University of the Pacific
Scholarly Commons

McGeorge School of Law Scholarly Articles | McGeorge School of Law Faculty Scholarship

2011

The Globalization of Corporate Law: The End of History or A Never-Ending Story?

Franklin A. Gevurtz
Pacific McGeorge School of Law

Follow this and additional works at: http://scholarlycommons.pacific.edu/facultyarticles

Part of the Business Organizations Law Commons, and the International Law Commons

Recommended Citation
86 Wash. L. Rev. 475

This Article is brought to you for free and open access by the McGeorge School of Law Faculty Scholarship at Scholarly Commons. It has been accepted for inclusion in McGeorge School of Law Scholarly Articles by an authorized administrator of Scholarly Commons. For more information, please contact mgibney@pacific.edu.

Copyright © 2011 by Washington Law Review Association

THE GLOBALIZATION OF CORPORATE LAW: THE END OF HISTORY OR A NEVER-ENDING STORY?

Franklin A. Gevurtz*

Abstract: Considerable scholarship during the last few decades addresses the question of whether corporate laws are becoming global by converging on commonly accepted approaches. Some scholars have asserted that such convergence is occurring around the most efficient laws and institutions, thereby marking the "End of History" for corporate law. This Article responds to such assertions by developing three claims not previously given due attention in the convergence literature. First, it demonstrates that the history of corporations and corporate law has been one of seemingly constant movement toward global convergence, yet the resulting convergence is always incomplete or transitory. Next, it points out that because forces besides efficiency also produce convergence, convergence often occurs around corporate laws and institutions that have no particular efficiency or other normative advantage, or that necessarily represent stable equilibrium points. Finally, the Article asks what are the important corporate laws and institutions by which to measure the extent of convergence at any one time. It develops the answer that a stable convergence is least likely for the most important corporate law issues, which are characterized by tensions between competing policies and no easy solutions for the problems presented.

INTRODUCTION ... 102
I. THE HISTORY OF CONVERGENCE IN CORPORATE LAW ... 106
- A. The Early Roots of Convergence ... 106
- B. Continuous Borrowing and Transplants ... 111
  1. The General Patterns ... 111
  2. Converging on Limited Liability ... 112
  3. Regulations to Protect Non-shareholder Interests ... 113
  4. Cycles of Regulation and Deregulation in Protecting Shareholders ... 116

II. WHY CONVERGENCE IN CORPORATE LAW OCCURS ... 120
- A. The Efficiency Hypothesis ... 120
  1. Economic Darwinism and Corporate Laws ... 120
  2. Forces for Divergence ... 121
- B. Inefficient Convergence ... 122
  1. Fads and Fashions ... 122
  2. The Endogenous Variables Problem ... 126
  3. Rent-Seeking ... 131

III. WHAT IS IMPORTANT IN MEASURING CONVERGENCE ... 133

* Distinguished Professor and Scholar, University of the Pacific, McGeorge School of Law; Director, Pacific McGeorge Global Center for Business and Development.

A. The Assumptions of Academics ... 133
B. The Tough Policy Issues ... 137
1. Mandatory Versus Permissive Corporate Law ... 138
2. Authority Versus Accountability for Corporate Managers ... 141
CONCLUSION ... 146

INTRODUCTION

While corporations, at least the largest ones, commonly operate on a global scale, the laws governing their internal affairs (in other words, the rights and duties of their owners and managers) are national or sub-national.[1] In the last few decades, considerable scholarship has focused on whether these national and sub-national corporate laws are becoming, like many of the corporations they govern, global—in this case by converging upon commonly accepted approaches.[2] Earlier comparative corporate law scholarship was to a great extent a technical affair, occupied with describing differences in specific rules—e.g., whether a nation's corporate law provided for a one- or two-tier board of directors[3]—and lacked any overarching purpose or direction motivating its inquiry.[4] This changed when scholars began to look at a broader context, which culminated in the convergence predictions.

The broader inquiry culminating in predictions of convergence has both descriptive and normative aspects. The descriptive aspect commonly begins with an observation about the pattern of shareholdings in the United States and England as contrasted with the pattern found in

1. *See, e.g.*, CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987); McDermott Inc. v. Lewis, 531 A.2d 206 (Del. 1987). *But see* Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., 2003 E.C.R. I-10155 (noting that corporate laws of European Union member nations are subject to corporate law harmonizing directives issued by the European Council).

2. *E.g.*, JEFFREY N. GORDON & MARK J. ROE, CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE (2004) (collected essays); Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999); Douglas M. Branson, *The Very Uncertain Prospect of "Global" Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321, 327 (2001); William W. Bratton & Joseph A. McCahery, *Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross-Reference*, 38 COLUM. J. TRANSNAT'L L. 213 (1999); John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641 (1999); Klaus Gugler et al., *Corporate Governance and Globalization*, 20 OXFORD REV. ECON. POL'Y 129 (2004).

3. *See, e.g.*, ALFRED F. CONARD, CORPORATIONS IN PERSPECTIVE 75–93 (1976).

4. *E.g.*, Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, *in* GORDON & ROE, *supra* note 2, at 128 ("This area of scholarship had been largely the domain of taxonomists . . . .").

most of the rest of the world.[5] Specifically, the largest corporations in the United States and England commonly have widely dispersed shareholdings in which no shareholder or cohesive group of shareholders holds enough stock to control the corporation; in contrast, in many other parts of the world, a relatively few shareholders will hold large enough blocks of voting shares to possess effective control over even the largest companies.[6] This, as well as other differences between corporations of different nations, fuels the following normative inquiry: do such differences produce superior performance for corporations from one nation versus another (which presumably translates into superior overall economic performance)?[7] Bringing the matter back to law, the descriptive and normative questions then become whether various corporate or other legal rules and institutions facilitate dispersed or concentrated shareholdings (or other differences encountered in corporations from different nations), and thereby lead to improved individual corporate and overall economic performance.[8]

The answers reached to these inquires tend to depend on the decade. In the 1980s and the beginning of the 1990s, the Japanese and German economies and companies were outperforming the economy and companies in the United States. Accordingly, scholarship noted the advantage of more concentrated shareholdings in disciplining or otherwise providing better incentives for corporate managers.[9] Scholars also noted the apparent advantage that systems for greater employee involvement in corporate decisions, as were found in Japan and Germany, possessed in producing better, and better implemented, corporate business practices.[10] The question became what laws and institutions were needed in the United States to make our corporations function more like Japanese and German corporations.[11] In the later

5. *E.g.*, Brian R. Cheffins, *Corporate Governance Convergence: Lessons from Australia*, 16 TRANSNAT'L LAW. 13, 15–18 (2002).

6. *Id.* Of course, there are also many large corporations in the United States and England controlled by one or more shareholders holding large blocks of stock.

7. *E.g.*, Donald C. Clarke, *"Nothing But Wind"? The Past and Future of Comparative Corporate Governance*, 59 AM. J. COMP. L. 75, 83–84 (2011); Gugler et al., *supra* note 2; Bratton & McCahery, *supra* note 2, at 235.

8. *E.g.*, Simon Johnson et al., *Tunneling*, 90 AM. ECON. REV. 22 (2000); La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000); Coffee, *supra* note 2, at 644.

9. *E.g.*, Masahiko Aoki, *Toward an Economic Model of the Japanese Firm*, 27 J. ECON. LIT. 1 (1990) (discussing the advantage of banks as shareholders in Japanese companies in monitoring management).

10. *See, e.g.*, Gilson, *supra* note 4, at 131–32 (discussing the theory that an implicit lifetime-employment guarantee in Japanese companies led to production advantages).

11. *E.g.*, Joseph A. Grundfest, *Subordination of American Capital*, 27 J. FIN. ECON. 89 (1990);

1990s, superior economic and corporate performance shifted to the United States. Accordingly, scholarship presumed the virtues of dispersed ownership in raising capital, promoting high technology start-ups, and facilitating management discipline through the threat of hostile takeovers[12]—and also recognized the dark side of more concentrated ownership as illustrated in the Asian Financial Crisis.[13] The question correspondingly became what laws and institutions other nations should develop to promote dispersed shareholdings as in the United States.[14]

These discussions in turn led to an additional question with both descriptive and normative aspects: if, indeed, a set of corporate practices and legal rules exist that produce better corporate and overall economic performance in every nation, will the corporate laws and practices in various nations not ultimately converge upon these laws and practices to create a global corporate law?[15] The normative implications of an affirmative answer are that individual national efforts to resist this convergence are both misguided and futile. Among the scholars reaching the conclusion that convergence toward superior corporate law and institutions is occurring, Professors Hansmann and Kraakman may have been the most provocative in their assertion at the beginning of the new century that we had reached "The End of History for Corporate Law."[16] Hansmann and Kraakman claimed that corporate law had converged a century earlier on the essential features of corporations, and now, after a century of experimentation, had solved the remaining critical issues by converging on a so-called standard shareholder-oriented model—thereby rejecting manager-, labor-, or state-oriented models.

Michael E. Porter, *Capital Disadvantage: America's Failing Capital Investment System*, HARV. BUS. REV., Sept.–Oct. 1992, at 65.

12. *E.g.*, Jonathan R. Macey & Geoffrey P. Miller, *Corporate Governance and Commercial Banking: A Comparative Examination of Germany, Japan, and the United States*, 48 STAN. L. REV. 73 (1995); Curtis J. Milhaupt, *The Market for Innovation in the United States and Japan: Venture Capital and the Comparative Corporate Governance Debate*, 91 NW. U. L. REV. 865 (1997).

13. *E.g.*, Stijn Claessens et al., Expropriation of Minority Shareholders in East Asia (Dec. 9, 1999) (working paper), *available at* http://papers.ssrn.com/paper.taf?abstract_ id=202390; Simon Johnson et al., Corporate Governance in the Asian Financial Crisis (Nov. 15, 1999) (working paper), *available at* http://deepblue.lib.umich.edu/bitstream/2027.42/39681/3/wp297.pdf (expropriation of firm assets at the expense of minority shareholders and creditors was a major contributing factor to the Asian financial crisis of 1997 to 1998).

14. *E.g.*, David Chiang, *Asia's Corporate Governance Revolution*, WALL ST. J. (Asia), June 24, 1999, at 8; Geoffrey Owen, *The Americanization of European Business*, WALL ST. J. (Eur.), July 28, 1999, at 14.

15. *See supra* note 2.

16. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

The ensuing decade, bookended by major corporate scandals and corresponding stock- and financial-market collapse, has not treated kindly the thesis that we have reached the end of history for corporate law by solving its remaining critical issues. Indeed, Hansmann and Kraakman's unfortunate choice of title bears increasing resemblance to the ill-timed statement of the hapless official who, late in the nineteenth century, called for closing the patent office on the ground that everything worthwhile to invent already had been invented.

The purpose of this Article is not to pick further, for the sake of doing so, at the bones of Hansmann and Kraakman's or similar theses. Rather, this Article seeks to use the failure of such theses as a launching point for a broader consideration of the subject of convergence in corporate law. Essentially, this Article makes three interrelated claims regarding convergence in corporate law.

Part I of this Article examines the history of convergence in corporate law. It develops the argument that the history of corporations and corporate law has been one of seemingly constant movement toward convergence. Yet contrary to the linear nature of the convergence theses typified by the "End of History" article, this seeming corporate law movement toward convergence never arrives at a final destination. From its beginning, corporate law was global law, and its history is marked by promiscuous transplants and copying between nations. Nevertheless, much like a school of fish, a flock of birds, a swarm of insects, or a herd of animals, corporate laws have not converged to a single point at which they stay at rest. Instead, corporate law convergence is incomplete and impermanent.

Part II of this Article begins to develop a theory to explain why we observe the phenomenon discussed in Part II. Key to convergence predictions typified by the "End of History" article[17] is the notion that forces of economic competition will drive corporations and corporate laws toward an equilibrium point marked by maximum efficiency—a sort of economic Darwinism. In response, various scholars have pointed out path dependencies and other forces that might maintain divergence despite such efficiencies. This Article will leave it to others to debate the relative strengths of the efficiency-based forces for convergence versus the forces for divergence. Instead, Part III's thesis is that forces besides efficiency produce convergence. This means that convergence commonly occurs around corporate laws and institutions that have no particular efficiency or other normative advantage, or that necessarily

17. *See infra* Part II.

represent stable equilibrium points.

Finally, Part III of this Article explores a question arising from Part I's conclusion that the movement toward convergence remains perpetual because it is always incomplete and transitory. Specifically, Part III asks what are the important corporate laws and institutions by which to measure the extent of convergence at any one time. Implicit in the convergence literature lies the assumption that the authors are looking at the important issues and that the remaining areas of non-convergence are less worthy of concern. Part III, however, develops the thesis that convergence—or, more precisely, a stable convergence marking the "End of History"—is, in fact, least likely for the most important issues. This is because the most important issues—as measured, in a practical normative sense, by the difficulties they present to policymakers—are those in which tensions exist between competing policies and which lack easy solutions. Such policy tensions and lack of easy solutions make convergence amounting to anything more than a transitory phenomenon less likely.

I. THE HISTORY OF CONVERGENCE IN CORPORATE LAW

While scholarship about convergence in corporate law is a relatively new phenomenon, convergence in corporate law itself is anything but. Indeed, as developed in detail below, corporate law's history begins with global companies established by nations copying corporate forms and laws from each other, and convergence of corporate laws has been a continuous process throughout the history of corporate law with perpetual borrowing and transplants of corporate forms and laws between nations.

A. *The Early Roots of Convergence*

Corporate law literally begins as global law because the inception of what we now refer to as the business corporation is found in European nations copying from each other in forming trading companies to engage in international commerce. What we in the United States call a "corporation" (or, more precisely, a business corporation) has been traditionally called a stock company or joint-stock company in other parts of the world.[18] The label "corporation" comes from one attribute of this business form—treatment of the firm as a legal person ("body corporate") able to own property and enter into and enforce contracts in

18. *E.g.*, FRANKLIN A. GEVURTZ, GLOBAL ISSUES IN CORPORATE LAW 4 (2006).

its own right.[19] The label "joint-stock company" comes from another aspect of this business form—ownership of the firm by investors of capital who receive transferable shares in the firm.[20] Today's corporations derive from the English and continental European joint-stock companies formed late in the sixteenth and early in the seventeenth centuries to engage in trade with the Far East.[21]

The Russia Company, formed in England in 1553 with the goal of finding a Northeast Passage to Asia, appears to have been the first English (and arguably the first altogether) joint-stock company.[22] The English East India Company, formed in 1600, furnishes a more famous and influential example.[23] These companies evolved out of an earlier form of merchant trading company, referred to by historians as "regulated companies."[24] Regulated companies received an exclusive franchise by the Crown to conduct trade in a particular foreign territory. The regulated companies, however, did not conduct operations as companies. Instead, the merchants, who were members of the company, conducted operations under the company's franchise, either individually or in ad hoc partnerships.[25] As trading voyages became longer, the resulting greater financial demands and risks led to a different approach: the members of the company subscribed to a common fund that financed the purchase of a combined or "joint" stock of goods for trading by agents of the company.[26] In the early days of the English East India

19. *E.g.*, CONARD, *supra* note 3, at 136–38.

20. *See, e.g.*, 1 WILLIAM ROBERT SCOTT, THE CONSTITUTION AND FINANCE OF ENGLISH, SCOTTISH AND IRISH JOINT-STOCK COMPANIES TO 1720, at 155–58 (1912) (discussing derivation of the term "stock").

21. *E.g.*, Charles R. Hickson & John D. Turner, *Corporation or Limited Liability Company*, *in* ENCYCLOPEDIA OF WORLD TRADE SINCE 1450 (John J. McCusker et al. eds., 2005) (modern corporation traces to the English Russia Company); Meir Kohn, *Business Organization in Pre-Industrial Europe* 52 (Working Paper No. 03-09, 2003), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=427744 (noting that English and Dutch joint-stock trading companies evolved into the modern industrial corporation).

22. *E.g.*, SCOTT, *supra* note 20, at 17.

23. *See, e.g.*, Ron Harris, The Formation of the East India Company as a Cooperation-Enhancing Organization (Dec. 2005) (working paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=874406 (discussing the role of the English East India Company in advancing the development of enterprises in which strangers would invest).

24. *E.g.*, M. Schmitthoff, *The Origin of the Joint-Stock Company*, 3 U. TORONTO L.J. 74 (1939) (tracing the joint-stock company to the regulated company in rebuttal to the claim that it was based upon Italian joint-fund arrangements).

25. *E.g.*, T.S. WILLAN, THE EARLY HISTORY OF THE RUSSIA COMPANY, 1553–1603, at 19–20 (1956).

26. *E.g.*, Ross L. Watts & Jerold L. Zimmerman, *Agency Problems, Auditing, and the Theory of the Firm: Some Evidence*, 26 J.L. & ECON. 613, 622–23 (1983).

Company, the joint stock lasted only for a given voyage; after which whatever money the voyage made would be distributed among the investors.[27] Over time, the joint stock became a permanent fund for the continuing operations of the company.[28] Investors who did not wish to wait until completion of the voyage, or indefinitely, for return of their money began to sell their shares in the joint stock—thus giving birth to stock markets.[29]

Not only did these joint-stock trading companies operate globally, but their structures and organization also resulted from transnational borrowing, creating a sort of global corporate law or convergence from the very beginnings of the institution. Some historical evidence exists that the organizers of the Russia and English East India Companies, in adopting the joint-stock model, may have been influenced by earlier financing schemes of Italian banks and merchants, who had developed the use of pooled investments in common funds with investors holding transferable shares.[30] Not long after the English East India Company came into existence, various Dutch merchants who traded in the East Indies came together to form the United (or Dutch) East India Company, following the joint-stock principle seen in the English company.[31] The Dutch East India Company may have also been influenced by already existing Portuguese joint-stock companies trading in the East Indies.[32] The success of the English and Dutch East India Companies, in turn, spurred the formation by other European countries of joint-stock companies for trade in the East Indies.[33]

---

27. *E.g.*, SCOTT, *supra* note 20, at 92–101.

28. *E.g.*, 2 JOHN P. DAVIS, CORPORATIONS: A STUDY OF THE ORIGIN AND DEVELOPMENT OF GREAT BUSINESS COMBINATIONS AND OF THEIR RELATION TO THE AUTHORITY OF THE STATE 119–33 (1905).

29. *E.g.*, Harris, *supra* note 23, at 31–32. Because trading in shares in the English East India Company's joint stock was somewhat restricted in its early years, the Dutch East India Company is able to claim credit for the first freely transferable shares trading in a stock market. *Id.*

30. *E.g.*, R. de Roover, *The Organization of Trade*, *in* 3 THE CAMBRIDGE ECONOMIC HISTORY OF EUROPE 58–59 (M.M. Postan et al. eds., 1963). *But see* Schmitthoff, *supra* note 24 (challenging the claim of Italian influence); *see also* SCOTT, *supra* note 20, at 1–2, 13–14 (suggesting some, but not decisive, Italian influence).

31. *E.g.*, Schmitthoff, *supra* note 24, at 93–96 (arguing that the Dutch were either influenced by the English or were following a parallel evolution).

32. *See, e.g.*, Murat Cizakca, *A Comparative Evolution of Business Partnerships, The Islamic World and Europe, with Specific Reference to the Ottoman Archives*, *in* 8 THE OTTOMAN EMPIRE AND ITS HERITAGE 10, at 44–45 (Suraiya Faroqhi & Halil Inalcik eds., 1996).

33. *E.g.*, Schmitthoff *supra* note 24, at 93 (listing the formation of East India companies by France in 1604, Sweden in 1615, Denmark in 1616, and by a German principality (Brandenburg) in 1651, as showing the Dutch East India Company's influence on the development of the joint-stock company in continental Europe). For a discussion of the early Spanish resistance to copying the

Having started in global trade, and with a pattern of international imitation (or convergence), use of the joint-stock company spread to other types of businesses[34] and to other nations—the transplants resulted either from imitation (as in the Meiji Restoration in Japan)[35] or from European colonization.[36] From the seventeenth to the nineteenth century, joint-stock companies—at least those arising from official sanction rather than creative contracting[37]—came into existence through charters granted individually by crown or legislature.[38] In another great wave of international imitation (convergence), nations and sub-national governments developed general incorporation laws that allowed corporations (joint-stock companies) to come into existence without the need for a special legislative or royal charter.

France, as a consequence of its revolution, seems to have pioneered this development—albeit with a retreat, until 1867, to a concession system requiring government approval for incorporation.[39] New York followed the earlier French general-incorporation approach in 1811, from which laws gradually spread in the nineteenth century throughout the United States allowing anyone to incorporate through registration if the company met certain requirements.[40] England, after facilitating

---

English and Dutch joint-stock trading companies, see Roland D. Hussey, *Antecedents of the Spanish Monopolistic Overseas Trading Companies (1624–1728)*, 9 HISP. AM. HIST. REV. 1 (1929).

34. *See, e.g.*, SCOTT, *supra* note 20, at 463–81 (listing English and Scottish joint-stock companies formed from the sixteenth to the eighteenth centuries in various fields).

35. *See infra* note 49 and accompanying text.

36. *E.g.*, Phanor J. Eder, *Company Law in Latin America*, 27 NOTRE DAME LAW. 5, 5–14 (1951) (discussing early Portuguese, Spanish, and colonial joint-stock companies in Latin America).

37. In England, numerous unincorporated associations followed the joint-stock principle by issuing transferable shares in a common capital. These were organized as partnerships, or later as trusts, in which trustees held title to the firm's property to be used for the benefit of the owners of transferable shares in the trust. These joint-stock associations often attempted to gain self-help limited liability for their shareholders by contracts with their creditors. *See, e.g.*, Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 582 (1986). Portuguese, Spanish, and early Latin American joint-stock companies also may not have needed a Royal charter to come into existence—as opposed to obtaining monopoly privileges. *E.g.*, Eder, *supra* note 36, at 15. Elsewhere in Europe, limited partnerships sometimes operated on the joint-stock principle. *E.g.*, Mariana Pargendler, *Politics in the Origins: The Making of Corporate Law in Nineteenth-Century Brazil*, 60 AM. J. COMP. L. (forthcoming Summer 2012), *available at* http://ssrn.com/abstract=1891915 (explaining that prior to 1867, limited partnerships with traded shares were far more prevalent than stock companies in France); JAMES M. BROPHY, CAPITALISM, POLITICS, AND RAILROADS IN PRUSSIA: 1830–1870, at 89–99 (1998) (discussing effort to form joint-stock banking companies in Prussia).

38. *E.g.*, Katharina Pistor et al., The Evolution of Corporate Law 14 (unpublished manuscript) (on file with author).

39. *Id.*

40. *E.g.*, LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 188–98 (2d ed. 1985).

contractually based joint-stock companies by repealing the Bubble Act in 1825, enacted company laws providing for incorporation by registration in 1844 (without limited liability for the shareholders) and 1855 (with limited liability).[41] In 1829, Spain introduced incorporation by registration; however, Spain, like France, retreated for a time in the mid-nineteenth century to a concession system.[42] Germany's stock-company law based upon incorporation by registration followed the unification of the country in 1870 and 1871.[43]

Not surprisingly, general-incorporation laws spread by imitation and transplant to the colonies and former colonies of European countries. For example, various Latin American countries, after achieving independence from Spain, eventually adopted company laws borrowing from Spanish or French laws.[44] In some instances, this borrowing entailed copying directly from Spain or France; in other instances the borrowing was indirect as one country copied the company law from another country that had copied from Spain or France.[45] This sometimes meant that the transplant, in fact, adopted approaches already abandoned in Spain or France.[46] This also meant gradual movement toward incorporation upon registration in Latin America, with Chile, for example, requiring a government decree for incorporation until 1981.[47]

Japan provides an interesting example of a transplant in a nation that had not been subject to European colonization. Japan imported the joint-stock company as part of the Meiji Restoration starting in 1870,[48] and

---

41. *E.g.*, HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS 22 (3d ed. 1983); L.C.B. Gower, *Some Contrasts Between British and American Corporation Law*, 69 HARV. L. REV. 1369, 1371 (1956).

42. *E.g.*, ROBERT CHARLES MEANS, UNDERDEVELOPMENT AND THE DEVELOPMENT OF LAW 132–34 (1980).

43. *E.g.*, Carsten Burhop, *The Underpricing of Initial Public Offerings in Imperial Germany, 1870–1896*, 2008/46 Preprints of the MAX PLANCK INSTITUTE FOR RESEARCH ON COLLECTIVE GOODS 3–4, *available at* http://econ.as.nyu.edu/docs/IO/10340/Burhoppaper.pdf (noting that free incorporation, which had previously only been available since 1861 in a few smaller German states, spread with the 1870 formation of the North-German federation, including Prussia, and then spread to the rest of Germany with the establishment of German Empire in 1871).

44. *E.g.*, Pistor et al., *supra* note 38, at 43–44.

45. *Id.*; *see also* Pargendler, *supra* note 37, at 39–40 (discussing Brazil's copying French and other nations' corporate laws in a "cafeteria approach").

46. *E.g.*, MEANS, *supra* note 42, at 152–64, 191–96 (discussing Colombia's borrowing of Spain's 1829 free-incorporation law after Spain had retreated to a more restrictive concession system, and later borrowing Chile's restrictive company law after European countries, like France and Spain, had liberalized their company laws to again allow free incorporation).

47. *E.g.*, Pistor et al., *supra* note 38, at 40–41, 43.

48. *E.g.*, JOHANNES HIRSCHMEIER & TSUNEHIKO YUI, THE DEVELOPMENT OF JAPANESE BUSINESS: 1600–1973, at 82, 89, 112 (1975).

adopted Germany's company law, including incorporation by registration, in 1898.[49]

B. Continuous Borrowing and Transplants

These global beginnings of corporate law are largely consistent with Hansmann and Kraakman's depiction of an earlier convergence in corporate law, which adopted what they view to be the essential features of the corporation.[50] The story of convergence and global corporate law, however, is not one of a hiatus after these initial steps, waiting for the wane of the twentieth century to complete the last step and reach the "End of History." Rather, it is a story of continuous imitation and transplant among national and sub-national corporate laws creating constant convergence.

1. The General Patterns

At this point, the reader might be puzzled at how constant convergence can exist, given that corporate law started as global law with substantial convergence, and that convergence, by its nature, seemingly implies an end point. The answer is that corporate laws are in a constant process of convergence and divergence as they move from one norm to another, and then to another or back again.

A simple example illustrates the pattern: consider the global spread of prohibitions against corporate insiders trading based on inside information ("insider trading"), which occurred in the latter part of the last century.[51] In the late 1980s and accelerating in the 1990s, an increasing number of nations passed laws prohibiting insider trading.[52] At first glance, this would appear to be a good illustration of convergence toward global law. Indeed, this development may be part of a broader convergence toward laws designed to promote dispersed

---

49. *E.g.*, K. Takayangi, *A Century of Innovation: The Development of Japanese Law 1868–1961*, *in* LAW IN JAPAN: THE LEGAL ORDER IN A CHANGING SOCIETY 31–32 (Arthur Taylor von Mehren ed., 1963); *see also* Masao Fukushima, *The Significance of the Enforcement of the Company Law Chapters of the Old Commercial Code in 1893*, 24 L. IN JAPAN 171 (William Horton trans., 1991) (discussing the earlier 1893 Code).

50. *See* Hansmann & Kraakman, *supra* note 16, at 439–40.

51. I confess that this example appealed to me on a personal level because this topic marked my first foray into comparative corporate law scholarship. *See* Franklin A. Gevurtz, *The Globalization of Insider Trading Prohibitions*, 15 TRANSNAT'L LAW. 63 (2002).

52. *E.g.*, Utpal Bhattacharya & Hazem Daouk, *The World Price of Insider Trading* 1 (unpublished manuscript) (on file with author).

shareholdings.[53] Taking a longer view, however, the story is more complicated. Prior to the 1960s, no nation prohibited insider trading.[54] Thus, a convergence existed on the legality of insider trading prior to the 1960s—it was not prohibited. The United States adopted the prohibition in 1962,[55] followed by France in 1967, a few more nations in the 1970s, followed by increasing numbers of nations in the 1980s and 1990s, reaching the point today where the vast majority of nations with stock markets prohibit insider trading.[56] Hence, what at first glance appears to be simply a story of convergence actually represents a gradual movement from one globally followed norm to another. Readers who carefully observe nature may find this phenomenon brings to mind the way in which a large flock of birds moves in stages from one perch to another.

Many of the examples of imitation and transplants to new points of convergence in corporate law involve micro-issues focusing on specific rules and structures, like the prohibition of insider trading, the requirements for independent directors,[57] or the mechanisms and standards for enforcing the duties of corporate directors.[58] Other examples involve larger-scale concerns that implicate numerous rules and structures, such as the overall philosophy regarding the balance between regulation and deregulation. Some of the movements to new convergence points seem fairly unidirectional, at least within the time horizon of what we know, while others follow a cyclical pattern.

2. *Converging on Limited Liability*

The spread of limited liability for a corporation's shareholders offers an example of a fairly unidirectional convergence. While today we tend

53. *See, e.g.*, Roberta S. Karmel, *Transnational Takeover Talk—Regulations Relating to Tender Offers and Insider Trading in the United States, the United Kingdom, Germany, and Australia*, 66 U. CIN. L. REV. 1133, 1152 (1998); Eugenio Ruggiero, *The Regulation of Insider Trading in Italy*, 22 BROOK. J. INT'L L. 157, 160–61 (1996).

54. *E.g.*, Bhattacharya & Daouk, *supra* note 52, at 10.

55. The 1934 Securities Exchange Act contained a provision (§ 16(b)) designed to remove incentives for insider trading by forcing certain categories of corporate insiders to give the corporation any money they made on certain purchases and sales of the corporation's stock. The actual prohibition of insider trading, however, occurs in a 1962 Securities Exchange Commission (SEC) decision interpreting a rule it promulgated in 1942 (Rule 10b-5) pursuant to authority granted in the Securities Exchange Act to prohibit manipulative or deceptive acts. *E.g.*, Gevurtz, *supra* note 48, at 70–71.

56. *See* Bhattacharya & Daouk, *supra* note 52, at 10.

57. *See infra* notes126–130 and accompanying text.

58. *See infra* notes 232–242 and accompanying text.

to think of limited liability as an inherent part of corporate law, it was not the universal rule for much of corporate law's history. Before general incorporation laws, the shareholders in individually chartered corporations (joint-stock companies) may have enjoyed limited liability, depending on the charter.[59] England's 1844 law allowing general incorporation did not provide limited liability for the shareholders of the companies formed under that act; this came after considerable debate in England's 1855 act.[60] Beginning in the nineteenth century, limited liability spread from state to state throughout the United States—from New York's statute for double liability for manufacturing companies in 1811, to New Hampshire and New Jersey in 1816, to Connecticut in 1818, to Massachusetts in 1830, and finally to California in 1931—and expanded from partial (double liability) to full limited liability and from manufacturing corporations to banks (for which double liability only ended in the Great Depression).[61]

Related to this convergence is the gradual spread of laws designed to make it easier for owners in closely held companies to enjoy limited liability. Probably the most notable example is Germany's 1892 invention of the limited liability company, which allowed owners of companies not issuing tradable stock to enjoy limited liability without meeting the requirements imposed on companies issuing such shares.[62] From Germany, the limited liability company spread throughout the civil law countries.[63] Finally, in the 1990s, the limited liability company spread throughout the United States, in this instance as a means to enjoy limited liability without incurring tax disadvantages imposed on corporations.[64]

3. *Regulations to Protect Non-shareholder Interests*

In contrast to the largely unidirectional convergence regarding limited liability, the overall balance in corporate laws between regulation and deregulation has followed a more cyclical and complex pattern of convergence. Discussing corporate regulation versus deregulation involves two fairly distinct concerns. First, a traditional concern of

---

59. *E.g.*, Blumberg, *supra* note 37, at 580.

60. *See* HENN & ALEXANDER, *supra* note 41.

61. *E.g.*, Blumberg, *supra* note 37, at 593–601.

62. *E.g.*, Marcus Lutter, *Limited Liability Companies and Private Companies*, *in* 13 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, Ch. 2, at 2–6 (1998).

63. *Id.* at 2–11.

64. *E.g.*, FRANKLIN A. GEVURTZ, BUSINESS PLANNING 64 (4th ed. 2008).

corporate law has been the protection of minority shareholders.[65] A second concern involves the protection of persons and interests beyond the company's shareholders. These persons and interests include a company's creditors, employees, and customers, as well as the welfare of the broader community and the environment in which the corporation operates.

As recent events illustrate, laws seeking to protect these non-shareholders from the actions of corporations and their managers follow a fairly predictable cycle of regulation and deregulation, both in the United States and in the global community.[66] These cycles, however, generally do not involve changes to corporate law. For example, cycles involving greater or lesser regulation over the lending practices of banks, the rights of workers to organize, the safety of products, and the limits on pollution generally do not address the subjects of corporate law. Corporate law addresses subjects such as selection of those in charge of the company, compensation of managers and owners of the corporation, liability of managers to the corporation and its owners, and other powers and duties of managers and owners.[67]

Nevertheless, a long-standing debate in corporate law is the extent to which the rules governing the subjects it addresses (such as manager selection) should be designed with an eye toward the impact on constituents and interests beyond the shareholders and managers.[68] This means that the movement in corporate law to protect such constituents and interests is not so much about regulation versus deregulation as it is about the locus of regulation—in other words, should corporate law seek to protect the interests of those dealing with corporations or should this be left to other laws?

An example that illustrates this point involves the worry that individual corporations might grow to obtain excessive economic power. Early general corporation laws in the United States contained various rules, such as a prohibition on forming holding companies, which

---

65. *See infra* notes 206–207 and accompanying text.

66. *E.g.*, Richard D. Cudahy, *The Coming Demise of Deregulation*, 10 YALE J. ON REG. 1, 2 (1993) ("An almost inescapable feature of the economic and political cycle is the swing of the pendulum between regulation and deregulation."); Lyman Johnson, *Beyond the Inevitable and Inadequate Regulation of Bankers: A Comment on Painter*, 8 U. ST. THOMAS L.J. 29 (2010) (discussing cycles of regulation, business evasion, and new regulation).

67. *E.g.*, McDermott Inc. v. Lewis, 531 A.2d 206, 214–15 (Del. 1987).

68. *See generally* E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932); A.A. Berle, Jr., Note, *For Whom Corporate Managers* Are *Trustees: A Note*, 45 HARV. L. REV. 1365 (1932).

limited the economic power of a single corporation.[69] In an example of convergence famously labeled a "race to laxity" by Justice Brandeis,[70] corporate laws abandoned these restrictions.[71] This abandonment, however, did not mark a unidirectional move toward deregulation because antitrust laws[72] arose to address the concern about excessive economic power.[73] Such laws have themselves seen their own cycles of regulation and deregulation.[74]

Hansmann and Kraakman's "End of History" thesis focuses largely on this question of using corporate laws to regulate the corporation in its dealings with non-shareholders.[75] For example, Hansmann and Kraackman invoke the state of law regarding co-determination as an illustration of purported convergence.[76] Co-determination, which German law pioneered,[77] protects the interests of corporate employees by allowing them to elect some of the corporation's directors. Some European nations,[78] and more recently China, have imported this German invention.[79] Still, in support of their claim that corporate laws are converging globally on a shareholder-oriented model, Hansmann and Kraakman note that there has been no widespread adoption of co-determination.[80]

On the other hand, the current status of co-determination provides limited support for Hansmann and Kraakman's theory of convergence

---

69. *E.g.*, Morton J. Horwitz, Santa Clara *Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 194–95, 200–02 (1985). This was not true in France and Germany, which seemed to have lacked concern with powerful companies. *E.g.*, Pistor et al., *supra* note 38, at 20.

70. Louis K. Liggett Co. v. Lee, 288 U.S. 517, 559 (1933) (Brandeis, J., dissenting) ("The race was one not of diligence but of laxity.").

71. *E.g.*, Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 263–66 (1976).

72. Known as "competition" laws in most parts of the world.

73. *E.g.*, HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW, 1836–1937, at 266–67 (1991) (explaining the abandonment of corporate law in favor of antitrust law to regulate corporate economic power).

74. *E.g.*, HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY 56–59 (3d ed. 2005).

75. *See generally* Hansmann & Kraakman, *supra* note 16.

76. *Id.* at 445–47.

77. *E.g.*, ANDREAS CAHN & DAVID C. DONALD, COMPARATIVE COMPANY LAW 308–11 (2010).

78. *E.g.*, Luca Enriques, Henry Hansmann & Reinier Kraakman, *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 89, 100 (2d ed. 2009) (listing Austria, Denmark, Luxemburg, Hungary, and the Czech Republic as allowing employees to elect one-third of the board).

79. *E.g.*, Jiong Deng, *Building an Investor-Friendly Shareholder Derivative Lawsuit System in China*, 46 HARV. INT'L L.J. 347, 353 (2005).

80. Hansmann & Kraakman, *supra* note 16, at 445.

away from a labor-oriented model. Far from representing a point of convergence, there seems to be little movement among nations to change to or from co-determination.[81] Citations to academic works by critics of co-determination[82]—at the same time ignoring contrary scholarship[83]—hardly shows that an intellectual, much less a policymaker, consensus has emerged rejecting the institution. Moreover, Hansmann and Kraakman ignore one source of growing employee power in the boardroom: the increasing ownership of stock by employee pension plans and the increasing willingness of unions and others operating these plans to utilize the power that comes with holding large blocks of voting shares.[84]

It is not hard to find counterexamples to the thesis that nations are converging on the conclusion that the sole role of corporate law is to protect shareholders. Among such counterexamples are the passage in many states in the United States of so-called "other constituency statutes," which allow directors to consider the interests of stakeholders other than the shareholders,[85] and some provisions in the recent Dodd–Frank financial regulation reform law that seem to use corporate governance reform as a tool to protect the public from the collapse of financial corporations.[86]

4. *Cycles of Regulation and Deregulation in Protecting Shareholders*

Largely absent from Hansmann and Kraakman's "End of History" thesis is convergence on the appropriate balance between regulation and

---

81. *See* Enriques et al., *supra* note 78.

82. *See generally* Mark Roe, *German Securities Markets and German Codetermination*, 1998 COLUM. BUS. L. REV. 167 (1998).

83. *E.g.*, Elmar Gerum & Helmut Wagner, *Economics of Labor Co-Determination in View of Corporate Governance*, *in* COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART AND EMERGING RESEARCH 341, 348–51 (Klaus J. Hopt et al. eds., 1998).

84. *E.g.*, Stephen Bainbridge, *Activist Shareholders Are Imposing Political Agendas on Pension Funds*, WASH. EXAMINER, Mar. 6, 2007, http://washingtonexaminer.com/node/436161 ("Union pension funds tried to remove directors or top managers, or otherwise affect corporate policy, at more than 200 corporations in 2004 alone.").

85. *See generally* A.B.A. Comm. on Corp. Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253 (1990).

86. Wall Street Reform and Consumer Protection (Dodd–Frank) Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (codified in scattered sections of 12 and 15 U.S.C.) (dealing with executive pay at §§ 951–54, proxy access at § 971, and disclosures regarding chairperson and CEO structures at § 972). For a discussion of how corporate governance provisions may limit excessive risk taking by financial corporations, see generally Franklin A. Gevurtz, *The Role of Corporate Law in Preventing a Financial Crisis: Reflections on* In re Citigroup Inc. Shareholder Derivative Litigation, 23 PAC. MCGEORGE GLOBAL BUS. & DEV. L. J. 113 (2010).

deregulation when it comes to shareholder protections. Hansmann and Kraakman identify the goal of protecting minority shareholders from expropriation by the majority and mention some currently favored approaches to protecting the minority. However, they do not address the balance between mandating protections for minority shareholders and allowing participants in corporations to make their own arrangements. This issue has continuously shifted between cycles of increased regulation and deregulation.

These cycles trace back to the inception of laws allowing incorporation by registration, which marked a move toward deregulation by removing the requirement that corporations receive a special charter from the government.[87] In nation after nation, the aftermath of such laws followed a depressingly similar pattern. A "founders' boom" of forming numerous new companies often occurred after the enactment of these laws.[88] When many of these new companies turned out to be ill-conceived—or even fraudulent—and later failed, shareholders as well as creditors lost their money. This led to wider economic dislocations and a legislative response entailing greater regulation.[89] Legislative responses to corporate busts have shifted over time and have included such fixes as: returning to the requirement for government approval to form a corporation;[90] restricting small investors from making potentially improvident stock purchases;[91] requiring companies to disclose numerous facts to investors before selling them stock;[92] and mandating

---

87. *See, e.g.*, FRIEDMAN, *supra* note 40, at 194 ("In theory, the special charter system was a strong mode of corporate control. But the demand for charters was too great.").

88. *E.g.*, Pistor et al., *supra* note 38, at 13, 17, 43 (giving examples of founders' booms in England, France, Germany and Spain); Pargendler, *supra* note 37, at 31 (discussing boom and bust in the decade following Brazil's adoption of incorporation by registration in 1882).

89. *Id.*; *see also generally* Stuart Banner, *What Causes New Securities Regulation? 300 Years of Evidence*, 75 WASH. U. L.Q. 849 (1997) (discussing how busts produced increased regulation of securities in England and the United States); Erik F. Gerding, *The Next Epidemic: Bubbles and the Growth and Decay of Securities Regulation*, 38 CONN. L. REV. 393, 403–17 (2006) (giving a history of speculative stock bubbles and regulatory response from 1690 England through recent events in the United States).

90. *E.g.* Pistor et al., *supra* note 38, at 13, 43.

91. *Id.* at 31 (explaining that German enactment of minimum par value for stock in 1884 was to keep small investors from buying stock); William J. Ward, Comment, *California Corporate Securities Law: Small Business Capital Formation and Investor Protection*, 13 PAC. L. REV. 459, 460 (1982) (discussing how the California administrative agency would apply the "fair, just and equitable" standard for approving the sale of securities to deny an open qualification allowing a sale to any buyer if the proposed business plan was speculative).

92. *E.g.*, LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 2–3 (1983) (explaining that the English "Companies Act of 1844 enacted the first modern prospectus requirement" with "compulsory disclosure through the registration of prospectuses inviting subscriptions to corporate

various corporate governance rules designed to give shareholders the power to protect their interests from actions by corporate management.[93] While the legislative approaches have varied, the common denominator is mandatory protections that do not allow participants in the corporation to completely contract for their own arrangements.[94] Invariably, fading memories and complaints about regulation push nations toward deregulation—renewed free incorporation,[95] removal of restrictions on stock sales,[96] reduction in the mandatory rules of corporate governance that protect minority shareholders[97]—only to be followed by booms, busts, and new restrictions.[98] This cycle has continued all of the way to this century's Sarbanes–Oxley[99] and Dodd–Frank[100] Acts in the United States, and similar laws in other countries.[101]

---

shares"; in the securities acts the United States Congress opted to follow the English compulsory disclosure model); Gerard Hertig, Reiner Kraakman & Edward Rock, *Issuers and Investor Protection*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, *supra* note 78, at 275, 282–83 (discussing disclosure regimes in various countries).

93. *E.g.*, Enriques et al., *supra* note 78, at 55, 65, 69–71, 72–75 (discussing the strategy of giving shareholders decision rights as a means of protecting shareholder interests).

94. *See, e.g.*, Facilitating Shareholder Director Nominations, Exchange Act Release No. 34-62764, at 17 (In issuing the proxy access rules pursuant to the Dodd–Frank Act, the SEC explained: "corporate governance is not merely a matter of private ordering. Rights, including shareholder rights, are artifacts of law, and in the realm of corporate governance some rights cannot be bargained away but rather are imposed by statute. There is nothing novel about mandated limitations on private ordering in corporate governance.").

95. *E.g.* Pistor et al., *supra* note 38, at 13–14, 43.

96. *E.g.*, Securities Act of 1933, Pub. L. 111-229, 48 Stat. 74 (preempting state securities laws regarding sale of "covered securities," including securities listed on a national stock exchange after a public offering).

97. *E.g.*, William Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 666 (1974) (arguing that state corporate laws in the United States "have watered the rights of shareholders vis-à-vis management down to a thin gruel").

98. *E.g.*, Banner, *supra* note 89; John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 69 (2002) ("Between the 1960s and the 1980s, each of the major European countries copied the United States in creating a strong regulatory agency that was more or less modeled after the American SEC. Much of this legislation was, of course, crisis- and scandal-driven . . . .").

99. Public Company Accounting Reform and Investor Protection (Sarbanes–Oxley) Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 and 18 U.S.C.).

100. *See* Wall Street Reform and Consumer Protection (Dodd–Frank) Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (codified in scattered sections of 12 and 15 U.S.C.),.

101. *E.g.*, Michel Menjucq, *Corporate Governance Issues in France*, 7 STUD. INT'L FIN. ECON. & TECH. L. 101 (2004–2005) (inspired by the Sarbanes–Oxley Act and recommendations of the European Commission on reforming the statutory audit, the French Government in August 2003 adopted the Financial Security Law); Katsumasa Suzuki, *Japan Exercises U.S.-Style Control*, 26 INT'L FIN. L. REV. 61 (2007) (describing "J-Sox," the Japanese version of the Sarbanes–Oxley Act); John Lyons, *Mexico Moves to Tighten Laws over Securities: Unanimous Approval Comes Despite a Fierce Opponent; New Test for Regulators*, WALL ST. J., Dec. 8, 2005, at A14 (reporting that after

In some instances, these cycles did not represent movement or convergence in global norms, as some nations may have been in periods of greater regulation at the same time that others were in cycles of greater deregulation.[102] In many cases, however, these cycles represented a moving global norm, as national and sub-national corporate laws converged around greater regulation or deregulation.[103] Indeed, a common refrain in favor of deregulation from the early days of general incorporation laws was the assertion that corporations will form elsewhere—for example, England as opposed to France,[104] or New Jersey and Delaware as opposed to New York[105]—if the more restrictive jurisdiction did not change its laws. At the other end of the cycle, the booms and busts that lead to a push for regulation may not be limited to one country.[106] Moreover, global convergence on corporate regulation often involved more than just the prevailing philosophy. It also included imitation and transplant of either particular forms of increased regulation (as in the spread of laws requiring disclosure upon the sale of stock[107]) or of mechanisms allowing deregulation (as in the spread of the German invention of the limited liability company form with fewer mandatory requirements for corporations not issuing transferable stock[108]).

In sum, whether the subject is the micro one of specific corporate laws and institutions, or the macro one of overall approach and philosophy, and whether the trend is unidirectional or cyclical, nations and sub-national jurisdictions are constantly copying each others' corporate laws and institutions, with the result that such laws and institutions appear to be in perpetual movement toward convergence at a point that is continually shifting. Under these circumstances, claims that corporate law has reached the end of history are likely to be a mirage.

---

enactment of the Sarbanes–Oxley Act in the United States, Mexican officials began pushing for a similar law and in 2005, Mexico's lower house of Congress approved sweeping changes to Mexico's securities law); Circular, Sec. and Exch. Bd. of India (SEBI), Corporate Governance in Listed Companies–Clause 49 of the Listing Agreement (Oct. 29, 2004), http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf (Indian version of the Sarbanes–Oxley Act).

102. *E.g.*, Pistor et al., *supra* note 38, at 43–44 (giving example of Columbia changing its corporate laws in a manner that ran counter to trends elsewhere).

103. *Id.* at 70–73 (discussing areas of both convergence and divergence in the evolution of corporate laws that protect investors in corporations and the parallel evolution of the development of free incorporation laws among nations).

104. *Id.* at 13–14; Pargendler, *supra* note 37, at 28.

105. *E.g.*, Louis K. Liggett Co. v. Lee, 288 U.S. 517, 548–65 (1933) (Brandeis, J., dissenting); Seligman, *supra* note 71.

106. *E.g.*, Coffee, *supra* note 98, at 69.

107. *See* Enriques et al., *supra* note 78, at 100.

108. *See supra* notes 62–63 and accompanying text.

This history, in turn, raises the question as to why corporate laws and institutions behave in this manner.

II. WHY CONVERGENCE IN CORPORATE LAW OCCURS

A. The Efficiency Hypothesis

1. Economic Darwinism and Corporate Laws

Biologists presumably have theories to explain convergence in the movement of flocks of birds, schools of fish, swarms of insects, or herds of animals. Why, however, do corporate (as well as many other) laws behave in a manner that creates a perpetual movement toward a never-lasting convergence? Underlying the corporate law convergence thesis, as exemplified by the "End of History" article, is a very Western view of human history as linear tale of progress. Under this narrative, nations move to convergence on corporate law and institutions when, after a period of divergent experimentation, a consensus is reached which recognizes the best approach.

The argument for this view of corporate law convergence lies in a sort of economic Darwinism. Corporations are in constant competition with each other and, in a global economy, this means competition with corporations from other countries. Corporations operating with less efficient corporate laws and structures will be at a disadvantage in this competition. At an extreme, this can mean the failure of firms operating under inefficient laws and institutions, and the survival of firms operating under an efficient system.[109]

Of course, this stark scenario may assume far more significance for legal rules and institutions than they have in the real world. For example, in a world where different nations possess comparative advantages in different industries—the traditional rationale for world trade—firms organized under less efficient corporate laws and institutions can nevertheless survive when operating in an industry in which their country has a comparative advantage.[110] Moreover, companies operating under less efficient corporate laws and institutions might actually grow more than their rivals if these corporate laws and institutions allow or

---

109. *E.g.*, Stilpon Nestor & John K. Thomson, *Corporate Governance Patterns in OECD Economies: Is Convergence Under Way?*, *in* CORPORATE GOVERNANCE IN ASIA: A COMPARATIVE PERSPECTIVE 19, 35 (2001).

110. *E.g.*, Clarke, *supra* note 7, at 100.

even encourage managers to sacrifice profit maximization for corporate empire building.[111]

Hence, proponents of the efficiency-driven convergence thesis often make more subtle claims. Instead of positing that corporations in nations with less efficient corporate laws and institutions will go bankrupt before the onslaught of companies from nations with more efficient laws and institutions, the common argument is that capital will gravitate toward companies organized under more efficient laws and institutions.[112] This means that more new, or more vibrant and growing, companies will be formed under efficient laws and institutions, gradually replacing or rendering less relevant the aging or smaller companies that were formed under less efficient laws and institutions.[113] Also, the greater tax base provided by companies formed under more efficient laws and institutions will lead governments to change less efficient laws and institutions.[114] Along similar lines, the greater interests of those who profit more from corporations operating under efficient laws and institutions will eventually place more pressure on governments to adopt such laws and institutions than the pressure governments feel from those groups who profit, but less in the aggregate, from inefficient laws and institutions.[115]

2. *Forces for Divergence*

Critics have challenged various links in the efficiency-driven convergence thesis, even in its more subtle variations. For example, they have questioned the empirical support for the proposition that corporations must operate under the most efficient rules and institutions in order to attract investment in globalized financial markets.[116] They have also argued that political forces are as likely, if not more likely, to preserve divergence as they are to promote convergence in corporate laws.[117]

The leading work dealing with the impact of political forces on convergence of corporate laws comes from Mark Roe (sometimes joined

---

111. *E.g.*, Hansmann & Kraakman, *supra* note 16, at 461–62.

112. *E.g.*, Nestor & Thomson, *supra* note 109, at 34.

113. *E.g.*, Gugler et al., *supra* note 2, at 151–52; Hansmann & Kraakman, *supra* note 16, at 451.

114. *E.g.*, Gugler et al., *supra* note 2, at 151–52; Hansmann & Kraakman, *supra* note 16, at 451.

115. *E.g.*, Hansmann & Kraakman, *supra* note 16, at 463.

116. *E.g.*, Clarke, *supra* note 7, at 98–99.

117. *E.g.*, Bebchuk & Roe, *supra* note 2, at 157–61.

with others).[118] Roe argues that the persistence of different national patterns of dispersed versus concentrated shareholdings reflects path dependence.[119] Specifically, the historic hostility toward large banks in the United States made banks and large financial institutions in the United States unable or reluctant to take potentially controlling interests in corporations, with the result that large corporations in the United States ended up with dispersed shareholders.[120] By contrast, other countries with less political aversion to large banks ended up with corporate control by holders of large blocks of voting shares.[121] Once they started down their respective routes, nations then adopted laws, institutions, and practices that supported and made it difficult to change the norm of either dispersed or concentrated shareholders.[122]

Of course, this discussion of convergence to a single most efficient set of corporate laws and institutions assumes that there is one set that has greater efficiency than other sets—or at least sufficiently greater to actually matter. This may not be true to the extent that there are tradeoffs between various laws and institutions and the results they might promote—i.e., dispersed versus concentrated shareholdings—which leaves the advantages more or less evenly balanced.[123]

In any event, existing scholarship has given due attention to the question of whether path dependence and other possible barriers to convergence will block the forces pushing convergence toward efficiency. A question that has received little attention is whether there are other forces that push convergence toward inefficient or less normatively desirable outcomes.

B. Inefficient Convergence

1. Fads and Fashions

It used to be said in jest about male law professors that you could tell when they left the practice of law to enter teaching by the width of the neckties they wore—because they stopped buying new ties upon leaving practice and the width of ties constantly changes. If one thinks about this

---

118. MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994).

119. *See id.*

120. *Id.*

121. *Id.*

122. Bebchuk & Roe, *supra* note 2.

123. *E.g.*, Mary O'Sullivan, *The Political Economy of Comparative Corporate Governance*, 10 REV. INT'L. POL. ECON. 23, 27 (2003).

saying, the interesting question is not what it says about male law professors, but rather what it says about male lawyers (or males in many other professions): why do (or did) so many men buy new ties and stop wearing their older ties as the fashionable width changes? Indeed, why does anyone wear as non-functional an item of clothing as a necktie? The answer, of course, is that the forces for convergence in human behavior are not necessarily based upon efficiency.

Returning to the discussion of corporate laws and institutions, there are at least three reasons why such laws and institutions may converge at points that fail to have any particular efficiency or other normative advantage. The first of these reasons, in fact, is the one illustrated by clothing—this being the tendency in human behavior to follow fads and fashions for their own sake. A body of comparative law scholarship studies the precise motivations and mechanisms causing migration of legal rules between nations, looking for such influences as overseas studies by persons pushing law reform, communication between legal elites from different nations, or the persuasiveness of "other nations do this" arguments.[124] Later portions of this Article will consider two more specific motivations for importation of corporate laws—the endogenous variables problem that confuses correlation and causation, and rent-seeking by those favored by another nation's law. For now, however, it is not necessary to consider the precise mechanisms causing one nation to imitate corporate laws simply because other nations have adopted those laws—just as it is not necessary to understand the precise mechanisms and motives for the influence of clothing fashions in order to appreciate that people follow clothing fashions for the sake of being in fashion. Rather, it is simply necessary to recognize the existence of this phenomenon.

The global spread of the prohibition on insider trading, discussed earlier,[125] may be a phenomenon best explained in terms of fads and fashions. Curiously, this prohibition spread around the world at the same time that academic commentary in the nation of its origin, the United States, increasingly questioned the utility of the prohibition.[126] The claim

---

124. *E.g.*, John J. Chung, *The New Chapter 15 of the Bankruptcy Code: A Step toward Erosion of National Sovereignty*, 27 NW. J. INT'L L. & BUS. 89, 131–34 (2006); Pierrick Le Goff, *Global Law: A Legal Phenomenon Emerging from the Process of Globalization*, 14 IND. J. GLOBAL LEGAL STUD. 119, 130–45 (2007); Katerina Lino, *Diffusion Through Democracy*, 55 AM. J. POL. SCI. 678 (2011).

125. *See supra* notes 51–56 and accompanying text.

126. *See generally* Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857 (1983); Michael Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1 (1980); H. Nejat Seyhun, *The Effectiveness of the Insider-Trading Sanctions*, 35 J.L. & ECON. 149 (1992) (noting that profitable trading by insiders in the United States suggests that

that the prohibition encourages investment by small shareholders, dispersed shareholdings, and a lower cost of capital—its efficiency justifications—rests either upon faith, or upon extremely subtle and only later-produced evidence.[127] Therefore, it would not seem to explain why the doctrine spread in the late 1980s and 1990s. Rather, the prohibition seems to have spread based upon the issue catching the public imagination[128]—particularly insofar as the acceleration in the prohibition's worldwide spread followed high profile insider trading prosecutions in the United States[129] and, in the case of Japan, a high profile insider trading scandal.[130]

More recently, the worldwide spread of requirements for boards to contain so-called independent directors has outstripped the mixed evidence supporting the utility of the institution—suggesting again fad or fashion is at work. Interestingly, the notion of independent directors harkens back to the German invention of the two-tier board in which a supervisory board of directors, who are forbidden to be executives of the company, monitor a board of senior executives who actually run the company.[131] From there it is but a short jump to Melvin Eisenberg's influential notion of the monitoring board—specifically, the idea that boards cannot run or make broad policy for the large firm, but rather can only serve a useful function by monitoring the senior executives who actually make policy and run the firm.[132] Moreover, such monitoring must be done by directors who are not the executives being monitored. The idea of independent directors expands upon the notion that the monitoring directors should not be executives, by adding that monitoring directors should also not have dealings that would subject them to

---

trading of material non-public information by insiders continues despite the prohibition on insider trading).

127. *See generally* Bhattacharya & Daouk, *supra* note 52 (discussing a study in 2000 that found that passage of insider trading prohibitions in various nations did not lower the cost of capital, but the first enforcement action did have this effect).

128. Gevurtz, *supra* note 51, at 67 ("[T]he spread of insider trading prohibitions might reflect nothing more rational than the securities law mirror of the spread of American rock-and-roll, Levi's Jeans, and McDonald's hamburgers.").

129. *See generally* Carpenter v. United States, 484 U.S. 19 (1987) (involving leaking the contents of the *Wall Street Journal*'s "Heard on the Street" column); *In re* Ivan F. Boesky Sec. Litig., 36 F.3d 255 (2d Cir. 1994) (involving the highly publicized insider trading by arbitrageur, Ivan Boesky).

130. *E.g.*, Tomoko Akashi, Note, *Regulation of Insider Trading in Japan*, 89 COLUM. L. REV. 1296, 1302–03 (1989).

131. Aktiengesetz [AktG] [Stock Corporation Act] Sept. 6, 1965, BGBL. I at 1089, "as amended," §§ 105(1), 111(1).

132. MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION 149–85 (1976).

influence by the corporation's executives.[133]

One problem, however, is that gains achieved by independent directors in terms of objectivity may be offset by the loss of firm specific expertise among the directors—as the board contains fewer people with inside knowledge of the company.[134] Whether it is for this reason or the hopelessness of the whole institution of the corporate board, various efforts to study the impact of independent directors have failed to demonstrate unequivocally improved performance.[135] Still, this has not stopped nations from jumping on the bandwagon.[136] For example, China adopted an independent directors requirement even though there was no evidence of improved performance in Chinese companies already having independent directors.[137] Moreover, China took this action despite the fact that it had already adopted the German supervisory board model and therefore already had non-executive directors monitoring the performance of executives. To top it off, in a milestone of the redundancy that can occur when a nation simply copies institutions from other nations, China left in place the requirement for supervisory directors.[138]

An examination of the history of corporate law transplants could endlessly multiply the examples of imitations reflecting fads and fashions as opposed to any particular efficiency advantage. Amusingly,

---

133. *See, e.g.*, Sarbanes–Oxley Act § 301, 15 U.S.C. § 78j–l (2006) (amended Section 10A of the Securities Exchange Act to mandate that independent directors, which the statute defines, serve on registered corporations' audit committees).

134. *E.g.*, Stephen M. Bainbridge, *A Critique of the NYSE's Director Independence Listing Standards*, at text accompanying nn.58–65 (UCLA Sch. of Law Research Paper Series, Paper No. 02-15, 2002), *available at* http://ssrn.com/abstract=317121.

135. *E.g.*, Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. LAW. 921, 922 (1999); E. Han Kim & Yao Lu, Unintended Consequences of the Independent Board Requirement on Executive Suites (March 8, 2011) (working paper), *available at* http://ssrn.com/abstract=1781462. Studies in less developed economies suggest perhaps a greater impact. J. Mark Mobius, *Issues in Global Corporate Governance*, *in* CORPORATE GOVERNANCE: AN ASIA-PACIFIC CRITIQUE 39, 47–48 (Low Chee Keong ed., 2002) (noting that studies in emerging markets show better stock performance of companies with so-called better corporate governance, including more independent boards). Nevertheless, it is difficult to say how much of this result comes from having independent directors versus from other so-called good corporate governance practices. It is also hard to see how much of improved market returns reflect a current desire by investors for stock of companies with so-called better corporate governance practices, and how much reflects actual improved performance by such corporations.

136. *E.g.*, Enriques et al., *supra* note 78, at 64–65 (discussing the spread of hard and soft law requirements for independent directors).

137. *E.g.*, Donald C. Clarke, *The Independent Director in Chinese Corporate Governance*, 31 DEL. J. CORP. L. 125 (2006); Deng, *supra* note 79, at 352–53.

138. *Id.*

in an earlier era of slower change, the reflexive copying of corporate laws from one nation to another might have been sufficiently gradual that later imitators only arrived at the initial approaches well after the nations at the beginning of the chain had already abandoned them.[139]

2. *The Endogenous Variables Problem*

A second explanation for convergence around corporate laws and institutions that lack any particular efficiency or other normative advantage lies in the endogenous variables problem. In less mathematical language, it is human nature to draw confused conclusions regarding causation when policy makers deal with bundled rules and institutions. Specifically, when looking at an apparently successful model—whether this is an individual company or the overall economy of a nation—policymakers face a difficult challenge in determining which of the many features of this model (such as laws) are responsible for its apparent success. Under these circumstances it is tempting to copy features that may have had little influence in the model's success.

The literature surrounding the relationship between corporate laws and dispersed shareholders provides a recent example of this endogenous variables problem. A series of studies by financial economists La Porta, Lopez-de-Silanes, Shleifer, and Vishny (LLSV)[140] began by noting the worldwide split, discussed earlier, in the shareholding patterns for the largest corporations between the dispersed pattern found in the United States and England, and the more concentrated ownership found in most other countries. LLSV then sought to determine the causes for this divide. They did this by looking for statistical correlations between various laws and legal institutions and the pattern of shareholdings.[141] So, for example, LLSV found a patent correlation between common law countries (England and the United States) and dispersed shareholders, as opposed to civil law countries (Continental Europe, Latin America, most of Asia) and concentrated shareholdings.[142] Focusing more specifically on corporate

---

139. *See supra* text accompanying notes 46–47.

140. Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997); Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997).

141. *See* sources cited *supra* note 140.

142. La Porta et al., *Legal Determinants of External Finance*, *supra* note 140.

laws, LLSV speculated that laws protecting minority shareholders should logically lead to greater dispersion of shares, and, sure enough, found a correlation between jurisdictions whose corporate laws followed LLSV's list of minority shareholder protections and greater dispersion of shareholdings.[143]

Policy prescriptions resulting from LLSV's work regarding minority shareholder protections soon followed. If, as appeared to be the case in the 1990s when this work was published, dispersed shareholders produced better corporate and overall economic performance, and if, as seemingly demonstrated by the correlation studies, minority shareholder protections led to dispersed shareholdings, then nations should adopt minority shareholder protections. This certainly seemed persuasive to the World Bank, as it advised developing nations on the rules they should adopt.[144]

Other scholars have pointed out serious holes in LLSV's work about minority shareholder protections. To begin with, there is a rather fundamental timing flaw in LLSV's effort to draw a causal link from a static correlation study. Specifically, the dispersal of shareholdings in the United States and England predated adoption of many of the minority shareholder protections LLSV depended upon in drawing a correlation between minority shareholder protections and dispersed shareholdings.[145] The implication of this history is that rather than minority shareholder protections leading to dispersed shareholdings, dispersed shareholdings created a demand for minority shareholder protections.[146]

Moreover, LLSV's list of minority shareholder protections contains numerous laws of questionable significance. For example, they list cumulative voting among the minority shareholder protections found in the United States.[147] Cumulative voting, however, is not the prevailing rule in the United States[148] and, in any event, only aids shareholders controlling substantial blocks of stock—meaning that it lacks much

143. La Porta et al., *Law and Finance*, *supra* note 140.

144. *E.g.*, Ralf Michaels, *Comparative Law by Numbers? Legal Origins Thesis, Doing Business Reports, and the Silence of Traditional Comparative Law*, 57 AM. J. COMP. L. 765, 771–72 (2009).

145. *E.g.*, Cheffins, *supra* note 5, at 30–31.

146. *See generally* Coffee, *supra* note 98.

147. La Porta et al., *Law and Finance*, *supra* note 140, at 1127. Cumulative voting allows a shareholder to place all of the shareholder's votes, as represented by the number of the shareholder's voting shares multiplied by the number of directors to be elected, on less than the number of directors to be elected. *E.g.*, FRANKLIN A. GEVURTZ, CORPORATION LAW 503–04 (2d ed. 2010).

148. GEVURTZ, *supra* note 147, at 505.

impact in corporations with dispersed shareholdings.[149] This illustrates that nations adopting LLSV's minority shareholder protection laws in order to encourage dispersed shareholdings will end up adopting a number of laws that achieve little in this regard—even though such laws may appear to correlate with the sought after goal.[150]

It is nothing new for nations to adopt pointless or inefficient corporate laws and institutions because they are part of a package that correlates with seemingly better corporate or economic performance. Consider the worldwide adoption of the norm that a board of directors, normally elected by the shareholders, has the ultimate authority over management of the corporation. Of course, delegated management would appear to be a practical necessity in a firm with widely dispersed and constantly trading ownership shares. Still, it is less clear why ultimate authority should reside in an elected board operating as peers as opposed to an elected or even unelected chief executive officer, manager, or managers—as is common in unincorporated firms such as limited partnerships[151] and also corresponds to reality in publicly held corporations.[152]

In fact, the corporate board of directors seems to be a fairly dysfunctional institution in search of a purpose for its existence. Various studies in the United States,[153] Japan,[154] France,[155] and Germany[156]

149. *Id.* at 503, 506. *But see* Jeffrey Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124 (1994) (arguing that cumulative voting may be useful in public corporations as a mechanism to allow institutional investors to obtain representation on the board).

150. For further discussion, see Holger Spamann, *On the Insignificance and/or Endogeneity of La Porta et al.'s "Anti-Director Rights Index" Under Consistent Coding* (Harvard Law Sch. John M. Olin Ctr. for Law, Econ. and Bus. Fellows Discussion Paper Series, Paper No. 7, 2006), *available at* http://www.law.harvard.edu/programs/olin_center/fellows_papers/pdf/Spamann_7.pdf.

151. *E.g.*, UNIF. LTD. P'SHIP ACT, prefatory note (2001) (purpose of the new Uniform Limited Partnership Act is to provide a form of business for people who want strong central management, strongly entrenched, and passive investors with little control).

152. *See infra* notes 154–158 and accompanying text.

153. *E.g.*, ROBERT AARON GORDON, BUSINESS LEADERSHIP IN THE LARGE CORPORATION 143 (1966) (the board of directors in the typical large corporation does not actively exercise an important part in the leadership function); MYLES L. MACE, DIRECTORS: MYTHS AND REALITY 107 (1971) (study finding that directors rarely challenged or monitored CEO performance but instead often served as little more than "attractive ornaments on the corporate Christmas tree"); ROBERT A.G. MONKS & NELL MINOW, CORPORATE GOVERNANCE 209 (2d ed. 2001) ("The primary conclusion of this chapter is that America's boards of directors have, more often than not, failed to protect shareholders' interests."); Rita Komik, *Greenmail: A Study of Board Performance in Corporate Governance*, 32 ADMIN. SCI. Q. 163, 166–67 (1987) (modern board is a "co-opted appendage institution"); Myles L. Mace, *Directors: Myth and Reality—Ten Years Later*, 32 RUT. L. REV. 293, 297 (1979) (study reaffirmed results of earlier study as to director passivity).

154. *E.g.*, OXFORD ANALYTICA LTD., BOARD DIRECTORS AND CORPORATE GOVERNANCE:

document how corporate boards are commonly passive pawns of management and have no real role in running the corporation or disciplining those who do. Claims of improvement in the institution in recent years have proven ephemeral.[157] The history of the institution documents that this state of affairs is nothing new.[158]

So why then did the corporate board of directors develop as the governing institution for corporations, and why did this model of governance spread from nation to nation and become the worldwide norm? The answer to the first question is historical accident. Elected boards (along with a governor) constituted the governing institution for the regulated companies from which the early joint-stock companies derived.[159] This mode of governance reflected medieval European political theories under which decisions impacting a society—be it a kingdom, a town, or a merchant guild—required the members' consent, either directly or through elected representatives.[160] These theories fit naturally into regulated companies in which the members conducted their own trading and the role of the elected board was largely to make

---

TRENDS IN G7 COUNTRIES OVER THE NEXT TEN YEARS (1992), *reprinted in* MONKS & MINOW, *supra* note 153, at 267 (stating that in Japan formal authority is held by the company president and the board of directors, but board meetings are infrequent and decisions are rubber stamped; real authority is held by the president and the operating committee composed of the president's immediate subordinates).

155. *Id.* at 292. The president director-general (PDG) of French companies wields almost unchecked control over the enterprise without the counter power of the board, whose composition and agenda the PDG controls; indeed, it is regarded as bad manners for the board to vote on a management decision. *Id.*

156. *E.g.*, Mark J. Roe, *Political Preconditions to Separating Ownership from Control*, 53 STAN. L. REV. 539, 568 (2000) (German corporate supervisory boards meet infrequently and their information has been weak).

157. *E.g.*, Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233, 1241–42 (2002) (Enron's board was "a splendid board on paper" and its failure "reveal[s] a certain weakness with the board as a governance mechanism"); *The Way We Govern Now—Corporate Boards*, ECONOMIST (Jan. 11, 2003), http://www.economist.com/node/1533377 (discussing poor board governance in light of corporate scandals involving Enron); Joseph Fuller & Michael C. Jensen, *What's a Director To Do?* (Harvard Negotiation, Org. and Mkts. Research, Paper No. 02-38, 2002), *available at* http://papers.ssrn.com/abstract=357722 ("The recent wave of corporate scandals provides continuing evidence that boards have failed to fulfill their role as the top-level corporate control mechanism.").

158. *E.g.*, William O. Douglas, *Directors Who Do Not Direct*, 47 HARV. L. REV. 1305 (1934); Franklin A. Gevurtz, *The Political and Historical Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89 (2004).

159. *E.g.*, Gevurtz, *supra* note 158, at 115–22.

160. *Id.* at 129; SUSAN REYNOLDS, KINGDOMS AND COMMUNITIES IN WESTERN EUROPE 900–1300, at 302–05 (2d ed. 1997); ANTONY BLACK, GUILDS AND CIVIL SOCIETY IN EUROPEAN POLITICAL THOUGHT FROM THE TWELFTH CENTURY TO THE PRESENT 25, at 52–53 (1984).

rules for the members.[161] When the regulated company evolved into the joint-stock company, the board governance model continued without anyone asking whether an institution providing consent in making rules for a merchant society was also the best way to run a business in which the voting members were now passive investors.[162]

As non-European nations adopted the joint-stock company (corporate) form of business, they simply copied all the features of the institution, including the board, without asking what was really necessary or useful. The Japanese experience is highly illustrative. Central to the Meiji Restoration was the importation of Western institutions that the Japanese believed would develop their country.[163] This included the joint-stock company, which the Japanese saw as the organization building railroads and industries in the United States, England, and Europe.[164] Because the Japanese observed that joint-stock companies (or corporations) in the United States, England, and elsewhere were apparently run by boards of directors, they abandoned, at least formally, their traditional modes of business governance in favor of board governance.[165] One irony is that in the earliest Japanese joint-stock companies, the Japanese seem to have been unclear what the directors were supposed to do.[166] Not surprisingly, the directors eventually figured out that their job was to let the officers run the company and not do much of anything.[167] This in turn led to the ultimate irony in endogenous reasoning: Japanese observers criticized their directors for such passivity in writings that assumed directors in the United States and England were behaving differently[168]—at the same time directors in the United States and England were passively watching management of railroads and other companies defraud the shareholders.[169]

---

161. *E.g.*, WILLAN, *supra* note 25, at 19–20; Gevurtz, *supra* note 158, at 120.

162. *E.g.*, WILLAN, *supra* note 25, at 19–21; Gevurtz, *supra* note 158, at 122.

163. *See generally* RODNEY CLARK, THE JAPANESE COMPANY 30 (1979).

164. *See* HIRSCHMEIER & YUI, *supra* note 48.

165. *E.g.*, Franklin A. Gevurtz, *The European Origins and Spread of the Corporate Board of Directors*, 33 STETSON L. REV. 925, 937–40 (2004); Tsunehiko Yui, *The Development of the Organizational Structure of Top Management in Meiji Japan*, *in* 1 JAPANESE YEARBOOK ON BUSINESS HISTORY 1, 4–5 (1984).

166. CLARK, *supra* note 163, at 18–19.

167. *E.g.*, HIRSCHMEIER & YUI, *supra* note 48, at 7 (quoting Ukichi Taguchi, the publisher of the *Tokyo Keizai Zasshi*, then Japan's most influential economic journal, who wrote in 1884, "directors [of Japanese banks] might as well be retired . . . the president handles everything himself").

168. *Id.*

169. For a contemporary literary account of board passivity in the face of the railroad frauds in

3. *Rent-Seeking*

A third reason for convergence around corporate laws and institutions that lack any particular efficiency or other normative advantage is interest group rent-seeking. Hansmann and Kraakman recognized this force for inefficient convergence in their "End of History" article.[170] As one example, they point to convergence around limited liability for corporate shareholders.[171] It is not surprising that Hansmann and Kraakman should point to limited liability as an inefficient convergence, because some years earlier they had achieved considerable scholarly notoriety for an article advocating significant curtailment of the doctrine.[172]

In fact, a controversial article by Hansmann and Kraakman is not the only thing that can cause one to question the efficiency of the convergence favoring limited liability. The excessive risk taking by financial corporations culminating in the 2008 financial crisis illustrates once again the moral hazard created by limited liability.[173] A common justification for allowing this moral hazard is the critical role that limited liability plays in facilitating dispersal of shareholdings and development of stock markets.[174] However, historical evidence from nineteenth century England—in which different approaches to limited liability allow for empirical observation of the extent to which dispersed shareholdings and stock markets arise with or without limited liability—raises strong questions as to the accuracy of this rationalization.[175] Closer to home and time, the fact that California's economy was able to function without limited liability for corporate shareholders until 1931

---

the late 1800s, see ANTHONY TROLLOPE, THE WAY WE LIVE NOW 298–309 (1875) ("Melmotte [the chief executive officer of the company and perpetrator of a fraudulent promotion] would speak a few slow words . . . always indicative of triumph, and then everybody would agree to everything, somebody would sign something, and the 'Board' . . . would be over.").

170. Hansmann & Kraakman, *supra* note 16, at 466–67.

171. *Id.*

172. Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L. J. 1879 (1991).

173. *E.g.*, Claire Hill & Richard Painter, *Berle's Vision Beyond Shareholder Interests: Why Investment Bankers Should Have (Some) Personal Liability*, 33 SEATTLE U. L. REV. 1173 (2010).

174. *E.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 94–96 (1985); Paul Halpern, Michael Trebilcock & Stuart Turnbull, *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117, 136–38 (1980).

175. *See generally* Graeme G. Acheson, Charles R. Hickson & John D. Turner, *Does Limited Liability Matter? Evidence from Nineteenth-Century British Banking*, 6 REV. L. & ECON. 247 (2010), *available at* http://www.bepress.com/rle/vol6/iss2/art6.

would seem to say something.[176]

Moreover, the rationale for shareholders in public corporations to enjoy limited liability hardly explains the extent and direction of the convergence in favor of the doctrine. As mentioned above,[177] the 1892 German invention of the limited liability company—which is expressly designed to make it easier to have limited liability for controlling owners in closely held firms—spread like wildfire in the 1990s throughout the United States, despite the fact that in closely held firms the moral hazard created by limited liability is high and the utility of this doctrine is low.[178] If this was not enough limited liability for controlling owners of businesses, the limited liability partnership—creating limited liability for ordinary partners by the magic of merely filing a piece of paper—also spread throughout the United States in the 1990s.[179]

Hansmann and Kraakman theorize that this spread of limited liability resulted from the fact that shareholders (whom the doctrine favors) are more organized in pursuing their interests than prospective unpaid creditors of corporations (whom the doctrine disfavors)—especially unpaid creditors like future tort victims, who do not even realize their interest in the issue until later.[180] Of course, one might suspect that a similar interest group dynamic could be at work in the periodic convergence toward deregulation that removes mandatory protections for minority shareholders. Corporate managers who face limits on their power and potential liability at the behest of minority shareholders presumably favor such deregulation.[181] And indeed, throughout the history of corporate laws, corporate managers have used the threat of incorporating in another jurisdiction to encourage removal of restrictive corporate laws.[182]

Deregulation with respect to shareholder protection, however, does not produce a permanent convergence because busts produce a backlash

---

176. Blumberg, *supra* note 37, at 597–99.

177. *See supra* text accompanying note 62–64.

178. *E.g.*, Easterbrook & Fishel, *supra* note 174, at 109–10; Halpern et al., *supra* note 174, at 140–41.

179. *E.g.*, Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 COLO. L. REV. 1065, 1065–66 (1995).

180. Hansmann & Kraakman, *supra* note 16, at 466–67.

181. *See, e.g.*, Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1468 (1992) (explaining why managers may prefer state laws that insulate them from threat of removal and allow self dealing despite such laws' lowering the value of corporate stock).

182. See *supra* text accompanying notes 104–105.

by disgruntled shareholders.[183] By contrast, the boom and bust cycle seems to have had a ratcheting effect that favors limited liability. During booms, corporate creditors presumably are less concerned with limited liability. It has been during busts, however, that many extensions of limited liability have occurred—such as California's change in 1931,[184] the creation of limited liability partnerships in the United States to protect professional firms being sued for malpractice following the savings and loan crisis in the early 1990s,[185] as well as earlier examples in England[186] and elsewhere. Such busts make the issue of limited liability even more salient to shareholders, who then recognize the danger from unlimited liability and are able to catch more sympathy than creditors. [187]

In sum, the debate over whether Darwinian evolution will force convergence of corporate law into efficient forms or be stymied by path dependence or other barriers overlooks much (if not most) of the action when it comes to corporate law convergence. Between mindless following of fads and fashions in corporate law, erroneous assumptions that corporate forms or rules correlating with successful performance produced that performance, and opportunistic rent-seeking by groups pushing for importation of forms and rules that favor their interests, much of corporate law convergence has little to do with efficiency.

III. WHAT IS IMPORTANT IN MEASURING CONVERGENCE

A. *The Assumptions of Academics*

Even the most diehard believer in the convergence of corporate laws and institutions expects that some residual differences will remain between the corporate laws and institutions of various nations.[188] At the same time, even the greatest skeptic of convergence recognizes the existing similarities among the corporate laws and institutions of various countries.[189] Hence, any discussion of convergence must embody some value judgments by which to decide the relative significance of the areas

---

183. See *supra* text accompanying notes 89–101.

184. *E.g.*, Blumberg, *supra* note 37, at 599.

185. *E.g.*, Hamilton, *supra* note 179, at 1065–66.

186. *E.g.*, Blumberg, *supra* note 37, at 584.

187. For a history of corporate law in one country (Brazil), which shows how elites selected corporate laws from other nations in order to advance their interests, see Pargendler, *supra* note 37.

188. *E.g.*, Hansmann & Kraakman, *supra* note 16, at 464–65.

189. *E.g.*, Bratton & McCahery, *supra* note 2, at 236–37.

of similarity versus the areas of difference.

If we accept the Darwinian evolution toward efficiency model, we might reach the rather circular conclusion that convergence itself proves the importance of the corporate law or institution upon which nations have converged—less important issues being ones where inefficient divergence can survive.[190] The prior part of this article, however, gives us reasons to pause before assuming that efficiency, rather than other forces, drives convergence. If we cannot rely on convergence itself, how else can we assess the importance of areas of convergence versus divergence?

Unfortunately, too much of the literature on convergence seems to rely on the authors' personal interest in a rule or institution or on the presence of academic literature addressing the particular rule or institution, rather than carefully examining the importance of the corporate rule or institution in the practical workings of corporate law. Hansmann and Kraakman's "End of the History" article provides a good illustration. It speaks of adoption of the "standard shareholder-oriented model" as marking the point of convergence on the ostensibly remaining critical issues facing corporate law—these being, according to Hansmann and Kraakman, the accommodation of non-shareholder interests as well as the protection of minority shareholders from expropriation by the majority.[191] This standard shareholder-oriented model encompasses a mélange of notions, some of which consist of the components of the model and others which consist of contrasts drawn with other models. This model, however, is largely irrelevant to corporate law, is relatively unimportant in the practical workings of corporate law, or fails to display the convergence that Hansmann and Kraakman proclaim.

The other models against which Hansmann and Kraakman contrast the standard shareholder-oriented model are the manager, labor, and state-oriented models. The state-oriented model, as Hansmann and Kraakman largely concede, has little to do with corporate law—at least since general incorporation laws replaced individually granted corporate charters bestowed upon those who asserted some public advantage from the proposed enterprise. State ownership of corporate enterprises, which existed in many parts of the world throughout the twentieth century, constitutes the most dramatic example of a state-oriented model. Since

---

190. *See, e.g.*, Hansmann & Kraakman, *supra* note 16, at 465–66 (referring to corporate law differences that do not impact efficiency and therefore are less likely to converge as "harmless mutations").

191. *Id.* at 440.

the fall of the "Iron Curtain," however, the prevailing consensus has generally disfavored state ownership of corporations[192]—albeit, state ownership, at least of many large banks, came close to making a comeback in 2008.[193] This, however, is an issue about economic structure on the most macro level, rather than the subject of corporate law.[194] About the best Hansmann and Kraakman can do is speculate that states might use their role in enforcing corporate laws to further a government industrial policy. Such actions, however, seem to be pretty small potatoes in the arsenal available to a government determined to implement such a policy, and there is no sign of a convergence that would make enforcement of corporate laws an entirely private affair.[195]

The labor-oriented model, which was pioneered in Germany, involves the ability of employees to elect some members of the board of directors (co-determination). Regardless of whether co-determination is all that significant in the practical workings of corporate law, Hansmann and Kraakman's thesis runs into a problem in claiming that there is convergence on rejecting this institution. Rather, as discussed above,[196] there does not seem to be much movement either way by nations on this question.

The manager-oriented model gets us into the heart of corporate law by addressing the balancing of discretion given to (versus checks imposed on) those in charge of the corporation. Hansmann and Kraakman, however, sidetrack this into a largely abstract academic debate. Specifically, they focus on the public interest rationale for granting managers substantial discretion in running the corporation. This rationale supports giving managers substantial discretion based upon the argument that managers will use their discretion to run the corporation in

---

192. *See, e.g.*, William Megginson, *Privatization*, Foreign Policy, No. 118, at 14–27 (2000) (describing the growing privatization of government owned enterprises in the 1990s and thereafter).

193. *See generally* Barbara Black, *The U.S. as "Reluctant Shareholder": Government, Business and the Law*, 5 ENTREPREN. BUS. L.J. 561 (2010).

194. *See supra* note 68 and accompanying text.

195. *See, e.g.*, Bundesgerichtshof [BGH] [Federal Court of Justice] Dec. 21, 2005, NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 522, 2006 (F.R.G.) (criminal prosecution in Germany for breach of duty in granting executive bonuses); JEFFREY D. BAUMAN, ALAN R. PALMITER & FRANK PARTNOY, CORPORATIONS LAW AND POLICY. MATERIALS AND PROBLEMS 157–58 (5th ed. Supp. 2006) (criminal prosecution of Tyco's ex-CEO in the "$5000 shower curtains" case for taking excessive perks); Klaus J. Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, 59 AM. J. COMP. L. 1, 63 (2011) (noting that in many nations, the capital market's regulatory authority enforces corporate governance rules).

196. Far from representing a point of convergence, there seems to be little movement among nations to change to or from co-determination.

a way that advances the interest of the general public[197] or the interests of all the stakeholders in the corporation, including employees, creditors, customers, and the like.[198] Hansmann and Kraakman come down on the side of what is generally labeled "shareholder primacy." In this shareholder-oriented model, "the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders; [while] other corporate constituencies, such as creditors, employees, suppliers, and customers, should have their interests protected by contractual and regulatory means . . . ."[199]

While the debate about whether corporate managers should prioritize the interests of the shareholders over the interests of other constituencies or should have discretion to balance interests as they see fit has occupied copious quantities of academic literature,[200] its impact on the practical workings of corporate law has been remarkably small. Even the strongest legal pronouncements of a shareholder primacy norm immediately defang the obligation by granting managers wide discretion to balance interests as they see fit.[201] All that is required is that someone (including, if necessary, the court) conjure up an imaginative theory under which, in the long, long run, the shareholders will be better off by virtue of the immediate favoring of other interests.[202] Conversely, outside the context of creditor protection in corporations facing insolvency, one would be hard pressed to find in any nation—except the Netherlands[203] —a judicial decision holding that directors breached a legal duty by favoring shareholders over other stakeholders in the company.[204]

---

197. *E.g.*, Dodd, *supra* note 68, at 1147–48.

198. *E.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 276–87 (1999).

199. Hansmann & Kraakman, *supra* note 16, at 440–41.

200. *E.g.*, Martin Gelter, *Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light*, 7 N.Y.U. J. L. & BUS. 641 (2011) (addressing the question of whose interests should take priority); Kent Greenfield, *The Impact of "Going Private" on Corporate Stakeholders*, 3 BROOK. J. CORP. & FIN. L. 72, 86 (2008); Milton Friedman, *The Social Responsibility of Business Is to Increase its Profit*, N.Y. TIMES SUNDAY MAGAZINE, Sept. 13, 1970, at 17; Blair & Stout, *supra* note 198. *See also generally* Dodd, *supra* note 68; Berle, *supra* note 68, at 1367–68.

201. *E.g.*, Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

202. *E.g.*, Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 775 (2005).

203. *E.g.*, Winfried van den Muijsenbergh, *Corporate Governance: The Dutch Experience*, 16 TRANSNAT'L LAW. 63, 69–70 (2002) (describing authority of Dutch worker councils to challenge decisions by corporation management before a specialized court in Amsterdam).

204. The other components of Hansmann and Kraakman's standard shareholder-oriented model

Hansmann and Kraakman are hardly alone in failing to focus on the objectively important—as opposed to the academically interesting—in addressing convergence. As discussed earlier,[205] LLSV picked a number of laws, presumably based upon their reading of legal scholarship, in order to test whether so-called minority shareholder protections impact the distribution of stock in large corporations. Yet careful analysis would suggest that many of the laws they picked, such as cumulative voting, do little to protect minority shareholders in public corporations.[206]

B. The Tough Policy Issues

Whether based upon an economic model that treats the corporation as a species of the principal-agent problem requiring the control of agency costs,[207] or whether based upon the history of corporations since the South Sea Bubble of the early 1700s[208] constituting a string of scandals in which those in charge of corporations fleeced their shareholders,[209] theory and history establish that a major concern of corporate law is to protect shareholders from those in control of the corporation. This concern with protecting shareholders is far more central to corporate law than the goal of protecting others impacted by corporate managers. For one thing, laws seeking to protect non-shareholders typically do not involve corporate law or may only involve corporate laws of limited geographic reach (as with co-determination). Also, such laws may deal with only narrow aspects of corporate law (as with laws designed to protect creditors[210]). Finally, concerns about protecting non-shareholders

---

are that ultimate control over the corporation should be in the hands of the shareholder class; that non-controlling shareholders should receive strong protection from exploitation at the hands of controlling shareholders; and that the principal measure of the interests of the publicly traded corporation's shareholders is the market value of their shares in the firm. The first and second of these three components are not new points of convergence; indeed, they have a sort of "well duh" quality. The third of these components has been rejected by the Delaware Supreme Court in *Smith v. Van Gorkom*, 488 A.2d 858, 876–78 (Del. 1985)—and, needless to say, the pronouncements of the Delaware Supreme Court can hardly be ignored in any discussion of convergence in the law of publicly held corporations.

205. *See supra* text accompanying note 140.

206. *See supra* notes 148–151 and accompanying text.

207. *E.g.*, Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308–10 (1976).

208. *See, e.g.*, EDWARD CHANCELLOR, DEVIL TAKE THE HINDMOST: A HISTORY OF FINANCIAL SPECULATION 58–95 (1999) (describing the South Sea Bubble of the 1700s).

209. *See supra* notes 90–102 and accompanying text (describing history of corporate scandals following deregulation resulting in losses to investors and the resulting increase in regulation to protect shareholders).

210. For a discussion of the primary approaches taken by corporate laws in different nations to

through corporate law are commonly more theoretical than practical in their impact (as with the debate over shareholder primacy and directors' duties). By contrast, laws seeking to protect shareholders are universal among jurisdictions and significantly impact most aspects of corporate law.[211]

Yet it is not merely the pervasiveness of shareholder protection in corporate law that renders shareholder protection an appropriate focus for a discussion of convergence. The very difficulty in crafting effective protections for shareholders necessitates comparative law analysis—after all, there is no sense in spending much time comparing how various nations handle the easy issues with obvious answers. Unfortunately, devising effective means of protecting shareholders has proven to be an intractable challenge—meaning that the end of history for corporate law will probably be the day before the Messiah arrives or the universe ends. In the meantime, we should not expect a stable convergence around the two fundamental questions that must be answered in addressing the protection of shareholders from those controlling the corporation.

1. Mandatory Versus Permissive Corporate Law

As discussed earlier,[212] one of the enduring cycles in corporate law is the moving convergence on the balance between regulation and deregulation in the protection of minority shareholders. Hence, one does not need familiarity with the voluminous academic literature addressing the topic[213] to recognize the critical importance of the debate over whether corporate law protections of minority shareholders should be mandatory or left for the participants to work out.

The competing tensions here are ideological, political, and practical. The ideological disagreements over mandatory versus permissive

---

protect creditors from the dangers created by limited liability, see GEVURTZ, *supra* note 18, at 33–41.

211. *See infra* text accompanying notes 237–255 (discussing divergent approaches to corporate law in different nations).

212. *See supra* text accompanying notes 87–108 (describing cycles of regulation and deregulation).

213. *See generally* Lawrence E. Mitchell, *Trust. Contract. Process.*, *in* PROGRESSIVE CORPORATE LAW 185 (Lawrence E. Mitchell ed., 1995); *Symposium on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989) (containing a number of leading articles on the topic); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001); Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990); James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207 (1988).

corporate law rules reflect differing factual assumptions about the rationality of individuals, i.e., whether people act as rational wealth-maximizing individuals or whether they act on irrational behavioral impulses.[214] The ideological disagreements also reflect different assumptions about the efficiency of markets[215] and the capability of government to avoid inefficient rent-seeking by public officials and other interest groups.[216] Finally, they reflect a philosophical disagreement about the intrinsic value of individual autonomy.[217]

The earlier discussion about cycles of regulation and deregulation illustrates the political tensions that prevent stable convergence regarding mandatory versus permissive corporate law.[218] Corporate managers, for obvious reasons, are generally resistant to regulation that would limit their autonomy. Furthermore, unless a crisis looms, there may be little push by shareholders for mandatory protections because shareholders may underestimate the danger and overestimate their ability to protect themselves.[219] The prospect of regulatory arbitrage—forming the corporation under more relaxed laws—creates special pressure for deregulation in the corporate arena.[220]

The increasing numbers of American and foreign limited liability companies organizing under Delaware law while operating largely or exclusively outside of Delaware[221] highlight the political forces behind deregulation. The Delaware limited liability company statute expressly sets forth a policy maximizing freedom of contract and allowing elimination of every fiduciary and other duty except the basic duty of

214. *See generally* Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1053 (2000); Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499 (1998).

215. *Compare* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998), *with* Melvin A. Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461 (1989).

216. *E.g.*, Stephen J. Choi, *Channeling Competition in the Global Securities Market*, 16 TRANSNAT'L LAW. 111, 115–16 (2002).

217. *See, e.g.*, David Crossley, *Paternalism and Corporate Social Responsibility*, 21 J. BUS. ETHICS, 291 (1999).

218. *See supra* text accompanying notes 87–108.

219. *See, e.g.*, Eisenberg, *supra* note 215, at 1474–80 (discussing problems with shareholder consent to fiduciary duty waivers).

220. *See supra* notes 103–105 and accompanying text.

221. *E.g.*, Jens Dammann & Matthias Schundeln, *Where Are Limited Liability Companies Formed: An Empirical Analysis* 2, 8 (Univ. of Tex. Sch. of Law, Law and Econ. Research Paper No. 126, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1633472.

good faith and fair dealing.[222] This law has been one of the main drivers of decisions by out-of-state limited liability companies to organize under Delaware law.[223]

Another and earlier example comes from the 1980s. In response to a highly controversial Delaware Supreme Court decision finding that directors had breached their duty of care,[224] Delaware enacted a striking example of permissive legislation in corporate law. The legislature amended Delaware's corporate statute to allow provisions in certificates of incorporation that waive monetary liability for directors who breach their duty of care.[225] Demonstrating convergence in action, this scene later replayed itself in Japan in the 1990s. Following a huge damage award against directors of a Japanese bank who breached their duty of care, the Japanese legislature enacted a provision allowing corporate charters to limit the amount of damages for which directors can be liable.[226]

As explained earlier, however, these political winds can blow in both directions, thereby preventing a permanent convergence in favor of deregulation. Ever since the South Sea Bubble, waves of corporate scandal and crisis have caused large losses for shareholders and triggered broader economic dislocation. The result—from the English Bubble Act's attempt to prevent joint-stock companies without official charter, from issuing transferable shares,[227] to the mandatory corporate governance provisions in the Sarbanes–Oxley[228] and Dodd–Frank[229] Acts—is a political backlash against deregulation and an adoption of mandatory shareholder protections.

Finally, what frustrates permanent convergence is the simple fact that both regulation through mandatory protections and deregulation through contractual freedom have merits and flaws. Practically speaking, finding

---

222. DEL. CODE ANN. tit. 6, §§ 18–1101 (2011).

223. Franklin A. Gevurtz, Why Delaware LLCs? (unpublished manuscript) (on file with author) (finding from a survey of attorneys whose clients formed limited liability companies (LLCs) that the Delaware freedom of contract provision was one of the most frequently cited reasons for establishing LLCs under Delaware law).

224. Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985).

225. DEL. CODE ANN. tit. 8 § 102(b)(7) (2011).

226. *E.g.*, Bruce E. Aronson, *Learning from Comparative Law in Teaching U.S. Corporate Law: Director's Liability in Japan and the U.S.*, 22 PENN ST. INT'L L. REV. 213, 232 (2003).

227. *E.g.*, HENN & ALEXANDER, *supra* note 41, at 21–22.

228. Public Company Accounting Reform and Investor Protection (Sarbanes–Oxley) Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 and 18 U.S.C.).

229. Wall Street Reform and Consumer Protection (Dodd–Frank) Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (codified in scattered sections of 12 and 15 U.S.C.).

the "Goldilocks" balance between bust-producing deregulation[230] and growth-stifling regulation[231] has not been an easy undertaking.

2. *Authority Versus Accountability for Corporate Managers*

Drawing on the organizational theories of Kenneth Arrow,[232] Stephen Bainbridge has crystallized a second fundamental tension in corporate law: the tension between the authority and accountability of those in charge of the corporation.[233] Specifically, in order for any organization to function, members of the organization must be given some authority to act; if no one has authority to do anything, nothing gets done. The problem—which economists call the "principal-agent" or "agency cost" problem[234]—is that those with authority to act often misuse their authority. They may engage in disloyal conduct to enrich themselves at the expense of the organization or they may act honestly but misguidedly out of carelessness, bad judgment, or various biases and emotions. As expressed in an old cliché instead of the language of economics, because humans are inherently fallible, "power corrupts." Hence, there is need for mechanisms of accountability, lest authority devolve into the corruption that results from absolute power.

The tension begins with the fact that mechanisms of accountability necessarily impinge on authority. This fact is particularly evident when the mechanism involves a requirement of advance approval. Even when the mechanism involves only after-the-fact consequences, however, the fear of such consequences can reduce the willingness to exercise authority. This may deter desirable as well as undesirable acts.[235] The real problem, however, is not simply that accountability limits authority; it is that mechanisms of accountability generally are not self-executing. Instead, fallible human beings carry out the accountability mechanisms, whether this involves selecting those who will have authority, approving specific actions, or deciding if authority has been misused. Hence, accountability mechanisms essentially transfer authority from one person to another person or group. These transferees, however, may

---

230. *See supra* notes 88–93 and accompanying text (describing bust-producing deregulation).

231. *E.g.*, Coffee, *supra* note 2, at 653–57 (describing problems of overregulation of financial markets in French and German history).

232. KENNETH J. ARROW, THE LIMITS OF ORGANIZATION (1974).

233. STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 252–53 (2002).

234. *See* Jensen & Meckling, *supra* note 207.

235. *E.g.*, Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982); Melvin A. Eisenberg, *The Duty of Care of Corporate Directors and Officers*, 51 U. PITT. L. REV. 945, 963–64 (1990).

themselves have poor motives or act misguidedly. Of course, one could have other persons impose accountability upon the persons who impose accountability, but then, given this logic, one must repeat this process endlessly.

At this point, one could throw up one's hands and decide that the whole enterprise of imposing accountability is pointless. Corporate law, however, is built on the notion of finding some balance. The difficulties and disagreements inherent in finding the appropriate balance suggest that this will be an area of divergence or constantly shifting convergence.

We can find examples of these disagreements in the various mechanisms of accountability, including selection, approval, and consequences. Recently in the United States, disagreements about accountability through selection have played out in the controversy over "proxy access," which refers to the right of shareholders in public companies to demand that shareholder nominees for board positions appear on the proxy form distributed by the corporation to its shareholders. While this would seem to be an elementary exercise in democratic governance, critics of proxy access have highlighted conflicts of interest and misguided motives among shareholders demanding proxy access.[236] In other words, critics have pointed to the fallible nature of those who would monitor others through the mechanism of selection.[237]

Actually, proxy battles for control of publicly traded companies are not major drivers of accountability because they rarely occur.[238] Of far more significance is the threat of a change in management following a corporate takeover.[239] Corporate laws in different nations diverge in the manner they govern such acquisitions and management's efforts to thwart them. Indeed, an attempt to harmonize corporate takeover laws in Europe provoked so much controversy that the resulting European Union harmonizing directive allows member nations to opt out of key

---

236. *E.g.*, Press Release, Sec. Exch. Comm'n, SEC Adopts New Measures to Facilitate Director Nominations by Shareholders (Aug. 25, 2010), http://www.sec.gov/news/press/2010/2010-155.htm; Jesse Westbrook, *SEC Delays Proxy-Access Rules Amid Legal Challenge*, BLOOMBERG BUSINESSWEEK (Oct. 4, 2010, 5:34 PM EDT), http://www.businessweek.com/news/2010-10-04/sec-delays-proxy-access-rules-amid-legal-challenge.html.

237. *E.g.*, Lynn A. Stout, *Corporations Should Not Be Democracies*, WALL ST. J., Sept. 27, 2007, at A17.

238. *E.g.*, Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 682–83 (2007) (reporting the small number of contested proxy solicitations).

239. *E.g.*, Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 115–17 (1965).

provisions.[240] This is yet another example of the difficulties of balancing authority and accountability between managers (who have an interest in preserving their positions)[241] and shareholders (who face collective action problems in deciding whether to sell).[242]

The dilemma of how to balance authority and accountability also has produced disagreement among nations about requirements for shareholder approval of management actions and shareholder ability to command management actions.[243] Shareholders in many nations possess more power in these areas than they do the United States.[244]

There is also marked divergence in approaches to achieving accountability by imposing liability on managers for disloyal or ill-advised decisions. In some instances, this divergence is subtle and even concealed under an apparent convergence. For example, the doctrine known as the "business judgment rule," which apparently originated in the United States,[245] has spread worldwide.[246] This doctrine calls for restraint in imposing liability upon directors for disinterested decisions that turn out badly or with which some shareholders may disagree.[247] Hence, at first glance, this would appear to represent an important example of convergence on the fundamental question of balancing authority and accountability through judicial review of business decisions.

---

240. *E.g.*, Marco Ventoruzzo, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, 41 TEX. INT'L. L. REV. 171, 212 (2006).

241. *E.g.*, Bebchuk, *supra* note 181.

242. *E.g.*, Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 256–64 (1989) (discussing coercive tender offers).

243. *E.g.*, Enriques et al., *supra* note 78, at 72–74.

244. *Id. Compare* CA, Inc. v. AFSCME Emp. Pension Plan, 953 A.2d 227, 238–39 (Del. 2008) (limiting ability of shareholders to command substantive business decisions through bylaw amendment), *with* AktG § 83 (giving shareholders authority to command management board of German public company to handle matters within shareholder competence), *and* AktG § 118 (listing matters within shareholder competence, including amendment of articles), *and* AktG § 174 (conferring on shareholders the authority to determine dividends).

245. *See* Percy v. Millaudon, 8 Mart. (n.s.) 68, 77–78 (La. 1829).

246. *E.g.*, Peoples Dep't Stores Inc. (Trustee of) v. Wise, [2004] 3 S.C.R. 461, para. 64 (Can.) (describing the adoption of the business judgment rule in Canada, the U.K., Australia and New Zealand); Bundesgerichtshof [BGH] [Federal Court of Justice] Apr. 21, 1997, 175 Entscheiungen des Bundesgerichtshofes in Zivilsachen [BGHZ] 135 (244) (F.R.G.) (*the ARAG/Garmenbeck case*) (describing adoption of business judgment rule in Germany); Tokyo Chiho Saibansho [Tokyo Dist. Ct.] Sept. 16, 1993, 1469 HANREI JIHO [HANJI] 25 (*Ikenaga v Tabuchi*) (invoking business judgment rule in Japan); Hopt, *supra* note 195, at 39 (describing introduction of business judgment rule in Switzerland, Japan, Germany, Portugal, Australia, and Denmark).

247. *E.g.*, GEVURTZ, *supra* note 147, at 286.

A closer examination of case law, however, reveals that a rule calling for restraint in second-guessing board decisions may be applied very differently in different legal cultures. For example, a few years ago, Delaware judges applied the business judgment rule in a highly deferential manner to exonerate directors who had approved payment of $130 million to the fired former president of a company after a one-year term in which he accomplished very little.[248] At around the same time, German judges found a breach of duty, despite applying the business judgment rule, by nitpicking at the decision of the directors of a German company to award a bonus of $17 million to the outgoing CEO, whose actions had played an important role in gaining over $50 *billion* for the company's shareholders.[249]

Such differences in attitudes may both reflect and reinforce important societal differences whose significance would be masked if one only paid attention to the apparent convergence marked by both courts' purported decision to apply the business judgment rule. There is a wide gulf between executive compensation levels in the United States and in the rest of the world, whether measured in absolute terms or in terms of comparison with the ordinary workers of the company.[250] Executive compensation levels in the United States have grown dramatically in the last thirty years and contribute to the growing income gap in the United States between the top one percent of earners and everyone else.[251] Unless there is convergence in broader national attitudes regarding the importance of equality in wealth distribution,[252] one cannot expect convergence in the application of even nominally similar corporate laws

248. *In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27, 73 (Del. 2006).

249. Bundesgerichtshof [BGH][Federal Court of Justice] Dec. 21, 2005, - 3 StR 470/04, Neue Juristische Wochenschrift [NJW] 522 (F.R.G.) (*the Mannesmann Case*). For a discussion of the different judicial attitudes revealed in the *Disney* and *Mannesmann* opinions, see Franklin A. Gevurtz, *Disney in a Comparative Light*, 55 AM. J. COMP. L. 453 (2007).

250. *E.g.*, John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 331 n.86 (2004) (contrasting compensation gaps in the United States and other developed nations); Susan J. Stabile, *Enron, Global Crossing and Beyond: Implications for Workers*, 76 ST. JOHN'S L. REV. 815, 829 n.63 (2002) (citing more articles that discuss the growing gap between executive and worker pay in the United States).

251. *E.g.*, JACOB S. HACKER & PAUL PIERSON, WINNER-TAKE-ALL POLITICS 39, 46, 61–66 (2010); Nicholas D. Kristof, *Our Banana Republic*, N.Y. TIMES, Nov. 6, 2010, at WK10.

252. *E.g.*, David Brooks, *The American Way of Equality*, N.Y. TIMES, Jan. 14, 2007, at 4 (reviewing the work of sociologist Seymour Lipset, whose studies of American exceptionalism highlight the willingness of Americans to accept income inequality, in contrast with citizens of other western societies); *Umfrage: Gerechtigkeit vor Freiheit*, ZEIT ONLINE, TAGESSPIEGEL (Dec. 2, 2006), http://www.zeit.de/news/artikel/2006/12/02/83097.xml (reporting on a survey by the German newspaper *Welt am Sonntag* that found that a majority of Germans (fifty-eight percent versus thirty-four percent) prefer "social justice"—i.e., income equality—to economic freedom).

addressing the balance of authority versus accountability in executive compensation.

Finding the balance between authority and accountability becomes even more difficult when one considers the process for enforcing liability upon corporate managers. The problem is that the concept of authority calls for managers to decide if the corporation should enforce claims against the managers themselves. Accountability is only achieved, however, if someone else makes enforcement decisions. Yet any other decision maker faces potential problems of suspect motives or significant costs (often paid by the corporation) in order to determine whether liability (or even further investigation) is warranted.[253]

Interestingly, there has been a growing convergence in this area. Many civil law nations have begun to recognize derivative suits brought by shareholders on the corporation's behalf against its directors while also subjecting such suits to minimum shareholding requirements for standing and perhaps to judicial preclearance of the merits of the action.[254] At the same time, the United States, which apparently pioneered the derivative suit,[255] has seen various efforts to curb such litigation, especially by turning the requirement that the plaintiff make a pre-suit demand upon the board into a judicial preclearance of the merits

253. *See generally* Franklin A. Gevurtz, *Who Represents the Corporation? In Search of a Better Method for Determining the Corporate Interest in Derivative Suits*, 46 U. PITT. L. REV. 265 (1985) (addressing the dilemma of who (among disinterested directors, plaintiff shareholder, shareholder majority, or the courts) should determine whether a lawsuit against directors is in the corporation's best interest).

254. Under a 2005 German amendment, stockholders with one percent or 100,000 euros' worth of the outstanding stock can bring a lawsuit on the corporation's behalf if evidence justifies the suspicion of illegal activities or a serious violation of the law or articles. Shareholders must first make a demand upon the board, and the court may dismiss the suit if the board can show the court that not suing would be in the overriding interest of the company. AktG § 148; s*ee also* Gōngsī Fǎ [Company Law of the People's Republic of China] (promulgated by the Standing Comm. Tenth Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006), arts. 152–153, translated in iSinoLaw (P.R.C.) (authorizing shareholders with one percent of the stock to demand the company sue a director or executive who violates the law or articles and causes the company losses, or to institute a suit if the demand is not met); Klaus J. Hopt, *Shareholder Rights and Remedies: A View from Germany and the Continent*, 2 CO. FIN. & INSOLVENCY L. REV. 261, 273 n.60 (1997) (reporting that derivative suits have become available to holders of at least one percent or 50 million Belgian francs worth of stock in Belgium); Marco Ventoruzzo, *Experiments in Comparative Corporate Law: The Recent Italian Reform and the Dubious Virtues of a Market for Rules in the Absence of Effective Regulatory Competition*, 40 TEX. INT'L L. J. 113, 140–41 (2004) (describing a 1998 change in Italian law that allows derivative suits by shareholders with at least five percent of the corporation's outstanding stock).

255. *See generally* Hawes v. Oakland, 104 U.S. 450 (1881) (example of early U.S. derivative suit); Dodge v. Woolsey, 59 U.S. 331 (1855) (same); *see also* CONARD, *supra* note 3, at 402 (discussing historical barriers to derivative suits outside the United States).

of the suit.[256] Still, this convergence may simply reflect unsatisfactory compromise in the face of intractable problems with the mechanisms for enforcing liability upon corporate managers.

In the end, the balancing of authority and accountability, like the balancing of permissive and mandatory protections for shareholders, defies stable and complete convergence. This is the expected result in areas in which there are significant policy tensions and no easy solutions.

CONCLUSION

Whether expressly stated or left implicit, a normative agenda underlies the predictions of convergence: if convergence is going to happen anyway because of efficiency, then nations should embrace convergence.[257] Depending upon the nation of the writer, this translates into support of legal exports (you should adopt my nation's corporate laws) or of legal imports (we should adopt another nation's corporate laws).

The theses developed here are intended to prevent an unexamined acceptance of such arguments. Convergence through imitation and transplant is constantly occurring in corporate law, but the points upon which corporate laws converge commonly represent only temporary way stations from which divergence will reappear until there is convergence again at a new point of temporary consensus. Corporate laws do not necessarily converge to more efficient or otherwise normatively superior points, but are influenced by fads and fashions, erroneous assumptions about correlation and causation, and rent-seeking by those favored by the particular points of convergence. This lack of permanent convergence is particularly likely in the difficult contexts of balancing regulation and deregulation or authority and accountability with respect to shareholder protection.

This is not to say that observing other nations' corporate laws is useless or unwise. If nothing else, we will learn that there are alternate approaches which may be as effective as our own. We may also learn, however, that when it comes to the really tough issues, no nation has a good solution—which is why these are the really tough issues in

256. *E.g.*, Aronson v. Lewis, 473 A.2d 805, 818 (Del. 1984) (holding that in order to excuse demand before filing a derivative suit, the plaintiff must plead with particularity facts that raise a reasonable doubt that the directors are disinterested and independent, or that their decision otherwise comes within the business judgment rule).

257. *E.g.*, Gugler et al., *supra* note 2, at 149–50; Hansmann & Kraakman, *supra* note 16, at 468.

corporate law.