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Corporate Governance in Context
Corporations, States, and Markets in Europe, Japan, and the US

Edited by

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Contents

Legal Ground Rules in Coordinated and Liberal Market Economies

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I. Introduction

This contribution seeks to explain the affinity between the nature of economic systems – coordinated market economies (CMEs) and liberal market economies (LMEs) on the one hand, and legal origin (civil vs common law systems) on the other. The paper starts with the simple observation that LMEs tend to be common law jurisdictions, and CMEs civil law jurisdictions. It proposes that the affinity between economic and legal system offers important insights into the foundations of different types of market economies and, in particular, differences in the scope of the state vs the powers of the individual. The main argument is that the legal system serves as a coordination device for social preferences. At the most basic level, these social preferences are reflected in the allocation of rights and responsibilities either to individuals or away from them – to the collective or the state. These social preferences are reflected in legal ground rules stipulating who has the power to determine the meaning and contents of private contracts and who may seek outside help – judicial recourse – to settle disputes: the individual(s) or the collective.

This paper uses examples drawn from contract and corporate law to illustrate this point, but consciously refrains from making any value judgments. Moreover, each system produces its own costs and benefits in economic, social, and political terms, and the relative costs and benefits may change over time. Each system is

* I would like to thank participants at the Berlin Conference of September 2004 on 'Changes of Governance in Japan, Europe, and the US', as well as Harald Baum, Jeffrey Gordon, and participants in the seminar on 'Advanced Readings in Corporate Law' at Columbia Law School for insightful comments and suggestions. Any remaining errors are those of the author.

highly path dependent.[1] By implication, changes in a subset of rules that realise ground rules of the legal system, such as the relaxation of mandatory provisions governing workers' participation in corporate governance (co-determination) in countries that follow a stakeholder model, or, conversely, the introduction of constituency statutes in systems that adhere to the shareholder value model, will not fundamentally alter the basic nature of the respective legal or economic system.

II. Types of Market Economies

Recent years have seen a renewed interest in comparing different types of market economies, or capitalist systems. Hall's and Soskice's publication of 'Varieties of Capitalism'[2] is only the culmination of a voluminous body of literature in political sciences on this issue. In economics, the collapse of the socialist system has precipitated substantial interest in comparing different types of capitalist systems.[3]

Observers of European economies have long noted differences across economic systems that are all built on principles of market economies, yet applied quite differently in practice. Much of this literature has focused on the distinction between corporatist and market systems. Indicators for corporatist systems have varied substantially across the literature, and attempts to standardise them have not been entirely satisfying. Indeed, there is often little correlation between what different scholars have proclaimed to be the core characteristics of corporatist systems.[4]

More recently, it has been proposed to simplify the classification and distinguish only between coordinated and liberal market economies.[5] A major reason for this reclassification has been the difficulty of identifying basic characteristics

[1] On the concept of path dependency, see DC North *Institutions, Institutional Change, and Economic Performance* (Cambridge University Press Cambridge 1990) 11.

[2] PA Hall and D Soskice *Varieties of Capitalism* (OUP Oxford 2001).

[3] S Djankov and others 'The New Comparative Economics' (2003) 31 J of Comparative Economics 595-619. To be sure, there has been a substantial and growing literature on the new institutional economics, which predates the collapse of the socialist system. See only DC North *Structure and Change in Economic History* (Norton New York 1981); North (n 1); and OE Williamson *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (Free Press New York 1985).

[4] For a comprehensive analysis of indicators of corporatism and their interaction, see L Kenworthy 'Quantitative Indicators of Corporatism: A Survey and Assessment Max-Planck-Institut für Gesellschaftsforschung' Discussion Paper 2000/4 <http://www.mpi-fg-koeln.mpg.de/pu/mpifg_dp/dp00-4.pdf> (6 May 2005).

[5] D Soskice 'Reinterpreting Corporatism and Explaining Unemployment: Coordinated and Non-coordinated Market Economies: The Case for an Extended Perspective' in R Brunetta and C Dell'Ariga *Labour Relations and Economic Performance* (Macmillan London 1990) 170-214.

of corporatism in all countries for which a broad consensus exists that they are certainly *not* pure market economies. Japan is the most glaring example. While there is widespread agreement that in Japan the government plays an important coordinating function, it is equally clear that labour unions are not nearly as strong as in the European corporatist economies. Moreover, the size and reach of welfare programs as well as processes of policy formation differ markedly from European corporatist systems.[6]

Following Hall and Soskice,[7] I define *liberal market economies* (LMEs) as economies in which 'firms coordinate their activities primarily via hierarchies and competitive market arrangements' and where 'the equilibrium outcomes of firm behaviour are usually given by demand and supply conditions'. *Coordinated market economies* (CMEs), by contrast, are economies in which 'firms depend more heavily on non-market relationships to coordinate their endeavours with other actors to construct their core competencies'. Hall and Soskice refrain from developing a detailed list of indicators to distinguish between the two types of economies, but highlight some core characteristics, such as formal contracting vs relational contracting, competition vs coordination, and different institutions for exchanging information, monitoring behaviour, and sanctioning defection.[8] Based on these general characteristics, they classify 17 leading OECD countries as follows (Table 1).

Table 1: Liberal and coordinated market economies

LME	CME
Australia	Austria
Canada	Belgium
Ireland	Denmark
New Zealand	Finland
United Kingdom	Iceland
United States	Germany
	Japan
	Netherlands
	Norway
	Sweden
	Switzerland

Source: PA Hall and D Soskice *Varieties of Capitalism* (OUP Oxford 2001)

[6] A Siaroff 'Corporatism in 24 Industrial Democracies: Meaning and Measurement' (1999) 36 European J of Policy Research 175-205.

[7] Hall and Soskice (n 2) 8.

[8] ibid p 10 following Ostrom's classification of core functions of institutions. See E Ostrom *Governing the Commons – The Evolution of Institutions for Collective Action* (Cambridge University Press Cambridge 1990).

Comparative law scholars and readers familiar with the new comparative economics literature (which emphasises the importance of legal families)[9] will note that all LMEs are common law countries, and that all CMEs are civil law countries.[10] This relation could be spurious. However, as I will argue below, there is a strong affinity between economic and legal institutions. The link between the type of legal system and the type of market economy, I suggest, constitutes the ground rules that allocate basic control rights. These ground rules do not necessarily originate in law, but they reveal social preferences, which have become deeply rooted in law and complementary legal institutions.

III. Legal Ground Rules and the Scope of the State

None of the characteristics that are commonly attributed to LMEs or CMEs – ie arm's-length vs relations contracting, competition vs coordination – directly refer to the role of the state. However, an important role of the state is implied in both types of market economies. In the ideal type of LMEs where formal contracting is said to prevail, disputes are resolved and contracts enforced by a 'neutral arbiter'. Typically this neutral arbiter is a state court. In this case the state provides a public good in the form of law and legal institutions in whose shadow parties can negotiate and re-negotiate private contracts, and on which they can rely for enforcing their contractual rights and obligations.[11] The state also plays an important role in safeguarding competition by way of antitrust regulation.[12] In CMEs, a more expansive role of the state is typically assumed. This role can take

[9] The basic paper is R La Porta and others 'Law and Finance' (1998) 106 J of Political Economy 1113-1155.

[10] Comparative law scholars subdivide the civil law family into the French, the German, and the Scandinavian legal families – all of which are represented in this sample.

[11] There is extensive literature on non-legal sanctions. See only AT Konman 'Contract Law and the State of Nature' (1985) 1 J of Law, Economics, & Organization 5-32 and D Charny 'Nonlegal Sanctions in Commercial Relationships' (1990) 104 Harvard L Rev 375-467.

[12] For a thorough treatment of antitrust law and corporate control in the US, compare N Fligstein *The Transformation of Corporate Control* (Harvard University Press Cambridge 1990). For a more critical assessment of the need for state intervention and the efficacy of the antitrust regime that has evolved, see H Demsetz *100 Years of Antitrust: Should We Celebrate?* (George Mason University School of Law: Law and Economics Center 1991). The nature of antitrust regulation in LMEs and CMEs has changed considerably over time. The US was a major advocate of antitrust law since the late 19th century and in fact transplanted this law to many CMEs (Germany and Japan after the Second World War). Prior to this, Germany actively fostered cartels and thereby created an environment based on extensive bargaining. G Spindler *Recht und Konzern – Interdependenzen der Rechts- und Unternehmensentwicklung in Deutschland und den USA* (Mohr Siebeck Tübingen 1993). In recent years, however, antitrust authorities have retreated from intervening more aggressively in market forces. By contrast, the EU has taken a more aggressive role.

the form of coordinating bargains among social partners (labour and employers), or may amount to increasing interventionism.[13]

The major difference in ground rules between CMEs and LMEs is the extent to which individuals vs collectives or the state are vested with important control rights. Ground rules in this context refer to how a legal system allocates the power to determine the meaning and contents of agreements among private parties (substantive ground rule); and to initiate judicial review (procedural ground rule). This argument differs from standard arguments that view the major differences between the two systems in more extensive codification in the civil law system as opposed to the common law system.[14] Along this dimension there is arguably a substantial degree of convergence, as common law jurisdictions have made increasing use of statutory law,[15] and civil law jurisdictions have witnessed the growth of case law to interpret and apply their codes to ever new circumstances.[16] The comparative law literature has taken a broader view, noting that major differences between legal families lie in 'legal styles' (*Rechtsstile*).[17] Elements that form a legal style are said to include the prevailing method of legal thought, particular legal institutions characteristic of that style, the sources of law, ideological factors, the nature of the legal profession, and ultimate history.[18] These elements are helpful for identifying differences across legal systems, but the analysis remains very much at a descriptive level.

This paper seeks to take the analysis a step further by identifying basic constraints that have shaped the evolution of different legal systems in a path-dependent fashion. Analytically, this approach is close to the new institutional economics, in particular to North's work on institutions and institutional change.[19] North argues that institutions are the basic rules of the game, be they formal and informal. They constrain human action by shaping the expectation of

[13] See H Siebert in this volume.

[14] See, for example, La Porta and others (n 9) with further references. See also K Pistor and others 'The Evolution of Corporate Law' (2002) 23 U of Pennsylvania J of Intl Economic L 791, who compare the evolution of corporate law across countries and find that civil law countries are somewhat less flexible than common law countries.

[15] The Companies Act of 1844 codified UK corporate law. In the US, the 1811 New York corporate law marked the beginning of a trend of codifying this law at the state level. In addition, the 1933 Securities Act and the 1934 Securities and Exchange Act codified the law that governed investor protection.

[16] The best evidence for this is the sheer length of standard commentaries to s 242 of the German Civil Code. For a theoretical treatment of the impact of socioeconomic and technological change on law, compare K Pistor and C Xu 'Incomplete Law' (2003) 35 J of Intl L and Politics 931-1013.

[17] See K Zweigert and H Kötz *Einführung in die Rechtsvergleichung auf dem Gebiet des Privatrechts* (2nd edn Mohr Siebeck Tübingen 1984) 78..

[18] ibid 79.

[19] North (n 1).

individual actors about the behaviour of others.[20] Institutional change is path dependent because expectations change slowly and existing constraints therefore influence actions not only today, but also in the future.[21] Not every rule constrains human action in a path-dependent fashion. Moreover, not only formal law, but also social habits do change over time, and often radically.[22] The task therefore is to identify basic norms, or ground rules, that are 'sticky' and therefore shape the style of a legal and economic system.

The claim is that the basic allocation of substantive and procedural powers to either individuals or the collective/state constitutes such ground rules. Whatever their historical origins – and this paper does not make any claims about how they have come about[23] – social expectations about how and by whom conflicts are resolved influence bargaining choices at the contracting stage. Moreover, the interplay between substantive and procedural ground rules may facilitate private contracting and judicial review, or else create conditions under which relational contracting or collective decision making prevails.

1. Substantive Ground Rules

Substantive ground rules determine the extent to which private relations are either contractible or are governed by mandatory law. The most prominent example is the mandatory nature of corporate law in Germany, and its extensive contractibility in Delaware.[24] Substantive ground rules also establish to what extent

[20] See also M Aoki *Toward a Comparative Institutional Analysis* (MIT Press Cambridge 2001) 11, who defines institutions as 'sustainable systems of shared beliefs.'

[21] On evolution and change in legal systems, see MJ Roe 'Chaos and Evolution in Law and Economics' (1996) 109 Harvard L Rev 641. For a related argument on the path dependency of corporate law, compare also L Bebchuk and M Roe 'A Theory of Path Dependence in Corporate Governance and Ownership' (1999) 52 Stanford L Rev 127 as well as the edited volume by J Gordon and M Roe *Convergence and Persistence in Corporate Governance* (Cambridge University Press Cambridge 2004).

[22] Kahn-Freund suggested long ago that areas which were often thought to be not amenable to fundamental change or legal convergence, such as family and inheritance law, have indeed converged substantially in the 20th century. See O Kahn-Freund 'On Uses and Misuses of Comparative Law' (1974) 37 The Modern L Rev 1.

[23] For a (problematic) attempt to trace the origins of legal systems back to the 11th century, see EL Glaeser and A Shleifer 'Legal Origins' (2002) 117 The Quarterly J of Economics 1193. Economic historians and economic sociologists, by contrast, regard the confrontation with industrialisation and emerging capitalism as the formative period for today's economies. See Gerschenkron for basic argument: A Gerschenkron 'Economic Backwardness in Historical Perspective' in A Gerschenkron (ed) *Economic backwardness in historical perspective: a book of essays* (Harvard University Press Cambridge 1962) 5 and more recently N Fligstein *The Architecture of Markets* (Princeton University Press Princeton 2001).

[24] On the debate about the extent of mandatory vs enabling corporate law in the US and the desirability of more mandatory standards, compare JN Gordon 'The Mandatory Structure of Corporate Law' (1989) 89 Columbia L Rev 1549; R Romano 'Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Law' (1989) 89 Columbia L Rev 1599; JC Coffee Jr 'The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role' (1989) 89 Columbia L Rev 1618.

cont. ...

issues that are contractible in principle are still subject to overriding social norms. Every society knows fundamental norms that cannot be contracted out of. Such norms are recognised, for example, in international conventions that allow countries to refuse abidance by the norms set out therein if their enforcement violates their *ordre public* (or public policy).[25] I exclude these fundamental norms from this analysis. Instead, the paper focuses on the more subtle guidance of contractual relations, as expressed in norms that require contracting 'in good faith' or similar general clauses, which allow for review of private transactions on the basis of social or collective norms, not only individual aspirations.[26] The distinction between contractible vs non-contractible on the one hand and unconstrained vs socially conditioned freedom of contract is depicted in Table 2 below.

Table 2: Substantive Ground Rules

	Contractible	Non-contractible
Individual preferences	Unlimited contractual freedom	Bright-line rules limit freedom of contract
	Judicial enforcement of contractual rights dominates	Judicial enforcement of contractual rights
Social norm conditionality	Standardised contracts with social norm conditionality	Mandatory regulation of socially sensitive issues without opt out
	Limited judicial enforcement	Little judicial enforcement

The cells inside the matrix make predictions about the kind of contracts parties will enter into and the nature of governance mechanisms they will employ in light of the substantive ground rule. The upper left and the lower right-hand corners give the two extremes – highly individualised contracts with extensive judicial review on the one hand, and mandatory regulation of socially sensitive issues on the other. In the latter case, judicial enforcement mechanisms may exist, but their primary function is to enforce the mandatory rules, not to resolve a dispute between parties with (assumed) equal bargaining power. In the real world we are

[25] See most prominently the 1958 New York Convention on the International Sales of Goods, art V.2.

[26] On the 'good faith' principle in continental European contract law and its 'transplantation' into UK law, see G Teubner 'Legal Irritants: How Unifying Law Ends up in New Divergences' in Hall and Soskice (n 2) 417-441 and the further discussion below, n 31 and accompanying text.

likely to observe mixed responses to these constraints. Put differently, the argument is not that freedom of contract absent social norm conditions means that parties will *always* revert to judicial enforcement of their rights, but that they will be more likely to seek judicial review when they have reached an impasse than parties contracting in a system with extensive social norm conditionality. There are two possible explanations for this. In the absence of well-established social norms that might help resolve a dispute, parties may be in greater need of third-party intervention.[27] Alternatively, they might be less fearful of social norm conditions imposed on them in the process of litigation.[28]

2. Procedural Ground Rules

Procedural ground rules determine the extent to which individuals have access to judicial review for resolving disputes. A procedural ground rule can take different forms. It may grant universal justiciability, where in principle any dispute may be brought to court, or delegated justiciability, where only those issues that are explicitly mentioned by law may be subject to judicial law enforcement. Moreover, the law may allocate the initiation right to individuals, the collective, a state agent, or a combination of the above (see Table 3 below).

Table 3: Procedural Default Rule

	Universal	Selective
Individual	Wide use of judicial enforcement	Moderate use of judicial enforcement
	Extensive formal contracting	Mix of formal and relational contracting
Collective	Relational contracting dominates	Relational contracting dominates
	Moderate judicial review	Limited judicial review

The nature of procedural ground rules determines the extent of formal vs relational contracting and the use of formal judicial review. Where the ground rule stipulates that collectives (the shareholder meeting) rather than individuals have the initiation right, litigation is less likely. The reason is that collectives typically face substantial 'collective action costs'[29] in making a decision. They may have access to alternative governance devices, and mutual monitoring and reputation bonds, including political bonding devices, or may simply concede power to those who exercise de facto control rights. By contrast, if the initiation right is firmly vested with individuals, it is likely to be used more frequently. The downside for this allocation of control rights is that individuals may hold up transactions that might be beneficial for others. This outcome, however, can be avoided by switching from property to liability rules.[30]

[27] The predictability of the outcome of a case seems to create incentives for parties to settle voluntarily and thus save litigation costs. See GL Priest and B Klein 'The Selection of Disputes for Litigation' (1984) 13 J of Legal Studies 1.

[28] These propositions are only suggestive. While it is possible to document differences in substantive ground rules, the incidence of judicial enforcement of contracts is difficult, if not impossible, to verify in the absence of comprehensive data on contracts, including relational contracts, which by definition are difficult to verify and record.

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The above argument notwithstanding, procedural ground rules are not the only determinants of the level of litigation one might observe in a given jurisdiction. Other factors, such as the cost of litigation, the independence, impartiality, and efficacy of the judiciary, and the availability of alternative dispute settlement and enforcement mechanisms will also play a role. Still, ground rules will effect the parties' bargaining strategy ex ante and influence the kind of monitoring systems they will establish. I would therefore posit that the scope of relational vs arm's-length contracting is, to a large extent, a function of the procedural ground rule. Where individuals may initiate litigation as a default, they

[29] M Olson *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard University Press Cambridge 1971).

[30] For the conceptual distinction between property and liability rules in the law, see G Calabresi and D Melamed 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 Harvard L Rev 1089. For an analysis of conflict-of-interest rules in corporate law from this perspective, compare Z Goshen 'The Efficiency of Corporate Self-Dealing: Theory meets Reality' (2003) 91 California L Rev 393.

[31] M Olson *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard University Press Cambridge 1971).

[32] For the conceptual distinction between property and liability rules in the law, see G Calabresi and D Melamed 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 Harvard L Rev 1089. For an analysis of conflict-of-interest rules in corporate law from this perspective, compare Z Goshen 'The Efficiency of Corporate Self-Dealing: Theory meets Reality' (2003) 91 California L Rev 393.

may be less inclined to safeguard their contracts by alternative mechanisms. By contrast, where the right to take recourse to the courts (and the formal legal system) is restricted, either because the law allows judicial recourse only when it explicitly says so, or because a collective rather than an individual holds the initiation right, the propensity to use non-legal mechanisms increases.

3. Ground Rules in LMEs vs CMEs

Applying this analytical framework to CMEs and LMEs, preliminary evidence suggests a fairly consistent pattern with respect to the allocation of substantive review and procedural initiation powers.[33] LMEs tend to rely on extensive contractibility that is not socially conditioned *and* on individual/universal enforcement rights. By contrast, CMEs condition freedom of contract on compliance with broadly accepted social norms and re-enforce this condition by limiting individual access to judicial review.[34]

Table 4: Ground rules in LMEs and CMEs

	LME/Common Law	CME/Civil Law
Substantive Default Rule	Contractibility/ Primacy of individual preferences	Contractibility is socially conditioned and/or limited by mandatory law
Procedural Default Rule	Universal justiciability/ Individual initiation rights	Selective justiciability/ Collective initiation rights

Ground rules embedded in formal law also influence the scope of state monitoring of private economic activities and the nature of judicial review, ie whether its purpose is primarily the enforcement of individual rights, or of justice understood as a social good. Law and legal institutions are important determinants of state involvement in the economy. This is most explicit in the case of specific rules designed to enforce these norms and can be most easily found in the areas of labour and social law. This should, however, not distract from the fact that the law functions as a coordination device for enforcing social preferences across the legal system. In the absence of specific legislation, the interpretation and enforcement of these norms is typically left to the courts which monitor private contracts and subject them to social norm conditions.

[33] This conclusion is drawn from the analysis of the US and the German system that follows. More extensive research would be needed to substantiate the conclusion for other countries.

[34] This proposition is based on a limited review of CMEs and LMEs – primarily in Germany on the one hand and the UK as well as the US on the other.

IV. Substantive Ground Rules in Private Law

This section seeks to substantiate the above propositions with examples drawn from contract law and corporate law primarily in two jurisdictions: Germany and the US. The areas of the law were selected to highlight the propensity of ground rules that may influence adjudication across different areas of the law and to demonstrate that they are not limited to the regulation of co-determination or labour law, areas that are most commonly selected to illustrate differences between LMEs and CMEs. Legal ground rules in areas of the law not typically targeted by legislation designed to re-enforce the choice of a particular, and perhaps temporary, economic model give greater credence to the argument that law serves as a coordination device between widely held social preferences and economic outcomes. An important implication of this argument is that altering specific legal realisations of such ground rules will not alter the social preferences on which a legal system rests. A moderate amount of judicial activism may ensure maintenance of the status quo, as judges may use general clauses (ie the good faith principle in contract law, or notions of the 'interest of the corporation') to re-enforce social preferences, even after specific legal incarnations of such principles have been abolished.

1. Ground Rules in Contract Law

The most prominent example of a substantive ground rule in contract law is the 'good faith principle' in most continental European legal systems – which incidentally are CMEs and civil law countries. In Germany, the provision can be found in section 242 of the Civil Code (Bürgerliches Gesetzbuch).[35] The principle has been incorporated into a European directive,[36] and as such has made its way into the UK legal system – an LME and common law country. In analysing the likely impact of the directive on the UK legal system, Gunther Teubner characterises the *bona fide* principle as 'clearly one of the unique expressions of continental legal culture'.[37] He notes that the principle has been used to infuse communitarian principles into contract law, or as 'contract law's recourse to social morality'.[38] The principle has been used as an overriding social condition for private contracts, which in principle

[35] 'Der Schuldner ist verpflichtet, die Leistung so zu bewirken, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern.' (The obligor must perform in a manner consistent with good faith taking into account accepted practice.)

[36] Regulation 4 of the Unfair Terms in Consumer Contracts, SI 1994 no 3159, implementing Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts [1993] OJ L95/29.

[37] Teubner (n 26) 427.

[38] ibid 431 quoting Esser and Wieacker.

are governed by the 'freedom of contract'. It is less clear whether the drafters of the civil code anticipated this development or had even meant this provision to serve this purpose. Arguably to the contrary, the framers of the German code had sought to limit the extent to which contractual parties could escape their obligations because of their limitations in adequately forecasting future events or anticipating all future contingencies. The overriding principle established by the German Civil Code of 1900 – which was deplored by Otto von Giercke as lacking even a drop of social oil – was that '*pacta sunt servanda*'.[39] It explicitly rejected a widely accepted legal principle known prior to the codification of the civil code, according to which each contract was based on implicit assumptions, ie the 'foundation of the transaction' (*Geschäftsgrundlage*), and that serious deviations from this foundation would justify an escape from contractual obligations.[40] This older principle was revived only in the wake of hyperinflation in the 1920s. The rigid enforcement of the principle *pacta sunt servanda* (without indexing for inflation) resulted in an 'endogenous legal boom'[41] that almost brought the judicial system to its knees, as the failure to account for galloping inflation resulted in a flood of cases brought by creditors who rushed to the courts to contain losses that grew larger by the day. In the inter-war period, the principle was primarily used to adjust prices to take account of inflation. However, in the postwar era, the principle was more extensively used in cases where imbalances in the original contract resulted from the 'discovery of unknown facts or the occurrence of unexpected events'[42] in cases where parties had not made provisions for such events, nor had they allocated the risk for unanticipated events among themselves. This practice has found widespread acceptance, and as a result has been incorporated in a recent revision of the Civil Code.[43]

By contrast, a general principle of good faith is not part of the common law tradition.[44] Courts invoke general principles of reasonableness, fairness, and good faith, or rather the absence of bad faith, but they are likely to interpret them in the context of a specific case and give much credence to the parties' intent. These

[39] See JP Dawson 'Judicial Revision of Frustrated Contracts: Germany' (1983) 63 Boston U L Rev 1039 for an excellent English-language survey of the developments that led to a change of this doctrine in subsequent case law.

[40] The relevant principle is the so-called *clausula rebus sic stantibus*. Ibid 1040.

[41] HC Wolf 'Endogenous Legal Booms' (1993) 9 The J of L, Economics, and Organization 181-187.

[42] See Dawson (n 39) 1075. German courts have, by way of case law, created different groups of cases that may qualify for adjustment of the original contract. See R Zimmermann and S Whittaker (eds) *Good faith in European Contract Law* (Cambridge University Press Cambridge 2000) 22 for a discussion of the proliferation of case law under BGB s 242.

[43] See the new provision s 313 in the BGB as enacted 1 January 2002 (Bundesgesetzblatt I 3138).

[44] See also Zimmermann and Whittaker (n 42) 39.

principles are not abstract doctrines that could be invoked to condition private contracts on the basis of social norms. Moreover, the doctrine of frustration, which is closest to the 'foundation of contracts' doctrine in the German tradition, is used to discharge both parties of their duties when performance of a contract becomes impossible. It is not, however, an invitation to courts to adjust contracts consistent with some overriding principles of justice or fairness.[45]

Against this background, Teubner predicted that the 'transplantation' of the bona fide principle will cause irritation in the UK legal system. As Teubner pointed out, it was, however, unlikely that the introduction of this principle would radically transform UK contract law. Instead, it was more likely that the principle's meaning and contents will be transformed when courts apply it to specific cases. This is so, because the UK legal and economic system is based on a different set of principles which are unlikely to be affected by the selective incorporation of foreign legal principles.[46] The latter is characterised by the principles of arm's-length contracting in a market-based system and case-by-case review of judicial disputes. Teubner's predictions about the limited impact of the good faith principle in UK contract law are supported by subsequent case law, and more explicitly by a review of this case law by the Lando Commission charged with developing the Principles of European Contract Law (PECL).[47] The Commission explicitly criticises English courts for failing to use the good faith principle to contradict or overrule express contractual terms.

A recent study by Zimmermann and Whittaker[48] suggests that there are more commonalities between continental European jurisdictions and English common law when it comes to good faith principles than is typically acknowledged. They survey the general principles of the law as well as a series of typical case studies and find that in most instances, English law reaches the same conclusions as civil law jurisdictions of continental Europe.[49] The argument put forward in this contribution is not necessarily at odds with their findings. This contribution focuses on frustration of contracts, not on other aspects of good faith. More importantly, we are less concerned with the question of whether broadly defined good faith principles can be found in English law, but in the allocation of decision-making powers and their use to either re-enforce the parties' will or impose social conditions on private contracts. From this vantage point, it appears that German law is more inclined to impose social conditionality, whereas English law is much more wedded to principles such as *caveat emptor* (buyer

[45] On the development of the frustration doctrine primarily in US case law, see JP Dawson 'Judicial Revision of Frustrated Contracts: The United States' (1984) 64 Boston U L Rev 1.

[46] Teubner (n 26) 426.

[47] O Lando and H Beale *Principles of European Contract Law Parts I and II Combined and Revised* (Kluwer Law International The Hague/Boston 2000) 117-118.

[48] Zimmermann and Whittaker (n 42).

[49] ibid 12, 653.

beware) and individual parties' risk taking.[50] Moreover, judges in Germany are more likely to overrule and actively adapt a contract than judges in the UK. The same does not necessarily hold for all civil law jurisdictions, however. In comparison with German law, French law appears to be more formalistic and less open to judicial intervention.[51]

Another counter argument against the suggestion that the good faith principle in contracts is alien to the common law system is that this principle can also be found in the US Uniform Commercial Code (UCC).[52] This general principle, which resembles continental European (as well as PECL) notions of good faith has, however, been enforced in a manner that is more consistent with UK practices than civil law practices, with Germany being the most prominent case. In fact, the official comment to the relevant UCC provision stresses that the good faith doctrine 'merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced . . .'.[53] In other words, the provision is not meant to be used by courts to contradict or override express contractual terms.[54] Importantly, the UCC Permanent Editorial Board concluded after reviewing some of the case law that had emerged that section 1-203 'does *not* support a cause of action where no other basis for a cause of action exists.'[55] As Flechtner observes, while the wording of the good faith principle in the UCC might resemble those of the PECL or even the German civil code, in practice the good faith principle in the US is a weak interpretative tool. And he goes on to suggest that 'this undoubtedly reflects the traditional distrust in the English common law tradition, which is the foundation for US contract law, of the vagueness of the good faith concept, and the sense that a strong good faith principle would give judges a dangerous power to create contractual obligations to which parties had not actually agreed'.[56] This, of course, is in contrast to legal

[50] This distinction is particularly apparent in cases involving asymmetry of information between the parties and one party taking advantage of the other party's lack of information or knowledge. See their discussion of the 'Degas Case' at p 208; on English law at p 226 and p 656.

[51] See ibid 34.

[52] The relevant provision is s 1-203 (2000 edition of the UCC) and states that 'every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement'.

[53] UCC 1023, cmt.

[54] See H Flechtner 'Comparing the General Good Faith Provisions of the PECL and the UCC: Appearance and Reality' (2001) 13 Pace Intl L Rev 295-337 for a detailed comparison of the UCC approach with the PECL. For a summary on good faith in US contract law, see also RS Summers 'The Conceptualisation of Good Faith in American Contract Law: A General Account' in Zimmermann and Whittaker (n 42) 118.

[55] Quoted in Flechtner (n 54) 310.

[56] ibid, quoting A Farnsworth 'Duties of Good Faith and Fair Dealing under the UNIDROIT Principles, Relevant International Conventions, and National Laws' (1995) cont. ...

practice in Germany, where the good faith principle – as described above – has been widely used as an independent cause of action and has allowed courts to develop extensive 'case law' beyond the specific strictures of the civil code.

The comparison of 'good faith' doctrines in common and civil law also helps refute the widely held notion that the main difference between the major legal systems is the greater 'rigidity' or formalism of law in codified systems, or the more limited power of judges in civil law as opposed to common law systems.[57] As this example demonstrates, in crucial areas civil law judges wield much more power and have much greater discretion than common law judges do. More important than this stylised comparison seems to be the extent to which judges are empowered to subject private contracts to social norm conditionality. This is where civil law judges can exert their greater powers and where common law judges are restricted to the will of the original contracting parties.

2. Default Rules in Corporate Law

Up to now the fundamental ground rule for corporate law in Germany has been first that corporate law is not contractible, and second that the interests of the corporation include the interests of all stakeholders without a single group prevailing over another. The corollary of a mandatory corporate law is limiting firms' choice over the corporate law they may wish to choose for incorporation. Not surprisingly, until recently Germany adhered to the so-called 'seat theory', which required a company to be incorporated where its headquarters were located. This theory came under attack by the European Court of Justice, which held in the famous *Überseering Decision* that a denial of legal personhood for a corporation which had been legally incorporated in another member state, simply because – under German law – this corporation had changed its seat without re-incorporating there, breached the principle of freedom of establishment under the European Union Treaty.[58] Subsequently Germany's Supreme Court has moved away from the seat theory.[59] Still, the legal implications for a German corporation

3 Tulane J of Intl and Comparative Law 55. In this article, Farnsworth reports the scepticism among common law experts in contract law about incorporating similar principles into the Convention on the International Sale of Goods.

[57] R La Porta and others 'Judicial Checks and Balances' (2004) 112 J of Political Economy 445-470; R La Porta and others 'The Guarantees of Freedom' Harvard Institute of Economic Research working paper <http://post.economics.harvard.edu/hier/2002papers/2002list.html> (9 May 2005).

[58] Preliminary Ruling of the European Court of Justice on 5 November 2002 on a referral from the *Bundesgerichtshof* (German Federal Court of Justice) in the proceedings *Überseering NV and Nordic Construction Company Baumanagment GmbH* (Case C-208/00).

[59] See Bundesgerichtshof of 13 March 2003 (VII ZR 370/98) available at <http://www.jurawelt.com/gerichtsurteile/zivilrecht/bgh/8514> (9 May 2005).

that wishes to re-incorporate elsewhere are yet to be clarified. Even here European law is likely to change the landscape in the future. The Regulation on the European Company (*Societas Europaea*) allows corporations from at least two member states to merge into one governed by the regulation and the law of the member state where the now merged company is located.[60] It has been suggested that this regulation could open the door to greater choice for the place of incorporation in Europe[61] and thus undermine each member state's 'monopoly' over regulating the affairs of corporations that are operating within its jurisdiction. The point is that while change is underway, the traditional approach to corporate law in Germany has been one that limited firms' choice and placed the governance structure of firms firmly under socially agreed-upon norms. The non-contractibility of German law is still reflected in a provision in the code that stipulates that the corporate charters may not deviate from statutes except where explicitly provided for.[62]

By contrast, the ground rule in English and American corporate law is that corporate law is contractible except where otherwise stated in the law. Most importantly, English and US corporate law have traditionally allowed corporations to choose their place of incorporation. Implicit in this choice is the power to opt out of the social consensus in the jurisdiction where the corporation is operating. This choice reflects a preference for individual choice by companies – or their management[63] – over social consensus with regard to the principles that shall govern a corporation's affairs. Consistently with this general approach, corporate law tends to be less mandatory. As is well known, the law of the state of Delaware is among the most 'enabling' of corporate statues in the common law world, with most of the statutory provisions providing opt-out or fall-back clauses

[60] Council Regulation (EC) 2157/2001 of 8 October 2001 on the Statute for a European Company (SE) [2001] OJ L294/1.

[61] L Enriques 'Silence is Golden: The European Company Statute as a Catalyst for Company Law Arbitrage' (ECGI Working Paper 2003).

[62] See s 23 para 5 Aktiengesetz (AktG). The general trend seems to be to relax the rigidity of mandatory corporate law. See H Baum 'Change of Governance in Historical Perspective: The German Experience' (ECGI Working Paper 2005) with further references. Note, however, that concurrently with this trend towards a more enabling corporate law, discussions are underway to make the voluntary corporate governance code of 2002 (available at <http://www.corporate-governance-code.de/index-e.html> [9 May 2005]) mandatory as most companies chose to opt out of it. Thus, there seem to be conflicting trends suggesting that the outcome is still unclear.

[63] The fact that management, or the law firms they choose, rather than shareholders typically determine the incorporation choice has long been recognised in the literature. See, for example R Romano 'Law as Product: Some Pieces of the Incorporation Puzzle' (1985) 1 J of Law, Economics, and Organization 225-283; R Daines 'The Incorporation Choices of IPO Firms' (2002) 77 New York U L Rev 1559-1611; M Kahan and E Kamar 'The Myth of State Competition in Corporate Law' (2002) 55 Stanford L Rev 679.

rather than mandatory law.[64] English company law provides a middle ground in that it firmly vests shareholders with basic control rights, but, in comparison to the law of Delaware, is more restrictive in allowing opt-outs or the delegation of control rights from shareholders to the board of directors.[65]

The nature of corporate law as contractible vs non-contractible (or mandatory vs enabling) has important implications for complementary institutions that have evolved over time.[66] A mandatory law relies heavily on the enforcement of these provisions ex ante when the company registrar reviews the consistency between the charter's provisions and statutory law. Since every change in the charter must be recorded, violations can be detected when they are registered. In the eyes of ex ante lawmakers, there was therefore little apparent need for ex post judicial review. It should, however, be noted that it has become increasingly obvious that everyday management decisions which do not require registration may endanger stakeholder interests just as much but largely escape judicial review, mostly because procedural ground rules limit the justiciability of corporate decision making (see below).

By contrast, when corporate law is contractible, violations of the law are harder to detect and require more extensive ex post review. The major complementary device to a contractible corporate law is therefore judicial review. With case law establishing the limits of private contracting, the need for statutory restrictions may in fact diminish over time.[67] To be sure, judicial review as the only check on free contracting is increasingly challenged, in particular by the growing influence of mandatory federal law in the US, which is intruding on the traditional territory of state corporate law.[68] This trend may suggest a shift in the ground rule in the US corporate law system from one that relied primarily on private contracting to one that is increasingly regulated by federal law. So far, however, the trend has not gone far enough to suggest a fundamental shift. The reason is that both securities regulations and corporate law in the US continue to be almost silent about the substantive norms that shall govern the corporate contract. Instead, both statutory and case law focus largely on process rather than substance. This is most apparent in the interpretation of the directors' and officers' fiduciary duties. Judicial review of the duty of care has developed into a review of procedures, except where the substance meets the threshold of 'bad

[64] On the balance between mandatory and enabling corporate law as a positive and a normative matter, see Coffee Jr (n 24) 1618-1691; Gordon (n 24) 1549-1598 and Romano (n 24) 1599-1617.

[65] English law is much more restrictive in allowing for a re-allocation of key control rights from shareholders to managers than Delaware corporate law.

[66] Pistor and others (n 14) 830 with table 5 ibid.

[67] This is the core of Coffee's argument that fiduciary duties enforced by the Chancery Courts are Delaware law's most mandatory core.

[68] See especially M Roe 'Delaware's Competition' (2003) 117 Harvard L Rev 588.

faith' or 'waste'. The doctrinal device is the business judgment rule which stipulates that judges will *not* second-guess the decision of directors or officers or try to impose their own or 'society's' values on them. Instead, they will review only whether a decision was made at all, whether the decision was informed, and whether it was below the bad faith threshold.[69] Statutory law in Delaware even allows corporate charters to eliminate directors' liability for duty of care violations except when they meet the bad faith threshold.[70] Defining the threshold as 'bad faith' rather than superimposing a 'good faith' review by the courts – as is the case for private contracts in civil law system – is crucial, because it limits the scope of judicial review and, by implication, the extent to which social norms can be invoked to limit contractibility in substance.[71]

The duty of loyalty review also focuses primarily on procedure. Transactions are not void just because they were conflicted, as long as the conflict was disclosed and the transaction was approved by disinterested directors or shareholders.[72] Even when courts apply the entire fairness test, they restrict their review to fair dealing and fair price. The first prong once again focuses on procedure; only the latter gives more room for debate over substance. Even here, much of the assessment is left to experts as judges try to avoid deciding matters beyond the strictures of the law. The Sarbanes-Oxley Act[73], which was enacted in 2002 in response to the uncovering of corporate scandals in the wake of the 'dot com bubble', follows this tradition. To the extent federal law intrudes into the realm of state law by regulating details of the corporation's governance structure, the manner of regulation remains primarily procedural, not substantive. Corporations require audit committees with independent directors;[74] corporate officers need to sign off corporate financials and stipulate that they have read them[75] and are required to create governance structures

[69] See MA Eisenberg WL Cary and MA Eisenberg *Corporations* (7th edn Foundation Press New York 1995).

[70] See Delaware General Corporate Law s 102(b)(7).

[71] The same principle can be found in tort law. Under 19th-century English law, tort liability was limited to intent, unless the particular relation among parties warranted liability for negligence or gross negligence. By contrast, Sec. 1382 of the French Civil Code and (though somewhat more restrictive) Sec. 823 of the German Civil Code establish universal liability for negligent misconduct. It was left to the courts to *restrict* this universal liability, whereas in England they had to create more extensive liability on a case-by-case basis. For a detailed analysis of comparative tort law across legal systems, see K Zweigert and H Kötz An *Introduction to Comparative Law* (3rd edn OUP Oxford 1998). The leniency of traditional common law torts has been corrected by a move toward strict liability in the area of product liability, in particular. Arguably, this 'backlash' (MJ Roe 'Backlash' (1998) 98 Columbia L Rev 217-241) was a heavy price to pay for a more lenient historical approach.

[72] See Delaware General Corporate Law s 144.

[73] See annex 3 in this volume.

[74] SOX s 301.

[75] SOX s 302.

that will help detect any misrepresentation of information at an early stage.[76] An exception to this pattern is the prohibition of credit contracts between the corporation and its management.[77] This explicit prohibition comes close to the substantive regulation of corporate affairs under German corporate law, where credit contracts between the corporation and members of the management board are prohibited, unless approved by the supervisory board.[78]

In general, German law denies directors or shareholders a voting right in the case of conflicted transactions.[79] This is true even if the others were informed about the decision. Moreover, German statutory law regulates the standard of behaviour for key corporate constituencies to a much larger extent than does US or English corporate law. Statutory law thus functions as a guideline for corporate conduct, even where it lacks specific enforcement mechanisms. Apparently, the lawmakers thought these guidelines to be largely self-enforcing.[80] An example are legal standards about executive compensation. German law provides that compensations paid to the members of the management board (ie the executives) must be 'reasonably related' to the tasks of the respective board member and to the overall situation of the corporation.[81] This provision, which was introduced into the law in 1937, had never been enforced or interpreted by a court until the Mannesmann trial of 2004. In this case, the payment of, according to German standards, a hefty 'appreciation award' in the amount of 15 million euro to the CEO of Mannesmann, Klaus Esser, resulted in a criminal investigation that gave a criminal court the opportunity to interpret this provision. Esser had been appointed CEO of Mannesmann fourteen months prior to the merger agreement. His compensation package included a fixed salary and bonuses but no stock options or a proviso for the event of a takeover or other change of control. Vodafone of UK launched a hostile tender offer for Mannesmann in November 1999. By February 2000, the virulent defence Mannesmann mounted under the leadership of Klaus Esser was crumbling. At that time, Vodafone and Mannesmann agreed to a friendly merger. The conditions favoured Mannesmann shareholders when compared with the initial offer. In particular, the value of the exchange ratio had

[76] SOX s 404.

[77] SOX s 402.

[78] Even then, they are restricted to 'specific credit transactions' and may not be granted more than three months in advance.

[79] The relevant provision is Civil Code s 34, which governs organisations with membership. The provision is applicable to corporations.

[80] For a more general argument about the nature of self-enforcing law drawing, however, on a more individualist model of (Anglo-American) corporate law, see B Black and R Kraakman 'A Self-Enforcing Model of Corporate Law' (1996) 109 Harvard L Rev 1911.

[81] See AktG s 87.

increased by 65 billion euro.[82] Two days after the merger agreement was signed, the presidium of Mannesmann's supervisory board met and agreed to pay Esser (and others) an appreciation award of 15 million.[83] The decision had the support of Vodafone (ie the acquirer) and Mannesmann's largest shareholder at the time.

Several shareholders notified the state prosecutor of a potential breach of the duty of trust (*Untreue*) under German criminal law. The relevant provision prohibits a *serious* breach of trust by someone who was charged with taking care of someone else's property or assets. A violation of the criminal law depended on whether the extra compensation violated any provisions of the corporate law. The court held that it did. It pointed out that the extra compensation was not 'reasonably related' to any 'task' the CEO, Klaus Esser, had yet to perform. In particular, the German word '*Aufgabe*' in the provision meant, according to the court, that the compensation had to be paid for future tasks. At the time the appreciation award was granted, however, all tasks related to the merger had already been performed and Esser had thus already been fully compensated for them. Neither was there a 'reasonable relation' between the extra compensation and the situation of the corporation. The court pointed out that under German law, the interests of the corporation are not limited to shareholder value. A broader assessment of the situation of the corporation at the time the appreciation award was granted should have included an assessment of the fact that Mannesmann was losing its independence as a result of the merger and that some of its subsidiaries were to be spun off. Having concluded that the payment constituted a breach of corporate law, the court nevertheless acquitted, because the breach of trust did not meet the threshold required under criminal law. In this context the court stressed that the decision had been made by the correct body, that it had been informed, and that the results of the decision had been disclosed in accordance with legal requirements.

Contrast this decision with the arguments of the Delaware courts in the context of the shareholder derivative action against Disney Corporation because of breach of fiduciary duty related to a compensation and termination package for the company's vice president, Michael Ovitz, a personal friend of the president, Michael Eisner. Ovitz had received a substantial compensation package including a fixed salary, bonuses, and stock options when he joined the corporation in the fall of 1995. The package was approved by the board, but it remains unclear how

[82] The original exchange rate offered by Vodafone was the equivalent of 240 Euro per share. The stock for stock price finally paid had a value of 360 Euro per share. Moreover, Mannesmann shareholders were given 49.5% in Vodafone, whereas the original deal had given them only 47.5% of the company's shares.

[83] Most contentious was another payment made to Mannesmann's former CEO, Joachim Funk, who was a member of the presidium and voted on his own compensation package. The issues under corporate law this case raises, however, are the same as those raised by the Esser compensation package. I will therefore limit the analysis to Esser.

well they had informed themselves prior to approving the package.[84] When he left the company less than a year later, he negotiated with Eisner a no-fault termination, which was also approved by the board. This allowed him to walk away with a total compensation of 140 million US dollars.[85]

The Delaware Supreme Court strenuously avoided any judgment of the level of compensation. Instead, the court stipulated the standard of review narrowly and in line with the procedural nature of court review of directors' action:[86]

> The inquiry here is not whether we would disdain the composition, behavior and decisions of Disney's Old Board or New Board as alleged in the Complaint if we were Disney stockholders. In the absence of a legislative mandate, that determination is not for the courts. That decision is for the stockholders to make in voting for directors, urging other stockholders to reform or oust the board, or in making individual buy-sell decisions involving Disney securities. The sole issue that this Court must determine is whether the particularized facts alleged in this Complaint provide a reason to believe that the conduct of the Old Board in 1995 and the New Board in 1996 constituted a violation of their fiduciary duties.[87]

This implied that the major issue the court had to decide was whether the directors who had approved the severance package were independent and (financially) disinterested, or whether for other reasons their business judgment may have been impaired. In the end, the analysis focused on the question of whether the board had taken its responsibilities seriously or absconded them in favour of the chief executive officer, Michael Eisner. In May 2003 the Chancery Court ruled that there was sufficient evidence that the board may have frivolously neglected its duties and that therefore Ovitz's employment contract fell outside the directors' business judgment rule.[88] It therefore allowed the case to move forward into full trial.

The major difference between the approach taken by the German court and that of the Delaware court is the extent to which the substance of the decision about the compensation package was deemed justiciable. Under Delaware law, judicial review is very much limited to procedural aspects of decision making,

[84] This was the focus of the trial at the Delaware Chancery Court in the fall of 2004. A final decision is still pending at the time of this writing (February 2005).

[85] Of which USD 101 million resulted from the fact that most of his stock options vested immediately.

[86] Supreme Court of Delaware, 746 A2d 244; 2000 Del Lexis 51. It should be noted that at this stage the major question was whether a derivative action was admissible, in particular whether a demand on the board was excused under procedural rules governing derivative action.

[87] ibid 31

[88] Court of Chancery of Delaware, in *re The Walt Disney Company Derivative Action* CA no 15452 of 28 May 2003.

and does not extend to judicial review of the level of compensation.[89] By contrast, German law not only stipulates a reasonableness standard, but also states that the interests of the corporation as a whole, not only those of shareholders, have to be taken into consideration. The court did not leave the balancing act to the relevant decision makers, but itself decided on the standard. In doing so it clearly confirmed the principle long established in German corporate law that the interests of the corporation are not limited to its shareholders, and that there is a corporate interest that can be clearly distinguished from the interest of other stakeholders. In the case at hand, the court suggested that the fact that Mannesmann was losing its independence as a result of the merger plan and that the merger also contemplated spinning off some of its subsidiaries clearly spoke against the 'corporate interests'. The case is now under appeal at the Supreme Court (BGH).

V. Procedural Ground Rules in Private Law

This section primarily addresses procedural ground rules in the context of corporate law. With regard to contract law, the ground rule in common and civil law systems is that private parties may seek judicial recourse to enforce their rights. Parties may choose arbitration over litigation, but absent a clearly expressed choice, the ground rule is litigation. In fact, comparative analysis of litigation rates across Europe suggests that Germany is quite a litigious society.[90] It has also been correctly noted that German civil procedural rules allow for a fairly adversarial procedure. Still, important differences consistent with the approach developed in this paper remain. Judges play a central role in collecting evidence, in contrast to civil procedure rules in the US that leave evidence collection primarily to the parties of the lawsuit.[91] German procedural law allocates the powers to examine witnesses primarily to the judge.[92] The parties may suggest questions to

[89] As Jill Fisch notes, these procedural requirements often bar judicial review of substance. See J Fisch 'Teaching Corporate Governance Through Shareholder Litigation' (2000) 34 Georgia L Rev 745, 760.

[90] HFP Ietswaart 'The International Comparison of Court Caseloads: The Experience of the European Working Group' (1990) 24 L and Society Rev 571.

[91] JH Langbein 'Comparative Civil Procedure and the Style of Complex Contracts' (1987) 35 AJCL 381, esp 387. Langbein's article triggered a vivid debate about the differences in civil procedural rules across legal systems, an area that has been much neglected in comparative law. For a recent summary of this literature, compare B Bryan 'Justice and the Advantage in Civil Procedure: Langbein's Conception of Comparative Law and Procedural Justice in Question' (2004) 11 Tulsa J of Comparative and Intl L 521-555.

[92] According to Civil Procedure Code (ZPO) s 273, the judge may prepare a hearing in court by requesting additional information from the parties and asking them to produce documents to verify their statement. The judge may also request information from state agencies and call expert witnesses independent of a move by one of the parties. However, with regard to ordinary witnesses, it can call only those that have been proposed by one of the parties.

the judge, but there is no cross-examination of witnesses.[93] Moreover, the judge is empowered and frequently exercises that power to call expert witnesses. Expert witnesses are required by law to give 'neutral' opinions and to use their special knowledge to help the judge – not the parties – ascertain facts.[94] Whether or not these procedural rules make for more or less efficient discovery, whether they distort or help uncover the truth, is not the primary concern in this paper. The key is that important control rights are allocated not to individual parties and their legal agents, but to an agent – the court – that is supposed to be neutral and advance the social interests of litigation, ie the discovery of the 'truth'.[95]

Litigation in the area of corporate law offers a fertile ground for comparing the allocation of litigation initiation rights across countries. In England and the US, the initiation right is firmly vested with individual shareholders. Reading through English or US corporate statutes, one looks in vain for a provision that explicitly states that shareholders have a right to sue to enforce their rights, as the right of shareholders to seek judicial recourse preceded statutory corporate law and was thus assumed.[96] Still, English and US corporate law does not offer the same tools for bringing corporate officers and directors to justice. English law has been much more reluctant to allow for derivative action, ie shareholders' rights to sue on behalf of the corporation.[97] Even direct shareholder actions are much less frequent in England than in the US This may be explained in part by the fact that English law vests key decision-making rights with shareholders and is less flexible in allowing them to delegate these rights to directors.[98] In addition, attorneys do not have the same incentives to function as 'bounty hunters', searching for suitable cases to offer their services.[99] Despite these differences, it still seems

[93] A Stadler 'The Law of Civil Procedure' in WF Ebke and MW Finkin *Introduction to German Law* (Kluwer Law International The Hague 1996) 357.

[94] ibid 367. See also German Civil Procedure Code (ZPO) s 402.

[95] The notion that litigation has both social and private costs as well as social and private benefits is based on S Shavell 'The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System' (1997) 26 J Legal Studies 575.

[96] By the time the relevant statutory law had been enacted a substantial body of case law on agency, partnerships, and trust already existed. On the history of English company law prior to 1825, see PL Davies *Gower's Principles of Modern Company Law* (6th ed Sweet & Maxwell London 1997) 18-35.

[97] See *Foss v Harbottle* 2 Hare 461 (1843). For the development of shareholder action under English law, see Davies (n 96) 658. For a comprehensive analysis of English company law, see also BR Cheffins *Company Law: Theory, Structure, and Operation* (OUP Oxford 1997).

[98] See Pistor (n 14) 832 for an argument along these lines.

[99] This role of the attorney in the US system has given rise to considerable attorney agency costs. Congress has sought to limit these costs by passing two Acts over the past 10 years, the Private Securities Litigation Reform Act (PSLRA) of 1995, and the Securities Litigation Uniform Standards Act (SLUSA) of 1998. For details on this Act and its impact on securities

cont. ...

fair to say that the ground rule in both countries is that shareholders have a right to sue, at least when their own rights and interests are at stake. Class action suits are not a deviation but an extension of the principle that enforcement rights are firmly vested with the individual. Class actions allow individual shareholders to claim that they are acting on the part of other aggrieved parties, without having to organise them prior to bringing suit. Even with regard to derivative action, the key question is whether an *individual* shareholder can bring action on behalf of the corporation, or whether this should be the task of the board.[100] Not a single state in the US requires this question to be decided by the collective, ie by the shareholder meeting.

By contrast, under German corporate law this has been the ground rule up to now.[101] The shareholder meeting is to determine whether or not a special auditor shall be appointed to review managerial misconduct, or whether to bring action against the management board.[102] Alternatively, a group of minority shareholders representing at least 5% of the corporate capital may request legal action if they can credibly demonstrate that they have been shareholders for at least three months. This may be a single shareholder, but the threshold excludes shareholders holding less than 5% of the total capital or capital valuing at least 500,000 euro from initiating lawsuits on their own.[103] While this threshold is easier to reach than the previous threshold of 10%, the law still establishes a powerful deterrent against litigation by requiring the minority to compensate the corporation for the costs of litigation should the corporation lose partially or fully, at least to the extent that the corporation's costs exceed what it received as a result of the lawsuit.[104] Not surprisingly, according to German law the default mechanism for enforcing shareholder rights against management to this date is not litigation, but making use of the corporation's internal governance structure, ie the shareholder meeting, the right to elect and dismiss members of the supervisory board, and their right to appoint and dismiss (albeit only for cause prior to their usual five-

litigation, see JA Grundfest and AC Pritchard 'Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation' (2002) 54 Stanford L Rev 627.

[100] This is the core of the 'demand rule', which requires the suing shareholder to first put his demand for legal action before the board, unless, however, such a demand is excused. See the leading decisions under Delaware law, *Aronson v Lewis* 473 A.2d 805 (Del 1984); and *Levine v Smith* 591 A 2d 194 (Del 1991).

[101] Proposed changes in this regard are discussed below at text accompanying notes 126 following.

[102] See AktG ss 142 and 147 para 1.

[103] AktG s 147.

[104] AktG s 147 para 3.

year term) members of the management board.[105] In exceptional cases, judicial review has been sought by way of criminal, not civil law.[106]

In the past, shareholder litigation rights against management have been somewhat extended by the *Holzmüller* decision of the German Supreme Court of 1982.[107] It established that shareholders have a right to bring an action with the aim of establishing the management's legal obligation to refer a decision to the shareholder meeting.[108] The decision is an excellent example for the prevailing ground rule, ie that legal actions are the exception and not the rule for upholding and enforcing shareholder rights. In its decision, the court carefully carved out a legal vacuum which justified the recognition of a right to sue, if only for a declaratory judgment rather than for damages. The court discussed selective procedural rights of shareholders found in statutory corporate law, including the right to challenge decisions of the shareholder meeting in court,[109] and the right to force the supervisory board to bring action against members of the management board after tangible harm has been done.[110] None of these provisions, however, allowed shareholders to enforce their right to vote on a major issue – in this case a capital increase in a subsidiary controlled by the parent following the transfer of assets from the parent to that subsidiary. The court concluded that in cases where a substantive shareholder right to vote on an issue is either explicitly granted in statutory law or recognised by the courts, as in the case at hand, the enforcement of this right should not fail just because the corporate law failed to specify a procedure for enforcing it.[111]

Despite all the fanfare that accompanied this decision, it did not establish a universal procedural rule, but maintained corporate law's ground rule that only in exceptional cases was judicial review of managerial actions an appropriate remedy for aggrieved shareholders. In fact, it took until April 2004, or 22 years, for the next case with a comparable fact pattern to be decided by the German Supreme Court[112] – which denied the claim on substantive grounds.[113]

[105] NR Banerjea *Die Gesellschafterklage im GmbH- und Aktienrecht* (Heymanns Cologne 2000) 16 for a review of the literature.

[106] See the discussion of the recent *Mannesmann* case below.

[107] BGH, 25 February 1982, II ZR 174/80, published in BGHZ 83, 122.

[108] The procedural device was the use of the *Feststellungsklage* in accordance with German Civil Procedure Code s 256, which allows parties to sue for confirmation that a legal obligation exists or does not exist between the parties. This lawsuit is not for remedies, however.

[109] AktG s 241.

[110] AktG ss 117, 147.

[111] 'Eine materiell begründete Rechtsverfolgung darf aber grundsätzlich nicht daran scheitern, daß die dem Aktiengesetz eigenen Rechtsbehelfe tatbestandsmäßig versagen.' BGH (n 107) 127.

[112] Decision of 26 April 2004. BGH II ZR 154/02. Available (in German) at <http://www.recht-in.de/urteile/master.php?wahl=101&u_id=111452> (30 June 2005).

An important exception to the limited rights to seek judicial review under current law are the extensive rights of shareholders to challenge decisions of the shareholder meeting.[114] Allowing individual shareholders to challenge in court the legality of decisions taken at the shareholder meeting, but limiting their powers to sue members of the management board, is consistent with the notion that relational contracting should prevail over judicial enforcement. The only disputes that are referred to the courts are disputes among shareholders, ie disputes for which there is no resolution within the corporation, such as by electing a different board. Nonetheless, the legal device has created costly hold-up problems and is at least in part responsible for the reluctance to extend shareholder litigation rights.

Further evidence for differences in the allocation of procedural control rights are claims in the context of mergers. Under Delaware law, shareholders who voted against a merger may use appraisal rights,[115] or under certain conditions, attach the merger agreement on the grounds of fiduciary duty violations.[116] The fairness of the price paid to shareholders is assessed only once such a claim is made by individual shareholders, or, in the case of fiduciary duty claims, in the form of class action suits. Thus, the allocation of control rights is firmly vested with individual shareholders. By contrast, under German law, *every* merger agreement has to be assessed by an independent agent before it is submitted to the shareholder meeting for approval.[117] This agent, the 'merger reviewer' (*Verschmelzungsprüfer*), is recommended by the management board but appointed by the court. The underlying rationale seems to be that whether or not a merger agreement is fair should not be left to a cost-benefit analysis of individual shareholders, who may in the end decide not to pursue the matter for reasons other than the unfairness of the price. In legal practice, the difference may not be substantial – in the US many firms will use independent committees and their financial advisors to assess the fairness of a merger. The difference, however, is that under German law such a mechanism is mandated by law, whereas in the US it is a quasi-voluntary arrangement aimed at avoiding an 'entire fairness' review by the

[113] A major difference to the Holzmüller decision was that this time the action was brought as a shareholder action against decisions taken by the shareholder meeting. Thus, the question about the scope of shareholders' procedural rights was not addressed.

[114] The relevant provisions are AktG ss 241, 243.

[115] See Delaware General Corporate Law s 262.

[116] See post-Weinberger case law, such as *Rabkin v Phillip A Hunt Chemical Corp* 498 A 2d 701 (Del 1985) and its prodigee.

[117] Compare Reorganisation Law (*Umwandlungsgesetz*) ss 60, 9-12. Note that s 12 explicitly requires that the reviewer states whether the exchange ratio or cash payment is appropriate (*angemessen*).

courts.[118] Companies that do not face legal challenge may thus 'get away' with less scrutiny in the US, not, however, in Germany.

Similarly, any claim for damages that may result from a merger transaction may not be brought directly by a shareholder, but only by a 'special representative' who is appointed by the court upon request from individual shareholders or creditors.[119] This special representative differs in important ways from a lead plaintiff's attorney in an American class action suit. The representative's function is to compile all claims by shareholders, creditors, or the merged company and ensure that primarily creditors of the merged companies are satisfied from the compensation payments.[120] Moreover, his or her remuneration is regulated by law and is ultimately determined by the courts. In other words, the special representative is not the agent of an aggrieved party, but a neutral agent of the court.

In light of this analysis it should not come as a surprise that under German law, investors' private rights of action are equally limited. In fact, the 1994 Securities Trading Law explicitly stated that wrongful ad hoc disclosure does not give rise to individual claims.[121] This has been recently confirmed in a decision of Germany's Supreme Court, which reiterated that ad hoc disclosure obligations of material company information had the purpose of protecting the capital market as such, but not, at least not directly, the interests of individual investors.[122] The decision also declined to give a private right of action to enforce section 88 of the Stock Exchange Law (*Börsengesetz*), which prohibits actions aimed at manipulating stock prices. The court held that the law's purpose was to ensure honesty of price formation on the market. Achieving honesty would also indirectly serve the interests of individual investors; however, the alignment of social and individual interests did not give rise to individual claims for compensation.[123] Surprisingly, the decision nevertheless held – and for the first time ever in Germany – that members of the board could be held personally liable for misrepresentation of material information. This ruling was based on a general tort provision that requires intentional misconduct in a grossly unfair manner.[124]

[118] Delaware courts will shift the burden of proof if a truly independent committee has been appointed with sufficient bargaining power so as to assure the courts that the transaction is at arms' length. See *Kahn v Lynch Communication Systems Inc* 638 A 2d 1210 (Del 1994), where such independence was, however, denied.

[119] Reorganisation Law s 26.

[120] Reorganisation Law s 26 para 3, which states that to the extent creditors of the merged company have not been satisfied, compensation payments shall be used to this end.

[121] See Securities Trading Law (*Wertpapierhandelsgesetz*) s 15 para 6. The law has meanwhile been amended to give investors some private right of action. See the discussion below.

[122] BGH II ZR 402/02 of 19 July 2004 at p 8.

[123] ibid 10.

[124] The relevant provision is BGB s 826 stipulating that whoever causes damage to someone else in a manner that violates general norms of conduct (*gute Sitten*) shall be liable for compensation.

There are signs that Germany is changing the allocation of procedural control rights. First, the securities trading law has been amended to give investors a private right of action against companies or their representatives who fail to comply with ad hoc disclosure requirements or engage in insider trading.[125] Moreover, a new draft law on the corporate integrity and the modernisation of legal claims[126] is under review by the upper house, and is expected to enter into force before the end of 2005. The explicit purpose of the law is the strengthening of shareholders' litigation rights. The threshold for appointing a special auditor to investigate wrongdoings by company insiders has been reduced to shareholders representing only 1% (rather than 10) of total shares or holding shares with a value of 100,000 euro (rather than 1,000,000 euro).[127] This change was, however, accompanied by an important change on the allocation of costs. While the previous version of section 146 AktG imposed the full cost for a court-appointed special auditor on the corporation, the suggested revision of this provision now adds a sentence stating that if the appointment was based on the initiator's intentional or grossly negligent representation of facts, he or she will have to bear the costs for the auditor and the judicial proceedings for appointing him or her.[128] This cost allocation could prove to be a powerful deterrent, especially in light of the fact that under German corporate and civil procedure rules, parties have only limited rights to discovery, thus limiting their ability to ascertain their claims.[129]

[125] Compare Securities Trading Law (*Wertpapierhandelsgesetz*) ss 37 b and 37 c as amended 15 December 2004, BGBl I 3408.

[126] The German title of the draft law is 'Entwurf eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG)'. The draft law in German language is available at <http://www.bmj.bund.de/media/archive/362.pdf> (30 June 2005).

[127] AktG s 142 in the version suggested by UMAG (n 126).

[128] AktG s 146 as amended by UMAG reads: 'Bestellt das Gericht Sonderprüfer, so trägt die Gesellschaft die Gerichtskosten und die Kosten der Prüfung. Hat der Antragsteller die Bestellung durhc vorsätzlich oder grob fahrlässig unrichtigen Vortrag erwirkt, so hat der Antragsteller der Gesellschaft die Kosten zu erstatten.'

[129] Shareholders do have a right to request information from the management board under German corporate law, but the right is limited to a request at the annual shareholder meeting. See AktG s 131. This does not preclude dissemination of information outside the shareholder meeting. However, AktG s 131 para 4 stipulates that whenever information has been made available to one shareholder outside the general shareholder meeting, the same information must be disseminated to all other shareholders, even if that information is not relevant for decision making. The implication of this provision is that specific requests of information are likely to be discouraged as the corporation entails substantial costs even when responding only to a single request. Note also that this provision is broader than Regulation FD in the US, which subjects only publicly traded corporations to the obligation to share information given to some shareholders with all other shareholders. See <http://www.sec.gov/rules/final/33-7881.htm> (effective as of 23 October 2000). Compare General Delaware Corporate Law s 220, which gives every shareholder the right to inspect the corporation's books and request information from the corporation during normal business hours, as long as this is done for a 'proper purpose', which the law defines as a purpose 'reasonably related to such person's interest as a stockholder'.

With regard to the shareholders' rights to initiate judicial review, the draft law establishes a new procedure that allows individual shareholders who represent at least 1% of the total stock of hold shares equalling 100,000 euro in value to seek judicial certification for bringing action against corporate insiders on behalf of the corporation themselves – ie without a special court appointee.[130] The court is to allow the litigation to proceed if the shareholders can substantiate a claim that they have made a demand on the corporation and that the corporation has been harmed by misconduct or major violations of law or the corporate charter.[131] The corporation has to reimburse the claimants for their costs should the claim not prevail unless the claimants obtained the right to bring litigation on the basis of intentionally or grossly negligently misrepresented facts.[132] The law seeks to limit the potential costs of litigation by also stipulating that shareholders acting together can be reimbursed only for one attorney, unless they can show that additional attorneys were indispensable for pursuing the matter.[133] At the same time, shareholders' ability to challenge decisions of the shareholder meeting shall be curtailed according to the proposed law. In the future, a decision can be challenged on the grounds that information provided to shareholders was insufficient or incorrect only if an 'objectively deciding' shareholder would regard the information as crucial for exercising his rights.[134] The provision implicitly empowers courts to dismiss claims that they deem to be abusive, as they will define how an 'objectively deciding' shareholder might act.

Finally, the Ministry of Justice is currently proposing a new law that would introduce 'model trials' for investor claims into the German system.[135] The purpose of this law is to bundle multiple lawsuits on related issues in a more efficient manner than is currently possible. In particular, the result of a model trial would be binding on other claims brought on the basis of the same fact pattern. For this legal effect to arise, however, a claim must be filed with the appellate court to hold a model trial and after such a trial has been decided, individual lawsuits will proceed for final resolution. The draft law explicitly rejects the US-style class action suit, which binds not only the named plaintiffs but other represented members of the class. The reason given in the proposal is that Germany is committed to an 'individualised' litigation system.[136] This argument is interesting from the perspective of the analysis presented in this paper, which suggests that Germany favours

[130] See the new AktG s 148 as proposed by UMAG.

[131] See AktG s 148 para (1) 1-4 as proposed by UMAG. In addition, the shareholders must show that they held the shares before the challenged incident occurred. See ibid.

[132] AktG s 148 para 5 as proposed by UMAG.

[133] ibid.

[134] Revised AktG s 243 para 4 (as proposed by UMAG).

[135] The full text of the proposal (in German) can be accessed at <http://www.bmj.bund.de/media/archive/798.pdf> (30 June 2005).

[136] See proposal (n 135) 35.

collective or state-centred approaches over individualised ones. Formally, the notion that a class action suit collectivises an individual lawsuit is correct, and in that sense German law is indeed more individualistic. Functionally, however, it allocates the entire cost of a lawsuit to that individual. If these costs are prohibitively high, it thereby effectively denies judicial recourse. Conversely, in order to allow litigation to go forward, the US system subordinates individual claims to the interests of the class with the effect that the balance of bargaining power shifts from the defendant to the lead plaintiff and/or its attorney.

As the above discussion suggests, different legal systems allocate (or at least, have allocated) the right to initiate judicial review in the context of corporate law quite differently. Whereas in the US individual shareholders and their attorney have the power to initiate lawsuits, in Germany they can only demand action from the corporation or request a special representative to be appointed by the court. The allocation of initiation powers reflects the same preference for individual over collective interests (or the reverse) that can also be found in substantive ground rules. The US, a common law jurisdiction and LME, favours universal litigation and individual initiation rights. In contrast, Germany has opted for selective litigation rights and, even when doing so, tends to vest the collective rather than the individual with the power to initiate legal action.

The changes now underway in Germany indicate an important change in the allocation of procedural ground rules. Private litigation will be given more room in the future, and its usefulness for enforcing corporate law and shareholder rights more generally is finally being acknowledged. However, whether the proposed changes will fundamentally alter the operation of the German system remains to be seen. There are reasons to caution against high expectations that shareholder and investor lawsuits will play an important role in the future. While the threshold for initiating litigation has been reduced significantly, the cost of litigation and the risk of costs that litigants bear when the case is dismissed remain substantial. Future judicial interpretation of what would amount to intentional or grossly negligent misrepresentation of facts that triggered a lawsuit will be crucial for any litigant's cost-benefit analysis prior to initiating legal actions. Absent extensive discovery rules and shareholder information rights,[137] which might reduce the risk of misrepresentation, this uncertainty alone might deter litigation. In addition, the fear of creating attorney agency problems has led the German legislature to propose a rule that limits compensation for attorneys' fees to a single attorney per case, even if the case is brought by several shareholders. In light of the staggering awards of attorney fees in the United States, the fear may be justified, but it also is likely to undermine the role of attorneys as 'private attorney generals', which has been identified as crucial for the private enforcement regime in the US[138] Finally, litigation might also be deterred by uncertainties about outcomes. As has been noted, given the traditional hostility towards shareholder litigation, there is very little case law interpreting and clarifying the *Aktiengesetz*, the German law on publicly held corporations. Case law developed for the law of limited liability corporations (GmbH), which is much more voluminous, may serve as a guideline, but clarification as to the extent to which courts will apply the same principles to publicly held corporations is still warranted. Moreover, unlike UK or Delaware corporate law, German corporate law was not written to be litigated, but more as a guideline for the corporation's stakeholders' main rights and responsibilities, subject to bargaining within the corporation rather than external judicial review. Many provisions include ambiguous terms that could give courts ample room for interpretation. The Mannesmann case is one example of how this might be done. The particular approach taken by the court of first instance in that case may have been influenced by the fact that it was a criminal rather than a civil lawsuit. Nevertheless, the case does suggest that courts may declare many of the ambiguous provisions justiciable and may interpret them in a fashion that is consistent with social preferences that value the collective good over individual interests, the greater role shareholders may now play in litigation notwithstanding.

[137] See n 129.

VI. Conclusion

This paper set out to explain the apparent affinity between the type of market economy and the type of legal system operating in a given country. Among the 17 major OECD countries that have been the subject of much analysis in the debate on corporatist vs market systems, or coordinated vs liberal market economies, all LMEs are common law countries, and all CMEs are civil law countries. This paper has sought to explain this link. It argues that social preferences for individual rights vs social norms on one hand, and for the pursuit of individual enforcement of legal rights vs bargaining and other collective enforcement mechanisms on the other, are deeply embedded in legal systems. They can be found in ground rules in areas of the law well beyond labour rights and union organisations, which have typically been the focus of analysis in the debate about corporatist systems. The paper developed ideal types for the allocation of substantial and procedural ground rules and illustrated them with examples drawn from contract and corporate law in primarily two jurisdictions – Germany and the US. These jurisdictions may not be representative for all CMEs/civil law systems

[138] JC Coffee Jr 'The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation' (1985) 48 L & Contemporary Problems 40. For a more recent discussion on the role of the state, law, and law enforcement, especially in systems with dispersed ownership, see JC Coffee Jr 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2002) 111 Yale L J 1.

or LMEs/common law systems. More research will need to be done to establish that similar ground rules can be found in other jurisdictions and that they confirm the link between legal families and types of market economies.

Assuming that this link can be further substantiated, it has important implications for the comparative analysis of economic/legal systems. It suggests that the rules and regulations that have commonly been identified with the corporatist system (or CMEs), may only be the tail end of norms engrained in formal rules and complementary institutions that govern these economies. Their adoption was not inevitable, as societies could have 'agreed' on less far-reaching legal representation of such norms. Moreover, societies, or lawmakers as their representatives, may choose to change specific rules. Yet, such a change, at least in isolation, is unlikely to change the social preferences that prevail in these economies. Even in the absence of specific legal arrangements, the basic allocation of substantive and procedural decision-making rights will continue to influence lawmaking and adjudication.

That is not to say that more far-reaching change is impossible. Recent changes in procedural ground rules governing corporate law in Germany are a case in point. They reflect a different perception of shareholder rights, and as such may be indicative of a more general change in social preferences towards greater recognition of individual rights and procedural powers. Still, the final assessment has to await the development of a body of case law that would indicate whether the reallocation of procedural ground rules also implies a shift in substantive ground rules away from concepts that give primacy to the interests of the corporation as a community of interests, to those of shareholders. While changes in procedural ground rules could in fact trigger lasting change over time, for the time being it seems to be premature to use the still marginal changes in specific legal rules as a sign of convergence of legal and/or economic systems.[139]

Table 5: Overview

	LME/Common Law	CME/Civil Law
Substantive Default Rule	Private contracts are valid unless they violate procedural rules and are in 'bad faith'	Private contracts are governed by 'good faith'
Procedural Default Rule	Individual initiation rights	Individual litigation rights limited and frequently delegated to the collective and/or a neutral agent

[139] Despite all the fanfare about convergence as a result of globalisation (see, for example, H Hansman and R Kraakman 'The End of History for Corporate Law' (2001) 89 Georgetown L J 439), there is little empirical evidence to substantiate this claim. See Fligstein (n 23) 191.