[Hastings Law Journal](https://repository.uchastings.edu/hastings_law_journal?utm_source=repository.uchastings.edu%2Fhastings_law_journal%2Fvol65%2Fiss2%2F4&utm_medium=PDF&utm_campaign=PDFCoverPages)

Volume 65 | Issue 2 Article 4

2-2014

The Mandatory Law Puzzle: Redefining American Exceptionalism in Corporate Law

Jens Dammann

The Mandatory Law Puzzle: Redefining American Exceptionalism in Corporate Law

JENS DAMMANN*

American corporate law stands out when compared to other legal systems. At no time is this more apparent than with regard to the use of mandatory law. Corporate law in the United States is largely enabling, whereas most other countries around the globe rely heavily on mandatory corporate law.

The traditional view seeks to explain this American exceptionalism by pointing to the phenomenon of regulatory competition. According to this view, regulatory competition has eroded mandatory corporate law norms in the United States, whereas the absence of such competition has allowed mandatory norms to persist in other countries. This narrative, however, confuses cause and effect. Regulatory competition exists where it is allowed to exist; the decisive question is why so many countries have chosen to protect their mandatory corporate law norms by suppressing regulatory competition while the United States has done the opposite.

This Article argues that efficiency considerations are key to understanding this mandatory law puzzle. The efficiency of enabling versus mandatory corporate law is not uniform across countries; instead, it depends on numerous social and institutional factors, particularly the efficiency of stock markets, ownership patterns, judicial infrastructure, and labor market flexibility. As a result, enabling corporate law is substantially more efficient in the United States than it is in many European countries. In other words, the U.S. commitment to private ordering in corporate law might not be a simple political choice that other countries can copy at will, but rather the reflection of various deep-seated institutional and social characteristics.

---

* William Stamps Farish Professor in Law, the University of Texas School of Law. For helpful comments, I thank William Carney, Jesse Fried, Stavros Gadinis, Birke Häcker, Alexander Hellgardt, Gerard Hertig, Ehud Kamar, Simon Link, Christian Kersting, Christine Osterloh-Konrad, Erik Röder, Mathias Siems, James Spindler, and Wolfgang Schön, as well as the participants of the 2013 International Financial Regulation Workshop at Berkeley, the 2013 Midwestern Law and Economics Association Conference, and workshops at the Max Planck Institute for Public Finance and Tax Law in Munich and the University of Southern California.

Table of Contents

Introduction

U.S. corporate law is largely of an enabling nature,[1] meaning that relatively few provisions are mandatory. Moreover, those norms that *are* mandatory are sometimes trivial in the sense that they either do not affect important issues or that they correspond to what the parties would have agreed upon in any case.[2]

Internationally, this U.S.-style libertarianism in corporate law is the exception rather than the rule.[3] Most foreign corporate law systems rely strongly on mandatory corporate law. In France, for example, the law governing public corporations is notorious for leaving little room for private ordering,[4] and German corporate law goes so far as to provide that all provisions in the German Stock Corporation Act are mandatory unless indicated otherwise.[5]

One then faces an obvious puzzle: Why does the extent of mandatory corporate law differ so drastically among nations? The prevailing understanding points to regulatory competition as the answer.[6] The argument is that regulatory competition has largely eroded mandatory corporate law in the United States,[7] whereas the traditional lack of such

---

1. *See, e.g.*, Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 Harv. L. Rev. 833, 888 (2005) (pointing out that U.S. corporate law follows a clear and consistent "enabling" approach); Margaret M. Blair & Lynn A. Stout, *Specific Investment: Explaining Anomalies in Corporate Law*, 31 J. Corp. L. 719, 742 (2006) (noting that U.S. corporate law is comprised mostly of default rules); John C. Coffee, Jr., *No Exit?: Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 Brook. L. Rev. 919, 939–40 (1988) (emphasizing that U.S. corporate law has become "largely enabling"); 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, 893 (1997) (noting the "prevalence of flexible enabling statutes in U.S. corporate law"); Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law*, 102 Yale L.J. 2021, 2023 (1993) (noting the enabling approach of U.S. corporate law).

2. *Cf.* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 Nw. U. L. Rev. 542, 544 (1990) ("[S]ome mandatory rules would be universally adopted anyway, assuming people thought about them.").

3. *See infra* Part II.

4. Yves Guyon, *Zur Gestaltungsfreiheit im französischen Gesellschaftsrecht* [*On Private Ordering in French Corporate Law*], *in* Gestaltungsfreiheit im Gesellschaftsrecht [Private Ordering in Corporate Law] 297, 297 (Marcus Lutter & Herbert Wiedemann eds., 1998) (noting that traditionally, the law governing public corporations in France has left almost no room for private ordering).

5. Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBl. I at 1089, last amended by Gesetz [G], July 23, 2013, BGBl. I. at 3044, § 23(5) (Ger.) (providing that the certificate of incorporation can only deviate from the provisions of the Stock Corporation Act where that is explicitly allowed).

6. William Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. Legal Stud. 303, 329 (1997) (pointing to charter competition as the reason behind America's more enabling approach to corporate law).

7. *See, e.g.*, William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 Wake Forest L. Rev. 619, 626–31 (2006) (describing how toward the end of the 19th and the beginning of the twentieth century, states stripped their corporation codes of mandatory provisions in an effort to compete for corporate charters, stripped their corporation codes of mandatory provisions).

competition in Europe and most of the world has allowed jurisdictions outside of the United States to retain their mandatory corporate law norms.[8]

Superficially, this traditional narrative, with its focus on regulatory competition, is quite appealing. Historically, it is clear that U.S. states have minimized the role of mandatory law in order to attract corporations.[9] Moreover, it is equally clear that European jurisdictions—and many other countries around the world—have long shunned regulatory competition in corporate law.[10] Despite recent steps toward a European charter market, regulatory competition for publicly traded firms is essentially nonexistent in Europe.[11] If this were not the case, then many of the mandatory norms found in European corporate law—such as worker codetermination—might be hard pressed to survive. In this sense, the argument that the absence or presence of regulatory competition is directly correlated to the survival or erosion of mandatory corporate law is quite persuasive.

However, pointing to regulatory competition as the key factor explaining the disparity in prevalence of mandatory corporate law is unsatisfactory; it confuses cause and effect. The conflict of law norms that allowed for the emergence of regulatory competition in the United States, while preventing it in Europe and many countries outside of Europe, have never been written in stone. In the United States, Congress could have federalized the law governing public corporations by exercising the power afforded to it by the Commerce Clause[12] but chose not to do so. In Europe, conversely, countries could have allowed regulatory competition to emerge but chose not to for the majority of the last century.[13]

In each case, lawmakers' attitudes toward mandatory corporate law played a crucial role in explaining the decision to allow or prohibit regulatory competition. In Europe, as in most other countries, the means for preventing regulatory competition was the so-called "real seat rule," which subjects corporations to the law of the state wherein their "real seat" or headquarters is located.[14] The "real seat rule" was introduced explicitly to prevent corporations from avoiding the mandatory corporate law regime of their home country by escaping to a jurisdiction with more

8. *See, e.g.*, Simon Deakin, *Legal Diversity and Regulatory Competition: Which Model for Europe?*, 12 EUR. L.J. 440, 450–51 (2006) (arguing that mandatory law rules such as those imposing codetermination have been able to survive because of the absence of regulatory competition).

9. Bratton & McCahery, *supra* note 7.

10. *See infra* Part III.

11. *See infra* Part III.

12. *See* Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 600 (2003) ("[T]he federal government can displace state corporate law . . . rather easily.").

13. *See infra* Part III.

14. *See, e.g.*, ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 132–33 (1993) (describing how the real seat doctrine prevented regulatory competition in Europe).

enabling corporate law.[15] Similarly, lawmakers' attitudes toward mandatory corporate law played a key role in the United States' path toward enabling corporate law. If Congress had been hell-bent on preserving mandatory corporate law, it would have federalized the relevant norms—as it did with securities law. It follows, then, that regulatory competition or the absence thereof is but a means to an end. The underlying reasons why the United States has allowed mandatory law to erode while it still plays a crucial role in much of Europe must be found elsewhere.

This Article argues that the answer to the mandatory law puzzle can, to a large extent, be found in efficiency considerations. Due to underlying social and institutional differences, enabling corporate law is simply more efficient and mandatory law *less* efficient in the United States than it is in Europe and much of the rest of the world. The larger point is that the benefits of enabling as opposed to mandatory corporate law are not identical all over the world; rather, they depend on the broader economic, social, legal, and institutional environment in each country. More specifically, this Article argues that the benefits of enabling norms are particularly pronounced in countries with dispersed stock ownership, well-developed securities markets, flexible labor markets, and highly specialized corporate law courts. On all of these, and various other pertinent measures, the United States does markedly well and is therefore uniquely positioned to reap the greatest possible benefits from adopting an enabling corporate law structure. By contrast, many foreign jurisdictions—including much of Europe—lag behind the United States on these relevant measures and therefore might not find enabling corporate law as rewarding—or mandatory corporate law as burdensome—as the United States.

The result of this analysis is a new understanding of American exceptionalism in corporate law: America's willingness to embrace private ordering is not simply the result of a political choice for regulatory competition that other countries can copy at will; rather, it is the expression of certain deep-seated structural features that distinguish the United States from other countries.

One might conjecture that some of these features could be endogenous. Prevailing ownership patterns, for example, might not simply be the result, but also to some extent, the cause of existing corporate law norms.[16] Accordingly, if the law were to change, ownership

15. France was the first country to introduce the real seat rule by statute, and it did so to stem the flight of French corporations to the more enabling corporate law jurisdiction of the United Kingdom. Bernhard Großfeld, *Nationale und internationale Unternehmensverfassungen in Marktwirtschaftlichen Ordnungen* [*National and International Corporate Constitutions in Capitalist Systems*], *in* CONFLICT AND INTEGRATION: COMPARATIVE LAW IN THE WORLD TODAY 589, 595 (1989).

16. *See infra* Part V.B.

patterns might as well. However, even in the case of ownership patterns, the case for endogeneity is relatively weak. While strong protections for minority shareholders may increase the attractiveness of minority investments and thereby set the ground for dispersed ownership,[17] it is not obvious why mandatory corporate law, which protects minority shareholders and constrains controlling shareholders, should lead to the emergence of controlling shareholders, or, vice versa, why enabling corporate law should result in dispersed ownership.[18] Moreover, various other features of European legal systems, such as the prevalence of collective bargaining or the for-cause termination requirement in employment law, are even more unlikely to be the result—rather than the cause—of Europe's predilection for mandatory corporate law.[19]

Crucially, this Article does not argue that enabling law is *generally* efficient in the United States or *generally* inefficient elsewhere. Instead, the point is relative—regardless of how one views the efficiency of enabling corporate law in the United States, this Article argues that enabling corporate law norms are *relatively* more efficient in the United States than in most other countries.

Obviously, efficiency considerations are not the only factors that play a role in explaining differences between U.S. and European corporate law. In many cases, it is possible to also name other factors that have contributed to the rise of a particular mandatory norm in Europe. A case in point is Germany's mandatory codetermination regime that requires corporate boards to include a certain number of employee representatives. The emergence of this regime is owed at least in part to the peculiar political situation of postwar Germany when firms in the coal and steel industries saw codetermination as a way to escape decartelization.[20] However, this type of case-specific political account fails to explain why European corporate law exhibits greater reliance on mandatory law across the board. In any case, an efficiency-based account does not contradict political narratives of this type; rather, both explanations can complement each other. In other words, as is so often the case, efficiency considerations are not the whole story, but they are a particularly important part of the story.

It should also be noted that the contrast between flexible corporate law in the United States and mandatory corporate law in Europe holds only for public corporations; even in Europe, the law provides much

17. *See infra* note 248.
18. *See infra* note 248
19. *See infra* notes 248, 196.
20. Jens C. Dammann, Note, *The Future of Codetermination After* Centros*: Will German Corporate Law Move Closer to the U.S. Model?*, 8 FORDHAM J. CORP. & FIN. L. 607, 676 (2003).

more flexible norms where privately held firms are concerned.[21] This is due in part to the fact that the vast majority of privately held firms are rather small and unsophisticated, and that smaller, less sophisticated firms tend to have more trouble complying with extensive mandatory regimes than larger firms. However, the differing treatment of privately held firms and publicly traded firms also provides further evidence for this Article's thesis. Various factors that make mandatory corporate law more attractive in Europe than it is in the United States, such as differences in ownership structures or in the efficiency of security markets, are only relevant to public corporations and do not apply to privately held firms. Therefore, we should expect the European law on privately held firms to be more flexible than the law on publicly traded firms, and that is precisely what we observe.

The analysis presented in this Article has far reaching implications for a number of important debates in corporate law. Chief among them is the debate over American exceptionalism. Scholars have long debated the extent to which American corporate law differs from other corporate law systems, and over what makes U.S. law unique. Traditionally, the focus has been on regulatory competition.[22] This is no doubt justified. However, this Article argues that there may, in fact, be a "story behind the story." Specifically, this Article argues that regulatory competition may have been able to thrive in the United States due to certain social and institutional factors that make enabling corporate law attractive and regulatory competition politically acceptable.

By extension, this Article also has profound implications for the so-called "convergence debate." Scholars have debated for more than a decade about whether or not corporate law systems across the world are in the process of becoming more alike.[23] With respect to the mandatory/enabling divide—an area in which the convergence question has not yet been raised—this Article argues that the answer lies somewhere in the middle. Given that the prevalence of enabling corporate law depends on the social and institutional environment, one

21. Many European countries have separate corporation statutes for closely held corporations. These statutes tend to rely much more strongly on enabling norms than the stock corporation statutes that are designed for public corporations. *Cf.* Sandra K. Miller, *Minority Shareholder Oppression in the Private Company in the European Community: A Comparative Analysis of the German, United Kingdom, and French "Close Corporation Problem"*, 30 CORNELL INT'L. L.J. 381, 394 (1997) (noting that in contrast to the German Stock Corporation Act, the German law on closely held corporations, the GmbHG, provides for a comparatively flexible management structure).

22. *See, e.g.*, ROMANO, *supra* note 14, at 4–5 (arguing that "[t]he genius of American corporate law is its federalist organization" which in turn allows for regulatory competition among states).

23. Contributions to this debate include Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999); Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 334–37 (2001); Henry Hansmann, *How Close is the End of History?*, 31 J. CORP. L. 745 (2006); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO L.J. 439 (2001).

cannot expect full-scale convergence unless the underlying social and institutional conditions converge as well; in that respect, as discussed below, the landscape is mixed.[24]

On a related note, this Article suggests that America's commitment to a system of enabling corporate law might be more contingent than previously thought. Already, and much to the chagrin of many commentators,[25] Congress has intervened to insert several mandatory federal stents into the heart of the enabling system of U.S. corporate law—most notably with the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010. This analysis suggests that more legislation might be to come unless the legal and institutional factors that render enabling law attractive are maintained. With respect to some factors—such as highly dispersed share ownership—this is not a given.[26] Should these factors fade, the United States might see a broader shift toward mandatory corporate law.

Part I of this Article demonstrates that mandatory corporate law is much more common in foreign countries than it is in the United States. Moreover, it shows that existing differences in the prevalence of mandatory corporate law are by no means economically or otherwise trivial. Part II summarizes the traditional arguments that have been used to justify the existence of mandatory corporate law. Part III then demonstrates that these same arguments have much more weight in foreign nations than in the United States. In other words, mandatory norms are in fact more defensible abroad than in the United States. Part IV discusses the implications of this analysis, and Part V focuses on possible future development, and concludes.

I. Diverging Roles for Mandatory Corporate Law

United States corporate law consists largely of default rules.[27] By international standards, however, this approach is unusual. Jurisdictions outside the United States rely much more heavily on mandatory corporate law. Particularly instructive is a study undertaken by Katharina Pistor and various co-authors that focuses on legal innovation in different

---

24. *See infra* Part V.

25. *See, e.g.*, Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 Yale L.J. 1521, 1597–99 (2005) (arguing that the matters governed by the Sarbanes-Oxley Act are better left to the states); J. Mark Ramseyer, *Stacking the Friday Workshop: An Introduction*, 9 Asian-Pac. L. & Pol'y J. 1, 5 (2007) (suggesting that Sarbanes-Oxley includes "badly inefficient mandatory rules"). *But see* Robert B. Ahdieh, *From "Federalization" to "Mixed Governance" in Corporate Law: A Defense of Sarbanes-Oxley*, 53 Buff. L. Rev. 721, 756 (2005) (defending the Sarbanes-Oxley Act on the ground that "selective federal regulation of corporate governance may offer a fruitful avenue of vertical competition, to supplement the horizontal competition at the heart of the present-day corporate law regime").

26. *See infra* Part V.B.

27. *See supra* note 2.

corporate law systems.[28] The study uses a jurisdiction's reliance on enabling rather than mandatory law as one indicator of potential for innovation.[29] It focuses on ten jurisdictions including Chile, Colombia, France, Germany, Israel, Japan, Malaysia, Spain, the United Kingdom, and the United States—the latter represented by Delaware law. Not surprisingly, when it comes to the prevalence of enabling norms, Delaware "wins" hands down; corporate law in all other jurisdictions is substantially more mandatory. In the words of the authors, Delaware is an outlier "on the flexible end of the spectrum."[30]

The findings on this issue in the Pistor study are consistent with a wealth of individual cross-country comparisons. It has been noted again and again that other countries, particularly those in continental Europe, rely much more strongly on mandatory corporate law than does the United States.[31]

Of course, the fact that foreign jurisdictions tend to make heavier use of mandatory corporate law does not per se imply that this difference matters. With respect to U.S. corporate law, Bernard Black has famously argued that mandatory corporate law is often trivial in the sense that it relates to unimportant issues, corresponds to what the parties would have agreed upon anyhow, or can be avoided by reincorporating in another jurisdiction.[32]

Assuming for the sake of the argument that this is a fair characterization of mandatory corporate law in the United States, can the same be said for mandatory corporate law in other jurisdictions? Can one argue that differences in the prevalence of mandatory corporate law are technical differences without much economic importance? For some mandatory norms found in foreign jurisdictions, the answer is yes. For example, this Article later argues that the mandatory legal capital requirements—still a mainstay of continental European corporate law—simply do not have much bearing on public corporations, and therefore

28. *See generally* Katharina Pistor et al., *Innovation in Corporate Law*, 31 J. COMP. ECON. 676 (2003).

29. *Id.* at 689–91.

30. *Id.* at 689.

31. *Cf.* Eddy Wymeersch, *Gestaltungsfreiheit und Gesellschaftsrecht in Belgien* [*Private Ordering and Corporate Law in Belgium*], *in* GESTALTUNGSFREIHEIT IM GESELLSCHAFTSRECHT [PRIVATE ORDERING IN CORPORATE LAW], *supra* note 4, at 186 (noting that Belgian corporate law is increasingly permeated by mandatory norms); Levinus Timmerman, *Gestaltungsfreiheit im niederländischen Gesellschaftsrecht* [*Private Ordering in Dutch Corporate Law*], *in* GESTALTUNGSFREIHEIT IM GESELLSCHAFTSRECHT [PRIVATE ORDERING IN CORPORATE LAW], *supra* note 4, at 215 (noting that while the Netherlands used to enjoy a reputation as the European Delaware, this is no longer true, and that Dutch corporate law now contains numerous mandatory norms, particularly in the interest of corporate creditors). Regarding Germany and France, see *supra* text accompanying notes 4–5.

32. Black, *supra* note 2, at 544.

fail to represent a meaningful difference between U.S. and European corporate law.[33]

There are also myriad mandatory corporate law norms that are clearly non-trivial—they are economically important, they fail to reflect the hypothetical bargain, and they cannot easily be avoided via reincorporation. The following Subpart begins by focusing on the first two of these criteria—economic importance and failure to reflect the hypothetical bargain—before demonstrating that reincorporation is not yet a viable option for public corporations in Europe.

A. Important Mandatory Norms

In Europe, it is not difficult to find mandatory corporate law norms that are economically significant and deviate from what the parties would have agreed upon if left to their own devices. Three examples might serve to illustrate this point: the rules on hostile takeovers, the mandatory bid rule in corporate acquisitions, and the rules governing employee codetermination.

1. Hostile Takeovers

Perhaps the most striking example of clearly non-trivial mandatory rules found in foreign jurisdictions is the law governing takeovers.

On this side of the Atlantic, Delaware is relatively generous to incumbent managers when it comes to defensive measures against hostile takeovers. Under the famous *Unocal* standard, antitakeover defenses are protected by the business judgment rule, as long as the directors reasonably viewed the takeover attempt as a danger to corporate policy and effectiveness, and the defensive measures were reasonable in relation to the threat posed.[34] Many commentators have argued that this allows managers to "just say no" to hostile takeovers.[35] This characterization might be somewhat exaggerated, and it has certainly been rejected by the Delaware Chancery Court.[36] However, there is a broad consensus that the board of a target corporation has wide latitude in defending against hostile takeover attempts.[37]

---

33. *See infra* Part III.

34. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954–55 (Del. 1985).

35. *E.g.*, Jennifer Arlen & Eric Talley, *Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. Pa. L. Rev. 577, 606 n.69 (2003); A.C. Pritchard, *Tender Offers by Controlling Shareholders: The Specter of Coercion and Fair Price*, 1 Berkeley Bus. L.J. 83, 106 (2004) (noting that the *Unocal* proportionality review leaves managers "essentially unconstrained").

36. *See* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 54 (Del. Ch. 2011) ("A board cannot '*just* say no' to a tender offer.").

37. *See, e.g.*, Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 Stan. L. Rev. 887, 950 (2002) [hereinafter *Staggered Boards*] (noting "the current trend in Delaware case law that is solidifying and expanding the 'Just Say No' defense").

By contrast, European countries tend to be much less deferential to target boards. The United Kingdom has long imposed a mandatory rule prohibiting target board managers from taking any defensive measures against hostile takeovers.[38] More recently, the European Union has followed in the United Kingdom's footsteps and imposed this so-called neutrality principle as a matter of E.U. law.[39] Although the relevant E.U. directive authorizes Member States to opt out of the prohibition against defensive measures,[40] nineteen out of the twenty-eight E.U. Member States—a substantial majority and one that includes most of the large Member States—have chosen not to opt out.[41]

Clearly, the neutrality principle is not trivial. This is true, first, in the sense that it has enormous economic significance. A wealth of evidence suggests that the availability of takeover defenses plays a crucial role in determining how many takeover attempts will occur and the extent to which they are successful. In the United States, the rise of the poison pill accompanied a sharp decline in the number of attempted hostile takeovers.[42] Moreover, those hostile takeover attempts that do occur are often thwarted by the target's defenses.[43] In the United Kingdom, where the neutrality principle bars hostile takeover defenses, takeovers are more likely to be hostile, and hostile takeover attempts have a higher likelihood of success than in the United States.[44] Thus, there is little question that the neutrality principle increases the likelihood and success rate of hostile takeovers.

Furthermore, hostile takeovers are of great economic significance. The empirical evidence suggests that successful hostile takeovers increase shareholder wealth. Although it is not clear that the effects on

---

Cf. Mark Gordon, *Takeover Defenses Work. Is That Such a Bad Thing?*, 55 STAN. L. REV. 819, 821 (2002) (citing to study that claims no corporation has redeemed a poison pill since 1989).

38. The Takeover Code, 2013, § F, r. 21.1 (U.K.). While the Takeover Code followed later, the neutrality principle was introduced as early as 1959. John Armour et al., *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework*, 52 HARV. INT'L L.J. 219, 236–37 (2011).

39. Directive 2004/25, of the European Parliament and of the Council of 21 Apr. 2004 on Takeover Bids, art. 2, 2004 O.J. (L 142) 12 [hereinafter E.U. Takeover Directive].

40. *Id.* art. 12.

41. *Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions: Application of Directive 2004/25/EC on Takeover Bids*, COM (2012) 347 final (June 28, 2012).

42. Bengt Holmstrom & Steven N. Kaplan, *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s*, J. ECON. PERSP., Spring 2001, at 121, 126–27.

43. *See* Bebchuk et al., *supra* note 37, at 950 (presenting evidence that the presence of a charter provision classifying the board "substantially increase the likelihood that a target receiving a hostile bid will remain independent").

44. John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1738–39 (2007).

the shareholders of the *acquiring* corporations are positive on balance,[45] the shareholders of the target corporation benefit substantially.[46] Crucially, these gains realized by the shareholders of target corporations are large enough to offset any losses to the shareholders of acquiring firms.[47] In addition to these concrete financial benefits that are realized from a successful takeover, the mere *threat* of hostile takeover tends to discipline managers[48] and is thus likely to increase shareholder wealth. Accordingly, studies that focus on abnormal returns to shareholders in case of takeovers are bound to understate the economic benefits of takeovers.

Additionally, one cannot argue that the neutrality principle is trivial in the sense that corporations would choose to adopt it voluntarily. Corporate practice in Delaware demonstrates the opposite, in fact. Corporations are free to adopt the neutrality principle but consistently fail to do so.[49] Instead, many of them do their best to prevent hostile takeovers: most initial public offering ("IPO") firms now have poison pills and staggered board provisions that are designed to make takeovers more difficult.[50] In sum, the mandatory neutrality principle clearly matters.

---

45. *See, e.g.*, Gregor Andrade et al., *New Evidence and Perspectives on Mergers*, J. ECON. PERSP., Spring 2001, at 103, 110 (summarizing several studies between 1973 and 1998 and finding abnormal negative returns of 3.8%); Marc Goergen & Luc Renneboog, *Shareholder Wealth Effects of European Domestic and Cross-Border Takeover Bids*, 10 EUR. FIN. MGMT. 9, 23 tbl.6 (2004) (focusing on takeovers in the U.K. between 1993 and 2000 and finding negative abnormal returns of 1.65%). *But see* Gregg A. Jarrell & Annette B. Poulsen, *The Returns to Acquiring Firms in Tender Offers: Evidence from Three Decades*, FIN. MGMT., Autumn 1989, at 16 (focusing on the time between 1963 and 1986 and finding positive abnormal returns of 1.96%); Michael C. Jensen & Richard Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 16 (1983) (focusing on the time between 1958 and 1981 and finding positive abnormal returns in the amount of 3.8%).

46. Andrade et al., *supra* note 45, at 110 (reporting abnormal returns of 23.3%); Jarrell & Poulson, *supra* note 45, at 16 (finding abnormal returns of 28.9%); Jensen & Ruback, *supra* note 45, at 10 tbl.3 (finding abnormal returns of 29.1%).

47. Andrade et al., *supra* note 45, at 103.

48. *See* Gerald T. Garvey & Gordon Hanka, *Capital Structure and Corporate Control: The Effect of Antitakeover Statutes on Firm Leverage*, 54 J. FIN. 519, 526–43 (1999) (providing indirect evidence that the takeover threat disciplines managers by showing that managers protected by second-generation antitakeover statutes tended to reduce their use of debt).

49. Marcel Kahan & Edward B. Rock, *How I Learned To Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 895 (2002) ("One does not . . . find IPO charters that limit the use of poison pills or incorporate the City Code's 'no frustrating actions' standard.").

50. *See* Bebchuk et al., *supra* note 37, at 889 ("In a large sample of major U.S. public companies, 59% had a staggered board in 1998. Among firms going public in the 1990s, the incidence of staggered boards increased from 34% in 1990 to over 70% in 2001."); Robert Daines & Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Protections in IPOs*, 17 J.L. ECON. & ORG. 83, 87–88 (2001) (stating that many IPO firms have both poison pills and staggered boards). It should be noted, though, that at least for the largest firms, the recent trend has been to move away from takeover defenses. For Standard & Poor's ("S&P") 100 firms, "the incidence of staggered boards has declined from 44% to 16% between 2003 and 2009." Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 1009 (2010).

2. *The Mandatory Bid Rule*

The so-called mandatory bid rule provides a further example of a mandatory law that cannot be categorized as trivial. Under U.S. law, an acquirer seeking to purchase control of a target corporation can limit himself to acquiring the minimum number of shares sufficient to convey control. For example, she might choose to buy just over fifty percent of the shares or an even lower number sufficient to exercise de facto control. Although the Williams Act, which governs tender offers, requires the acquirer to buy the relevant shares pro rata from all target shareholders willing to sell,[51] she can still limit the overall number of shares she wants to purchase. Moreover, in the absence of a tender offer, the acquirer can also decide from whom she wants to buy the shares. For example, she might wish to purchase the shares from the incumbent controller in a private transaction.

By contrast, European Union law imposes a so-called mandatory bid rule. This means that anyone acquiring a controlling stake in a public corporation has to offer to buy the remaining shares for the same price.[52] In other words, anyone seeking to buy a controlling stake faces the risk of having to purchase all of the target firm's outstanding shares.

This mandatory bid rule—so named because the acquirer has to make a bid for all of the target firm's shares—has two main consequences. First, it necessitates that the acquirer have much more liquidity available than would be necessary under U.S. law. This effect has substantial economic importance because it means that the mandatory bid rule places an additional financial burden on the acquirer and thereby makes takeovers more expensive.[53]

Second, because the mandatory bid rule applies to private transactions as well as to tender offers, it effectively allows the minority shareholders to share in any control premium paid to the controlling shareholder: if the incumbent controller demands a control premium when selling his shares, the minority shareholders can partake in the premium because they can demand to sell at the same price. Forcing the controlling shareholder to share the premium with the minority has well-known consequences. On the one hand, such a rule deters inefficient takeovers in which the acquirer's motivation for the takeover is the

51. 15 U.S.C. § 78n(d)(6) (2012).

52. E.U. Takeover Directive, *supra* note 39, art. 5(1).

53. *Cf.* Armour & Skeel, *supra* note 44, at 1737–38 ("By restricting the permitted range of partial bids, the mandatory bid rule chills some potential offers by forcing bidders to raise enough money to acquire the entire company, rather than just a controlling stake.")(footnote omitted); Sapnoti K. Eswar, Has Takeover Regulation Altered Value Creation in the European M&A Market 23 (Feb. 2012) (unpublished manuscript), *available at* http://northernfinance.org/2012/program/papers/411.pdf (finding that the mandatory bid rule makes at least some types of transactions more expensive).

intent to exploit the other shareholders.[54] On the other hand, the buyout rule deters some efficient takeovers.[55]

In sum, there is no doubt that the mandatory bid rule is economically important. The only question left is whether the mandatory bid rule is trivial in the sense that corporations would adopt it voluntarily. Again, however, the answer is no. A charter provision imposing a mandatory bid rule is unheard of.[56]

3. *Codetermination*

Codetermination is the third example of a mandatory rule that is clearly nontrivial. Codetermination regimes, adopted by many European countries, give employees a voice in how their company is run.[57] The details vary depending on jurisdiction and company size and industry.[58]

Germany has the most famous and far-reaching regime. By law, German corporations have a two-tier board structure comprising the managing board[59] and the supervisory board.[60] As the names imply, the managing board is charged with managing the company, whereas the supervisory board appoints the members of the managing board and supervises the managing board's work.[61] This two-tier board structure is crucial to the function of the German codetermination regime. Under the Codetermination Act,[62] which applies to most corporations with two thousand or more employees,[63] the shareholders elect only half of the supervisory board members while the employees elect the others.[64]

---

54. Lucian Arye Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 Q.J. ECON. 957, 971 (1994) (noting that with an equal opportunity rule, "if a transaction takes place, the minority shareholders will always be made better off by it"); Marcel Kahan, *Sales of Corporate Control*, 9 J.L. ECON. & ORG. 368, 369 (1993).

55. *See* Bebchuk, *supra* note 54, at 972 (noting that the equal opportunity rule "impedes efficient transfers"); Kahan, *supra* note 54, at 369 (noting that a rule that treats all shareholders equally "prevents all undesirable sales, but deters some desirable control sales").

56. *Cf.* Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1329 (2013) ("The only significant governance provisions that appear in IPO charters are staggered boards.").

57. For a survey of various European codetermination law regimes, see MADS ANDENAS & FRANK WOOLDRIDGE, EUROPEAN COMPARATIVE COMPANY LAW 417–47 (2009).

58. *Id.*

59. Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at 1089, last amended by Gesetz [G], July 23, 2013, BGBL. I. at 3044, § 76(1) (Ger.) (entrusting the managing board with managing the corporation).

60. *Id.* § 84(1)(1) (charging the supervisory board with appointing the members of the managing board).

61. *See supra* notes 57–58; Brian R. Cheffins & Bernard S. Black, *Outside Director Liability Across Countries*, 84 TEX. L. REV. 1385, 1421 (2006) (pointing out that the supervisory board appoints and monitors the managing board).

62. Gesetz über die Mitbestimmung der Arbeitnehmer, May 4, 1976, BGBL. I at 1153 (Ger.) [hereinafter Codetermination Act].

63. *Id.* § 1(1)(2). A somewhat different regime applies to companies in the coal and steel industries. Such companies are exempt from the Codetermination Act, *id.* § 1(2), because and to the extent that they

There is no question that codetermination is economically important; however, the economic impact of codetermination is notoriously difficult to quantify. Non-German corporations of equal size that are not subject to the same regime operate in a different environment than their German counterparts, making it difficult to attribute differences in performance to the presence or absence of codetermination.[65] Nonetheless, the indirect changes that codetermination brings alone are sufficient to categorize codetermination law as important. For example, there is a wealth of research showing that board size matters—all else equal, smaller boards are more effective than larger ones.[66] Yet, in order to make room for employee representatives and to ensure the representation of different types of employees on corporate boards, codetermination law forces corporations to have rather large boards. For instance, the Codetermination Act requires corporations with more than twenty thousand employees to have a supervisory board with twenty members.[67]

Moreover, as noted above, rules that allow corporations to take defensive measures against hostile takeovers matter a great deal; under German law, codetermination substantially facilitates such defensive measures because German law requires supervisory board approval of defensive measures[68] and the employees' board members can generally be expected to vote in favor of such measures given that workers tend to

are subject to an older codetermination statute developed specifically for the coal, iron, and steel industries: the so-called Coal, Iron, and Steel Codetermination Act. *See* Gesetz zur Ergänzung des Gesetzes über die Mitbestimmung der Arbeitnehmer in den Aufsichtsräten und Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie [Supplementary Act to the Law Pertaining to the Participation of Workers in the Supervisory Boards and Managing Boards of Companies in the Coal, Iron and Steel Industries], Aug. 7, 1956, BGBL. I at 707 (Ger.).

64. Codetermination Act, May 4, 1976, BGBI. I at 1153, § 7(1).

65. *See, e.g.*, Stephen M. Bainbridge, *Participatory Management Within a Theory of the Firm*, 21 J. CORP. L. 657, 678 (1996) (noting the absence of evidence that codetermination improves worker attitudes or motivation); Felix R. FitzRoy & Kornelius Kraft, *Economic Effects of Codetermination*, 95 SCANDINAVIAN J. ECON. 365, 366 (1993) (finding "no significant effects of codetermination on productivity").

66. *See, e.g.*, Marianne Bertrand & Sendhil Mullainathan, *Are CEOs Rewarded for Luck? The Ones Without Principals Are*, 116 Q.J. ECON. 901, 929 (2001) (noting that in firms with concentrated ownership, smaller boards are "better able to charge their CEOs"); Theodore Eisenberg et al., *Larger Board Size and Decreasing Firm Value in Small Firms*, 48 J. FIN. ECON. 35, 53 (1998) (presenting "evidence that a negative correlation between board size and profitability extends to small firms with small boards in Finland"); Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 48 J. FIN. 831, 865 (1993) ("Keeping boards small can help improve their performance. When boards go beyond seven or eight people they are less likely to function effectively and are easier for the CEO to control."); David Yermack, *Higher Market Valuation of Companies with a Small Board of Directors*, 40 J. FIN. ECON. 185, 209 (1996) (finding "an inverse association between board size and firm value"). *But see* Mohamed Belkhir, *Board of Directors' Size and Performance in the Banking Industry*, 5 INT. J. MANAGERIAL FIN. 201, 217 (2009) (analyzing firms in the banking sector and finding "robust evidence that larger boards achieve a higher performance").

67. Codetermination Act, May 4, 1976, BGBI. I at 1153, § 7(1).

68. Wertpapiererwerbs- und übernahmegesetz [WpÜG] [Securities, Acquisitions, and Takeover Act], Dec. 20, 2001, BGBL. I at 2479 (F.R.G.) § 33(1) (Ger.).

oppose hostile takeovers out of concerns that the acquirer will seek to reduce the workforce.[69] In sum, there is no question that codetermination has substantial economic significance.

Further, codetermination certainly is not trivial in the sense that it would be adopted voluntarily. Quite to the contrary, one of the traditional arguments against the efficiency of codetermination has been that firms do not choose to adopt codetermination regimes on their own.[70]

B. Mandatory Law and Regulatory Competition

The question remains whether mandatory laws in foreign countries are trivial in a different way; namely, that they can easily be avoided via reincorporation. Europe has recently taken important steps toward regulatory competition in corporate law, raising the question of whether corporations can now escape mandatory law by reincorporating elsewhere. However, some mandatory laws—such as those governing mandatory bids—are imposed by E.U. law and therefore cannot be avoided by reincorporating in another Member State. Moreover, even to the extent that certain mandatory rules can be found at the Member State level, firms do not currently seem to view reincorporation in another Member State as a viable option for public corporations. Despite the potential for regulatory competition that Europe arguably has, its incipient charter market has so far failed to usher in an age of regulatory arbitrage for public corporations.

For much of the twentieth century, prevailing choice of law rules made it prohibitively difficult and expensive for most European corporations to escape mandatory corporate law rules via reincorporation. More specifically, a majority of European countries used the so-called "real seat rule" to impose their own corporate law.[71] According to this rule, the law that applies to a corporation's internal affairs was determined by the corporate headquarters' location or "real seat."[72] The only way for a corporation to escape its home state's corporate law,

69. This has also been observed in the American context. Brett McDonnell, *ESOP's Failures: Fiduciary Duties When Managers of Employee-Owned Companies Vote To Entrench Themselves*, 2000 Colum. Bus. L. Rev. 199, 260; William H. Simon, *The Prospects of Pension Fund Socialism*, 14 Berkeley J. Emp. & Lab. L. 251, 263 (1993). Whether these fears on the part of workers are well-founded is another question. *Cf.* Jeffrey N. Gordon, *Corporations, Markets, and Courts*, 91 Colum. L. Rev. 1931, 1953 (1991) ("It is difficult even to trace a causal connection between takeovers and job loss.").

70. *E.g.*, Romano, *supra* note 14, at 129–30.

71. *E.g.*, Ehud Kamar, *Beyond Competition for Incorporations*, 94 Geo. L.J. 1725, 1727 (2006); Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 Yale J. Int'l L. 477, 480 (2004) [hereinafter Dammann, *Freedom*]; Jens C. Dammann, *Indeterminacy in Corporate Law: A Theoretical and Comparative Analysis*, 49 Stan. J. Int'l L. 54, 68 (2013) [hereinafter Dammann, *Indeterminacy*].

72. *E.g.*, Larry E. Ribstein, *The Important Role of Non-Organization Law*, 40 Wake Forest L. Rev. 751, 791 (2005).

therefore, was to move its headquarters to another Member State.[73] In practice, this option was far too complicated and costly to gain practical relevance.[74]

Over the past fifteen years, the European Union has gradually moved toward greater choice in corporate law. This process began in 1999, when the European Court of Justice, in its famous *Centros* judgment,[75] found that the real seat doctrine violated European law.[76] As a result of *Centros* and the cases that followed, European firms are now subject to the corporate law of the Member State where they are incorporated, even if their state of incorporation differs from their real seat state.[77] This leaves firms free to choose the applicable corporate law by incorporating in the Member State of their choice.[78]

However, for purposes of regulatory competition, *Centros* and its progeny had a vital shortcoming: they only concerned the ability of corporations to choose the applicable corporate law at the moment of formation. As a result, existing corporations still did not have the ability to reincorporate in order to change the applicable corporate law.[79] Such reincorporation required corporations to be dissolved and formed anew in the state of destination—a move usually associated with significant adverse tax consequences.[80] In other words, *Centros* only benefited newly formed corporations and was essentially useless to established firms.[81]

In 2005, the European Union remedied this problem by adopting the so-called Cross-Border Merger Directive.[82] Together with another directive exempting cross-border mergers from taxation, the Cross-Border Merger Directive now allows corporations to merge with corporations in other E.U. Member States without incurring a tax

---

73. Dammann, *Freedom*, *supra* note 71, at 480; Dammann, *Indeterminacy*, *supra* note 71, at 68.

74. *Id.*

75. Case C-212/97, Centros Ltd. v. Erhvers-og Selskabsstyrelsen, 1999 E.C.R. I-1484.

76. This holding was later confirmed and explicated in two other cases: Case C-208/00, Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC), 2002 E.C.R. I-9943; Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., 2003 E.C.R. I-10195.

77. *E.g.*, William W. Bratton et al., *How Does Corporate Mobility Affect Lawmaking? A Comparative Analysis*, 57 AM. J. COMP. L. 347, 348 (2009).

78. *E.g.*, Jens Dammann, *A New Approach to Corporate Choice of Law*, 38 VAND. J. TRANSNAT'L L. 51, 56 (2005); Dammann, *Indeterminacy*, *supra* note 71, at 69.

79. *E.g.*, Hanne Sondergaard Birkmose, *A Market for Company Incorporations in the European Union?—Is* Überseering *the Beginning of the End?*, 13 TUL. J. INT'L & COMP. L. 55, 60 (2005); Bratton et al., *supra* note 77, at 370.

80. Dammann, *Freedom*, *supra* note 71, at 490–91; Dammann, *Indeterminacy*, *supra* note 71, at 69.

81. Dammann, *Indeterminacy*, *supra* note 71, at 69.

82. Directive 2005/56/EC, On Cross-Border Mergers of Limited Liability Companies, 2005 O.J. (L 310) 1 [hereinafter Cross-Border Merger Directive]. This directive had to be implemented by the end of 2007. *Id.* art. 19(1).

penalty.[83] This means that E.U. corporations can now reincorporate in another Member State by forming a new corporation in that Member State and then merging the old corporation into the newly formed one.[84]

However, despite the theoretical ability of corporations to reincorporate, the impact of corporate mobility has remained quite limited. For very small privately held firms, *Centros* managed to gain some limited importance. In the years immediately following *Centros*, an increasing number of entrepreneurs made use of their newfound mobility and set up small privately held firms in other member states to avoid the often much higher incorporation fees in their home state.[85] Typically, they went to the United Kingdom, where incorporation costs are modest. Data presented in a landmark study by Marco Becht, Colin Mayer, and Hannes Wagner is particularly instructive on this point: In 2000—the year immediately following *Centros*—only 807 firms headquartered in Germany were formed as private limited companies ("PLCs") under U.K. law.[86] By 2004, that number increased to 10,263, and by 2006 it increased to 16,438.[87]

Yet, more recent data suggest that even among small privately held firms, the interest in incorporating abroad might be waning.[88] By 2008, the number of German-based businesses that were newly formed as U.K. PLCs had declined to 4884,[89] and the year 2010 saw a further decline to 1978.[90] Concurrently, the number of firms formed as privately held corporations under German law continued to increase—from 57,299 in 2008[91] to 69,474 in 2010.[92] Even more crucially, the trend to make use of *Centros* always remained limited to very small privately held firms; it

83. *See* Council Directive 90/434/EEC, On the Common System of Taxation Applicable to Mergers, Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States, 1990 O.J. (L 225) 1 [hereinafter Merger Tax Directive], amended by Council Directive 2005/19/EC, 2005 O.J. (L 58) 19. According to that Directive, "[a] merger or division shall not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes." *Id.* art. 4 (1).

84. *See* Dammann, *Indeterminacy*, *supra* note 71, at 69. In the United States, corporations have long reincorporated via cross-border mergers. *See* Dammann, *Freedom*, *supra* note 71, at 489.

85. *See* Dammann, *Indeterminacy*, *supra* note 71, at 70.

86. Marco Becht et al., *Where Do Firms Incorporate? Deregulation and the Cost of Entry*, 14 J. CORP. FIN. 241, 248 tbl.3 (2008).

87. *Id.*

88. Dammann, *Indeterminacy*, *supra* note 71, at 71.

89. STATISTISCHES BUNDESAMT, UNTERNEHMEN UND ARBEITSSTÄTTEN: GEWERBEANZEIGEN: DEZEMBER UND JAHR 2008 at tbl.5 year 2008 (2009) [hereinafter: STATISTISCHES BUNDESAMT 2008].

90. STATISTISCHES BUNDESAMT, UNTERNEHMEN UND ARBEITSSTÄTTEN: GEWERBEANZEIGEN: DEZEMBER UND JAHR 2010, at 14 [hereinafter: STATISTISCHES BUNDESAMT 2010].

91. STATISTISCHES BUNDESAMT 2008, *supra* note 89, at 18 (reporting newly formed ("Newgründung") Private Company Limited by Shares for 2008 as 4,884).

92. STATISTISCHES BUNDESAMT 2010, *supra* note 90, at 14.

never caught on among the public corporations that are the subject of this Article.[93]

Why public corporations fail to incorporate is not entirely clear. Possible reasons include language barriers,[94] concerns about having to litigate important corporate matters before foreign—and therefore potentially unsympathetic—courts,[95] conflicts of interest on the part of corporate lawyers who might be loath to lose their clients due to a change in the state of incorporation,[96] and the fact that established firms might be heavily invested in the corporate law of their home state. In any case, it is clear that so far, public corporations do not see reincorporation in another Member State as a practical way of avoiding their home state's laws.[97]

II. Traditional Justifications for Mandatory Law

To understand why foreign jurisdictions rely more heavily on mandatory corporate law than the United States, it is helpful to begin by asking how mandatory law can be justified in the first place. The contractarian view of the corporation assumes that, as a general rule, the internal structure is best left to private ordering.[98] Desiring to maximize the price that they can obtain for the shares of their enterprise, the owners of a firm will generally adopt value-maximizing governance arrangements in anticipation of taking the firm public. Why then would mandatory corporate law ever be needed? Scholars have traditionally given three main answers to this question, and while at least two of them remain controversial,[99] they are worth reviewing briefly.

93. Dammann, *Indeterminacy*, *supra* note 71, at 70; Becht et al., *supra* note 86, at 242 ("Between 2003 and 2006, over 67,000 new private limited companies were established in the U.K. from other E.U. Member States."). However, they note that there is no evidence for migration among publicly traded firms, and, instead, stress that "[m]ost of the new foreign limited companies are small entrepreneurial firms." *Id.*; *see* Bratton et al., *supra* note 77, at 385 (noting that regulatory competition is "limited to economically-negligible small entrepreneurs").

94. Dammann, *Freedom*, *supra* note 71, at 492.

95. *Id.*

96. *Id.* at 505–06.

97. *See* Dammann, *Indeterminacy*, *supra* note 71, at 70 ("[C]orporate mobility in the European Union has thus-far remained a phenomenon whose importance is strictly limited to very small privately held firms.").

98. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 Colum. L. Rev. 1416, 1418 (1989) (arguing that a corporation is best understood as "a complex set of explicit and implicit contracts"); Henry N. Butler, *The Contractual Theory of the Corporation*, 11 Geo. Mason L. Rev. 99 (1989).

99. *See* Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 Colum. L. Rev. 1599, 1617 (1989) (taking the position that only externalities constitute a persuasive justification for mandatory corporate law and that even then, federal mandatory law is only appropriate if the outcome of the federal political process is superior to the market solution).

A. Imperfect Pricing of Charter Terms

To begin, it has been suggested that IPO markets might price charter terms imperfectly.[100] This claim, if true, has far-reaching consequences for the efficiency of charter terms and the desirability of mandatory corporate law. As long as charter terms are accurately priced by IPO markets, entrepreneurs taking their company public will bear the full costs of any inefficient charter terms. It is then in their interest to choose the most efficient charter terms.

By contrast, once one assumes that IPO markets fail to price charter terms accurately, it follows that some or all of the costs of inefficient charter terms will be borne by investors buying the shares of IPO firms. If the benefits of the inefficient terms accrue to the entrepreneurs taking the company public, it might actually be in their financial interest to include inefficient charter terms. In other words, the market no longer guarantees that IPO firms will choose efficient charter terms. Hence, mandatory corporate law norms might be needed to ensure that firms are subject to efficient rules.

For many law and economics scholars, the claim that IPO markets are substantially imperfect at pricing charter terms is quite difficult to swallow;[101] it runs counter to the so-called semi-strong version of the efficient capital market hypothesis, which holds that share prices fully reflect publicly available information—including publicly available information on charter terms.[102] Despite some well-known evidence tending to show that markets are not completely efficient in pricing publicly available information,[103] the semi-strong efficient capital market

---

100. Lucian Arye Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, 152 U. Pa. L. Rev. 713, 740–42 (2003); *cf.* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 Nw. U. L. Rev. 542, 571–72 (1990) (discussing various factors that might prevent IPO charter terms from being efficiently priced).

101. *See, e.g.*, Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 Colum. L. Rev. 1549, 1563 (1989) (calling the claim that otherwise efficient markets will fail to price charter terms "puzzling").

102. The terminology goes back to Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. Fin. 383, 383 (1970) (distinguishing between weak, semi-strong, and strong forms of capital market efficiency). This definition of semi-strong capital market efficiency is now generally accepted. *See, e.g.*, Daniel R. Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 Cornell L. Rev. 907, 911 (1989) (discussing the semi-strong version of the efficient capital market hypothesis); Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 Va. L. Rev. 549, 555 (1984) (same).

103. Werner F. M. De Bondt & Richard H. Thaler, *Further Evidence on Investor Overreaction and Stock Market Seasonality*, 42 J. Fin. 557, 580 (1987) (presenting evidence that markets overreact to news and are slow to correct pricing mistakes); Jay R. Ritter, *The Buying and Selling Behavior of Individual Investors at the Turn of the Year*, 43 J. Fin. 701 (1988) (presenting evidence that small firms tend to earn abnormally high results). These qualms about the limits of capital market efficiency are now taken more seriously in the legal literature as well. *See, e.g.*, Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. Corp. L. 635, 636–67 (2003) (detailing the shortcomings of capital markets).

hypothesis has long been—and continues to be—widely regarded as a more or less accurate and proven description of how capital markets work.[104]

Nonetheless, the imperfect pricing hypothesis is not easily dismissed, in part because the empirical literature on the efficiency of IPO pricing is mixed. On the one hand, at least one study suggests that underwriters' treatment of publicly available information, while imperfect, comes close to being consistent with efficient pricing.[105] On the other hand, various authors have presented evidence that IPO markets do not fully incorporate all publicly available information[106] and in particular, that readily available public information can be used to predict IPO underpricing.[107] In other words, the empirical literature on IPO pricing is hardly sufficiently settled to conclude whether charter terms are fully priced.

Moreover, IPO charters are notoriously ill behaved. Although commentators tend to agree that antitakeover defenses[108] in general and staggered boards in particular[109] reduce shareholder wealth, such provisions are very common in IPO charters.[110] Some experts have attempted to reconcile this finding with the efficient capital market hypothesis. For example, it has been suggested that at least at the IPO stage, such provisions might not be as inefficient as traditionally

104. *E.g.*, Nathan Cortez, *Adverse Publicity by Administrative Agencies in the Internet Era*, 2011 BYU L. REV. 1371, 1397 n.152 (2011) (noting that empirical evidence "tends to support" the semi-strong version of the efficient capital markets hypothesis).

105. *See* Michelle Lowry & G. William Schwert, *Is the IPO Pricing Process Efficient?*, 71 J. FIN. ECON. 3, 25 (2004) (analyzing the efficiency of IPO pricing and concluding that "underwriters' treatment of public information appears to be *almost* consistent with an efficient IPO pricing process").

106. *E.g.*, Tim Loughran & Jay R. Ritter, *Why Don't Issuers Get Upset About Leaving Money on the Table in IPOs?*, 15 REV. FIN. STUD. 413, 426 (2002) (presenting evidence that "underwriters do not fully adjust the offer price with respect to public information"); Daniel J. Bradley & Bradford D. Jordan, *Partial Adjustment to Public Information and IPO Underpricing*, 37 J. FIN. & QUANTITATIVE ANALYSIS 595, 612 (2002) ("IPO offer prices only partially adjust to public information.").

107. Bradley & Jordan, *supra* note 106, at 596.

108. *See generally* Michael Ryngaert, *The Effect of Poison Pill Securities on Shareholder Wealth*, 20 J. FIN. ECON. 377 (1988) (presenting evidence that the adoption of the most restrictive poison pills is associated with stock price declines); Paul H. Malatesta & Ralph A. Walkling, *Poison Pill Securities: Stockholder Wealth, Profitability, and Ownership Structure*, 20 J. FIN. ECON. 347 (1988) (presenting evidence that poison pills reduce shareholder wealth). *But see generally* Robert Comment & G. William Schwert, *Poison Or Placebo? Evidence on the Deterrent and Wealth Effects of Modern Antitakeover Measures*, 39 J. FIN. ECON. 3 (1995) (presenting evidence that poison pills do not reduce the likelihood of takeovers and that poison pills are associated with higher takeover premiums).

109. Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409, 430 (2005) (concluding "that staggered boards are associated with an economically meaningful reduction in firm value"); Bebchuk, *supra* note 100, at 719 (noting that "there are reasons to believe that strong antitakeover protections decrease share value").

110. Klausner, *supra* note 56, at 1333 (noting that IPO charters commonly contain takeover defenses and, in particular, staggered boards). For a more detailed treatment, see Daines & Klausner, *supra* note 50.

believed,[111] or that their popularity might be due to agency problems between the entrepreneurs and their lawyers.[112] However, the most straightforward explanation for the proliferation of staggered board provisions in IPO charters is that pricing is imperfect.[113]

B. Midstream Charter Amendments

A second explanation for mandatory corporate law focuses on the potential for opportunistic midstream charter amendments.[114] After a corporation has gone public, those in control of the corporation—be they managers or controlling shareholders—might seek to amend the charter in a way that benefits them at the expense of shareholders. Investors anticipate this and will only pay a price that reflects a discount for future opportunism. To overcome this problem, firms need a mechanism that allows them to signal that no opportunistic amendments will occur in the future. Mandatory law, so it is said, provides a solution to this problem.[115]

The strength of this argument depends on how likely those in control are to change the charter in opportunistic ways. Accordingly, in the United States, where most corporations lack a controlling shareholder,[116] the decisive question is whether managers have the power to push through charter amendments that decrease shareholder wealth.

Critics of mandatory law have voiced some skepticism in this regard. Charter amendments have to be approved by the shareholders, and why

111. Bebchuk, *supra* note 100, at 732–33 (raising the possibility that the existence of antitakeover defenses in the IPO charter might make a subsequent move to dispersed ownership more likely and might therefore be preferable to investors).

112. *Id.* at 736–39. Yet another explanation has been suggested by Michael Klausner. According to Klausner, it might be "privately rational, but socially inefficient, for private equity funds to have their portfolio companies adopt takeover defenses" due to "private equity funds' need to maintain a reputation for dealing well with successful managers of portfolio companies." Michael Klausner, *Institutional Shareholders, Private Equity, and Antitakeover Protection at the IPO Stage*, 152 U. Pa. L. Rev. 755, 784 (2003).

113. *Cf.* Klausner, *supra* note 56, at 1335 (noting that the proliferation of antitakeover defenses in IPO charters "raises questions about whether governance terms are priced when they are included in the IPO charter").

114. *See, e.g.*, Gordon, *supra* note 69, at 1593 (suggesting the risk of opportunistic charter amendments as a rationale for mandatory corporate law rules); Lucian Arye Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 Colum. L. Rev. 1395, 1401 (1989) (arguing that mandatory rules might be needed to prevent opportunistic charter amendments).

115. *E.g.*, Gordon, *supra* note 69, at 1593; Bebchuk, *supra* note 114, at 1401.

116. Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. Pa. L. Rev. 1263, 1267 (2009) ("In the United States and the United Kingdom, most public companies do not have a controlling shareholder."); Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. Fin. 471, 491–93 (1999) (showing that among the largest firms in the United States and the United Kingdom, most have dispersed ownership). *But see* Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 Rev. Fin. Stud. 1377, 1394 (2009) (presenting evidence that many public corporations in the United States have large blockholders).

would the shareholders approve charter amendments that harm them?[117] Defenders of mandatory corporate law have answered that question by citing tactics that allow managers to obtain shareholder approval for value-decreasing charter amendments. They mention two such techniques in particular. First, they note that managers might simply speculate on the ignorance of shareholders hoping that the latter will vote in favor of resolutions proposed by the board without getting informed.[118] Second, they emphasize that directors might resort to what is known as "bundling"—because charter amendments can only be proposed by the board of directors, the latter can "bundle" an amendment that decreases shareholder wealth with another one that increases shareholder wealth.[119] As long as the net effect of the bundle is to increase shareholder wealth, shareholders will find it in their interest to vote for the bundle despite the fact that one of its components is detrimental to their interests.[120] Assuming these techniques work reasonably well, the shareholder-approval requirement offers only imperfect protection against opportunistic charter amendments. In that case, mandatory law can be used to provide additional protection to shareholders.

C. Externalities

A third justification for mandatory corporate law focuses not on shareholder wealth, but on corporate law's effects on third parties. To the extent that corporate law norms produce positive or negative externalities, one cannot assume that corporations will adopt the most efficient rules. Accordingly, mandatory law might be necessary to ensure efficient outcomes.[121]

Perhaps the most well-known example involves the principle of limited liability. When the corporation's creditors deal with the corporation voluntarily, limited liability does not impose externalities. After all, creditors can protect themselves by demanding surety or insisting on higher interest rates. However, as Henry Hansmann and Reinier Kraakman have pointed out, there are also many involuntary creditors, such as tort victims, who are unable to bargain for protections.[122]

117. Romano, *supra* note 99, at 1607–14 (arguing that the shareholder approval requirement might limit the ability of managers to push through value-decreasing charter amendments).

118. Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1472 (1992) (noting, with respect to reincorporation decisions, that shareholders might vote with management because they are insufficiently informed).

119. Bebchuk, *supra* note 1, at 864–65.

120. *Id*.

121. Romano, *supra* note 99, at 1616 ("[T]here is . . . a role for mandatory corporate law when externalities are present.").

122. Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1920 (1991).

With respect to such involuntary creditors, corporations cannot be expected to adopt the most efficient liability rules; rather, they will seek to minimize personal liability.[123] Accordingly, mandatory law might be needed to secure efficient outcomes.

III. Transnational Differences

The central question that this Article seeks to address is a comparative one: Why do foreign jurisdictions rely so much more heavily on mandatory corporate law than the United States? This Article argues that the traditional justifications for mandatory corporate law constitute an important building block for answering this question. More specifically, it demonstrates that the very considerations that are thought (by some) to justify mandatory corporate law rules in the United States tend to be much more compelling in foreign countries. Put differently, if one believes that the traditional justifications for mandatory corporate law justify the existence of some mandatory rules in the United States, then one should not be surprised to see a much larger number of mandatory rules in foreign jurisdictions.

A. The Pricing of Charter Terms

The imperfect-pricing justification distinctly demonstrates the point that the traditional reasons for mandatory corporate law are more compelling abroad than they are in the United States. As noted above, it has become common to defend mandatory corporate law on the ground that IPO markets are imperfect at pricing charter terms. How much weight one is willing to accord this explanation depends on how strongly one believes in the efficiency of capital markets. Scholars who believe that the efficient capital market hypothesis in its semi-strong form is overall a good description of how capital markets work will generally be less willing to accept the imperfect-pricing hypothesis than scholars who view the efficient capital market hypothesis as far removed from reality.

Either way, it is crucial to note that the efficiency of capital markets is a matter of degree. Some capital markets are more efficient than others;[124] the more efficient they are, the more difficult it is to justify mandatory corporate law with the possibility of imperfect pricing.

123. *Id*. at 1881 ("[S]trong empirical evidence indicates that increasing exposure to tort liability has led to the widespread reorganization of business firms to exploit limited liability to evade damage claims.").

124. There is a substantial literature examining the efficiency of capital markets in various corners of the globe and often coming up with mixed results. *See, e.g.*, Mahdi M. Hadi, *Review of Capital Market Efficiency: Some Evidence from Jordanian Market*, 3 Int. Res. J. Fin. & Econ. 13, 22 (2006) (finding mixed evidence regarding semi-strong capital market efficiency in the Jordanian capital market); Frimpong Joseph Magnus, *Capital Market Efficiency: An Analysis of Weak-Form Efficiency on the Ghana Stock Exchange*, 5 J. Money, Investment & Banking, 5, 11 (2008) (presenting evidence that not even weak-form capital market efficiency is given on the Ghana Stock Exchange); Nicolaas

Despite the recent handwringing about the United States losing ground to other countries,[125] it is widely acknowledged that the United States has the most efficient capital markets in the world.[126] The empirical literature supports this view; while the literature comparing capital market efficiency across countries is still in its infancy and does not focus on the specific problem of IPO pricing, there has recently been some evidence that U.S. capital markets are in fact more efficient than those of other countries.[127]

These findings are not surprising. While there continues to be some disagreement about the determinants of capital market efficiency—regarding, for example, the reasons for why some capital markets are more efficient than others—it is clear that there are two features that set U.S. capital markets apart from their international competitors.

Sheer size is one factor. The New York Stock Exchange ("NYSE") and the NASDAQ are the dominant stock exchanges in terms of domestic market capitalization at $14.1 trillion and $4.6 trillion, respectively. The runner-ups are the Tokyo Stock Exchange ($3.5 trillion) and the London Stock Exchange ($3.4 trillion).[128] Even then, the market capitalization of the Tokyo Stock Exchange is only one fourth that of the NYSE. This U.S. advantage in size is likely to matter not least because efficient IPO pricing crucially relies on sophisticated underwriters, and a competitive market for sophisticated underwriters is more likely to emerge in countries with well-developed capital markets.

Just as important, the United States has particularly stringent securities law and what is widely thought to be an unparalleled

---

Groenewold et al., *The Efficiency of the Chinese Stock Market and the Role of the Banks*, 14 J. ASIAN ECON. 593 (2003) (presenting evidence of departures from weak-form efficiency).

125. Of course, gloomy warnings are nothing new. *See, e.g.*, Egon Guttman, *Federal Regulation of Transfer Agents*, 34 AM. U. L. REV. 281, 328 (1985) (arguing that without measures to improve the efficiency of America's capital markets, "a loss of preeminence is inevitable").

126. *E.g.*, James H. Freis, Jr., *An Outsider's Look into the Regulation of Insider Trading in Germany: A Guide to Securities, Banking, and Market Reform in* Finanzplatz Deutschland, 19 B.C. INT'L & COMP. L. REV. 1, 66 (1996) ("[T]he New York Stock Exchange is generally considered the most efficient capital market in the world."); Mark J. Hanson, *Becoming One: The SEC Should Join the World in Adopting the International Financial Reporting Standards*, 28 LOY. L.A. INT'L & COMP. L. REV. 521, 539 (2006) ("The U.S. has the most efficient capital markets in the world."); Eric M. Sherbet, *Bridging the GAAP: Accounting Standards for Foreign SEC Registrants*, 29 INT'L L. 875, 875 (1995) ("[T]he United States has the largest, most efficient capital markets in the world."); Louis M. Solomon, *International Comity at the Crossroads: Practical Implications and Public Policy Challenges*, 1 N.Y.U. J. L. & BUS. 269, 284 (2004) ("America has developed the world's most efficient capital market system.").

127. *See generally* Daniel O. Cajueiro & Benjamin M. Tabak, *Ranking Efficiency for Emerging Equity Markets II*, 23 CHAOS, SOLITONS, & FRACTALS 671 (2005) (finding that the U.S. stock market is more efficient than stock markets in emerging economies); Enrico Onali & John Goddard, *Are European Equity Markets Efficient? New Evidence from Fractal Analysis*, 20 INT. REV. FIN. ANALYSIS 59 (2011) (presenting evidence that some of the smaller European stock markets are less efficient than stock markets in the United States or the United Kingdom).

128. WORLD FED'N OF EXCHS., 2012 WFE MARKET HIGHLIGHTS 6 tbl.2 (2013), *available at* http://www.world-exchanges.org/files/statistics/2012%20WFE%20Market%20Highlights.pdf.

enforcement structure.[129] As John Coffee has noted, "the United States pursues securities law violations through both public and private enforcement with an intensity unmatched elsewhere in the world."[130]

Thus, the United States has so far preserved its edge with respect to capital market efficiency. Foreign capital markets are certainly becoming more competitive—an issue to which this Article turns later[131]—but they still have a long way to go to catch up to the United States. That, in turn, has obvious implications for the efficiency of mandatory corporate law. Given the strength of U.S. capital markets, imperfect pricing arguments for mandatory corporate law are quite simply more difficult to make here than they are in other countries where capital markets function less well.

B. Opportunistic Midstream Amendments

The second traditional justification for mandatory corporate law—the threat of opportunistic midstream charter amendments—also proves more compelling abroad than it does here in the United States. The plausibility of the midstream amendments argument depends on the severity of the risk that, in the absence of mandatory law, those in control of the corporation can successfully adopt charter amendments that decrease shareholder wealth. Accordingly, the question is whether the risk of such amendments is lower in the United States than it is elsewhere. The answer to that question is yes, and the underlying reason is quite simple: most foreign countries have much more concentrated share ownership, and more concentrated ownership translates into a greater risk for opportunistic charter amendments.

By international standards, share ownership in the United States and the United Kingdom is relatively dispersed.[132] Although it is not uncommon for public corporations in the United States to have large shareholders owning a substantial portion of their stock,[133] the existence of a *controlling* shareholder is the exception rather than the rule, especially among very large companies.[134] By contrast, in most European countries, with the notable exception of the United Kingdom, ownership

129. For an empirical assessment, see Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. Fin. Econ. 207, 211, 214 tbl.2 (2009) (focusing on "regulator's budgetary resources and staffing levels" and showing that the United States does exceptionally well on both measures).

130. John Coffee, *Law and the Market: The Impact of Enforcement*, 156 U. Pa. L. Rev. 229, 309 (2007).

131. *See infra* Part V.

132. La Porta et al., *supra* note 116, at 491–93 (1999) (showing that among the largest firm in the United States and the United Kingdom, most have dispersed ownership).

133. Holderness, *supra* note 116, at 1394 (presenting evidence that many public corporations in the United States have large blockholders).

134. *See supra* note 109.

is far more concentrated, and the existence of a controlling shareholder is the norm.[135] Incidentally, the same is true in Asia.[136]

This difference in ownership concentration has important implications for the likelihood of opportunistic charter amendments. In the United States, where the salient conflict is between managers and shareholders, the decisive question is to what extent managers can push through charter amendments that decrease shareholder wealth. Their ability to do so is limited by the necessity of obtaining shareholder approval.

Admittedly, there might be ways to secure shareholder approval even for those amendments that decrease shareholder wealth. In particular, the board might seek to rely on shareholder ignorance or it might bundle unattractive charter amendments with more attractive measures to gain shareholder approval.[137] However, the usefulness of these tactics declines as the desired charter amendment becomes more damaging to the interests of the shareholders. Bundling, for example, can only work to the extent that management has a sweetener to offer that offsets the detrimental impact of the charter amendment. Similarly, the more damaging the amendment is to shareholder interests, the more difficult it will be for directors to rely on the ignorance of shareholders to obtain shareholder approval.

Compared to the conflict of interest between managers and shareholders, the one between controlling and minority shareholders is far more difficult to contain. Given that the controlling shareholder controls the board, the requirement of a board resolution as a prerequisite for amending the charter does not constrain him. Similarly, the necessity to obtain shareholder approval is no obstacle to a shareholder who owns a majority of the shares, and not much of an obstacle to a shareholder who owns close to a majority of the shares. In other words, shareholder

---

135. *E.g.*, Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1645 (2006) ("[E]xcluding the United States and the United Kingdom, the worldwide corporate governance landscape has a monolithic feature: control of publicly traded corporations is typically lodged in a single individual, family, or group."); Marco Becht & Colin Mayer, *Introduction* to THE CONTROL OF CORPORATE EUROPE 1, 19 tbl.1.1 (Fabrizio Barca & Marco Becht eds., 2001) (presenting data on ownership concentration for publicly traded corporations in Europe and the United States showing, inter alia, that largest voting block was 57% in the median German corporation, 56% in the median Belgian corporation, 54.5% in the median Italian corporation, and 52% in the median Austrian corporation, but only 9.9% in the median U.S. corporation); Marco Becht & Alisa Roell, *Blockholdings in Europe: An International Comparison*, 43 EUR. ECON. REV. 1049 (1999) (presenting evidence of much higher ownership concentrations in continental Europe than in the United Kingdom or in the United States); Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations*, 65 J. FIN. ECON. 365, 378 (2002) (studying a sample of over five-thousand corporations from Western Europe and showing that more than 44% are controlled by a single family).

136. Stijn Claessens et al., *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 J. FIN. 2741, 2742 (2002) (noting that in East Asian firms, "the largest shareholder is often able to control a firm's operations with a relatively small direct stake in its cash-flow rights").

137. *See supra* text accompanying notes 119–120.

approval requirements are of little use in controlling opportunistic charter amendments in countries where controlling shareholders are the norm. That, in turn, makes mandatory law more attractive because mandatory law offers an alternative way to prevent controlling shareholder opportunism.

At this point, skeptics might point out that there are other mechanisms aside from mandatory corporate law that can protect minority shareholders against opportunistic controllers and thereby compensate for the uselessness of the shareholder approval requirement. In particular, these mechanisms include: a judicial review of the fairness of the amendment,[138] supermajority requirements,[139] and majority-of-the-minority requirements.[140] However, all of these alternative mechanisms have significant limitations. This is not to say that they are completely without merit. Rather, each of them can play a certain role in corporate governance. But the decisive question is whether they are sufficiently effective to contain controlling shareholder opportunism as effectively as shareholder approval requirements contain managerial opportunism. There are good reasons to think that that is not the case.

1. Fairness Review

A judicial assessment of the fairness of charter amendments seems particularly problematic. Both practical experience and theoretical considerations suggest that such a fairness review would be of little help except in the most extreme cases.

As a practical matter, it is worth noting that there already exists a widespread tendency among corporate law systems to allow some type of fairness review of shareholder resolutions. In Delaware, minority shareholders can invoke the controlling shareholder's duty of loyalty.[141] Similar principles apply elsewhere, including in France (*abus de majorité*),[142] Germany (*Treuepflichtverletzung*),[143] and the United Kingdom (unfair prejudice).[144]

In practice, however, it is quite difficult for minority shareholders to challenge charter amendments on these grounds. Of course, the fact that European jurisdictions are reluctant to use judicial fairness review to

138. *See infra* Part III.B.1.

139. *See infra* Part III.B.2.

140. *See infra* Part III.B.3.

141. *See, e.g.*, Oliver v. Bos. Univ., No. Civ.A 16570, 2006 WL 1064169, at *18 (Del. Ch. Apr. 14, 2006) (holding that the duty of loyalty "requires that a 'controlling' shareholder not act, or cause its representatives to act, in such a manner as to deal unfairly with the minority shareholders").

142. MICHEL GERMAIN ET AL., 1 TRAITÉ DE DROIT COMMERCIAL 369 (18th ed. 2002).

143. For a survey on fiduciary duties in German corporate law, see KARSTEN SCHMIDT, GESELLSCHAFTSRECHT 587–95 (4th ed. 2002).

144. *See, e.g.*, PAUL L. DAVIES, GOWER'S PRINCIPLES OF MODERN COMPANY LAW 681–708 (8th ed. 2008).

police charter amendments[145] might not come as a surprise. Given the prevalence of mandatory corporate law, these jurisdictions simply offer fewer opportunities for charter amendments in the first place. However, even in Delaware where there are few mandatory norms, and where the Delaware Supreme Court has explicitly acknowledged the possibility that, given the right circumstances, a charter amendment might violate the duty of loyalty,[146] one looks in vain for a case in which a charter amendment was actually declared void for that reason.[147]

It is easy to see why corporate law jurisdictions are reluctant to subject charter amendments to a judicial fairness review. Unlike in ordinary self-dealing transactions, in which a controlling shareholder enters into a contract with the corporation, it is difficult to come up with clear guidelines as to when charter amendments are unfair. When fiduciary duties are used to contain shareholder opportunism, the goal is usually quite straightforward—the law seeks to ensure that the shareholder does not enrich himself at the expense of the corporation and hence the other shareholders. In case of charter amendments, however, the situation is more complicated. Charter amendments typically affect the balance of power within the corporation. For example, a corporation might switch from cumulative voting to majority voting.[148] Any change in the allocation of power necessarily leaves some shareholders less powerful while making others more powerful. If this were enough to constitute a duty of loyalty violation, many desirable charter amendments would become impossible. Hence, one must conceive of additional tests, such as whether the charter amendment is in the interest of the corporation. However, courts are notoriously ill-positioned to determine what might or might not be in the corporation's interest, explaining why they have historically been hesitant to apply judicial fairness review to charter amendments. As a leading French commentator notes, the prevailing restrictive interpretation of the

145. For example, in Germany, only very few cases deal with the controlling shareholder's fiduciary duty, and none of them concerns a charter amendment. For a review of the relevant case law, see SCHMIDT, *supra* note 143, at 587–95. Regarding French law, see GERMAIN ET AL., *supra* note 142, at 369 (noting the demanding requirements of the abus-de-majorité doctrine).

146. Williams v. Geier, 671 A.2d 1368 (Del. 1996). The Chancery Court, too, has suggested that charter amendments can be subject to the entire fairness standard. President & Fellows of Harvard Coll. v. Glancy, No. Civ.A. 18790, 2003 WL 21026784, at *21 (Del. Ch. Mar. 21, 2003) ("Whether the business judgment rule or the entire fairness doctrine is applicable to [a stock option plan and related charter amendments] turns on whether the defendants had a financial interest sufficient to render them incapable of exercising objective business judgment.").

147. *See* Stroud v. Grace, 606 A.2d 75, 83 (Del. 1990) (applying the business judgment rule); *In re* Tri-Star Pictures, Inc., 634 A.2d 319, 334 (Del. 1993) (declaring moot the question regarding the standard of scrutiny to be applied).

148. Majority voting is the default under Delaware law, but the certificate of incorporation can provide for cumulative voting. DEL. CODE ANN. tit. 8, § 214 (2013).

relevant French doctrine has the great advantage of not allowing courts to be drawn into running the firm in the place of its owners.[149]

2. *Supermajority Requirements*

In light of the difficulty inherent in any attempt to scrutinize the substantive fairness of charter amendments, it might seem tempting to focus instead on procedural mechanisms that constrain controlling shareholders. Supermajority requirements are perhaps the most obvious examples of such mechanisms.

Indeed, whereas Delaware requires only a simple majority for a charter amendment,[150] many other jurisdictions specify a higher threshold. French law, for example, requires a two-thirds majority,[151] and both German[152] and U.K.[153] law demand a three-fourths majority. However, while Delaware law might only require a simple majority to change the charter,[154] that simple majority refers to the outstanding shares entitled to vote.[155] By contrast, the supermajority requirements common in other countries such as France, Germany, or the United Kingdom refer to the shares present or represented at the shareholder meeting, or even to the votes cast.[156]

This difference matters because in practice, only a fraction of the outstanding shares tend to be represented at the shareholder meeting. For example, a study of shareholder meetings of listed Belgian companies found that on average, only 57.2% of the outstanding shares were represented at the shareholder meeting.[157] For the largest German corporations, the relevant fraction has been shown to be around 58 to

149. GERMAIN ET AL., *supra* note 142, at 369.

150. DEL. CODE ANN. tit. 8, § 242(b)(1).

151. CODE DE COMMERCE [C. COM] art. L225-96(3) (Fr.).

152. Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at 1089, last amended by Gesetz [G], Dec. 22, 2011, BGBL. I. at 3044, § 179(2) (Ger.).

153. Companies Act, 2006, c.46, §§ 21(1), 283(1) (U.K.).

154. DEL. CODE ANN. tit. 8, § 242(b)(1) (requiring the affirmative vote of a majority of the outstanding stock entitled to vote on the amendment).

155. *Id.*

156. *See, e.g.*, Companies Act, 2006, c.46, § 283(5) (U.K.), ("A resolution passed on a poll taken at a meeting is passed by a majority of not less than 75% if it is passed by members representing not less than 75% of the total voting rights of the members who (being entitled to do so) vote in person or by proxy on the resolution."); Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at 1089, last amended by Gesetz [G], Dec. 22, 2011, BGBL. I. at 3044, § 179(2) (Ger.) (requiring three fourths of the shares present or represented at the shareholder meeting to be voted for the charter amendment).

157. Christoph Van der Elst, *Attendance of Shareholders and the Impact of Regulatory Corporate Governance Reforms: an Empirical Assessment of the Situation in Belgium*, 5 EUR. BUS. ORG. L. REV. 471, 506 (2004).

59%.[158] The impact of such attendance is dramatic. Assume that there are one million shares outstanding. If 40% of the shares fail to be present or represented at the shareholder meeting, then a three-fourths supermajority requirement in the European style translates into a requirement that 450,000 shares—or 45% of all outstanding shares—approve the charter amendment—less than what is needed under Delaware law. In practice, therefore, the "supermajority requirements" found in Europe might not offer minority shareholders any more protection than Delaware law.

The fact that European jurisdictions do not adamantly attempt to control shareholders by adopting stricter supermajority requirements suggests that such requirements have their limitations. In fact, supermajority requirements come with obvious drawbacks. Most importantly, it is difficult to impose supermajority requirements that are meaningful without being insurmountable given that ownership concentrations vary across corporations. For example, a rule requiring all charter amendments to be approved by three quarters of all outstanding shares will have a very different impact depending on whether the controlling shareholder holds forty or eighty percent of the outstanding shares. In the former case, the rule makes charter amendments all but impossible and thus offers little more flexibility than a rule making the relevant corporate law provisions mandatory. In the latter case—where the controlling shareholder owns enough shares to meet the supermajority requirement—the supermajority rule proves entirely useless for purposes of protecting the minority shareholders. In other words, given the fact that levels of ownership concentration differ across firms, it is all but impossible to impose a supermajority requirement that does not misfire in one of the two ways described above.

Supermajority requirements also raise the inevitable risk of hold-ups:[159] while protecting minority shareholders, supermajority requirements also offer the minority shareholders a chance to extort unjustified concessions from the corporation in exchange for their consent.[160] At first glance, this might not seem to matter much when the alternative is a mandatory corporate law rule; after all, the fact that the controlling shareholder is willing to meet the possibly illegitimate demands made by the minority shareholders demonstrates that he prefers that outcome over being unable to change the charter at all. In reality, however, the situation is more complicated. To gain the desired supermajority, the

158. Christoph Van der Elst, *Shareholder Rights and Shareholder Activism: The Role of the General Meeting of Shareholders*, 60 BELGRADE L. REV. 39, 62 (2012) (focusing on DAX 30-companies and finding attendance of 58.2% in 2009 and 57% in 2010).

159. Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1937 (1996).

160. Richard Holden, Supermajority Voting Rules (June 16, 2004) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=625122.

controlling shareholder does not have to pay off all the minority shareholders. Rather, she needs only to bridge the distance between her own shareholdings and the fraction required to reach the supermajority threshold; it is enough, then, for her to pay off *some* of the minority shareholders. In the worst case scenario, the supermajority requirement not only fails to prevent the controlling shareholder from pushing through a charter amendment that reduces shareholder wealth, but it causes her to use corporate funds to bribe some of the minority shareholders in order to reach the supermajority requirement. For example, in exchange for approving the charter amendment, some of the corporation's non-controlling blockholders might secure lucrative contracts with the corporation. The result is that the other minority shareholders are even worse off than they would be without the supermajority requirement; they are forced to accept the charter amendment while the value of their shares is reduced as a result of the bribes paid.[161]

3. Majority-of-the-Minority Requirements

A more promising technique for avoiding opportunistic charter amendments involves so-called majority-of-the-minority requirements. In other words, charter amendments can be made contingent upon approval by the minority shareholders.

European countries have shown no appetite for this particular approach as a mechanism for preventing opportunistic charter amendments.[162] In Delaware, by contrast, the situation is more complex. Under the Delaware Supreme Court's caselaw, self-dealing transactions involving a controlling shareholder are subject to the so-called entire fairness standard.[163] However, approval by the disinterested shareholders will shift the burden of proof from the corporation to the plaintiff.[164] In

161. Of course, in a perfect world, the rules governing self-dealing would be policed so effectively as to render bribes unfeasible. In the real world, however, bargains of this type can be quite difficult to prevent, especially in countries with ineffective courts.

162. Regarding Germany, see SCHMIDT, *supra* note 143, at 910–20 (describing the law applicable to charter amendments). Regarding France, see GERMAIN ET AL., *supra* note 142, at 609–14 (describing the law applicable to charter amendments). In the United Kingdom, under the so-called Listing Rules, approval by the disinterested shareholders becomes relevant with respect to transactions between the corporation and another party. *See* Listing Rules, 2013, §§ 11.1.7(3)–(4) (U.K.). Under Listing Rule section 11.1.7(3), the company must obtain shareholder approval before entering into a related party transaction, and under section 11.1.7(4), the interested party, e.g. the controlling shareholder, is precluded from voting on this matter. *Id.*

163. Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997).

164. *Id*. At least in one area—namely freeze-out mergers—the Delaware Chancery Court has now embraced an approach that is more generous to the controlling shareholder. If the merger is approved by both a committee of independent directors and the minority shareholders, then the Chancery Court accords the transaction the protection of the business judgment rule. *In re* MFW S'holder Litig., 67 A.3d 496, 502 (Del. Ch. 2013). It remains to be seen whether the Delaware Supreme Court approves of this approach.

other words, minority shareholder approval is not mandated, but the law provides a strong incentive to procure such approval. In principle, therefore, the U.S. experience suggests that majority-of-the-minority requirements can be valuable mechanisms for addressing the challenges posed by controlling shareholders. In practice, of course, this has been less true where charter amendments are concerned. The incentive to seek shareholder approval exists only where the entire fairness standard applies in the first place. So far, Delaware courts have not applied the entire fairness standard to charter amendments despite hinting that they will do so when the circumstances are right, such as when the board has pushed through a charter amendment for the sole purpose of entrenching the incumbent directors.[165]

As with other mechanisms aimed at protecting minority shareholders, there are reasons behind the reluctance to subject charter amendments to majority-of-the-minority approval. To begin, there is the concern that minority shareholders are insufficiently well-informed to impose meaningful constraints on shareholder opportunism. Of course, rational ignorance is a general problem in the context of shareholder voting. But when it comes to minority shareholder approval requirements, that problem is more severe than usual. By focusing only on minority shareholders, one excludes the shareholder (namely the controller) who is most likely to be informed. Differently put, it is one thing to expect blockholders in the United States to be sufficiently well-informed to constrain managerial opportunism. It is quite another to expect minority shareholders to be informed well enough to constrain controlling shareholders—especially in those cases where control lies in the hands of a group of shareholders that includes some or all of the corporation's large blockholders.

To make matters worse, some foreign jurisdictions have structured the voting process in a way that undermines the efficacy of minority shareholder voting. Germany is a case in point. German law allows banks to obtain a general authorization from their customers to exercise voting rights on their behalf.[166] Once such a general authorization has been granted, the bank, even though it is required to act in the shareholder's best interest, will exercise its own discretion in deciding how to vote, unless the shareholder gives specific instructions.[167] As a practical matter, this means that minority shareholder votes are largely directed by banks

---

165. *See* President & Fellows of Harvard Coll. v. Glancy, No. Civ.A. 18790, 2003 WL 21026784, at *21 (Del. Ch. Mar. 21, 2003) (suggesting that charter amendments can be subject to the entire fairness standard).

166. *Cf.* Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at 1089, last amended by Gesetz [G], Dec. 22, 2011, BGBL. I. at 3044, § 135 (Ger.) (governing the exercise of voting rights by banks on behalf of their customers).

167. *Id.*

since only a small fraction of minority shareholders make use of their right to issue specific voting instructions.[168] This mechanism, known as *Depotstimmrecht* ("depositionary voting right"), has the obvious advantage of addressing minority shareholder passivity in the sense that it makes it much more likely that the voting rights of minority shareholders will be exercised. At the same time, however, it creates a new principal-agent conflict. Banks that might have their own business relationships with the corporation or the controller might not always be scrupulous in adhering to the best interest of minority shareholders when casting their vote.[169] As a result, charter amendments might be approved by the minority shareholders despite the fact that they are detrimental to the minority shareholders' interests.

Finally, majority-of-the-minority requirements raise concerns about bribes that are similar, if somewhat less severe, to those discussed with respect to supermajority requirements. As in the case of supermajority requirements, there is the risk that the controller will use corporate funds to bribe a sufficient number of minority shareholders, all at the expense of those who oppose the charter amendment.

In sum, then, the basic problem remains. In countries with dispersed ownership, managers seeking opportunistic charter amendments can at least to some extent be constrained via shareholder approval requirements. In countries where controlling shareholders are the norm, such requirements are largely worthless. While there are various alternative mechanisms that can be used to prevent opportunistic charter amendments, all of them have their limitations and none of them are widely used to invalidate charter amendments. This has obvious implications for the usefulness of mandatory corporate law norms. When it comes to preventing opportunistic charter amendments, mandatory corporate law norms are likely to be more useful in foreign countries with concentrated ownership than they are in the United States.

C. Externalities

The third justification for mandatory law pertains to the protection of non-shareholder interests. To the extent that corporate law norms produce positive or negative externalities, one cannot assume that corporations will adopt the most efficient rules. Accordingly, mandatory law might be necessary to ensure efficient outcomes.[170]

---

168. 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, 88 n.83 (1995) ("Although depository shareholders do have the right to direct their vote, only about 2–3% do so.").

169. *E.g.*, Macey & Miller, *supra* note 168, at 89 (stressing the existence of a "significant conflict of interest").

170. Romano, *supra* note 99, at 1617 ("[T]here is . . . a role for mandatory corporate law when externalities are present.").

At first glance, this consideration offers a ready explanation for the stronger reliance on mandatory norms that characterize many foreign corporate law systems. Whereas U.S. corporate law is widely thought to focus on shareholder wealth maximization as its primary objective,[171] many foreign jurisdictions, especially in Europe, have traditionally defined the corporate objective much more broadly, concentrating not just on shareholder wealth but also placing substantial emphasis on the protection of other constituencies such as employees and other creditors.[172]

However, if the question is whether mandatory law is more efficient in foreign countries than it is in the United States, then pointing to the different goals of corporate law systems is not enough; the goals of corporate law themselves can be chosen based on efficiency considerations. Indeed, according to the prevailing view among U.S. scholars, the reason U.S. corporate law focuses, and should focus, on maximizing shareholder wealth is not that other constituents do not matter; rather, shareholder wealth maximization is deemed the appropriate goal for corporate law because it is thought to be more efficient than other models, and because non-shareholder constituencies are better protected by other means.[173]

---

171. *See, e.g.*, Lisa M. Fairfax, *The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms*, 31 J. CORP. L. 675, 676 (2006) ("For the past few decades, corporate scholars have agreed almost universally that the shareholder primacy norm most accurately captures the corporation's personality and purpose."). Of course, two caveats are worth making. First, some U.S. scholars have long argued that U.S. law places more emphasis—and indeed should place more emphasis—on the protection of other constituencies than the shareholder primacy model acknowledges. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 320–21 (1999) (arguing that existing features of U.S. corporate law can be more readily explained by a "mediating hierarchy model" rather than by the shareholder primacy model). Second, the prevailing view that U.S. corporate law focuses *primarily* on shareholder wealth does not imply that U.S. law leaves no room for taking the interests of other constituencies into account. The most obvious example to the contrary are the so-called other-constituency statutes that many U.S. jurisdictions have adopted. *See, e.g.*, CONN. GEN. STAT. § 33-756 (2012) (authorizing directors to consider, inter alia, the interests of the corporation's employees when determining the best interests of the corporation); FLA. STAT. § 607.0830(3) (2012) (providing that directors might consider such factors as "the social, economic, legal, or other effects of any action on the employees"). Overall, no less than twenty-five states have enacted some form of constituency statute. Ann E. Conaway, *Lessons To Be Learned: How the Policy of Freedom To Contract in Delaware's Alternative Entity Law Might Inform Delaware's General Corporation Law*, 33 DEL. J. CORP. L. 789, 806 (2008).

172. *See* Martin Gelter, *Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light*, 7 N.Y.U. J.L. & BUS. 641, 645 (noting that "[t]he intellectual history seems to support a greater focus on shareholder welfare in the US" than in Europe); Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT'L L.J. 129, 176 (2009) ("Continental laws like those of France and Germany are usually said to have a broader corporate objective and a dearth of shareholder primacy."). *But see* Hansmann & Kraakman, *supra* note 23, at 469 (finding "ideological hegemony" of the shareholder primacy model).

173. *See, e.g.*, John Armour et al., *What is Corporate Law?*, *in* THE ANATOMY OF CORPORATE LAW 1, 28–29 (Reinier Kraakman et al. eds., 2d ed. 2009).

Accordingly, the decisive question is whether mandatory corporate law is more efficient in other countries because focusing on the protection of non-shareholder constituents is a more efficient goal in those countries than it is in the United States.

1. Creditor Protection

Third party creditors are one of the major non-shareholder constituencies playing a role in foreign corporate law systems: traditionally, many foreign jurisdictions—especially in Europe—are thought to place much more emphasis on creditor protection than the United States.

Of course, all corporate law systems protect creditors to some extent. More specifically, corporate laws generally impose distribution constraints to the effect that assets necessary to pay back creditors cannot be distributed to the shareholders. This basic constraint can be found around the world,[174] and it must be mandatory to protect creditors from shareholder opportunism. Delaware is no exception to this rule.[175]

However, jurisdictions differ on whether to provide an additional layer of protection for creditors via so-called legal capital rules. In corporate law, legal capital rules serve essentially two functions.[176] First, they impose minimum capitalization requirements; that is, they specify the amount of equity capital that the founders of a corporation must provide.[177] Second, they impose an additional distribution constraint: corporations formed in jurisdictions with legal capital requirements can only pay dividends or repurchase stock to the extent that their net assets exceed the legal capital.[178]

In the United States, legal capital requirements play a minor role. Some corporation laws do not provide for legal capital at all; in others, such as Delaware,[179] corporations are free to select a certain legal capital,

---

174. *See, e.g.*, *id*. at 116, 131 ("Company laws generally restrict distributions to shareholders.").

175. DEL. CODE ANN. tit. 8, § 170(a) (2013) (mandating that the corporation can only pay dividends out of the surplus or out of the net profits for the current or preceding fiscal year); *id.* § 102(b)(7) (providing that the liability of directors for unlawful dividend payments cannot be limited or eliminated in the certificate of incorporation).

176. Legal capital rules can also be relevant to bankruptcy law, but that aspect is beyond the scope of this Article. Armour et al., *supra* note 173, at 134 (noting that legal capital requirements can be combined with recapitalization requirements in order to provide an incentive to promote early filing for bankruptcy).

177. *Id*. at 130–31.

178. *Id*. at 131–33.

179. In Delaware, the legal capital cannot be less than the aggregate par value of the par value shares issued by the corporation. DEL. CODE ANN. tit. 8, § 154(1) (providing that whenever the corporation issues par value shares, the "the capital of the corporation in respect of such shares shall be an amount equal to the aggregate par value of such shares having a par value"); *id*. § 242(a)(4) (preventing the corporation from lowering its legal capital below the aggregate par value). However, the corporation can avoid these rules by issuing non-par value shares.

but there is no mandatory minimum capital.[180] In Europe, by contrast, minimum legal capital requirements can be found both at the European Union and at the country level, which draws the scorn of corporate law scholars, many of whom believe such capital rules to be inefficient.[181]

Regardless of the efficiency question, the most stunning aspect of Europe's legal capital rules is how little economic significance they bear on public corporations. E.U. law currently prescribes a minimum legal capital of 25,000 Euros—or about $34,000—for public corporations.[182] For these corporations, that amount is trivial. Some Member States have opted to prescribe higher legal capital requirements, something that E.U. law explicitly allows, but the requirements are still easily achievable. For example, the minimum capital requirements for public corporations is 37,000 Euros in France,[183] 50,000 Euros in Germany,[184] 50.000 pounds in the United Kingdom,[185] 60,000 Euros in Spain,[186] 70,000 Euros in Austria,[187] and 120,000 Euros in Italy.[188] Even the most rigorous among these requirements, the Italian one, which corresponds to about $164,000, is a trivial amount for public corporations.[189] In other words, the question of why legal capital rules for public corporations have survived in Europe might have an easy answer: they simply do not matter.

---

180. *See* Richard A. Booth, *Capital Requirements in United States Corporation Law*, *in* LEGAL CAPITAL IN EUROPE 620 (Marcus Lutter ed., 2006).

181. *E.g.*, Luca Enriques & Jonathan R. Macey, *Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules*, 86 CORNELL L. REV. 1165, 1202 (2001) (arguing that legal capital rules cannot be justified on efficiency grounds).

182. Second Council Directive 77/91/EEC, of 13 Dec. 1976 on Coordination of Safeguards Which, for the Protection of the Interests of Members and Others, are Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 58 of the Treaty, in Respect of the Formation of Public Limited Companies and the Maintenance and Alteration of Their Capital, with a View to Making Such Safeguards Equivalent, 1977 O.J. (L 026) 1, as last amended by Directive 2006/68/EC, of the European Parliament and of the Council of 6 Sept. 2006, art. 6., 2006 O.J. (L 264) 32–36.

183. CODE DE COMMERCE [C. COM] art. L225-96(3) (Fr.).

184. Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at 1089, last amended by Gesetz [G], Dec. 22, 2011, BGBL. I. at 3044, § 179(2) (Ger.). Germany is a somewhat special case, though, in that it also makes it mandatory to increase the legal capital on certain occasions. *Id.* § 150(2); HANDELSGESETZBUCH [HGB][COMMERCIAL CODE], May 10, 1897, REICHGESETZBLATT [RGBL.] 219, last amended by Gesetz [G], Oct. 4, 2013, BGBL. I at 1981, § 272 (Ger.).

185. Companies Act, 2006, c.46, § 283 (U.K.).

186. Las Sociedades de Capital art. 4(2) (B.O.E. 2010, 161) (Spain), *available at* http://noticias.juridicas.com/base_datos/Privado/rdleg1-2010.t1.html.

187. AKTIENGESETZ [AKTG] [Stock Corporation Act], Mar. 31, 1965, BGBL. 98/1965, last amended by Gesetz [G], Apr. 24, 2012, BGBl. I Nr. 35/2012, at 8, § 7 (Austria).

188. CODICE CIVILE [C. c.] art. 2327 (It.).

189. I am not the first to notice this. *See, e.g.*, Armour et al, *supra* note 173, at 130 (noting that, with respect to the minimum capital requirement imposed by E.U. law, the relevant number "is actually quite small when compared to the actual capital needs of businesses organized as public firms").

2. *Employee Protection*

A more significant and therefore more interesting deviation from shareholder primacy lies in codetermination rules that give employees a voice in corporate governance.[190]

In the United States, corporate law does relatively little to protect employees. Admittedly, many states have adopted so-called constituency statutes that permit the board to take into account the interest of stakeholders, including employees, when deciding which actions are in the corporation's best interest.[191] Delaware has not adopted such a provision, but the Delaware Supreme Court has embraced a similar position in its case law.[192] However, it is not clear how much constituency statutes actually benefit employees. In practice, their main effect, and arguably their goal, is to make it easier for incumbent directors to defend against hostile takeovers. Thus, constituency statutes appear to be more about protecting directors than about protecting employees.[193]

By contrast, many foreign countries—especially in Europe—give employees a direct voice in corporate governance. The most drastic example is the German codetermination regime,[194] which allows employees to elect half the members of the supervisory board. However, Germany is by no means alone in giving employees access to corporate boards. Many other European countries including Austria, France, Poland, Denmark, Sweden, Finland, and the Netherlands have also adopted some type of codetermination regime.[195] The decisive question, then, is whether protecting employees by giving them a voice in corporate governance is more efficient in Europe than it is in the United States. There are, in fact, at least two reasons to believe that this is the case.[196]

---

190. *See supra* text accompanying notes 57–70.

191. *See supra* notes 52–65.

192. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (holding that directors deciding whether to take defensive action against hostile takeovers might take into account "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)").

193. *Cf.* Mark J. Loewenstein, *The SEC and the Future of Corporate Governance*, 45 ALA. L. REV. 783, 793 (1994) (pointing out that such statutes make it much more difficult for shareholders to show that directors acted with the intention of protecting their own jobs).

194. *See supra* Part II.

195. *See* Horst-Udo Niedenhoff, *Mitbestimmung im Europäischen Vergleich* [*A Comparison of European Codetermination Regimes*], 32 IW-TRENDS VIERTELJAHRESSCHRIFT ZUR EMPIRISCHEN WIRTSCHAFTSFORSCHUNG 1, 5 tbl.3 (2005) (detailing the various European codetermination regimes); ANDENAS & WOOLDRIDGE, *supra* note 57, at 417–40 (describing codetermination regimes in Germany and the Netherlands).

196. A different explanation has recently been offered by Martin Gelter, *supra* note 172, at 134. According to Gelter, codetermination as well as other statutes protecting shareholders can be viewed as a response to concentrated stock ownership. *Id.* at 133. In a nutshell, his thesis can be summarized as follows: by and large, directors are more likely to treat employees fairly than shareholders. *Id.* at 152. Because concentrated ownership translates into less power for directors and more power for

3. *Codetermination and Costs of Contracting*

One of these reasons relates to the function of codetermination as a disclosure mechanism. As Henry Hansmann has shown in his seminal work on corporate ownership, a central benefit of codetermination is that it can lower the corporation's contracting costs by reducing informational asymmetries between firms and the labor unions with whom they negotiate.[197] If labor unions lack credible information about their bargaining partners' economic situation, then both sides might resort to costly measures such as strikes or lockouts.[198] Codetermination helps to overcome this problem. Through the employee representatives on corporate boards, the unions have reliable information about the economic situation of firms, greatly reducing the likelihood of strikes and other distributive measures.[199]

The disclosure function of codetermination is now widely recognized.[200] Crucially, it has important implications for explaining transnational differences in codetermination laws. Obviously, the disclosure function can only acquire relevance where firms (or associations of firms) are confronted with labor unions, and where wages are in fact determined by collective bargaining agreements. It is in this

---

shareholders, some other mechanism is needed to protect shareholders. *Cf. id.* at 155 ("[C]oncentrated ownership also exacerbates the holdup problem vis-a-vis nonshareholder constituencies."). Codetermination and other statutes protecting employees fill this gap. *Id.* at 169. Despite Gelter's careful and insightful analysis, I remain unconvinced. First, there is no persuasive evidence that European managers are more sympathetic to employees than to shareholders. That is particularly true in Germany, where large blockholders are often banks. Much of the power of these banks is derived from the fact that they are not limited to voting on their own shares, but also exercise voting rights for their customers. *See supra* text accompanying notes 166–169. Thus, if anything, the concern is that these large shareholders are not sufficiently profit-oriented. Second, the German codetermination regime seems ill-designed if its purpose is to counterbalance concentrated stock ownership. That is because stock ownership is usually most concentrated in smaller, privately held firms, and full-scale codetermination does not apply unless the corporation has two-thousand or more employees. Third, even if greater ownership concentration were to translate into a greater risk of expropriation for employees, the various statutes protecting employees in Germany and other European countries should not be interpreted as a response to that risk because they go far beyond what is necessary to counterbalance any risks posed by increased ownership. Notwithstanding greater ownership concentration, there is a broad consensus that workers in European countries such as Germany have a much lower risk of being terminated than their American counterparts. Hence, enacting these very wide-ranging protections as a response to concentrated stock ownership would have been a complete overkill.

197. Henry Hansmann, *When Does Worker Ownership Work? ESOPs, Law Firms, Codetermination, and Economic Democracy*, 99 YALE L.J. 1749, 1803 (1990).

198. *Id.* at 1766.

199. *Id.*

200. *E.g.*, Luca Enriques et al., *The Basic Governance Structure; Minority Shareholders and Non-Shareholder Constituencies*, *in* THE ANATOMY OF CORPORATE LAW, *supra* note 173, at 89, 110. The same considerations apply to the so-called works councils where the employees are represented at the firm level but outside the supervisory board. *See* Richard B. Freeman & Edward P. Lazear, *An Economic Analysis of Works Councils*, *in* WORKS COUNCILS: CONSULTATION, REPRESENTATION, AND COOPERATION IN INDUSTRIAL RELATIONS 27 (Joel Rogers & Wolfgang Streeck eds., 1995).

context that a further difference between the United States and Europe gains importance. Compared to the United States, European countries rely much more strongly on collective bargaining agreements to set wages.

As of 2011—the most recent year for which data is available—only about 13% of U.S. employees were covered by collective bargaining agreements.[201] This number contrasts rather sharply with the corresponding percentages in European countries: 99% of employees are covered in Austria, 92% in France, 92% in Slovenia, 91% in Sweden, 89.5% in Finland, 62% in Germany, 40% in Slovakia, and 28.9% in Poland.[202]

It follows that one of the central benefits of codetermination—namely its potential to reduce bargaining costs between labor unions and employers—simply has much more relevance in many European countries, such as Germany, France, or Austria, than it does in the United States. This does not per se imply that codetermination is efficient in Europe; even there, its costs might outweigh its benefits. However, the crucial point is that codetermination is likely to be relatively more efficient in Europe than in the United States.

4. Securing Employment Law Rules

There is also another reason why codetermination might be more efficient in Europe than the United States. In practice, the employee representatives tend to use their role in the supervisory board to voice the concerns of employees and ensure, as they view it, that the latter are treated fairly.[203] The additional protection thus accorded to employees might be the answer to an efficiency problem that arises due to the particular structure of European employment law. In the United States, employees can generally be fired at will.[204] In most European countries, by contrast, the basic rule is that employees cannot be terminated without cause.[205] One can question whether this type of strong

201. Jelle Visser, *ICTWSS: Database on Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts in 34 Countries Between 1960 and 2012* (Amsterdams Instituut voor ArbeidsStudies (Amsterdam Inst. for Advanced Labour Studies), Database No. 4, 2013), *available at* http://www.uva-aias.net/207.

202. *Id*. Note, however, that the reference years vary slightly. The data for Austria, Germany, Poland, and Sweden are for the year 2010; those for Finland, Slovakia, and Slovenia for 2009; those for France for 2008.

203. *Cf.* Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, *in* EMPLOYEES AND CORPORATE GOVERNANCE 163, 189 (Margaret M. Blair & Mark J. Roe eds., 1999) (noting that, in practice, employee representatives specialize in employee matters, such as the workplace, social concerns, wages, and benefits).

204. *E.g.*, Julie C. Suk, *Discrimination at Will: Job Security Protections and Equal Employment Opportunity in Conflict*, 60 STAN. L. REV. 73, 78–79 (2007).

205. CODE DU TRAVAIL [C. TRAV.] art. L 1231-1 (Fr.) (requiring cause for the termination of employees if the employment contract was for unlimited duration); Kündigungsschutzgesetz [KSchG] [Protection Against Termination Act], Aug. 25, 1969, BGBL. I at 1317, last amended by Gesetz [G], Mar. 26, 2008, BGBL. I at 444, § 1 (Ger.) (prohibiting dismissals that are not justified by the

employment protection is efficient, but that is beside the point. As a practical matter, for most European countries, far-reaching steps toward the liberalization of employment markets are simply not politically feasible.[206]

One major drawback of the for-cause requirement is that it creates an obvious incentive for harassment and, more generally, bad faith treatment. Seeking to rid themselves of below-average employees, employers have an incentive to make the relevant employees' work environment unpleasant in order to persuade them to quit "voluntarily." This is an issue of great practical importance. Empirical studies in various European countries suggest that workplace bullying is a widespread and serious problem affecting between two and twenty-two percent of employees, and that it has significant negative consequences for the health of employees.[207]

Admittedly, one can make a theoretical case that workplace bullying and other bad faith treatment aimed at persuading employees to leave is not necessarily inefficient. After all, if one strongly believes in the efficiency of termination at will, then measures that weaken Europe's for-cause requirements might seem prima facie desirable. However, in light of the significant negative impact that bullying has on the affected employees' health—costs that are not usually reflected in the employer's cost-benefit analysis—such a line of reasoning seems rather implausible.

If, on the other hand, one assumes that bullying aimed at persuading workers to quit is inefficient, then one of codetermination's benefits might be that it provides some protection against such bullying; employee representatives can use their clout in the supervisory board to persuade corporations to respect the rights of the employees. If one further assumes that American employers who can fire their employees at will do not need to rely on bullying to rid themselves of unwanted employees, the relevant protection might be more sorely needed in Europe than in the United States.

In sum, the fact that some European countries protect employees through corporate governance, while the United States does not, can be

---

employee's behavior or person or compelling business reasons); Legge 15 luglio 1966, n. 604, in G.U. 6 Aug. 1966, n. 195, art. 1 (It.) (requiring a justification for the termination of employees). *See* Jens Dammann, *Place Aux Dames: The Ideological Divide Between U.S. and European Gender Discrimination Laws*, 45 CORNELL INT'L L.J. 25, 63 (2012) (noting that in most European countries, employees cannot be dismissed except for cause); *see also* Carol Daugherty Rasnic, *Balancing Respective Rights in the Employment Contract: Contrasting the U.S. "Employment-at-Will" Rule with the Worker Statutory Protections Against Dismissal in European Community Countries*, 4 J. INT'L L. & PRACTICE 441, 478–93 (1995) (analyzing cause-requirements in Austria, Denmark, Finland, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom).

206. *See infra* Part V.4.

207. *Cf.* B. MESCHKUTAT ET AL., DER MOBBING-REPORT: EINE REPRÄSENTATIVSTUDIE FÜR DIE BUNDESREPUBLIK DEUTSCHLAND 9–12 (2002) (summarizing various studies on workplace bullying).

explained to a certain extent by efficiency considerations. Codetermination might simply be a response to Europe's heavier reliance on collective bargaining agreements and less flexible termination rules.

D. Doing More With Less

Different court systems might also help explain why it is efficient for the United States to have fewer mandatory rules than many foreign (and in particular, many European) countries. Simply put, public corporations in the United States have access to better and more specialized courts, and as a result, might be "doing more with less." One single norm in the United States—namely the duty of loyalty, which is generally thought to be mandatory[208]—might be enough to ensure a meaningful degree of minority protection because the United States can trust its courts to apply that duty more rigorously than it is applied in many other countries.

To be clear, the point here is not that other countries fail to recognize fiduciary duties. In fact, fiduciary duties including the duty of loyalty are firmly established in European corporate law systems.[209] Nor is the Delaware duty of loyalty more indeterminate and therefore more flexible than its European counterparts. Rather, as addressed elsewhere, the duty of loyalty in the legal systems of major European countries such as Germany and the United Kingdom is at least as indeterminate as it is in Delaware law.[210] The decisive difference, then, does not lie in the existence of an indeterminate, or standard-based, duty of loyalty.[211] Rather, it lies in the extent to which jurisdictions are equipped with courts that have sufficient expertise to rigorously apply that duty. And it is in this respect that the United States dominates most and perhaps all other jurisdictions.

In the United States, more than half of all public corporations are incorporated in Delaware;[212] accordingly, they profit from Delaware's

---

208. *E.g.*, Lucian Arye Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 Nw. U. L. Rev. 489, 496 n.16 (2002); Reza Dibadj, *The Misguided Transformation of Loyalty into Contract*, 41 Tulsa L. Rev. 451, 474 n.173 (2006); Jill E. Fisch, *Picking a Winner*, 20 J. Corp. L. 451, 458 (1995) (reviewing Roberta Romano, The Genius of American Corporate Law (1993)); Tamar Frankel, *The Delaware Business Trust Act Failure as the New Corporate Law*, 23 Cardozo L. Rev. 325, 340 (2001).

209. *See, e.g.*, Dammann, *Indeterminacy*, *supra* note 71, at 56–100 (demonstrating that the law governing fiduciary duties is similarly indeterminate in Germany, the United Kingdom, and the United States).

210. *Id.*

211. Following Kaplow's distinction between rules and standards, it is now common to refer to indeterminate norms, whose content is determined only ex post, as standards. By contrast, rules are norms whose content is determined ex ante. Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 Duke L.J. 557, 557 (1992).

212. *See generally* Lewis S. Black, Jr., Del. Dep't of State Div. of Corps., Why Corporations Choose Delaware (2007).

Chancery Court, which is widely thought to be unparalleled in terms of quality, experience, and speed.[213]

In countless other countries—including many European ones—court systems are less impressive. Often, the judicial infrastructure is simply lacking, and courts suffer from basic and obvious flaws such as extensive delays in the administration of justice, lack of expertise, and insufficient independence.[214] Even in developed economies like France, Germany, or Spain, courts tend to share one common weakness—at the trial court level they tend to be far less specialized than the Delaware Chancery Court. To be sure, it is often asserted in the literature that civil law courts are more specialized than common law courts.[215] This reflects the fact that civil law countries typically organize their court system to ensure a basic level of specialization. Typically, the judiciary is first divided into several distinct branches dealing with specific areas such as administrative law, civil and criminal law, tax law, and employment law.[216] Then, within the civil and criminal law branch of the judiciary,[217] courts usually have a special chamber, or even a specialized court, that is dedicated to commercial law matters such as the *Kammer für Handelssachen* (chamber for commercial affairs) in Germany[218] or the *Tribunal de Commerce* (commercial court) in France.[219]

---

213. *See, e.g.*, Rochelle C. Dreyfuss, *Forums of the Future: The Role of Specialized Courts in Resolving Business Disputes*, 61 BROOK. L. REV. 1, 5 (1995) ("Delaware's Chancery Court is renowned for its contributions to the corporate area, in terms of both the quality of law it has created and its efficiency in resolving disputes."); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 708 (2002) ("A principal attraction of incorporating in Delaware is the high quality of its chancery court."); Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1212 (2001) ("Delaware's chancery court is one of the most highly regarded courts in the country."); David A. Skeel, Jr., *Icarus and American Corporate Regulation*, 61 BUS. LAW. 155, 167 (2005) ("[A]s even Delaware's critics concede, the Delaware court system is remarkably efficient.").

214. *Cf.* Jens Dammann & Henry Hansmann, *Globalizing Commercial Litigation*, 94 CORNELL L. REV. 1, 7–10 (2008) (giving a detailed account of disparities in the quality of national judicial systems).

215. *E.g.*, John C. Coffee, Jr., *Privatization and Corporate Governance: The Lessons from Securities Market Failure*, 25 J. CORP. L. 1, 29 (1999) ("The inflexibility of civil law courts has already led to the creation of specialized courts in some civil law countries, which specialized courts have exclusive jurisdiction over some subject matters."); Samuel L. Bufford, *Bankruptcy Law in European Countries Emerging from Communism: The Special Legal and Economic Challenges*, 70 AM. BANKR. L.J. 459, 476 (1996) ("[C]ommon law courts tend to be general jurisdiction courts, while civil law court systems are frequently specialized, based on the particular code for which a given court is responsible.").

216. *See, e.g.*, JOHN BELL, JUDICIARIES WITHIN EUROPE: A COMPARATIVE REVIEW 45, 51 (2009) (noting that in France, criminal and civil cases are handled by the *tribunaux d'instance*, whereas commercial cases are litigated before *tribunaux commerciaux* and administrative cases are litigated before the *tribunaux administratifs*); *id*. at 110 (noting that the German judiciary is divided into ordinary courts, administrative courts, tax courts, labor courts, and social courts).

217. For historical reasons, civil and criminal law cases are typically handled by the same branch.

218. GERICHTSVERFASSUNGSGESETZ [GVG] [CODE ON COURT CONSTITUTION], May 9, 1975, BGBL. I at 1077, § 93 (Ger.) (authorizing state governments to form chambers for commercial affairs at the district court level).

219. CODE DE COMMERCE [C. COM.] art. L.721-1 (Fr.).

However, compared to what U.S. courts afford corporate litigants, this level of specialization is rather unimpressive. Even in U.S. states other than Delaware, there are often specialized commercial courts; in that respect, U.S. states do not lag behind their European counterparts.[220] Much more importantly, there is another reason why the Delaware Chancery Court—where much of the litigation involving the law of public corporations takes place—is far more specialized than European commercial courts. The Delaware Chancery Court hears corporate law cases from all over the United States, as well as some international ones, making it the nation's primary forum for cases involving public corporations.[221]

By contrast, civil law countries typically do not have one single predominant lower level court to hear most or all of the cases involving public corporations.[222] Instead, such cases are spread throughout courts located all over the country. In Germany, for example, corporate law cases are typically tried—and often *must* be tried[223]—before the court where the corporation's real seat is located.[224] As a result, important corporate law cases are litigated in courts all over Germany. Although some court districts have the advantage of being home to more corporate headquarters—and thus trying more corporate law cases—than others,

220. *See*, *e.g.*, Mitchell L. Bach & Lee Applebaum, *A History of the Creation and Jurisdiction of Business Courts in the Last Decade*, 60 BUS. L. 147, 152–202 (2004) (providing an overview of the commercial divisions that many U.S. state courts have set up).

221. *Cf.* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 881 (referring to the Delaware Chancery Court as "the most prominent corporate law court"); Stephen J. Massey, *Chancellor Allen's Jurisprudence and the Theory of Corporate Law*, 17 DEL. J. CORP. L. 683, 705 (1992) (noting the Delaware Chancery Court's "prominence as a forum for the adjudication of corporate law issues"). For an empirical perspective, see Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975, 1987 (2006) (examining a large sample of merger agreements and finding that the state of Delaware "leads as a litigation forum choice").

222. The counter-examples are civil law countries that, like Luxembourg, are so small that they only have one or two trial courts dealing with commercial matters. However, due to the lack of a functioning charter market for public corporations in Europe, these courts also are not particularly specialized in corporate law.

223. For many types of cases, the district court where the corporation's seat is located has exclusive jurisdiction. *See, e.g.*, Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at 1089, last amended by Gesetz [G], Dec. 22, 2011, BGBL. I. at 3044, § 98(1) (providing that the district court in the district where the corporation's seat is located has exclusive jurisdiction over disputes relating to the composition of the supervisory board); *Id*. § 132(1) (providing that the district court in the district where the corporation's seat is located has exclusive jurisdiction over disputes relating to shareholder information rights); *Id*. § 148(2) (providing that the district court in the district where the corporation's seat is located will decide whether a derivative suit can be brought against the corporation); *Id*. § 246(3) (providing that the district court in the district where the corporation's seat is located has exclusive jurisdiction over complaints seeking to have a board resolution declared void).

224. *Cf.* ZIVILPROZESSORDNUNG [ZPO] [CODE OF CIVIL PROCEDURE], Dec. 5, 2005, BGBL. I at 3202, last amended by Gesetz [G], Oct. 10, 2013, BGBL. I at 3786, § 17(1) (Ger.) (providing that corporations can be sued in the district where the corporate seat is located and that a corporation's seat is generally located where its administration is located).

this remains a far cry from Delaware, where a large portion of all major cases in the United States are heard.[225] In other words, at the trial court level, the Chancery Court enjoys a tremendous advantage in terms of specialization over its civil law peers.

Why does specialization matter? In the absence of a detailed set of mandatory corporate law norms, it is the general fiduciary duties—particularly the duty of loyalty—that protect minority shareholders against controlling shareholders. However, fiduciary duties are notoriously vague in both European countries and the United States.[226] In other words, they are indeterminate standards rather than bright-line rules. Given that the law provides limited guidance, courts that lack experience with the law governing public corporations are ill positioned to apply existing fiduciary duty law aggressively. Therefore, the duty of loyalty in U.S. corporate law might end up offering substantially greater protection to minority shareholders than fiduciary duties in foreign corporate law systems. In other words, the United States might be able to constrain private ordering more strongly than the relatively low number of mandatory norms would suggest because it can rely on the peculiar specialization of the Delaware Chancery Court. Accordingly, differences in the quality of courts might be yet another reason why having fewer mandatory norms might be more efficient in the United States than elsewhere.

IV. The Costs of Mandatory Corporate Law

For a comparative analysis seeking to justify varying degrees of the prevalence of mandatory law, it is not enough to focus on the benefits of such rules; one must also examine the costs. The costs of mandatory corporate law fall into two main categories which, although they overlap, are helpful to distinguish for analytical purposes.

First, even if lawmakers choose the best possible mandatory rule, it is unlikely to be well suited for *all* companies. Thus, mandatory law always imposes a uniformity cost. Contractarians frequently point to this cost as an argument in favor of an enabling corporate law regime.[227]

225. John Armour et al., *Is Delaware Losing Its Cases?*, 9 J. Empirical Legal Stud. 605, 653 (2012) ("The Delaware Chancery Court has long functioned as a de facto 'national' court for U.S. corporate law."). *But see id*. at 607 ("[T]here has been a large decline in the proportion of corporate lawsuits involving Delaware companies (by which we mean shareholder suits against the directors, officers, or controlling shareholders of these companies) filed in Delaware courts.").

226. *See* Dammann, *Indeterminacy*, *supra* note 71, at 73–95 (demonstrating that the law governing fiduciary duties is similarly indeterminate in Germany, the United Kingdom, and the United States).

227. *E.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 Colum. L. Rev. 1416, 1418 (1989) ("No one set of terms will be best for all; hence the 'enabling' structure of corporate law.").

Second, it is not clear that lawmakers are very good at choosing the best possible mandatory rule.[228] Aside from the general question of whether public officials are well-placed to furnish optimal corporate governance rules, there is the problem that mandatory law limits the potential for learning and experimentation: when all firms are subject to the same mandatory rule, it becomes difficult to find out what other rules might be more efficient.[229]

These drawbacks to mandatory law exist in both the United States and Europe. Nevertheless, it is worth noting that the relevant costs might not be uniform across countries.

A. One Size Does Not Fit All

Most notably, the problem that mandatory law imposes uniform rules on all types of firms will be more severe in countries where the landscape of firms is highly heterogeneous—or at least would be in the absence of mandatory corporate law. On the other hand, in countries where most firms have similar governance needs, uniform mandatory rules are less problematic.

This observation is important to the issue at hand because on all conceivable measures, uniformity costs are likely to be particularly high in the United States: the size and diversity of the U.S. economy suggest that in most corporate governance matters there will be some firms that are not well-suited for the general rule. For example, it has been suggested that the rules that normally govern corporate boards need to be modified in venture-capital backed startups where directors arguably serve a different function than they do in regular corporations.[230] None of this implies that other countries do not suffer from uniformity costs of this type, but the costs might be somewhat less severe. For example, in small countries with only a handful of public corporations, mandatory law might not matter much as long as lawmakers can be expected to closely tailor existing law to the needs of existing firms.

B. The Quality of Mandatory Norms

Concerns about the quality of mandatory norms are more difficult to evaluate. The question of whether mandatory norms are well designed

---

228. *See, e.g.*, Lucian A. Bebchuk, *Reply: Letting Shareholders Set the Rules*, 119 Harv. L. Rev. 1784, 1787 (2006) (noting that public officials might err in identifying the optimal rules for public companies).

229. The importance of learning has also been advanced as an argument for regulatory competition. *See* Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 Yale J. on Reg. 209, 211 (2006) (noting that the U.S. system of regulatory competition "has resulted in considerable experimentation and innovation in corporate law").

230. Jesse M. Fried & Mira Ganor, *Agency Costs of Venture Capitalist Control in Startups*, 81 N.Y.U. L. Rev. 967, 1020–24 (2006) (suggesting that fiduciary duties might need to be adjusted in start-ups).

depends in part on the quality of the political process, the aptitude of lawmakers, and other considerations. These considerations suggest that the costs of mandatory law are particularly high where the political process is corrupt, lawmakers are incompetent, etc. On that score, relatively well-governed countries like the United States would seem to be better positioned to make use of mandatory laws than many other jurisdictions, including some European ones. Of course, one can also make the argument that in truly corrupt countries, the content of the law does not matter much anyway, so the mandatory/enabling divide ends up being of little consequence. Meanwhile, among well-governed countries, it is difficult to tell whether some jurisdictions are inherently better at promulgating well-designed laws than others. The importance of this factor, therefore, must remain highly speculative.

Foregoing experimentation should also be costly for all countries; however, as long as some countries are willing to allow room for experimentation, others can free ride. It is noteworthy in this context that many foreign countries are quite open to learning from U.S. corporate law. Over the past decade, the influence of U.S. corporate law and practice on corporate law systems around the world has been tremendous.[231] These other countries forego experimentation themselves, but are still able to learn from the United States.[232] Of course, the effectiveness of such free riding remains unclear. Insights gained in the United States might not be directly applicable to other countries, and what might be good for U.S. corporations might not work well elsewhere.

On the cost-side, then, an account of why the United States relies less on mandatory corporate law than other countries remains vague and elusive. One can make a plausible conjecture that the uniformity costs imposed by mandatory law are probably higher in the United States than in some other countries; beyond this, one is left with little more than speculation.

V. The Future of American Exceptionalism

Thus far, this Article has argued that differences in the prevalence of mandatory corporate law are by no means coincidental. Rather, they seem to be driven in no small part by efficiency considerations. Due to its peculiar institutional strengths and corporate ownership patterns, the United States stands to gain much less from mandatory corporate law than other countries.

---

231. For a detailed study on how U.S. corporate law has influenced German corporate law, see Jan von Hein, Die Rezeption US-amerikanischen Gesellschaftsrechts in Deutschland (2008).

232. Thus, ironically, the fact that U.S. law relies heavily on default rules might have made mandatory law in other countries less costly.

But are the underlying differences between the United States and foreign countries written in stone, or is the United States becoming more similar to the rest of the world and vice versa? This Part emphasizes that there is no easy answer to this question.

A. Capital Markets

Perhaps the most intriguing development pertains to capital markets. In recent years, much has been written about U.S. capital markets falling behind their foreign competitors.[233] These concerns tend to focus on two issues. First, some voices bemoan that U.S. stock markets do not seem to be faring well in the international competition for new listings.[234] Second, the costs of being listed in the United States are said to have increased substantially as a result of regulatory reforms, particularly the much-reviled Sarbanes-Oxley Act and more recently, the Dodd-Frank Act.[235] Neither concern is without foundation, but upon closer analysis, neither suggests that the U.S. advantage with respect to capital markets will fade anytime soon.

1. *Listings*

In recent years, concerns that the U.S. capital markets are losing too many listings or gaining too few new ones have been widespread. "U.S. Falls Behind in Stock Listings" reads a fairly typical headline from a 2011 article in the *Wall Street Journal*.[236] And a 2010 piece in the *New York Times* decries that "the number of companies listed on the nation's major exchanges has plummeted"[237] and contrasts the situation with that of "China or India where new listings are growing at a fast rate."[238]

However, as the U.S. economy has improved, so has the news on listings. In 2012, the most recent year for which data are available, 146 new companies were listed on the NYSE. Taking into account delistings, this translated into a 1.3% increase in the total number of listed firms. Admittedly, the Shenzen Stock Exchange achieved a higher growth rate, experiencing a 9.1% increase in the number of listed firms. However, most foreign exchanges did much worse, and many of them even faced negative growth.

---

233. Aaron Lucchetti, *U.S. Falls Behind in Stock Listings*, Wall St. J. (May 26, 2011, 12:01 A.M.), http://online.wsj.com/news/articles/SB10001424052748703421204576329400112880300 ("A combination of mergers, fewer U.S. IPOs, lower listing costs abroad and a shift in how investors and stockbrokers do their jobs has driven down the number of U.S. stock listings by a startling 43% since the peak in 1997—all during a period when the number of listings outside the U.S. has more than doubled.").

234. *See infra* Part V.A.1.

235. *See infra* Part V.A.2.

236. Lucchetti, *supra* note 233.

237. Graham Bowley, *Wall Street, the Home of the Vanishing IPO*, N.Y. Times, Nov. 18, 2010, at B1.

238. *Id*.

Figure 1: New Listings and Delistings in 2012[239]

Exchange	Newly Listed	Percentage Change, Number of Listed Firms
Shenzhen Stock Exchange	129	+9.1%
Deutsche Börse	25	+0.1%
London SE Group	115	-4.1%
NASDAQ	75	-3.8%
NYSE Euronext (U.S.)	146	+1.3%
Hong Kong Exchanges	64	+3.4%
Korea Exchange	33	-1.8%
Tokyo SE Group	69	+0.6%
NYSE Euronext (Europe)	27	-3.5%

In any case, looking at the number of new listings is not very helpful. First, they strongly reflect the current dynamic of the economy rather than long-term trends. Second, the mere number of listings does not reveal anything about the economic weight of the companies involved.

A more useful measure of the size of capital markets focuses on market capitalization, defined as the product of the number of shares issued by listed companies and their respective share price. On that measure, it is true that some foreign exchanges are growing more rapidly than those in the United States, but U.S. markets are still far ahead.

Figure 2: Stock Exchanges by Domestic Market Capitalization[240]

	1996	**2001**	**2006**	**2011**	**2012**
NYSE	6,841,987.6	11,026,587	15,421,168	11,795,575.5	14,085,994.1
NASDAQ	1,511,824.4	2,739,674.7	3,865,003.6	3,845,131.6	4,582,389.1
London	1,642,582.4	2,164,716.2	3,794,310.3	3,266,418.1	3,396,504.9

239. WORLD FED'N OF STOCK EXCHS., MONTHLY REPORT FOR DECEMBER 2012 tbls. 1.2, 1.5, http://www.world-exchanges.org/statistics/monthly-reports (follow "Year 2012" and "Month December" to download complete report; then select "New Listings" for newly listed values; then select "Listed Companies" for percentage change). The number of new listings was calculated by adding the number of new companies listed through an IPO and the number of other newly listed companies. The data on the percentage change in the number of listed firms was taken from table 1.2, which compares the number of companies listed in December 2012 to the number of companies listed in December 2011.

240. *See* WORLD FED'N OF STOCK EXCHS., MONTHLY REPORTS FOR DECEMBER 1996, 2001, 2006, 2011, AND 2012 tbl. 1.1, http://www.world-exchanges.org/statistics/monthly-reports (follow "Year" for the relevant year and "Month December"; then select "Market Cap" for table 1.1—Domestic market capitalization).

Tokyo	3,011,161.4	2,264,527.9	4,614,068.8	3,325,387.8	3,478,831.5
Frankfurt	664,913.2	1,071,748.7	1,637,609.8	1,184,500.2	1,486,314.8
Hong Kong	449,218.8	506,072.9	1,714,953.3	2,258,035.2	2,831,945.9
Shanghai	NA	NA	917,507.5	2,357,423.3	2,547,203.8
Euronext	NA	NA	3,708,150.1	2,446,767.5	2,832,188.5

For example, the domestic market capitalization of the NYSE has grown from almost $7 trillion in 1996 to about $14 trillion in 2012—a growth of about 106% (see Figure 2). Other exchanges have achieved more impressive growth rates; Hong Kong, for example has grown by over 530%. However, these growth rates have been achieved from a relatively small basis, and it is doubtful whether they can be maintained.

2. *Excessive Regulation*

Governmental regulation is a second area of concern for those who see U.S. capital markets falling behind. Critics of U.S. regulation usually claim that recent steps toward more regulation have made U.S. listings unduly costly. In particular, it has been argued that Sarbanes-Oxley imposes costs on corporations that are not outweighed by corresponding benefits.[241]

Whether U.S. exchanges are indeed overregulated, or whether existing regulation is too costly to justify its benefits, is a question that goes beyond the scope of this Article. Nonetheless, it is important to note that tighter regulation can affect capital markets on several levels.

First, tightened regulation drives up compliance costs. These costs might drive away some issuers; thus, tighter regulation might result in smaller markets. However, even if some foreign issuers are driven away by increased compliance costs or if some domestic firms are deterred from going public, other issuers might value tighter regulation because it allows them to send a stronger signal of quality by listing on U.S. exchanges. There is not yet sufficient evidence to tell which effect prevails in the long run.

241. *See, e.g.*, Eric C. Chaffee, *The Internationalization of Securities Regulation: The United States Government's Role in Regulating the Global Capital Markets*, 5 J. BUS. & TECH. L. 187, 190 (2010) ("[A] result of the passage of the Sarbanes-Oxley Act of 2002, which placed substantial new corporate governance requirements on entities wishing to issue stock in this country, the United States has experienced a significant drop in initial public offerings by foreign issuers.") (footnote omitted); Roberta S. Karmel, *The Once and Future New York Stock Exchange: The Regulation of Global Exchanges*, 1 BROOK. J. CORP. FIN. & COM. L. 355, 356–57 (2007) (arguing that one of the primary reasons that the "NYSE has been losing listings is that foreign issuers are disenchanted with the U.S. stock market because of the costs of compliance with the requirements of the Sarbanes-Oxley Act of 2002").

Second, tighter regulation might enhance investor confidence and thereby contribute to the liquidity of capital markets. In fact, there is some evidence that Sarbanes-Oxley has done just that.[242]

Third, increased regulatory safeguards, while costly, can increase the quality and reliability of publicly available information, thereby increasing the efficiency of capital markets. And again, there is evidence that Sarbanes-Oxley has in fact led to higher quality information.[243]

Thus, claims that tighter regulation endangers U.S. capital markets seem problematic. On the one hand, one can plausibly paint a scenario in which firms increasingly list on foreign exchanges to avoid what is considered excessive U.S. regulation. On the other hand, one can also conjecture that by opting for high-level regulation and enforcement, the United States will end up with the most efficient capital markets, regardless of size. On some measures, clearly, foreign countries are catching up, but whether they will challenge the U.S. lead is a different question. Given the empirical uncertainties involved, it seems too early to predict the decline of U.S. capital markets.

B. Ownership Patterns

Whether ownership patterns converge or diverge is equally difficult to predict. Different strands of the literature suggest different outcomes. On the one hand, part of the literature has argued that strong forces such as the rise of the shareholder class, regulatory competition, and ideological convergence are pushing countries toward the most efficient governance arrangements.[244] This suggests that ownership patterns, too, will ultimately end up looking similar across the globe. On the other hand, it has been argued that ownership patterns should show substantial path dependence and thus resist convergence.[245] The matter is further complicated by the fact that the direction of the causal link between the law on the one hand and ownership patterns on the other hand is not always clear. As noted above, the shape of ownership patterns might partially determine what legal rules countries adopt,[246] but at the same

242. *See, e.g.*, Robert Prentice, *Sarbanes-Oxley: The Evidence Regarding the Impact of SOX 404*, 29 Cardozo L. Rev. 703, 763 (2007) ("Considerable empirical academic evidence indicates that SOX 404 has improved the accuracy of financial reporting, improved liquidity and corporate governance, and helped disclose some frauds and discourage others."). An entirely different question is whether higher liquidity leads to greater informational efficiency. *See* Paul C. Tetlock, Does Liquidity Affect Securities Market Efficiency? (Mar. 2007) (unpublished manuscript), *available at* http://www.columbia.edu/~pt2238/papers/Tetlock_Liquidity_and_Efficiency_03_07.pdf (presenting indirect evidence that an increase in liquidity does not lead to an increase in informational efficiency).

243. *See, e.g.*, Prentice, *supra* note 242, at 763.

244. *See generally* Hansmann & Kraakman, *supra* note 23.

245. *See generally* Bebchuk & Roe, *supra* note 23.

246. The idea that ownership patters can determine the shape of legal rules is not new of course. *See generally* John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in*

time, ownership patterns might be driven at least in part by the shape of legal rules.[247]

It is only fitting, then, that the empirical evidence on the convergence in ownership patterns is also ambiguous. Studies undertaken in different years are poorly suited for comparing trends across time since they often differ in focus and methodology. On the European side, the most informative study was performed by Christoph Van der Elst concerning Belgium, France, Italy, Spain, and the United Kingdom.[248] The study tracks the development of ownership concentration for more than 1300 companies between 1999 and 2007.[249] Interestingly, this study yielded mixed results for different countries. Ownership became somewhat more dispersed in France, Italy, and Belgium, while becoming more concentrated in Spain and the United Kingdom.[250]

In the United States, it is clear that ownership has changed over time, but the current direction is less obvious. Much of the older literature explains how the twentieth century saw the United States progress from concentrated to highly dispersed ownership.[251] The more recent literature presents a snapshot of present time ownership structures and finds that block holdings are much more frequent than previously presumed.[252] However, it remains unclear whether there is

---

the Separation of Ownership and Control, 111 Yale L.J. 1 (2001) (providing examples of how, historically, changes in ownership patterns prompted changes in the law rather than vice versa).

247. This claim is most strongly associated with La Porta, Lopez-de-Silanes, Shleifer, and Vishny, who have argued that differences in the level of legal protection accorded to minority shareholders can explain why dispersed ownership has arisen in some countries but not in others. Rafael La Porta et al., *Investor Protection and Corporate Governance* , 5 J. FIN. ECON. 3, 14–15 (2000). It should be noted, though, that even if one accepts the claims made by La Porta et al., it is quite difficult to argue that mandatory corporate law is the cause—rather than the result—of concentrated ownership. La Porta et al. have argued that the strength of protections for minority shareholders affects ownership patterns. Weak protections for minority shareholders encourage the emergence of controlling shareholders because controllers can expropriate minority shareholders. *Id.* at 13. Moreover, weak protections for minority shareholders are detrimental to the development of capital markets because investors are more willing to invest in public companies if the risk of expropriation is low. *Id.* at 15. Regardless of whether these claims are empirically correct, they are certainly internally coherent. By contrast, it is not at all clear why mandatory law should cause concentrated ownership. Mandatory law limits the power of controlling shareholders and thereby protects minority shareholders. Hence, to the extent that mandatory law affects ownership patterns, it should reduce rather than increase the concentration of ownership, and for the same reason, mandatory law should be beneficial to the development of capital markets.

248. Christoph Van der Elst, *Shareholder Mobility in Five European Countries* (European Corp. Governance Inst., Working Paper No. 104/2008, 2008).

249. *Id*. at 16.

250. *Id*. at 23.

251. *See, e.g.*, Marco Becht & J. Bradford DeLong, *Why Has There Been So Little Block Holding in America?*, *in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 613, 613–51 (Randall K. Morck ed., 2005).

252. Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377, 1379 (2009) (concluding that "most public corporations in the United States have large-percentage shareholders"). *But see* Brian Cheffins & Steven Bank, *Is Berle and Means Really a Myth?*,

now an enduring trend toward greater ownership concentration. Thus, it remains difficult to predict whether in the foreseeable future, ownership patterns across the globe will converge.

C. Collective Bargaining Agreements

Reliance on collective bargaining agreements is another key factor in explaining differences in the prevalence of mandatory corporate law. As noted above, codetermination regimes might be more efficient in countries that rely more heavily on collective bargaining agreements to set employees' wages than the United States.

The most obvious way of assessing the importance of collective bargaining agreements is to focus on the fraction of employees covered by such agreements (bargaining coverage rates). As shown in Figure 3 below, coverage rates in codetermination countries have remained fairly stable. The main exception is Germany, where coverage rates have declined from 85% in 1970 to 61% in 2010. In the Scandinavian countries, coverage rates have actually increased; in Finland, for example, coverage grew from 73% in 1970 to 98.5% in 2009.

Figure 3: Bargaining Coverage Rates[253]

	1970	**1980**	**1990**	**2000**	**2007–10**
Austria	95	95	98	98.5	99 (2010)
Czech R.	NA	NA	NA	41.1	47 (2010)
France	70	77.4	94.5	92 (2001)	92 (2008)
Germany	85	85	85	68.9	61 (2010)
Hungary	NA	NA	NA	42.5 (2001)	33.5 (2009)
Luxemb.	60	60	60	60	58 (2008)
Poland	NA	NA	NA	42 (2001)	28.9 (2010)
Slovakia	NA	NA	NA	51	40 (2009)
Slovenia	NA	NA	100	100	92 (2009)
Denmark	80	82	84	83 (2001)	85 (2007)
Sweden	84	85	86 (1989)	94	91 (2010)
Finland	73	77	85 (1989)	86.5	89.5 (2009)
Netherlands	76	81.1	78.9	84.7	84.3 (2010)

However, coverage rates do not necessarily tell the whole story. Another interesting variable is the fraction of employees that are members of labor unions—a figure known as "union density." In

83 Bus. Hist. Rev. 443, 466 (2009) ("Other evidence . . . indicates, however, that blockholding is not as prevalent as Holderness's findings imply.").

253. Visser, *supra* note 201.

practice, a country's union density can be much lower than its coverage rate because collective bargaining agreements are frequently applied to all of the firm's employees, not just to those employees who are union members. Moreover, in some countries, such as France or Germany, the government can require that collective bargaining agreements be applied to all firms in a particular sector.[254] The resulting difference is particularly striking in France, where in recent decades, only about ten percent of workers were members of labor unions, but more than ninety percent of workers received wages governed by collective bargaining agreements.

Precisely because union density can be very different from coverage rates, the former is not particularly useful to assess the importance of collective bargaining arrangements. However, in the long run, declining union membership might also predict a declining role for collective bargaining agreements. It is instructive to consider, then, how union density has developed over time. As Figure 4 shows, union density has declined significantly in most of the codetermination countries, with the notable exception of the Scandinavian nations.

Figure 4: Union Density[255]

	1970	1980	1990	2000	2010	2012
Austria	62.8	56.7	46.9	36.6	28.4	27.8 (2011)
Czech Republic	NA	NA	NA	27.2	17.3 (2009)	NA
France	21.7	18.3	10	8.0	7.9	NA
Germany	32	34.9	31.2	24.6	18.6	18 (2011)
Hungary	NA	94 (1979)	83.1	21.7	16.8 (2008)	NA
Luxembourg	46.8	50.8	44.4 (1993)	42.8 (2003)	37.3 (2008)	NA
Poland	90	65.7 (1981)	36.5	17.2	14.1	NA
Slovakia	NA	NA	67.3 (1993)	32.3	16.9	16.7 (2011)
Slovenia	NA	NA	69	41.6	26.3	24.4 (2011)
Denmark	60.3	78.6	75.3	74.2	68.5	NA
Sweden	67.7	78	81.5	80.1	68.9	NA
Finland	51.3	69.4	72.5	75	70	69 (2011)
Netherlands	36.5	34.8	24.3	22.6	19.3	19 (2011)

254. Dammann, *supra* note 205, at 61.
255. Visser, *supra* note 201.

As a result, it is quite difficult to predict whether collective bargaining agreements will retain their present importance. It is conceivable that as union membership declines further, coverage rates will eventually follow suit, and thereby undermine the relevant efficiency argument for codetermination. However, as the French example demonstrates, it is also possible that union coverage rates will remain largely decoupled from union density rates, allowing coverage rates to remain high despite falling union membership.

D. Protections Against Dismissals

The second feature of European employment policy that is relevant to codetermination concerns protections against dismissal. As noted above, most European countries only allow dismissal for cause.[256] Over the last decade, some European countries have relaxed their employment protections, raising the question of whether Europe is slowly moving toward American-style flexibility.

Contrary to the often simplistic depictions in the news,[257] however, the actual picture is quite mixed. Over the last decade, those Member States that protect employees by giving them a voice on the supervisory board have adopted numerous changes to their law on protection against dismissals.[258] While some of these changes have facilitated the dismissal of employees, others have had the opposite effect.[259] More importantly, the relevant reforms have hardly touched the essence of the for-cause requirements. Rather, they have tended to constitute rather modest modifications around the edges. Reforms in France and Germany, the two largest codetermination states, might serve to illustrate this point. Both countries have clearly moved toward flexibility, but the scope of their reforms remains quite modest.

France has been particularly active in reforming its employment law since the start of the new millennium. In 2005, it extended the duration of the probationary period in which management can terminate newly hired employees without cause. More specifically, the probationary period was extended from three months to three years.[260] However, this

256. *Id.* at 63.

257. *See, e.g.*, Mark Thompson, *Europe Must Push On With Reform—Merkel*, CNN Money (Jan. 24, 2013, 10:41 AM), http://money.cnn.com/2013/01/24/news/economy/europe-economy-merkel/index.html ("Germany introduced a radical overhaul of its labor market 10 years ago, increasing flexibility for employers and moderating wage growth.").

258. Data based on Labor Market Reform Database (LABREF), European Comm'n, http://ec.europa.eu/economy_finance/indicators/economic_reforms/labref/result.cfm (last visited Jan. 15, 2014).

259. *Id.*

260. Loi 2005-846 du 26 juillet 2005 habilitant le Gouvernement à prendre, par ordonnance, des mesures d'urgence pour l'emploi [Law Authorizing the Government to Take Emergency Measures in

change concerned only firms with twenty or fewer employees[261] and thus did not have any relevance for large publicly-traded firms.

The following year, 2006, France adopted legislation designed to phase out the so-called Delalande contribution—essentially a tax that employers have to pay upon terminating an employee who is at least fifty years old.[262] The relevant contribution had been designed to protect senior employees, but de facto created an incentive for employers to terminate older employees shortly before their fiftieth birthday.

Also in 2006, France adopted legislation facilitating the conclusion of fixed-term employment contracts with employees who are at least fifty-seven years old.[263] Fixed-term contracts benefit employers because they effectively allow employers to let their employees go at the end of the predetermined period without having to show cause for termination. Finally, a 2008 law extended probation periods for all workers and authorized the conclusion of fixed duration contracts between eighteen and thirty-six months for managerial employees.[264] In other words, it is true that France took various steps toward a more flexible employment law. But the relevant reforms were hardly monumental and left the core of the for-cause requirement untouched.

Germany presents a similar picture. As in France, various reforms sought to increase the flexibility of employment law but left the core of the for-cause requirement untouched. A statute adopted in 2002 allows fixed-duration contracts for a period of up to two years, and without the employer having to demonstrate a special justification for the fixed duration provided that the employee is at least fifty-two years old.[265] Previously, this had only been allowed for employees who were at least fifty-eight years old.[266] In 2003, Germany changed its prohibition against

---

the Area of Employment], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], July 27, 2005, p. 12223.

261. *Id.*

262. Loi 2006-1770 du 30 décembre 2006 pour le développement de la participation et de l'actionnariat salarié et portant diverses dispositions d'ordre économique et social [Law for the Development of Participation and Employee Ownership and Miscellaneous Provisions Economic and Social], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Dec. 31, 2006, p. 20210, art. 50.

263. Décret 2006-1070 du 28 août 2006 aménageant les dispositions relatives au contrat à durée déterminée afin de favoriser le retour à l'emploi des salariés âgés [Decree Adjusting the Provisions Relating to Fixed-term Contracts to Facilitate the Return to Employment of Older Workers], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Aug. 29, 2006, p. 12763.

264. Loi 2008-596 du 25 juin 2008 portant modernisation du marche du travail [Law on the Modernization of the Labor Market], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], June 26, 2008, p. 10224.

265. Erstes Gesetz für Moderne Diestleistungen am Arbeitsmarkt [First Act for Modern Services on the Labor Market], Dec. 23, 2002, BGBL. I at 4607, art. 7 (Ger.).

266. *Id.*

dismissals without cause to exempt firms with ten or fewer employees.[267] Prior to this reform, only firms with less than six employees had been exempt.[268] The same statute introduced a provision allowing newly formed firms to hire employees on the basis of fixed-term contracts for up to four years and without special justification[269]—a departure from the general rule in German employment law that such contracts can only be concluded for two years and require a special justification.[270] The relevant statute also simplified the law on mass layoffs by reducing the number of criteria that have to be considered in determining which employees have to be terminated first.[271]

In light of the above, it can hardly be said that the codetermination countries are rushing toward American-style labor market flexibility. At most, one can conclude that some codetermination countries—such as France and Germany—are taking modest steps to soften the for-cause requirement around the edges; and some of these reforms do not even apply to the large public corporations subject to codetermination. Hence, to the extent that one sees codetermination as a mechanism that complements the for-cause termination rule, there is no reason to believe that this argument will fade anytime soon.

E. Courts

Differences in the quality of courts constitute another reason why mandatory law might be less efficient in the United States than in other countries. In most countries, this is an area where major changes cannot be expected within the foreseeable future. Reforming judicial systems is a notoriously daunting task, not least because judges often cannot be dismissed without putting judicial independence at risk.[272] Moreover, among countries with well-functioning court systems, the main problem is a lack of specialization resulting from geographically decentralized decisionmaking. There is no reason to believe that European countries are in any way inclined to remedy this situation or that they even perceive it as a problem.

Ironically, though, it is on the United States side that change might be afoot. A recent empirical study suggests that Delaware has been finding it more difficult to maintain its role as the primary forum for

267. Gesetz zur Reformen am Arbeitsmarkt [Law on Labor Market Reforms], Dec. 24, 2003, BGBl. I at 3002, art. 1 (Ger.).

268. *Id*.

269. *Id*. art. 2.

270. Teilzeit-und Befristungsgesetz [Part-time and Temporary Employment Law], Dec. 21, 2000, BGBl. I at 1966, § 14(2) (Ger.).

271. Gesetz zur Reformen am Arbeitsmarkt [Law on Labor Market Reforms], Dec. 24, 2003, BGBl. I at 3002, art. 1 (Ger.).

272. *See, e.g.*, Dammann & Hansmann, *supra* note 214, at 3 (pointing out that reform is "both difficult and slow").

public corporate law cases.[273] If this trend persists, the long-term result might be a decline in judicial specialization. To be sure, there is an opposing complementary trend as well. Over the past decade, other states have been rushing to establish special commerce courts or commercial divisions.[274] However, having many business courts, each of which hears some fraction of the United States' major corporate law cases, still means a decline in specialization if the alternative is one court that hears all (or almost all) of the major cases. Thus, if the Chancery Court keeps losing litigants to courts in other states, the overall result is likely to be a decrease in judicial specialization.

Conclusion

American corporate law is different. At no time is this more apparent than with regard to the use of mandatory law. Whereas most other countries around the globe rely heavily on mandatory corporate law, U.S. corporate law is largely of an enabling nature.

The traditional, if implicit, view seeks to explain this American exceptionalism by referencing the phenomenon of regulatory competition. According to this view, regulatory competition has forced U.S. states to disband their mandatory corporate law norms, whereas the absence of regulatory competition has allowed mandatory norms to persist elsewhere in the world. However, this narrative confuses cause and effect. Regulatory competition exists where it is allowed to exist, and the decisive question is why so many other countries have decided to protect their mandatory corporate law norms by suppressing regulatory competition while the United States has taken the opposite approach.

This Article has shown that efficiency considerations might be key to understanding this mandatory law puzzle. The efficiency of enabling versus mandatory corporate law is not uniform across countries; it instead depends on numerous social and institutional factors. In particular, the efficiency of stock markets, ownership patterns, judicial infrastructure, and labor market flexibility play crucial roles. As a result, this Article argued that enabling corporate law might be substantially more efficient in the United States than it is in Europe and many other countries. In other words, the United States' commitment to private ordering in corporate law might not be a simple political choice, but the reflection of various deep-seated institutional and social characteristics.

None of this means that the gap between U.S. corporate law and the law used in most of the rest of the world is written in stone. Rather, with respect to some of the underlying factors—particularly the efficiency of capital markets—the gap between the United States and other countries

---

273. *See supra* note 221.
274. *See* Bach & Applebaum, *supra* note 220, at 152–202.

is shrinking. Some of the other differences, though, show little sign of fading. It follows, then, that when it comes to the mandatory/enabling divide, the end of American exceptionalism is not likely to come anytime soon.

***