls for making at least some general assumptions about what the course is intended to accomplish. Apart from the objectives associated with most law school classes—training in case law analysis, statutory interpretation, argumentation, advocacy, analogical reasoning, critical thinking, and so on—the basic course in business organizations probably is supposed to give students a firm but broad understanding of the corporation and its organizational cognates in their legal, business, political, and social contexts.

The basic course should equip the student to function in professional settings where business law (corporate and otherwise) and business issues arise, which in turn means the course should give the student a sense of business and of the special and unusual role the business lawyer plays as business advisor rather than—or at least in addition to—that of advocate or litigator (the model associated with most typical law school subjects). Ultimately, the course is a vehicle for conveying the basics of corporate and related law by helping students understand that law from theoretical, normative, possibly political, and certainly practical perspectives.

So how, if at all, would including comparative corporate governance in the basic course advance these broad and general objectives? Unexceptionally, the basics of business organization law in the United States can best be taught by covering United States law. But part of that exercise is often at least a comparison of the ways different states deal with similar issues, or between how, say, Delaware or New York and the Revised Model Business Corporations Act (R.M.B.C.A) deal with those subjects, as well as some understanding of the relationship between state business organization law and various federal laws, particularly the securities laws. Common questions in such an inquiry are why these states have adopted different laws, whether one or the other is better, and ultimately how the variations reflect (and how the federal presence bears) on the competition among states for attracting business organizations and how that competition bears on bedrock principles like the internal affairs doctrine.

[. . .]

Introducing a comparative perspective could shed light on such questions and equip the students with a greater range of examples and

alternatives to inform the kinds of argument necessary to sustain one view against the other. Understanding managers as the central actors in the course, it is always important to convey their role and their power in relationships with shareholders, markets, and government officials, which can vary substantially across 728 geographic borders. The variance from a global perspective can furnish a very powerful basis for argument.
[. . .]

These sorts of questions can be elevated to a more political or perhaps geopolitical or policy level as well. There is a tendency of policymakers around the world to look elsewhere for answers when internal problems arise, whether intractable or otherwise. The United States tended to look toward Japan in the 1980s for lessons about how to recover from its economic malaise. Then Japan looked to the United States in the 1990s as the situations of these economic powers reversed. A similar back-and-forth has gone on for many years between the United Kingdom on the one hand and much of the rest of Europe on the other.

[. . .]

For the practical minded, as so many students in the basic course are (and teachers should be and mostly are), globalization must be considered in deciding whether and, if so, to what extent to introduce comparative corporate governance in the basic course. Merger activity is increasingly global in scale and scope, with 1998 marking the largest number of cross-border deals and involving the largest dollar amount of transactions ever, on the heels of the second largest year ever in 1997. Nearly one-fourth of all deals involving United States companies in 1998 also involved some cross-border element, including such mega-deals as the merger of Chrysler with Germany's Daimler and of Amoco with Britain's British Petroleum.

This increasing global activity means many more students are likely to encounter businesses organized outside the United States during the early stages of their professional careers.

[. . .]

Other benefits can accrue from introducing comparative corporate governance in special circumstances, such as where students from around the world are in the class [. . .]. This presence could further enrich classroom discussion of comparative issues. Contrariwise, it may be even more important for students at schools that are more homogenous to get exposure to the international arena through some treatment of comparative corporate governance.

[. . .]

[There is] the common problem of finding suitable materials. No corporate law casebooks I have reviewed treat comparative corporate

governance as a topic. In addition, there are few cases specifically raising questions of comparative corporate governance.

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We hope, with this book, to have at least partially answered this last concern of Professor Cunningham.

What exactly, however, is comparative corporate law, and how does it affect, or is affected by, lawyers, courts, legislatures, and legal scholars? The following excerpt by Klaus J. Hopt, one of the leading comparative corporate law scholars of our times, offers some interesting ideas, also from an historical perspective.

KLAUS J. HOPT, COMPARATIVE COMPANY LAW IN THE OXFORD HANDBOOK OF COMPARATIVE LAW

(Mathias Reimann & Reinhard Zimmermann, eds.), Oxford, 2006, 1161 ff[2]

Comparative company law is at once very old and very modern. It is very old because ever since companies and company laws first existed, trade has not stopped at the frontiers of countries and states. The persons concerned, practitioners as well as rule-makers, had to look beyond their own city, country, rules, and laws. This became even more true after the rise of the public company and the early company acts in the first half of the nineteenth century. Ever since, company lawmakers have profited from comparison.

But comparative company law is also very modern. Most comparative work has focused on the main areas of private law, such as contract and torts, rather than company law. While the law of business and private organizations was covered in voluminous *International Encyclopedia of Comparative Law,* and national company law books and articles occasionally also provided some comparative information, an internationally acknowledged standard treatise on comparative company law has not yet emerged. Company law and comparative company law work remained a task for professionals. The few academics who joined in this work tended also to be practitioners such as outside counsel, arbitrators, or advisers to legislators, who were less interested in theory and doctrine.

[. . .]

Looking across the Border in Company Law: Legislators, Lawyers, Academics, Judges

[2] Footnotes omitted.

(a) *Legislators*

One important aim of comparative law is the mutual understanding of other people and nations. But this serves not only altruistic purposes. Comparative law has always been considered to be an enrichment of the 'stock of legal solutions' and a wealth of actual experience. Some speak of an *école de verité*, some even of real 'social science experiments'. The legislators in the nineteenth and early twentieth centuries were already demonstrating this when they prepared their company law statutes on the basis of thorough comparisons of the laws and experiences of other countries. The major company law codifications in the second half of the nineteenth century, when European countries moved away from the state concession system, testify to this. Before the German Company Act of 1937 was drafted, many preparatory comparative law opinions were commissioned from the Kaiser Wilhelm Institute in Berlin, the predecessor of today's Max Planck Institute in Hamburg. One of the most impressive opinions dealing with American and English company law was written by Walter Hallstein, who later became president of the European Commission, while he was still an assistant at the Institute in Berlin and *Referendar* (legal trainee) at the Berlin Court of Appeals, the *Kammergericht*.

In the United States, where company law is state law, the use of comparative company law by the legislator is common in so far as one state will take into account the company laws of other American states when reforming its own company law. Delaware has taken the lead since it became, and remains, the major incorporation state for American companies. The competition of state company legislators is a well-known and, until recently, largely indisputable phenomenon. Yet its interpretation as a 'race to the bottom' or a 'race to the top' is highly controversial, and the precise reasons for Delaware's leading position—be it its company law, or rather its company lawyers and specialized courts—remain disputed.

Merely learning from foreign company laws is one thing. More or less adopting them either voluntarily or under moral suasion or even pressure is another. Japan is one of many examples. China is another, although its position is different in important respects. Most recently the same can be seen in many of the Middle and Eastern European countries which, following the collapse of the Soviet Union, reformed or are reforming their company laws with the aim, sooner or later, of joining the European Union. In this context it is also important to mention the American Influence on these countries, particularly strategic ones such as Russia and certain former states of the Soviet Union, which is sometimes secured with the help of financial promises. The Japanese company law of 1893 (*Kyû-shôhô*) was based to a significant extent on a draft by the German scholar Carl Friedrich Hermann Roesler, and combined elements of the

French *Code de commerce* (mainly as to its form) and of the German *Allgemeines Deutsches Handelsgesetzbuch* of 1861 (concerning many substantive principles). The later company law of 1899 (*Shôhô*) was close to the German company law revision of 1870 in its revised form of 1884, and the revised *Shôhô* of 1938 was closely modelled on the German Stock Corporation Act of 1937. After World War II, Japanese company law reform closely followed the United States company law principles, in particular the Illinois Business Corporation Act of 1933. This was because the relevant American official of the Supreme Commander for the Allied Powers (SCAP) happened to come from Chicago. Such historical coincidences happen more often than is generally known, and this is also true in company law. Modern Japanese company law reform, some of which is being carried out at present, is based on extensive comparison of both United States' and European company laws.

Most recently there has been renewed interest in comparative company law, partly because of the emergence of European company law and partly because the corporate governance movement has sharpened the sense of competition with other countries. The German ministries of justice and finance, for example, have commissioned several comparative law studies from, amongst others, the Max Planck Institute when preparing their reform on highly controversial questions such as whether to make directors liable to investors for untrue or misleading financial statements.

(b) *Lawyers and Legal Counsel*

The role of lawyers and legal counsel in comparative law is traditionally underrated, since they do their work for their clients and enterprises on a day-to-day basis. Yet they are the real experts in both conflict of company laws and of foreign company laws. This is even more true now that the forces of globalization have also reached law firms, with the consequence that the top layer of firms in all major countries has become international either by merger or by cooperation. Occasionally some of their comparative work is published, often only in the form of practical advice, but sometimes also with fully legitimate academic claims. The creation of companies abroad and their subsequent control is common practice today. Working out the best company and tax law structures for international mergers, and forming and doing legal work for groups and tax haven operations, is a high, creative art.

Much more in the public eye is the comparative company law work of the American Law Institute, aimed at drafting uniform company laws and model codes. Notable results are the Principles of Corporate Governance: Analysis and Recommendations of 1992 (2 vols., 1994) and the Federal Securities Code of 1978 (2 vols., 1980).

(c) *Academia*

As stated above, traditionally only a few have engaged in comparative company law work. In all industrialized countries with well-developed companies there are, of course, standard company law treatises, many of them highly knowledgeable and some at the peak of traditional doctrinal wisdom. Yet, what is conspicuous about most of these leading texts is their restriction to national law and practice. This is certainly the impression for Germany, France, and the United Kingdom, but also for smaller countries where looking beyond their borders has always been more natural, such as Switzerland. Exceptions seem to prove the rule, but even they are usually confined to areas such as conflict of company laws, that is, national law, and, more recently, to European Community company law, or to the occasional use in a general text of foreign literature and comparative observations. Comparative company law work is rarely addressed in these leading texts as a prerequisite of European company law harmonization or to provide a better understanding, and to aid the development, of one's own national company law.

Of course, the state of comparative company law is different as far as more specialized monographs and articles are concerned. It is impossible here to go into detail; it would not only be futile, but also unjust to the many works which could not be mentioned. Some more general observations must suffice. First, of course, there is much comparative company law work in the context of conflict of laws and, more recently, of European company law. As to the latter, there were initially quite influential collections of texts on European company law, which included comments and some case law. Since then impressive treatises on European company law have been developed in most member states.

Second, in many countries American company law has had a considerable influence on legal literature. This is not surprising for those countries mentioned above where American company law and securities regulation was broadly followed. But similar trends can be discerned, for example, in Germany after World War II, where contacts with German émigrés were rekindled and whole generations of young academics studied in the United States and wrote their doctoral theses and their *Habilitationen* on comparative American and German company law. Some of these works happened to stand at the beginning of the development of whole new areas in their respective national laws. At a later stage there were even treatises and handbooks on American company law written by non-Americans in German and other languages, which provided much insight into its peculiarities.

Third, the influence of international networks has been important for comparative company law. Some examples of organized efforts include

International Encyclopedia of Comparative Law, the work of international institutions such as the International Faculty of Corporate Law and Securities Regulation and the International Academy of Comparative Law, or the research which was facilitated by international institutions such as the European University Institute in Florence, where comparative work on groups of companies, corporate governance, directors' liabilities, and the harmonization of companies was done and the so-called green book series was started. Other such networks resulted from private initiatives, for example between the United States, Germany, and Switzerland; Germany and Belgium, Italy and the United States, or within Scandinavia.

Fourth, the law and economics movement in the United States and abroad led to a new and increased interest in comparative company law. This will be dealt with in more detail below.

Fifth, this new interest in comparative company law was not only permanently covered by a few national company law reviews such as the German *Zeitschrift für Unternehmens-und Gesellschaftsrecht* (ZGR), the Italian *Rivista della Società*, and to a certain degree also the French *Revue des Sociétés*, but a number of new specialized law reviews appeared on the market such as the English *International and Comparative Corporate Law Journal* (ICCJ), that seemed for a while to have made way for the *Journal of Corporate Law Studies* (JCLS), the Dutch *European Business Organization Law Review* (EBOR), the German, and in the meantime internationally based, *European Company and Financial Law Review* (ECFR), and the *European Company Law* (ECL), published jointly by the Universities of Leiden, Utrecht, and Maastricht.

In view of the golden age of the elaboration of common principles of law such as the UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law, it is astonishing that similarly successful work has not yet been undertaken in the area of company law.

(d) *Courts*

In nearly all countries it is the courts which have been particularly reluctant to look to comparative company law. There are some obvious exceptions. It is clear that United States' court decisions on company law do not only deal with the company law of the respective state, but also with precedents of other states of the Union. The same was and still is true, though to a much lesser degree, within the former Commonwealth. Apart from these instances, it is the courts of smaller countries such as Switzerland which are more likely to take foreign decisions into consideration. This is because the academics and lawyers in such countries are generally more open to looking to the wealth of experience in their larger neighboring states. But even then the fact that they look

abroad rarely results in the actual citation of foreign company law in court decisions themselves. One reason for this may be the traditional theory in Continental Europe that judges simply 'find the law' as enacted by the legislature. This, of course, is not true, as is shown very clearly by many cases decided by the Second Senate of the German Federal Supreme Court, which is responsible for disputes in company law.

A similar observation can be made for the European Court of Justice. Ninon Colneric, the German Justice on that Court, remarked recently that comparative law plays a much higher role in the decision-making of the Court than one might assume from reading its decisions. The fact that the Court does not cite literature does not mean that it does not take legal literature into consideration. Quite the contrary is true: sometimes even special research notes on the treatment of a legal question in the member states are commissioned by the Court. Of course, the European Court of Justice is special due to its nature and jurisdiction; it needs to consider not only the law of the member state concerned in a specific case, but more broadly the acceptability of its decision in all member states.

While company law has long been the domain of national courts in the EU, this is no longer true. The European Court of Justice has rendered quite a number of important decisions in the fields of company law and accounting. For a long time, national courts were rather reluctant to refer questions concerning harmonized company law and accounting to the European Court of Justice. In the meantime, however, the relationship between the judiciaries has become more relaxed. Most recently, one of the landmark cases in company law and conflict of company laws was the *Centros* decision of the European Court. Combined with the decisions in the subsequent cases of *Überseering* and *Inspire Art*, this marked an end, at least within the European Union, to the seat theory that had been so dear to German lawyers for so long. These cases allow free incorporation in any of the EU member states, which has binding effects in all member states under the incorporation theory.

In concluding this section, it should be mentioned that, according to some observers, the real impetus toward comparative company law is provided by the forces of financial and other markets, with their scandals; the needs of these markets do not stop at national frontiers. Although true to a considerable extent, this is not the whole story. Comparative company law is conceived, practiced, and reformed by persons such as those dealt with in this section. Their actions and reactions depend on many influences, not only on market forces. Yet the observation that company law reforms, like many others, are driven by scandals (and therefore often come too late and overreact) can be verified throughout the history of company law and investor protection, and was seen most recently in the Enron scandal and the shock waves which it sent through company law in the United States and abroad.

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Professor Hopt's analysis explains the relevance of comparative corporate law for legislatures, academics, lawyers, and courts. Let's however make this discussion even more concrete, especially with respect to courts. Does comparative corporate (and more general business) law have any specific relevance in court? In addition to situations in which courts are required to apply the laws of a different jurisdiction, in which obviously they are forced to understand foreign law, do courts look abroad for guidance? Do foreign precedents have some persuasive value?

In an interesting recent article, Martin Gelter and Mathias Siems (*Citations to Foreign Courts—Illegitimate and Superfluous, or Unavoidable? Evidence from Europe*, 62 AM. J. COMP. L. 35 (2014)), have conducted an empirical research on the use of foreign precedents by courts. As they note in the introduction (citations omitted):

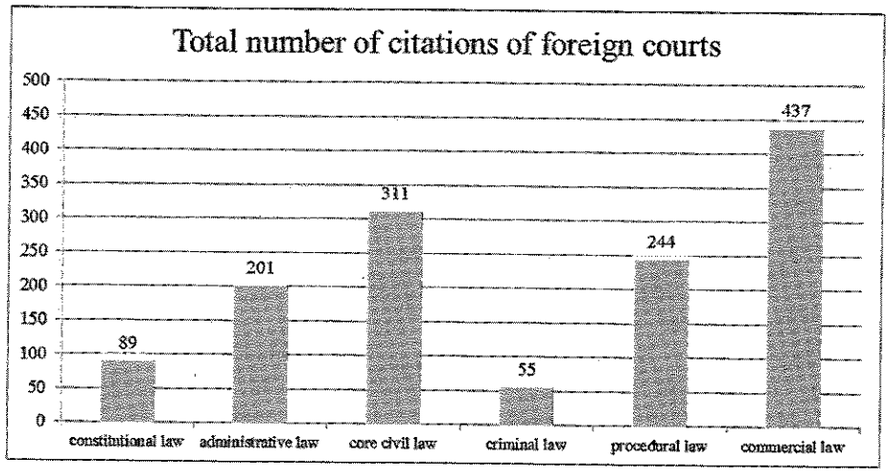
> In the United States it is highly controversial whether courts should be allowed, or even encouraged, to refer to precedents from foreign courts. This is not a purely academic debate. The U.S. Supreme Court itself is divided on whether it is legitimate to consider foreign law in the interpretation of the U.S. Constitution, and the occasional reference to foreign sources by some judges has been the subject of congressional hearings and debates in the Blogosphere as well as in legal scholarship. Justice Kennedy has actually been called "the most dangerous man in America," inter alia, because of his endorsement of citations of foreign cases. In addition, the state of Oklahoma attracted considerable attention by explicitly prohibiting state courts from looking "to the legal precepts of other nations or cultures" specifically mentioning international law and Sharia Law; other states have passed or are debating measures with similar intentions.
>
> In Europe, the discussion about the desirability of cross-citations is less politically contentious. A possible explanation could be that due to E.U. law (as well as the European Convention on Human Rights) it may just be natural for national courts to consider the case law of other member states. But the European Union is not (yet) akin to a federal state. A study comparing the European Union with twenty federal states found that the former provides significantly less legal uniformity than the latter. Thus, for topics largely uninfluenced by E.U. law it may be a bit questionable if, say, an English court cited a Spanish one. Such reluctance may be related to the diversity of European countries in terms of legal traditions, languages and cultures. Europe thus makes an interesting testing ground for assessing the frequency and desirability of cross-citations.

Considering a large number of cases decided by the Supreme Courts of different European countries between 2000 and 2007, the data they collected and studied offer important insights. Consider, for example, the following table (elaboration from Gelter & Siems (2014), 48):

citing court	cited court										total
	Austria	Belgium	England	France	Germany	Ireland	Italy	Netherlands	Spain	Switzerland	
Austria	-	0	1	4	447	0	3	0	0	21	476
Belgium	0	-	0	37	6	0	0	6	0	1	50
England	2	1	-	9	10	7	0	6	2	0	37
France	0	2	0	-	3	0	1	1	0	1	7
Germany	34	0	1	2	-	0	1	1	0	2	41
Ireland	0	1	228	2	0	-	0	2	0	0	233
Italy	0	2	0	2	3	0	-	0	0	0	7
Netherlands	2	13	5	9	54	0	1	-	0	6	90
Spain	0	1	0	1	14	0	0	0	-	0	16
Switzerland	3	0	2	11	42	0	0	1	0	-	59
total	41	20	237	77	579	7	6	16	2	31	1016

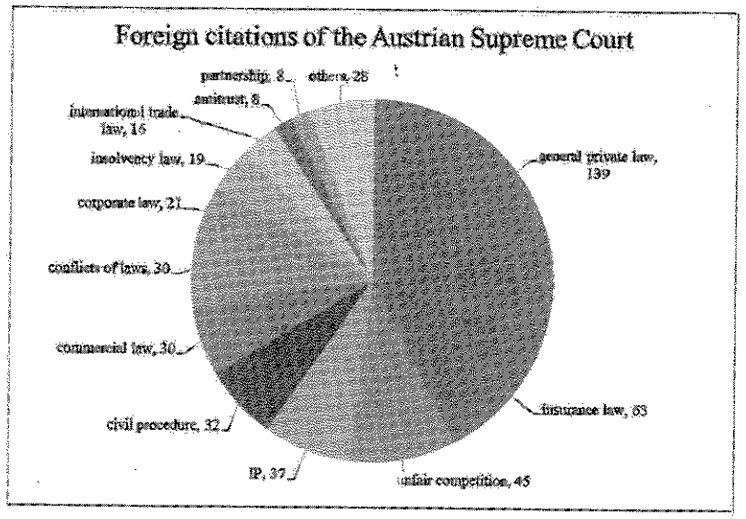
The most cited courts appear to be the ones of Germany, followed by England, even if this data is strongly inflated by the high number of citations from one single neighboring country, Ireland. The courts that seem to be more outward looking, at least in terms of citations of foreign judgments, are Austria (which not surprisingly very often cites German precedents), Ireland (but once again, looking almost exclusively at England), and the Netherlands. There are interesting paths that can be observed. For example, smaller countries, which have a relatively lower number of cases, consider foreign jurisprudence relatively often: this is the case of Switzerland, which often cites German or French precedents (also in the light of the legal, cultural, and linguistic commonalities), and Belgium, which often cites French, German, and Dutch precedents. The Italian and the French Supreme Courts are quite inward looking, by comparison.

An interesting fact also concerns the legal areas more often cited when courts look abroad. The following graphs, again an elaboration on Gelter & Siems (2014), 61–62, illustrate this point with respect to the same countries and courts considered previously from 2000 to 2007.



Of course, as the authors mention, these data are sometimes difficult to collect because often citations concern different fields, but it is undisputed that the greatest number of foreign citations are in the area of commercial law, which includes corporate law. This is not surprising in the light of the international nature of business activity, but it confirms the practical and theoretical importance of comparative corporate law. Interestingly enough, also in fields traditionally considered less open to the international debate, such as criminal law, administrative law, and procedural law, judges need or want to take a comparative perspective.

Gelter & Siems (2014) also offer a further breakdown of citations of foreign cases by sub-fields of law: consider for example the following data concerning the Austrian Supreme Court.



Talking about the use by courts of foreign sources, we must mention one interesting but bizzare experiment in legal history. The 1769 Portuguese *Lei da Boa Razão* prohibited the (then common) use of Roman law sources to resolve commercial disputes. This statute, however, indicated that Portuguese courts, when applicable national rules could not be identified, had to apply the laws of other "enlightened and polished Christian nations" (interestingly enough, a commentator in the XIX interpreted the reference as including all other European countries, but not Turkey). In other words, courts were obliged to engage in a comparative analysis, and apply foreign law. Contradicting the *nomen omen* adage, the statute led quickly to irrational, contradictory and arbitrary results. It was unclear which systems would be relevant, which rules should be selected, and it was obviously impracticable for Portuguese and Brazilian judges, lawyers and parties to understand and apply foreign law. This approach was abandoned both in Portugual and in Brazil, but not before several decades. None suggests replicating this bizzare experiment, but we wanted to mention it because it is very telling about the possible role of comparative law. It also confirms that, as we observed beforehand not surprisingly, smaller countries with a limited number of cases tend to be more outward looking than bigger systems. For more on the Portuguese experiment and generally on the history of corporate law reforms in Brazil *see* Mariana Pargendler, *Politics in the Origins: The Making of Corporate Law in Nineteenth-Century Brazil*, 60 AM. J. COMP. L. 805, 815 (2012).

Another interesting and more recent example of courts of one country relying or at least attentively considering decisions and scholarship of another system is offered by Israel, whose judges often take into account U.S. and specifically Delaware law. This is probably due to both the extensive cultural connections between the two jurisdictions, in light of the significant number of Israeli jurists studying and teaching in the U.S., and the economic relationships between the two countries. Whether this consideration for U.S. law is always correct and desirable is debated: for a discussion focused on how Israeli courts have used the notion of "good faith" in corporate law, *see* Itai Fiegenbaum & Jana Rabinovich, *Lost in Translation: "Good Faith" in Israeli and Delaware Corporate Law*, in Festchrift for Prof. Joseph Gross (A, Barak, Y. Zamir, D. Libai, eds., forthcoming in 2015 in Hebrew).

COMPARATIVE CORPORATE LAW AND LEGAL FAMILIES; CONVERGENCE OF CORPORATE LAW AND THE (QUESTIONABLE) SEARCH FOR THE "BEST SYSTEM"

Many of you reading this book might already be familiar with comparative law generally. You might have taken a general course on comparative law, or other courses that (often) include a comparative element, such as European Union law, International Business Transactions, and the like. Also in purely domestic law courses your instructors might have exposed you to comparative law aspects. It is nonetheless useful to say a few words on legal families, for at least three reasons: to familiarize the ones that have no background in comparative law with the field; to clarify some of the methodological perspectives shared by the authors of this book; and to discuss some specific general issues on comparative corporate law and some economic data concerning different countries. We believe this discussion will provide insights that will be useful throughout the course.

The human mind needs to organize and systematize information, even at the cost of some simplifications. In comparative law, one of the most important systematizations aggregates legal systems in different legal families based on shared features. Of course one of the basic distinctions is between common law countries (generally, the U.K., the U.S., Australia, New Zealand, and other former British colonies) and civil law countries; civil law systems are also generally divided into French civil law traditions and German civil law traditions (some comparativists distinguish a "Roman" and a "Germanic" tradition). Several other important legal families exist that cannot be easily accommodated in the common law/civil law distinction: examples are Scandinavian systems (Denmark, Finland, Norway, and Sweden), Socialist or "non-market" economies (the relevance of this group is fading for obvious reasons), and also Asian systems have distinctive features. In Africa and other parts of the world, together with the legacy of colonialism, traditional or tribal legal traditions are important, especially in certain areas such as family law. And of course non-secular legal systems also exist or co-exist with secular ones: in Arabic and Muslim countries Sharia is extremely relevant. There are also systems that, according to some scholars and practitioners, must be considered "mixed" jurisdictions that present elements of both common law and civil law, such as Louisiana in the United States and Scotland. Another fascinating example is Israel, a common law country partially based on British common law, in which however there are profound influences from civil law countries such as Germany, Ottoman law had a meaningful impact, and religious norms govern some aspects of family law. More recently U.S. law has also had a

major role in shaping Israeli corporate law and securities regulation, and also on legal scholarship in these areas in light of the extensive relationships between Israeli and American law schools.

Focusing on the divide between common law and civil law, the distinctive features are often identified in the sources of the law, the model of legal education, and the approach to legal thinking. More concretely, differences often pointed out, and too well known to be here examined analytically, are the fact that in common law systems judicial precedents are particularly important and often technically binding, and that common law countries did not experience the codification of their private law in the eighteenth and nineteenth centuries; in civil law systems, on the other hand, statutory law seems to be more relevant than case law, precedents are not binding, and codification played and plays a crucial role in the development of the legal system. The role of the jury in common law systems is also often mentioned as a basic difference with civil law systems, as well as the way in which judges and justices are appointed (generally, elected in some kind of political fashion in common law, and selected through a purely technical exam in civil law countries).

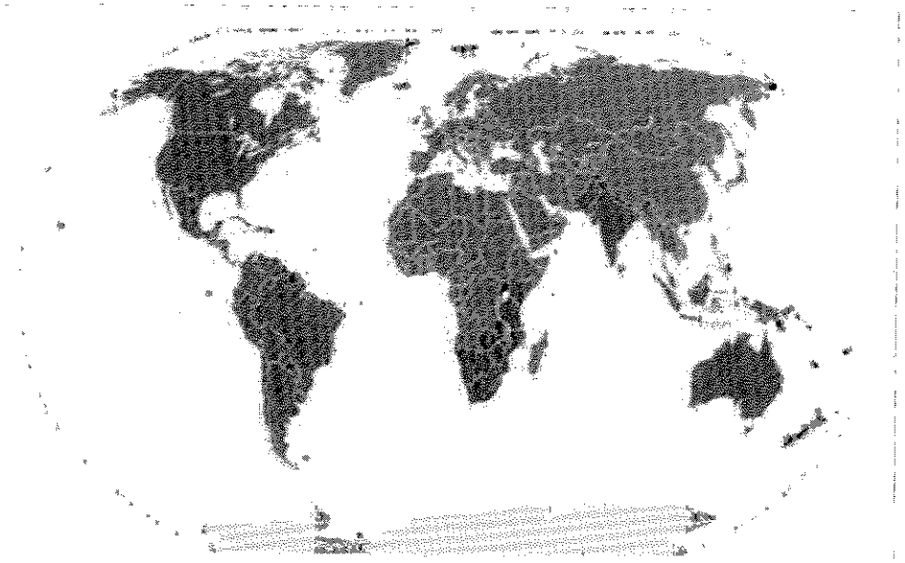
We believe that these differences, which exist and are relevant, are however often overemphasized and are, in any case, fading. For example, if you are a lawyer in a civil law system and you need to research a legal issue, of course you will look at the applicable statutory provisions, but you will immediately also look at precedents and how courts interpret the law. Even if precedents are technically not binding, they have a strong persuasive authority, especially the ones of the higher courts. Keep also in mind that, differently from common law countries, in civil law ones, only a small percentage of cases are published and easily accessible in legal journals. Similarly, statutory and regulatory law is becoming more and more pervasive also in common law countries, especially in complex technical areas such as commercial law or securities regulation; and even in these systems it is often easy to distinguish a case from a precedent, therefore reducing the binding value of the precedent. The role of the jury in common law systems is also often exaggerated. In the U.S., for example, approximately 2% of litigation actually goes to trial (most is settled or dismissed before trial); and one of the most important jurisdictions for corporate law, Delaware, has a Chancery Court that decides without a jury. In addition, in many commercial contracts jury waiver provisions or arbitration clauses exclude the possibility to try the case in front of a jury. As for "legal education" and "legal reasoning," to the extent that these slippery concepts can be discussed, most lawyers and judges—and definitely the most successful ones—now study and practice not only in their home country, but also abroad, and they develop and bring with them different styles of legal thinking. As for codification, several common law systems have gone through legislative developments

that resemble codification, at least in certain areas of the law, and consider in this respect the Uniform Commercial Code or the securities laws in the U.S. but also, in our area, the development of the Model Business Corporation Act.

All we want to say is that distinguishing and classifying different legal families is useful, and captures quickly and effectively some relevant differences, but one should be careful in using it too rigidly. This is also true just looking at statutory law in the very area of corporate law and financial markets regulation, and Italy is a good example: in the Italian Civil Code and in the most important statutes regulating this field, as we will see in this book, clear French and German influences can be spotted (sometimes even rules almost literally copied from foreign sources), but especially in the last few decades the influence of U.S. law, and European law inspired by British law (for example in the area of takeovers), has been profound.

Another reason of caution when dividing the world into legal families is that comparative law developed historically primarily with respect to private law. In other areas, for example constitutional laws, the usual distinctions based on private law elements do not apply. For instance, consider Central and South American systems: while their legal origins in terms of private law can be traced to civil law countries (Spain, Portugal, and to some extent Italy), in many cases the U.S. Constitution had a particularly significant influence in shaping their constitutions. In a similar vein, it is also interesting to point out that some very important differences concern procedural rules. In fact, one idea shared by many scholars and lawyers is that differences in civil procedure rules are as relevant as differences in the substantive laws to understand comparative differences. Think, for example, of the importance of discovery, class actions, contingency fees, and the absence of the loser-pays rule to explain how legal rules develop in the U.S. and the attractiveness of the U.S. as a forum for plaintiffs. Unfortunately, for historical and somehow self-evident reasons, scholars and jurists specializing in procedural law tend to be very focused on domestic law (with few notable exceptions, such as Italian scholars Michelino Taruffo and Vincenzo Varano, Professor Joachim Zekoll from Germany, and Mirjan R. Damaška at Yale Law School); procedural law courses at most law schools around the world rarely include a comparative or international perspective; and a few procedural rules are often neglected by comparativists. The result is that there is a lot of work that should be done to understand better comparative differences in the area of civil procedure. Interestingly enough, the first Max Planck Institute in law established outside of Germany, in Luxembourg, has among its research goals also comparative civil procedure, under the directorship of Professor Burkhard Hess.

To lighten up a bit our discussion, allow us a little fun quiz. Look at the following map without reading what is written below it (you would see the answer and spoil the exercise). It divides countries based on a very important legal rule, one that you should always be aware of when travelling to those countries, no matter what your business is. Can you tell the difference before looking at the answer below?



So what is the different applicable rule?

In lighter-gray countries people drive on the right side of the street, and in darker-gray countries people drive on the left side. In general, former British colonies follow the second rule, but a notable exception is the United States (by the way, the historical roots of this difference are interesting, and there are conflicting theories: we do not have space to discuss them here, but if you are curious you should look it up). This little example suggests how one should be careful in distinguishing different legal families.

Having said that, in this casebook we will focus primarily on two common law countries, the U.S. and the U.K., and on several civil law, continental European countries (in particular France, Germany, and Italy), and Japan, but occasionally we will also consider cases and materials from other jurisdictions including Asia, Latin America, and Eastern European countries. In our analysis we will often start from the U.S. perspective, and then examine comparative differences with other systems. This is not due to an "America-centric" bias, but because we believe it is useful to have a clear and consistent starting point. Focusing on the jurisdictions we mentioned, which often represent the legal origins

of other systems (especially due to the colonial period), we believe, allows us to capture most of the existing variations in corporate law regimes and offers a rich enough basis to discuss specific different rules. The economic importance of some of the countries on which we focus also justifies the attention that we give them.

One basic distinction between the U.S. and the European Union in terms of sources of law must be mentioned briefly, also because we will come back to this issue in the following chapters. In the U.S., corporate law is state law, even if more recently the federal legislature has introduced some rules that affect the internal affairs of listed corporations, for example in terms of proxy access or composition of the board of directors (think of the Sarbanes-Oxley Act and the Dodd-Frank Act). In Europe, the national laws of the single member states govern corporations, but a significant effort of harmonization has been made through European directives and regulations. It is obviously impossible here to offer a crash-course on the general aspects of E.U. law, but suffice it to say that directives are enacted by the European Union and must be implemented by the single member states with a statute (and often directives present different options or a certain degree of flexibility in how to implement them), while regulations are directly and immediately applicable in all the member states. In addition, the European Court of Justice, which decides on issues concerning European law, has also played an important role in the development of European corporate law, as mentioned in the excerpt from Professor Hopt above, and as we will discuss more extensively in Chapter 2.

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One interesting question is if legal systems, in the area of corporate law, are converging or diverging. The circulation of legal models and ideas might suggest greater convergence, and several scholars have argued that in this historic period the convergence is toward Anglo-Saxon corporate law models with strong protections for minority shareholders and an emphasis on the creation of wealth for shareholders (a somehow irritating formula due to its indeterminacy). The issue is however far from being clear-cut. Rather than a long theoretical discussion on the convergence vs. divergence debate, let's take a look at India and China, two jurisdictions that show significant differences from the Western legal tradition, but in some of the most recent reforms seem to have looked at Anglo-Saxon legal systems. The following excerpts offer some food for thought on this issue.

AFRA AFSHARIPOUR, CORPORATE GOVERNANCE CONVERGENCE: LESSONS FROM THE INDIAN EXPERIENCE

29 NW. J. INT'L L. & BUS. 335 (2009)[3]

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A vast academic inquiry has emerged, particularly at the intersection of law and economics, regarding whether globalization and increasing financial integration have led to convergence of corporate governance standards across countries. Numerous scholars have studied the differences between corporate governance structures of civil law and common law systems around the world. These scholars argue that different corporate governance regimes have been competing for dominance. Therefore, much of the corporate governance convergence debate has revolved around which of the two different models of corporate forms, the shareholder-oriented/dispersed ownership model or the stakeholder-oriented/concentrated ownership model, has triumphed or will triumph.

Most convergence theory scholars advance the primacy of the Anglo-American model of governance, arguing that this model is the "endpoint of an evolutionary development" and is "both desirable and inevitable." They contend that a global consensus of shareholder primacy is developing. These scholars further suggest that convergence to the Anglo-American model will benefit countries and companies. They assert that, given globalization and the increased interdependence of financial markets around the world, some level of uniformity and convergence would promote the global competitiveness of firms.

However, there are a number of opponents of the convergence theory. Some opponents argue that not only is there a lack of convergence toward a shareholder-oriented/dispersed ownership model, but that theories of convergence reflect U.S. economic imperialism. Other opponents, most notably Professors Roe and Bebchuk, argue that such convergence is not possible because "path dependency" creates significant obstacles to convergence. As Professor Coffee articulated, path dependence theory argues that "history matters, because it constrains the way in which institutions can change, and efficiency does not necessarily triumph."

Professors Coffee and Gilson have made important contributions to the above debates. Instead of arguing that full convergence to the Anglo-American model has occurred or will occur, Professors Gilson and Coffee classify three different levels of convergence that have been observed under various legal regimes: functional convergence, formal convergence, and convergence by contract. Functional convergence can occur when

[3] Footnotes omitted.

existing governance institutions are flexible enough to respond to the demands of changed circumstances without altering the institutions' formal characteristics. Formal convergence, on the other hand, occurs when an effective response requires legislative action to alter the basic structure of existing governance institutions. Convergence by contract may arise when existing governance institutions lack the flexibility to respond without formal change, and political barriers restrict the capacity for formal institutional change.

More recently, some scholars have begun to recognize a middle ground between the two opposing sides of the convergence debate. These scholars argue that corporate governance models cannot be exported merely by changes in formal laws, and that recognizing the forces of the local culture is necessary for effective corporate governance. According to Professor Pistor, "a simple convergence story does not do justice to the complexity of legal change." However, that is not to state that formal legal changes are not occurring and are not important. These scholars differentiate between de facto and de jure convergence, i.e., between adoption of similar corporate governance laws and actual corporate governance practices.

[. . .]

India was well-poised to go down the path of formal corporate governance convergence. The trajectory of India's corporate governance reform efforts was shaped by India's vast economic growth and the attempts of India's corporate elites to access new foreign and local capital. These forces placed competitive and political pressures on the Indian government to improve its formal corporate governance standards and to develop legal rules based on Anglo-American corporate governance practices. From decades of almost non-existent corporate governance, India's current regime now exhibits some of the same formal governance rules instituted in more developed economies. According to one influential scholar of the Indian economy, "India is sort of a noisier version of the U.S. system."

Despite extensive governance rules, large numbers of companies have been unable to comply with new governance standards and Indian regulators have been slow, at best, to enforce these new standards. According to a recent review of India's governance by the Asian Corporate Governance Association, Indian enforcement and implementation of Clause 49 [a provision of the listing agreement of the Indian Stock Exchange, regulating corporate governance and partially inspired to Anglo-Saxon governance rules, modified in 2005] is, at best, weak: "Most mid- and small-cap companies do not see the value of corporate governance. Most listed companies, including many large ones, take merely a box-ticking approach." A number of factors, including regulatory

competition between two government institutions, an inefficient judicial system, and the sustained closed ownership structure of Indian firms, have created barriers that prevent these robust formal rules from being implemented and enforced.

India's reform efforts thus provide an interesting pattern of corporate governance convergence for they can be characterized as either formal convergence toward the Anglo-American governance practices, or as continuing persistence of the traditional weak corporate governance norms long-evident in India. Despite the initial exuberance about Clause 49 and promises of rigorous enforcement, implementation and enforcement of Clause 49 demonstrate that while formal convergence may have been achieved, complete convergence requires greater institutional changes.

What are some of the lessons we can learn from India's corporate governance experience and the ensuing enforcement and implementation process? It becomes clear that even with attentive crafting of detailed governance rules by a group of elites with a deep understanding of corporate governance standards around the world, the reform process is useless if an effective infrastructure for enforcement and implementation is not in place. Thus, the corporate governance reform process must take account of these limitations in the crafting of new standards. Convergence cannot be complete with adoption of formal rules alone; true convergence requires similarities in implementation and enforcement. In fact, introducing formal rules into a system where there is an inadequate infrastructure to support the implementation and enforcement of such rules may mean that these rules have little chance of succeeding. Moreover, even if the infrastructure is in place, as the debates between SEBI and the MCA illustrate, reform efforts are not likely to have a significant impact on the country's governance norms unless there is cohesive political support for them.

Undoubtedly the trajectory of India's corporate governance reforms and whether complete convergence to the Anglo-American model will occur will be shaped largely by local factors. India's corporate governance experience establishes that there are important political and social factors that shape the evolution of a nation's corporate governance system. These factors place such enormous pressures on countries that convergence of different national systems in a single direction is unlikely to happen in the near future, regardless of how well placed each national system is to replicate one model of governance.

CHI-WEI HUANG, WORLDWIDE CORPORATE CONVERGENCE WITHIN A PLURALISTIC LEGAL ORDER: COMPANY LAW AND THE INDEPENDENT DIRECTOR SYSTEM IN CONTEMPORARY CHINA

31 HASTINGS INT'L & COMP. L. REV. 361 (2008)[4]

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While Western capitalism is said to have its basis in the "rule of law," the developing Chinese bureaucratic capitalism, characterized as free market under central command, is based on "rule of man." Although there have been widespread arguments that the rule of law is conducive to economic growth, this assumption is challenged by China's recent prodigious economic achievements. Opponents of the theory of global convergence of corporate governance disagree that all corporate governance regimes around the globe are converging toward a single system, described above. They further disagree on the existence of a global convergence. China may be an exception since its current economic achievements apparently do not result from the certainty brought by a clear and definite legal system, but from the centrally planned commands of an autonomous government.

Is China moving toward shareholder-oriented and dispersed ownership model? Yes, convincing evidence indicates that China is indeed moving toward shareholder-oriented and dispersed ownership model regardless of how its economic developments have occurred in the past couple of decades. The establishment of the 1994 [Company Law] indicated China's determination to embrace a shareholder-oriented model. The 2006 [Company Law] amendment and the installation of legal institutions regarding independent directors affirmed that China had already started its transition to a shareholder-oriented model of corporate governance and a dispersed-ownership system. Although market participants and government regulators are still struggling with efficiency or rent protection path dependencies and other problems, there are strong indicia that China is indeed moving toward a shareholder-oriented model/dispersed-ownership corporate governance structure. Despite this progress, China's "rule of man" path-developing process has made path dependency problems much harder to overcome than other "rule of law" countries. "Chinese bureaucratic capitalism" has been using "clientelism" and "corporatism" as available options or partial substitutes for "rule of law."

"Clientelism" refers to a close-knitted society in which personal and social networks (also known as guanxi in Chinese) are highly regarded. Horizontal clientelism consists of relationships among equal interest groups. Vertical clientelism, to some extent, advocates a relationship

[4] Footnotes omitted.

between superiors and subordinates such as government agencies and private entities. This phenomenon has gradually deepened the ultimate influence of the persons in power and further strengthened the power of "rent-protection" path dependency.

Corporatism has been asserted as a middle ground between Liberalism and Marxism. Liberalism promotes a state of weak government authority with strong self-regulatory private interest groups; whereas Marxism advocates a state of totalitarian or at least authoritarian with weak self-regulatory private interest groups. Corporatism is characterized by a strong central government authority with some private interest groups existing and enjoying a certain degree of autonomy. With a tradition of being a centralized, authoritarian country, the People's Republic of China survives by maintaining an accomplished hierarchical system, which can also be traced to the influence of Confucianism. This single value system has made the efficiency-driven path dependency even harder to overcome.

In China, "business is subordinate to and depends heavily on ties with the techno-bureaucracy to accomplish its (overall) goal." The strong ties of clientelism and corporatism produce an active and highly concentrated ownership structure in the newly developed shareholding system. The majority of the ownership in Chinese stock markets has traditionally been controlled by the State. Businessmen have to network, socially and professionally, in a highly concentrated ownership structure to enhance their business profits. The domestic market, which for a long time was dominated by government's discretionary black-box manipulation dealings and close-knit social network, has been challenged as China has opened their door to attract more foreign investment. China has tried to corporatize [State Owned Enterprises] to reduce the power-abusing opportunities of government officials, has stipulated numerous rules and regulations to standardize the corporatization of their [State Owned Enterprises], has amended their national company law, and has set up an independent director system in order to protect minority shareholders' rights. Nevertheless, the obstacles caused by path dependency hinder their convergence toward the worldwide corporate governance standard.

Although the Chinese government has encountered significant path [dependence] while transplanting various business laws and regulations, it firmly believes "rule of law" is the ground for economic growth. It also believes that accountability will enable China to pursue economic development without democracy. [. . .] However, an effective enforcement mechanism is needed in addition to rules and codes in order to ensure an effective legal system in practice not merely in theory. Reduction of the influence of path dependency in a "rule of man" market is China's toughest task.

NOTES AND QUESTIONS

1. Notwithstanding the profoundly different systems and experiences considered in these two articles, they both underline a probably obvious, but often overlooked, question: one thing is the law in the books, another thing is the law in action. The formal adoption of a statutory or regulatory provision or set of provisions does not necessarily imply actual convergence. It should be considered if and how the rules are actually enforced, and in this analysis it is crucial to understand not only the role of courts and regulators, but also broader political, social, and cultural norms. In fact procedural rules and enforcement are one issue often overlooked especially by traditional comparative law, but it is clear that sometimes these aspects are as important, if not more, as substantive rules in order to fully understand how a legal system works. Think, for example, of the effect on litigation (and therefore of actual enforcement of statutory rules) of procedural devices such as the class action, discovery mechanisms, the permissibility of contingency fees agreements to compensate lawyers, or the existence of a "loser-pays" rule that puts some of the litigation expenses of the winning party on the shoulders of the losing party. These procedural rules determine profound differences among the jurisdictions that we will consider, and that you need to keep in mind.

2. It is very difficult to determine if specific systems are converging toward one specific model, also because it means shooting a moving target. The law is alive and legal systems are not static, but continue to evolve and change. It is obviously even more difficult to determine if generally *most* systems are converging toward a core of corporate law rules. We can, however, leave this question open. You can decide what the best answer is at the end of this book. In the course of our discussion we will provide both examples of convergence and divergence among legal systems.

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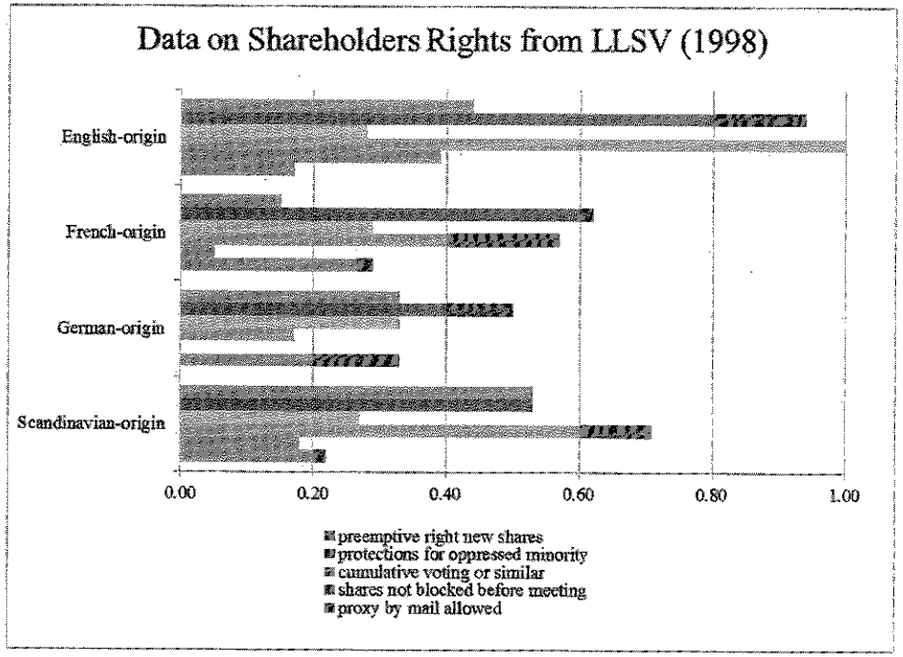
Some people are obsessed with rankings. Not surprisingly, even in the area of corporate law, people debate whether there is a "superior" system, at least vis-à-vis certain specific pre-defined goals.

One important and controversial attempt to "rank" both single jurisdictions and legal families has been made by four economists: Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny (their work became so famous that they are sometimes collectively referred to as "LLSV"). In a series of papers starting in the mid-1990s, LLSV have extensively studied the level of investors' and creditors' protection in different countries and tried to correlate it with different legal origins (in particular, English-origin, French-origin, German-origin, and Scandinavian-origin).

One article of these authors is particularly interesting in this respect: *Law and Finance*, 106 J. POL. ECONOMY 113 (1998). Their methodology is fairly straightforward, at least in theory. In a nutshell, and somehow

simplifying, they identify a set of variables that indicate the level of protection of shareholders and creditors, in particular the existence of specific legal rules, and other variables including ownership structure, efficiency of the judicial system, corruption indexes, and others, and attribute a value to each of them. More specifically, for legal rules protecting shareholders or creditors they give to each country considered a value of 1 if the rule is present, and a value of 0 if it is not (they use different measures when applicable, for example they cumulate different "antidirector rights" in a single measure that ranges from 0 to 6 depending on the presence of several rules protective of shareholders). Just to give an example, they verify if a given legal system provides for pre-emptive rights in favor of existing shareholders in case of issuance of new shares and, considering this rule protective of investors, give 1 to countries that have such a rule and 0 to countries that do not have it (*see* Chapter 4 for a discussion of pre-emptive rights). They then calculate the average value for the four different legal families considered: English-origin, French-origin, German-origin, and Scandinavian-origin, and rank them.

Let's take a look at some of their results in the following graphs, which are elaborations on the data contained in the cited article for shareholders' rights (Table 2, page 1130 f.).



Based on these and other data, LLSV concluded that "countries whose legal rules originate in the common-law tradition tend to protect investors considerably more than the countries whose laws originate in the civil-law, and especially the French-civil-law, tradition. The German-civil-law and the Scandinavian countries take an intermediate stance toward investor protections." They also observed that "law enforcement differs a great deal around the world. German-civil-law and Scandinavian countries have the best quality of law enforcement. Law enforcement is strong in common-law countries as well, whereas it is the weakest in the French-civil-law countries" (*Id.*, at 1151). If we can make a joke, LLSV are not particularly loved in France . . .

NOTES AND QUESTIONS

1. The work of LLSV is important and influential, and it contributed significantly to the international debate on comparative corporate law, bringing to the table a new and fresh approach; but—not surprisingly—it has attracted also a lot of criticism (*see*, e.g., Holger Spamann, *The "Antidirector Rights Index" Revisited*, 23 REVIEW OF FINANCIAL STUDIES 467 (2010)). LLSV, collectively or individually, have offered answers to some of their critics, but let's try to see the possible weaknesses of their methodology. You can both think about that yourself and then see the issues we raise below; or read them and discuss if you agree, and if there are other issues that should be considered.

2. First of all, the countries that LLSV group together under the same legal-origin label are profoundly different among themselves: in their model, English-origin countries put together Pakistan and the United States, Malaysia and Canada, Nigeria and the United Kingdom. In addition to France, French-origin countries include Brazil, Turkey and the Philippines. German-origin countries go from Switzerland to Taiwan. You get the point. There is no need of a particularly sophisticated comparative analysis to argue that averaging together Nigeria and the U.K. raises eyebrows and evokes quite strongly the usual warning about apples and oranges. One possible answer to this objection is that their data are still valuable considering single countries, because they offer us a quick sense on the existence of certain protections for investors in one country, but even if this is the case, doubts on their classifications cast a shadow on the entire legal origins hypothesis.

3. In addition, even the very classification of some countries has attracted specific criticism. For example Mariana Pargendler, a Brazilian scholar with broad comparative experience, has pointed out several problems in labeling Brazil as a French-civil law country in a detailed historical study (Maria Pargendler, *Politics in the Origins: The Making of Corporate Law in Nineteenth-Century Brazil*, 60 AM. J. COMP. L. 805 (2012).

4. Lots of criticism concern the variables considered. Just to mention a few issues: first, the rules that LLSV consider represent a limited sub-set of corporate law rules, and probably the choice was also constrained by the

available data. But there are many other rules that have an impact on the level of protection for investors; think for example of rules concerning conflicts of interest of directors or of controlling shareholders, transactions with related parties, takeovers, mergers, etc.

5. Another possible limit of LLSV's approach is that there is no consideration of how these rules are actually interpreted and applied in court. It's the problem mentioned above about legal reforms in China and India. True, LLSV include in their analysis some general measures of efficiency of the judiciary, relevance of the rule of law, and corruption, which indirectly suggest something on the ability of the courts to enforce the rights of shareholders. But the link is very tenuous. For example, the simple fact that a statute provides an appraisal or withdrawal right for minority shareholders dissenting from fundamental corporate changes (it is the variable named "protection for oppressed minority" in the graph above) does not tell us much about the actual level of protection of shareholders: are there rules that ensure a fair evaluation of the shares of the dissenting minority? How are these rules interpreted and applied? What evaluation techniques are considered acceptable in a given system? How quickly do courts adjudicate these disputes? And so on. Needless to say, this objection somehow captures a never-ending debate between a more "traditional" jurist and an economist, since the latter often needs to simplify and reduce complexity to build her models and collect data, ignoring the nuances and technicalities that the former tends to consider essential for a true and deep understanding of the law. Economists, in other words, are often accused by jurists of being too simplistic and, vice versa, jurists are accused by economists of losing themselves in minor and negligible details. A balanced approach, in our opinion, is to recognize the value of the study of LLSV (and of similar ones), but also be aware of its limits.

6. Another quite profound critique is that the very decision that the existence of a rule is protective of investors is often questionable, or at least it is questionable which investors it protects. Consider, for example, pre-emptive rights in case of issuance of new shares. LLSV simply consider them always favorable of shareholders, giving 1 to countries that have adopted mandatory pre-emptive rights. But are we sure that this is always the case? As we will see in Chapter 4, for example, the existence of pre-emptive rights does not prevent a controlling shareholder from causing the issuance of new shares at a time when minority shareholders do not have the financial means to buy them, and therefore increase her share of control. There might be remedies against a similar conduct, but litigation might be uncertain and costly. Similarly, are we sure that a strict "one-share, one-vote" rule is always desirable for all the shareholders? Isn't it possible that, under certain circumstances, to allow more flexibility in the creation of different classes of shares might maximize the value of the corporation and be in the best interest of investors? (Also on this issue, see Chapter 4.) In other words: are we sure that LLSV's coding is always correct? Once again, in all fairness we must recognize that virtually any statistical analysis, especially when dealing

with complex variables such as legal rules, requires some kind of judgment call. It's just a matter of being aware of these possible pitfalls.

7. In any case, one cannot avoid noting that in the 15 years following the work of LLSV, several countries have adopted the rules that would make them gain a "1" in their methodology. Just to give one example, a European directive of 2007 (2007/36/CE) on shareholders' rights has required the adoption of a "record date" system, which implies that shares are not blocked before shareholders' meetings. Institutional investors are particularly interested in this rule, because it allows them to vote without losing the ability to trade on the shares. Another example is Italy, in which an important comprehensive reform of corporate law in 2003 introduced, among many other innovations, rules more protective of investors through dissenting shareholders' appraisal rights, both expanding the grounds for appraisal, and adopting more fair evaluation criteria for the shares (Articles 2437 ff. of the Italian Civil Code). Notwithstanding all the criticism, therefore, the perspective of LLSV has had some consequences on the policy debate, and has captured some important issues that have been the object of legal reforms.

OWNERSHIP STRUCTURES OF CORPORATIONS IN DIFFERENT LEGAL SYSTEMS

One important economic data that you should keep on the back burner as you go through the materials in this casebook concerns the ownership structure of corporations, especially listed ones (in closely held corporations, by definition, the ownership structure is concentrated and there is usually one or a small group of controlling shareholders and some minority shareholders). Data on the ownership structure of listed corporations that can be compared across countries are however somehow difficult to obtain. In fact, notwithstanding extensive disclosure obligations concerning the ownership of shares in listed corporations in all developed nations and most developing ones, to precisely calculate the average stake of the controlling shareholder is fairly difficult. Different legal devices can be used to enhance, and sometimes hide, the actual voting power of shareholders, such as pyramid structures, different classes of shares, trusts, and foreign holding corporations, and shareholders' agreements. There is a general consensus, however, that the ownership structure of listed corporations in common law systems, especially the U.S. and the U.K., is more widespread than in civil law countries, even if some scholars have challenged this conclusion (*see*, e.g., an interesting study by Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FINANC. STUD. 1377 (2009), observing, "[A]lthough many believe that the United States has diffuse ownership, the evidence is to the contrary. Among a representative sample of U.S. public firms, 96% of them have block holders").

The data from an article by Professor Van der Elst of Tilburg University (Christoph Van der Elst, *Industry specificities and size of corporations: Determinants of ownership structures*, 24 INT'L REV. L. & ECON. 425 (2004)) confirm this observation:

Japan has a unique ownership structure. According to empirical evidence, the percentage of listed corporations (excluding those in emerging markets) that have a controlling shareholder holding more than one-third of its shares is around 15% as of 2005. Also, controlling shareholders of Japanese listed corporations are often other listed corporations that do not have a controlling shareholder. Thus, Japanese listed corporations are rather widely held in comparison to those of continental European and other East Asian countries (for data available in English, *see*, Stijn Claessens, Simeon Djankov & Larry H.P. Lang, *The Separation of Ownership and Control in East Asian Corporations*, 58 J. FIN. ECON. 81 (2000)). Ownership structures in Japan, however, show significant differences with the U.S. or the U.K. In Japan, a substantial amount of shares of listed corporations is held by banks (this also happens in Germany), insurance companies and other non-financial corporations that have business relationships with the issuer. These shareholders usually support the management. The amount of shares held by each of these shareholders individually is not high, but the aggregate amount could be significant enough to constitute a majority in the shareholders' meeting. Cross-ownership is also very common. To make the situation more complicated, cross-shareholding in large listed corporations (especially those by banks) has declined since the late 1990s, while share ownership by foreign and domestic institutional investors has increased, as it has also happened more recently in other countries, for example, Italy. On the other hand, small and medium listed corporations

still seem to keep cross-shareholding relationships. *See* Gen Goto, *Legally "Strong" Shareholders of Japan*, 3 MICHIGAN JOURNAL OF PRIVATE EQUITY AND VENTURE CAPITAL LAW, 25, 44–46 (2014).

A fascinating puzzle is whether legal rules determine or favor specific ownership structures, or on the other hand the presence of a certain ownership structure influences rulemaking. The lobbies of controlling shareholders, executives and managers, institutional investors and bankers might push for the adoption of rules that favor a more or less widespread ownership structure, depending on their interests. It is the old question of whether the economic structure influences the legal system, or vice versa: probably it is a symbiotic relationship in which economic, political, and legal institutions concur to determine the legal framework.

In any case, you want to keep in mind different ownership structures to fully understand the original effects of legal rules. For example, it is clear that when the ownership structure is more concentrated, the key agency problem concerns the relationship between controlling shareholders and minority shareholders; on the contrary, with a more widespread ownership structure, the crucial agency relationship is the one between directors and managers, on the one hand, and all shareholders, on the other.

We do not want to anticipate problems that will be considered later in this book (Chapter 10), but to further illustrate the consequences of different ownership structures consider for example a rule mandating a public tender offer on all the outstanding shares if someone acquires more than a set threshold of shares (for example, 30%, as it is provided in several European Union countries). The effects of this rule can be very different depending on the fact that the existing controlling shareholder has more or less of the triggering threshold. If he has more, the mandatory tender offer might operate as a protection against hostile bids, because in order to challenge the position of the incumbents, a bidder must be able to launch an expensive offer on *all* the outstanding shares.

But there is more. To know the stake of relevant shareholders is not enough. It is also necessary to consider who the most important shareholders are, and what their interests are. Once again, data are not easy to collect, but for a complex set of economic, legal, political, social, and historical reasons institutional investors (investment funds, pension funds, etc.) generally play a more important role in common law systems, while families often have a controlling stake in continental European countries. State ownership of large enterprises is also more common in some civil law countries (and was obviously also a dominant feature of Communist systems). Banks also play an important role, both as creditors and (sometimes also) as shareholders, in countries such as Germany,

Italy, and Japan. Also worker's ownership has attracted the attention of scholars (*see* Henry Hansmann, *When Does Worker Ownership Work? Esops, Law Firms, Codetermination and Economic Democracy*, 99 YALE L.J. 1749 (1990); more generally for a theoretical framework on different ownership structures in terms of types of relevant shareholders *see* Henry Hansmann, *Ownership of the Firm*, 4 J. LAW, ECON., AND ORG. 267 (1988)).

Different types of shareholders have an important role in the development and application of corporate rules. For example, in an insightful work, John Armour & David Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, in 95 GEORGETOWN L. J. 1727 (2007), argue that in the U.S. and the U.K., takeover rules developed differently largely because in the country institutional investors played a more important role and were able to successfully lobby the policy makers to introduce provisions, such as the mandatory bid rule and the board neutrality rule, intended to protect shareholders vis-à-vis directors. But also simply think of the different dynamics that can affect proxy voting or litigation when minority shareholders are institutional investors, with a relatively important stake in the corporation and the ability to use corporate information effectively, as opposed to small individual shareholders that face information asymmetries and collective actions problems.

In short, one interesting issue to keep in mind that links ownership structures with financial issues, is that—and, again, it is a simplification—there are systems that rely more on financial markets (and in particular stock exchanges) to finance the corporation, and systems that rely more on credit extended by banks ("bank-centric" systems). Anglo-Saxon systems fall in the first category; Germany, Japan, and other countries, in the latter.

Another extremely important issue to consider, with respect to ownership structure, is whether corporate groups and "pyramids" (meaning a chain of corporations in which control is exercised by the holding through a high leverage) are present and common, or free-standing corporations are more widespread. A brutal distinction indicates that in many civil law systems, from Japan to Italy, from France to Brazil, listed corporations belong to groups, and groups adopt a pyramid structure; on the other hand, "stand-alone" corporations are more common in the U.S. The distinction is very important because corporate groups raise specific problems in terms of protection of minorities and creditors, problems that will be discussed throughout this book. In addition, it could be argued that groups can offer important legal and economic advantages, but they also present unique challenges, because they create both the incentives and the opportunities to extract private benefits from investors. The existence and relevance of corporate groups

is both a cause and a consequence of different legal regimes. A recent and excellent historical (but not only) analysis of the abandonment of the group structure in the U.S. is offered by E. Kandel, K. Kosenko, R. Morck, Yishay Yafeh, *The Great Pyramids of America: A Revised History of US Business Groups, Corporate Ownership and Regulation, 1930–1950*, ECGI Finance Working Paper N° 449/2015, available on *www.ssrn.com*. In the Authors' own words, as clarified in the Abstract of the paper:

> "Most listed firms are freestanding in the U.S, while listed firms in other countries often belong to business groups: lasting structures in which listed firms control other listed firms. Hand-collected historical data illuminate how the present ownership structure of the United States arose: (1) Until the mid-20th century, U.S. corporate ownership was unexceptional: large pyramidal groups dominated many industries; (2) About half of these resembled groups elsewhere today in being industrially diversified and family controlled; but the others were tightly focused and had widely held apex firms; (3) U.S. business groups disappeared gradually, primarily in the 1940s, and by 1950 were largely gone; their demise took place against growing concerns that they posed a threat to competition and even to society; (4) The data link the disappearance of business groups to reforms that targeted them explicitly—the Public Utility Holding Company Act (1935) and rising inter-corporate dividend taxation (after 1935), or indirectly—enhanced investor protection (after 1934), the Investment Company Act (1940) and escalating estate taxes. Banking reforms and rejuvenated antitrust enforcement may have indirectly contributed too. These reforms, sustained in a lasting anti-big business climate, promoted the dissolution of existing groups and discouraged the formation of new ones. Thus, a multi-pronged reform agenda, sustained by a supportive political climate, created an economy of freestanding firms."