# PART I

## The essential qualities of the corporation

# 1

# Approaching comparative company law*

## Required reading

**EU:** First Company Law Directive, art. 1
**D:** AktG, § 1
**UK:** CA 2006, secs. 1, 3, 4
**US:** DGCL, § 101(b); Model Act, §§ 1.40(4), 3.01(a)

## Approaching comparative company law

### *I. The approach coordinates*

The disciplines of "comparative law" in general and "comparative company law" in particular are natural companions to the globalization of social, political and economic activity. The course of economic and political developments in recent decades has thus increased the amount of comparative law taking place at every level, whether it be that of fact-oriented practitioners, result-seeking legislators and development agencies, or theory-focused academics. Each of these activities has its own interests, priorities and goals. Nevertheless, there are certain "approach coordinates" that mark the path for all their comparative studies. This introductory chapter will outline some important approach coordinates for the comparison of the laws that govern public companies in the United States, the United Kingdom and Germany.

Just as the merchants who engaged in the earliest forms of international trade developed a commercial law that was trans-jurisdictional,[1]

* The text of this chapter is adapted from an article of the same title, first published in *Fordham Journal of Corporate and Financial Law* (2008) 14: 83. We are grateful to the *Fordham Journal of Corporate and Financial Law* for permission to use the text in the context of this larger project.

[1] See e.g. Merryman and Pérez-Perdomo (2007: 13); Horn (1995: Intro. VI mn. 3 *et seq.*); Glenn (2005: 114–116).

so today merchants and their counsel are often at the forefront of comparative legal activity. When a transaction spans international borders, the persons responsible for structuring it must of necessity become corporatists. As Professor Klaus Hopt has observed, lawyers and legal counsel "are the real experts in both conflict of company laws and of foreign company laws … Working out the best company and tax law structures for international mergers, and forming and doing legal work for groups and tax haven operations, is a high, creative art."[2] Legal counsel's repeated choices of a given structure or law can gradually crystallize into a "best practice," which independently or under the auspices of professional associations[3] can lead to many jurisdictions adopting the practice and converging toward a perceived optimal rule. In this way, the practical choices of lawyers eventually collect into recognized legal norms. Comparative scholars like Professor Philip R. Wood, whose numerous books focus on the practical details of the financial laws and instruments in many countries,[4] give internationally active lawyers the information they need to approach transnational problems. His is a comparative law that focuses on providing detailed and accurate information about disparate legal systems rather than either reflecting on the policy goals of legislation or seeking the overall coherence of a given system's solution to a specific problem.[5]

Comparative activity with great practical impact also occurs at venues quite removed from commercial transactions. The unprecedented level of international cooperation occurring on the regulatory side of contemporary globalization creates systematic comparative studies that have dramatically accelerated legal understanding and convergence. Any project to harmonize national laws or draft a convention to govern an area of law among nations will likewise of necessity compare laws to find the best, or at least the most mutually acceptable, solution. Institutions such as the

[2] Hopt (2006: 1169).

[3] Such "associations" can range from the International Chamber of Commerce and their "Incoterms" for international sales transactions, to the International Bar Association and their numerous practice guides, to the voluntarily adopted master framework agreements created by organizations like the International Swaps and Derivatives Association, Inc.

[4] See e.g. Wood (2007); Wood (1995).

[5] The method used, as is appropriate for the goal of the comparative study, centers around the practitioner's desire to use the law: "There are three broad steps in this type of measurement: (1) the legal rules; (2) the weighting of the importance of the legal rules in practice; and (3) actual implementation or compliance by the jurisdiction concerned." Wood (2007: 16).

European Union,[6] the United Nations,[7] the International Institute for the Unification of Private Law (UNIDROIT)[8] and the Hague Conference on Private International Law[9] engage in comparative law on a grand scale in order to produce their directives, regulations and conventions. This activity falls under the rubric of "legislative comparative law" in the descriptive schema offered by Professors Konrad Zweigert and Hein Kötz, and has historically been one of comparative law's most solid domains.[10] If legislative efforts seek to achieve a specific result,[11] like economic prosperity, stable government or investor protection, then a second-level problem arises: the legislator must correctly ascertain a real, causal connection between the chosen law or legal system and the desired social or economic effect. The latter type of project falls squarely within the mission of institutions such as the World Bank, which seeks to "help developing countries and their people … [by] building the climate for investment, jobs and sustainable growth."[12] In addition to the studies prepared by their own staffs and experts, much of the academic comparative law produced in universities also supports the activities of legislators and development agencies.

The increasingly high stakes for the success of commercial transactions of correctly understanding foreign law and of comparing, choosing and

[6] As it developed from an initial six to its current twenty-seven member states over a fifty-year period, the European Economic Community (now the European Union) harmonized a core of minimum standards in many areas and followed this up with mutual recognition of member state law while introducing a parallel movement toward European standardization. See Craig and de Búrca (2008: 620–627). This combination of legislative strategies allowed mandatory harmonization to implement an initial uniformity, which made home rule and voluntary convergence acceptable and then led to greater harmonization becoming unproblematic, so that the laws of individual member states – particularly the later entrants, which were forced to adopt packages of introductory laws – became ever more tightly matched.

[7] This activity is performed, in particular, by the United Nations Commission on International Trade Law (UNCITRAL) and the Office of Legal Affairs, Codification Division's Codification of International Law. See www.un.org/law/.

[8] UNIDROIT "is an independent intergovernmental organisation … [whose] purpose is to study needs and methods for modernising, harmonising and co-ordinating private and, in particular, commercial law as between States and groups of States." See www.unidroit.org.

[9] "Since 1893, the Hague Conference on Private International Law, a melting pot of different legal traditions, develops and services Conventions which respond to global needs." See www.hcch.net.

[10] Zweigert and Kötz (1998: 51). Also see Donahue (2006: 3).

[11] Zweigert and Kötz call this "applied comparative law" (1998: 11).

[12] See the "Challenge" of the World Bank, at www.worldbank.org.

implementing laws have naturally drawn an increasing amount of academic attention to comparative law. Although the steady growth actually began in the nineteenth century, with the major codifications in continental Europe,[13] the increase was dramatic as efforts to develop the economies of the former Soviet Union, Eastern Europe and China took off in the 1990s. This activity has been particularly intense in the area of comparative company law, specifically addressing questions of "comparative corporate governance," comparative "shareholder rights"[14] and, within the European Union itself, comparative methods of "creditor protection."[15] Major events in this "academic comparative law" were the publication in 2006 of a collection of theoretical essays on the activity of comparative law in the *Oxford Handbook to Comparative Law*,[16] and, with particular regard to comparative company law, the teaming up of seven leading corporate law scholars from different jurisdictions to produce in 2004 a high-level comparison of the company law of the United States, Europe and Japan, which is now in its second edition.[17]

Comparative company law is thus expanding quickly at various levels of abstraction and practice. Each level has its own focus and its own tasks. While practical comparatists might concern themselves with the type of document filed or lodged in order to perfect a security interest, the legislative comparatists could focus on whether a specific regime for collateral could stimulate desired commercial activity, and the theoretically oriented academic comparatists might well be occupied with whether a practical comparatist's understanding of both "filings" and "creditor possession" as two forms of "publicity"[18] is a tenable functional analysis or displays unacceptable levels of an Aristotelian teleological essentialism.[19] All three levels of activity occur separately but are closely related, and many works, like that of Wood, tend to cross the line from practice to theory and back again. Like any other theoretical activity, academic comparative law examines the steps taken in the practical activity of comparison in an attempt to make its methods more transparent and conscious and its results more objective and accurate. This includes, at a minimum, scrutiny of the perspective from which foreign legal systems are investigated

[13] Zweigert and Kötz (1998: 51). [14] Siems (2008).
[15] See e.g. the special issues of the *European Business Organization Law Review* (2006) on creditor protection and the *European Company And Financial Law Review* (2006) on legal capital in Europe.
[16] Reimann and Zimmermann (2006).
[17] Kraakman, Davies, Hansmann, Hertig, Hopt, Kanda and Rock (2009).
[18] Wood (2007: 140 *et seq.*). [19] Michaels (2006: 345–347).

and understood, the scope and content of such investigation, the conceptual tools that are used to compare and evaluate laws, and the basis on which causal links between law and a desired social or economic result are posited.[20]

One of the best methodological analyses of comparative law, that of Zweigert and Kötz, proposes a flexible, inductive process of preliminary hypotheses, investigation of functional values, checking of preliminary results, and a reformulation of the hypotheses.[21] This method moves back and forth between functional parts understood as parts of a hypothetical whole, and adjustments to the initial understanding of that whole based on new information gained from an analysis of the parts. Although the type of caution a comparatist should exercise when using this circular method of assuming a whole to determine the functions of the parts and then employing a deepened understanding of the parts' complementary functions to reformulate the idea of the whole cannot be reduced to a simple checklist, it would include at least the following approach coordinates to reduce the risk of committing certain, predictable mistakes.

At the most basic level, it is important that accurate information about the respective legal systems be procured and only comparable items indeed be compared, so as to avoid creating useless or misleading comparisons. Next, it must be remembered that, unlike discrete objects (e.g. apples and oranges), legal rights, duties and forms cannot be accurately compared in isolation. Even if a problem is universal to humanity, the rights and duties selected to address this problem within a given legal system present only one possible configuration of solution, which serves a relative (not a transcendently essential) function within the chosen framework.[22] The functions of a given right, duty or organizational form might also complement other functions within the same system, so that the functions create an almost organic network of interdependence within the legal system. In order better to understand what is strictly considered "law," comparatists must also remember that legal systems exist within societies, and both receive and exercise influence *vis-à-vis* such societies.[23] Further, societies and their legal systems exist in history. They evolve in reaction to historical events, and such evolution is restricted by paths earlier taken,[24] which

[20] Zweigert and Kötz (1998 34–47). [21] Zweigert and Kötz (1998: 46).
[22] Michaels (2006: 358–359). Such contingency would not affect the debate on natural law, for the same principle or norm argued to have universally prescriptive force could be protected by various, differing, functionally equivalent rights and duties.
[23] Luhmann (2004: 142–147).
[24] Roe (1996b: 641); Bebchuk and Roe (1999: 139–142).

means that the comparatist should be aware of the historical position of the legal system being studied. Finally, since at least one leg of a legal comparison will include a law or legal system of a foreign state or country or from a distant time, accurate comparison will require an acute awareness of the distorting tendencies of one's own perspective in time, nation and culture. The foregoing indicates that comparatists should exercise caution with regard to at least the following points of approach:

1. They should obtain accurate information (particularly texts and translations) and compare only comparable items.
2. They should examine the functional values of rights, duties, procedures and forms as system components within the context also of society as a whole.
3. They should consider history's impact on the legal system.
4. They should be aware of the natural distorting tendencies of one's own perspective.

In drafting this text, we have tried to respect these approach coordinates. Each of the legal systems examined in this volume has first been studied from within, relying on the best available understanding offered by experts on their own domestic law, followed by a comparative analysis that attempts to take into account the differences in perspective when a national legal system is seen from the vantage point of each of the other two systems. We hope that an intrinsic analysis of each legal system, combined with a view from each to the other, can help us overcome the circus phenomenon sometimes found in comparative law, in which local institutions (e.g. German co-determination, UK voting by show of hands and US contingent fees) are trotted out as exotic oddities that are interesting primarily as curious deviations from our familiar domestic norm. Society and history must be drawn into the analysis of the object of study, but to the extent possible excluded from the perspective of the studying subject.

An essential prerequisite for the first point listed above is to define the object of our study, to know exactly what we are attempting to compare. We must therefore draw a boundary with some specificity around the concept of "company law." To this end, the following subsection will examine the content of company law in Germany, as expressed primarily in the Stock Corporation Act (*Aktiengesetz* or AktG),[25] in the United Kingdom, as expressed primarily in the Companies Act 2006 (Companies Act 2006

[25] Law of September 6, 1965, as amended most recently on January 5, 2007, BGBl I, p. 20.

or CA 2006),[26] and in the United States, as expressed primarily in a state corporate law, represented here by the Delaware General Corporation Law (DGCL or Title 8, Del. Code)[27] and the Model Business Corporation Act (the Model Act).[28]

## *II. Defining company law functionally*

"Company law" or "corporate law"[29] in all jurisdictions is generally understood as a body of law enabling the creation of an entity with "five core structural characteristics": "(1) legal personality, (2) limited liability, (3) transferable shares, (4) centralized management under a board structure, and (5) shared ownership by contributors of capital."[30] If a law other than a "company" law were to regulate one of these "core characteristics"

[26] CA 2006, Chapter 46, 8 November 2006.

[27] Delaware Code Annotated, Title 8.

[28] The Model Act is drafted by the Section on Business Law of the American Bar Association. It was originally published in 1950, was revised substantially in 1984, and has been revised on a regular basis since. The Model Act has been adopted in substance in thirty of the fifty US states. See Chapter 3, Section V.A, below.

[29] This text uses the terms "company" law and "corporate" law indistinguishably. "Corporate law" is a US term and "company" law is the preferred term in the UK, as well as in the English-language versions of EU legislation. From a German perspective, the term "corporate" law might be more accurate for this text, as the object of this study is stock corporations that may well be large enough to be listed on a stock exchange, an area of study that German scholars might call the "law of capital collecting companies" (*Kapitalgesellschaftsrecht*), as opposed to "company law" (*Gesellschaftsrecht*), which would likely include various forms of partnerships and limited liability companies (*Gesellschaften mit beschränkter Haftung*) as well as stock corporations (*Aktiengesellschaften*). The German understanding of the term "company law" might be rendered as "corporations and other business organizations." Here, both "company law" and "corporate law" will refer to the law governing entities with the five characteristics listed below.

[30] Armour, Hansmann and Kraakman (2009a: 5). These characteristics are by no means a recent invention. For similar lists of core characteristics, at least with respect to US law, see Clark (1986: 2); and Ballantine (1946: 1). For historical discussions of the development of these characteristics, see Cheffins (2009) (focusing on the power of shareholders to control management), Harris (2005) (discussing the early stock corporation as a device to allow impersonal cooperation among investors), Gevurtz (2004: 89) (focusing on central management under a board) and Mahoney (2000) (focusing on legal personality and limited liability). Although limited liability is considered to be one of the most valuable characteristics of a corporation, it should be noted that both German and UK law offer companies with unlimited liability: the German limited partnership by shares (*Kommanditgesellschaft auf Aktien* or KGaA) and the English "unlimited company" both offer the possibility of an entity that issues shares to investors but leaves at least one of their owners with unlimited liability. Moreover, UK law also provides for limited companies in which a guarantee replaces capital as the financial core of the company.

of the corporate entity, it would require treatment in a study of company law. This is unproblematic when another law is expressly linked to the company law. Labor co-determination in Germany provides a good example. The sections of the *Aktiengesetz* that refer to the number, qualifications and appointment of members of the supervisory board expressly refer to the provisions of the various laws providing for co-determination in Germany.[31] The inclusion of co-determination laws in any study of German company law is thus beyond question.

Difficulties arise, however, when a law's function closely complements the corporation law in the jurisdiction in question, but the law is not expressly linked to the company law. If such laws are excluded from treatment, any picture of the jurisdiction's "company law" will be incomplete. If different mixes of topical laws govern the same area in different jurisdictions, a comparison that does not take this difference into account could be distorted. For example, if we compared the German company law rule requiring disclosure of an interest in a stock corporation that exceeds 25 percent of its capital, expressed in § 20(1) of the *Aktiengesetz*, exclusively with the DGCL and the case law related to that statute, which states no such requirement, we would have to conclude that German company law creates greater transparency. However, if we add to the mix a US federal law, the Securities Exchange Act of 1934 (the Exchange Act), particularly § 13(d) thereof and the rules issued under it requiring disclosure of any holding exceeding 5 percent of a class of shares "registered" under the Exchange Act,[32] we tend to reach the opposite conclusion, and German law appears less extensive. Yet when the requirements of § 21 of the German Securities Trading Act (*Wertpapierhandelsgesetz* or WpHG), which applies to listed companies, are also added to the comparison,[33] we see that the obligations of Delaware and German listed companies are quite similar in this respect. Because the rules governing companies

[31] §§ 95–104 AktG. See Chapter 10.

[32] 17 CFR § 240.13d-1(a). Securities must be registered under § 12 of the Exchange Act if either (i) they are listed on a national securities exchange or (ii) the issuer of the securities has more than 500 shareholders and total assets exceeding $10 million (see § 12(g) of the Exchange Act, in connection with Exchange Act Rule 12g-1, 17 CFR § 240.12g-1). In addition to securities registered under § 12 of the Exchange Act, Rule 13d-1 also applies to "any equity security of any insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of the Act, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940." 17 CFR § 240.13d-1(i).

[33] Securities Trading Act (*Wertpapierhandelsgesetz*) published on September 9, 1998, BGBl vol. I, p. 2708, as most recently amended by art. 4 of the Law of July 31, 2009, BGBl vol. I, p. 2512.

are often differently distributed among the companies laws and various other relevant laws in different countries, knowledge of the applicable relevant laws, including their nature and the range of their application, is necessary.

Moreover, each of the five "core" characteristics of a corporation may be closely tied to other areas of law. Bankruptcy (or insolvency) law presents a good example. One purpose of legal personality and limited liability is to demarcate the assets against which creditors may have recourse to recover the debts of the corporation,[34] and such recourse is often taken in insolvency proceedings over the company's assets. The inclusion of bankruptcy law in the study of company law is, however, still debated. In choosing not to address most aspects of bankruptcy law in a 2004 study of corporate law, Professors Henry Hansmann and Reinier R. Kraakman argued that "bodies of law *designed to serve* objectives that are largely unrelated to the core characteristics of the corporate form … do not fall within the scope of corporate law."[35] Following this view, the lawmaker's legislative purpose would determine whether a given piece of legislation should be included within a study of corporate law. However, as discussed above, the functional method of comparative law should not limit itself to intention, but rather to the systemic role played by the given law within the legal system and the society. The intention behind a topical law would then not be the best criterion for deciding whether to include it in a study of company law. For example, German labor laws express a legislative *intention* to have employees treated fairly by corporations, but as one means to this end the law serves the *function* of specifying the composition of the supervisory board. US securities laws have the express legislative intention to protect investors regardless of who or what is selling the relevant securities, but as one means to this end such laws have the *function* of, *inter alia*, regulating the information a registered corporation must disclose. The fiduciary principles and rules of agency law that are central to corporate governance were also in no way devised with the intention of regulating the centralized management of a corporation. It would seem that a test based on legislative intent would not be the best way to separate company law from related but extraneous norms.

In a different context, Professor John Armour asked in 2005 whether EU member states could successfully use their bankruptcy laws to compete

[34] Armour, Hansmann and Kraakman (2009a: 9–10); Hansmann and Kraakman (2000: 393 *et seq.*).
[35] Hansmann and Kraakman (2004: 17) (emphasis added).