Corporate Governance in the Common-Law World

The Political Foundations of Shareholder Power

Christopher M. Bruner

CAMBRIDGE

CAMBRIDGE more information - www.cambridge.org/9781107013292

CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD

The corporate governance systems of Australia, Canada, the United Kingdom, and the United States are often characterized as a single "Anglo-American" system prioritizing shareholders' interests over those of other corporate stakeholders. Such generalizations, however, obscure substantial differences across the common-law world. Contrary to popular belief, shareholders in the United Kingdom and jurisdictions following its lead are far more powerful and central to the aims of the corporation than are shareholders in the United States.

This book presents a new comparative theory to explain this divergence and explores the theory's ramifications for law and public policy. Christopher M. Bruner argues that regulatory structures affecting other stakeholders' interests – notably differing degrees of social welfare protection for employees – have decisively impacted the degree of political opposition to shareholder-centric policies across the common-law world. These dynamics remain powerful forces today, and understanding them will be vital as postcrisis reforms continue to take shape.

Christopher M. Bruner is an Associate Professor at the Washington and Lee University School of Law. His teaching and scholarship focus on corporate law and securities regulation, including international and comparative dimensions of these subjects. Bruner's articles have appeared in a variety of law and policy journals. His comparative study of corporate governance in the United Kingdom and the United States, *Power and Purpose in the "Anglo-American" Corporation*, won the 2010 Association of American Law Schools Scholarly Papers competition.

Corporate Governance in the Common-Law World

The Political Foundations of Shareholder Power

CHRISTOPHER M. BRUNER
Washington and Lee University School of Law

CAMBRIDGE
UNIVERSITY PRESS

CAMBRIDGE UNIVERSITY PRESS
Cambridge, New York, Melbourne, Madrid, Cape Town,
Singapore, São Paulo, Delhi, Mexico City

Cambridge University Press
32 Avenue of the Americas, New York, NY 10013–2473, USA

www.cambridge.org
Information on this title: www.cambridge.org/9781107013292

First published 2013

Printed in the United States of America

A catalog record for this publication is available from the British Library.

Library of Congress Cataloging in Publication Data

Bruner, Christopher M., 1972–
Corporate governance in the common-law world : the political foundations of shareholder
power / Christopher M. Bruner, Washington and Lee University School of Law.
pages cm.
Includes index.
ISBN 978-1-107-01329-2 (hardback)
1. Corporate governance – Law and legislation. 2. Common law. 3. Stockholders – Legal
status, laws, etc. I. Title.
K1327.B78 2013
346′.0666–dc23 2012042747

ISBN 978-1-107-01329-2 Hardback

For Lia, Cullen, and Claire

Contents

List of Figures

Acknowledgments

At the risk of understatement, I have run up big debts in numerous quarters to bring this work to fruition. I hope that in time I can repay those debts. In the meantime, my deepest gratitude will have to suffice.

This book is the product of a long-term project that directly builds upon a series of articles written over the last few years, notably:

- *The Enduring Ambivalence of Corporate Law*, 59 Ala. L. Rev. 1385 (2008), where I developed the argument that U.S. corporate law remains fundamentally ambivalent regarding the role of shareholders in corporate governance and the consistency of their interests and incentives with the public good;
- *Managing Corporate Federalism: The Least-Bad Approach to the Shareholder Bylaw Debate*, 36 Del. J. Corp. L. 1 (2011), where I applied this argument to the debate regarding the scope of the shareholders' authority to enact, amend, and repeal corporate bylaws;
- *Power and Purpose in the "Anglo-American" Corporation*, 50 Va. J. Int'l L. 579 (2010), where I developed the U.K.–U.S. comparative argument linking their differing degrees of shareholder-centrism to differences in the degrees of extra-corporate social welfare protection available to employees in each country; and
- *Corporate Governance Reform in a Time of Crisis*, 36 J. Corp. L. 309 (2011), where I applied this comparative argument to the debate regarding U.K. and U.S. corporate governance reforms in the wake of the global financial and economic crisis that arose in 2007.

I remain deeply grateful to the editors of these fine journals, as well as to many colleagues and friends for their helpful comments, suggestions, and conversations regarding the subjects addressed in these articles. They include John Armour, Stephen Bainbridge, Barbara Black, Bryan Camp, William Casto, Brian Cheffins, John Cioffi, Alan Dignam, Susan Fortney, Brian Galle, Martin

Gelter, Joshua Getzler, Andrew Gold, Catherine Howarth, Lyman Johnson, Brett McDonnell, Russell Miller, David Millon, Donald Nordberg, Dean Pawlowic, Gerhard Schnyder, David Skeel, D. Daniel Sokol, and Robert Vandersluis, as well as workshop participants at the Association of American Law Schools 2010 Scholarly Papers Competition awards panel, the Indiana University–Bloomington Maurer School of Law, the Southeastern Association of Law Schools 2010 Annual Meeting Panel on Shareholders' Role in Corporate Governance, the Texas Tech University School of Law, the University of Cincinnati College of Law, the University of Oxford, the Virginia Junior Faculty Forum (University of Richmond School of Law), and the Washington and Lee University School of Law 2010 Faculty Enclave.

Whatever its strengths and weaknesses, the book is immeasurably improved because of the time that I was able to spend conducting comparative research in Australia, Canada, and the United Kingdom. Many thanks to the Centre for Corporate and Commercial Law at the University of Cambridge, where I was a Visitor to the Faculty of Law in the spring of 2009 (and to the Texas Tech University School of Law for financial support of this component of my comparative research); to the University of Toronto, where I was a Visitor to the Faculty of Law in the summer of 2011; and to the Ross Parsons Centre of Commercial, Corporate and Taxation Law at the Sydney Law School, where I was a Parsons Visitor in the summer of 2011. For guidance, suggestions, and encouragement in my comparative research on Australian, Canadian, and U.K. law, I am deeply grateful to Anita Anand, Helen Anderson, John Armour, Joanna Bird, Brian Cheffins, Aaron Dhir, Alan Dignam, Jennifer Hill, Edward Iacobucci, Ian Lee, Jeffrey MacIntosh, Christopher Nicholls, Luke Nottage, Ian Ramsay, Joellen Riley, and Jacob Ziegel.

I am particularly indebted to Jonathan Eastwood, Martin Gelter, and D. Daniel Sokol, who provided valuable comments and suggestions on the whole manuscript. For advice, suggestions, and encouragement to pursue this project, many thanks to John Berger (Cambridge University Press), Robert Danforth, Sunit Das, Mark Drumbl, Joshua Fairfield, Brant Hellwig, Margaret Howard, Lyman Johnson, Timothy Jost, Russell Miller, David Millon, Elizabeth Oliver, Doug Rendleman, and Ben Spencer. Thanks also to workshop participants at Boston College Law School, Florida State University College of Law, Melbourne Law School, and Sydney Law School, for feedback on numerous aspects of the project at various stages of its development.

Throughout the writing of this book I have been a member of the faculty of the Washington and Lee University School of Law. I could not imagine a more supportive faculty and institution. For generous financial support, I am grateful to the Frances Lewis Law Center. Thanks also to Alana Dagher, Parker Kasmer, James Moore, and Jillian Nyhof, who provided excellent research assistance; Linda Newell, who expeditiously tracked down numerous sources; and Diane Cochran, who provided superb administrative assistance throughout.

I am most grateful of all to my family. My parents, Richard and Sharon Bruner, always expected me to work hard and think for myself. I dedicate this book to my wife, Lia Pierson Bruner, and to our kids, Cullen and Claire, who have supported me in this endeavor with patience, optimism, and grace.

Lexington, Virginia
September 2012

CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD

PART I

SHAREHOLDER ORIENTATION IN THE COMMON-LAW WORLD

1 Introduction and Overview

The global financial and economic crisis that arose in 2007 has led to widespread debate regarding the adequacy of decision-making processes in financial and nonfinancial firms alike. Lawmakers and regulators, in particular, have asked whether corporate boards of directors ought to be more directly answerable to their shareholders, rendering comparative study of differing regulatory approaches to corporate governance a matter of vital public interest. This book presents a theory explaining the varying degrees of shareholder orientation historically exhibited by corporate governance systems in the common-law world – including Australia, Canada, the United Kingdom, and the United States – and explores the theory's practical ramifications for contemporary law and public policy.

The comparative literature tends to place corporate governance systems[1] in one of two broad categories. Throughout most of the world, the stock of large companies is generally concentrated in the hands of controlling families, banks, corporate groups, or governments. In such countries, the corporate governance system typically aims to balance the competing claims of various "stakeholders" in the corporate enterprise – notably, shareholders and employees. In common-law countries, conversely, publicly traded stocks are often held by widely dispersed, passive investors, and the corporate governance system typically places greater emphasis on their interests – a shareholder-centric approach to corporate governance often described as uniquely "Anglo-American," "Anglo-Saxon," or "common-law" in orientation.[2]

[1] Although definitions vary considerably – see, e.g., Peter Alexis Gourevitch & James J. Shinn, Political Power and Corporate Control: The New Global Politics of Corporate Governance 293–95 (2005) – I use the term "corporate governance" to describe the rules that govern decision making in public corporations, whether arising from corporate law, securities regulation, exchange listing rules, or elsewhere.

[2] *See, e.g.*, Ruth V. Aguilera, *Corporate Governance and Director Accountability: an Institutional Comparative Perspective*, 16 Brit. J. Mgmt. S39, S41–S49 (2005) (contrasting "Anglo-Saxon"

Common-law jurisdictions – so called because they trace their legal origins to English judge-made "common law"[3] – undoubtedly exhibit substantial similarities in their business cultures, financial structures, and corporate governance systems.[4] Generalizations regarding the "Anglo-American model," however, tend to obscure the truly substantial differences exhibited by corporate governance systems in the common-law world – differences of great theoretical and practical significance. Simply put, shareholders in the United Kingdom and jurisdictions following its lead are far more powerful and far more central to the aims of the corporation than are shareholders in the United States. This central divergence – observable both in law and in market practice – has embarrassed all previous efforts of which I am aware to devise a comprehensive theory of corporate governance in widely held public corporations of the sort that predominate in common-law jurisdictions.

In this book I survey the vastly differing positions occupied by shareholders in public companies across a category of corporate governance systems too often lumped together in the comparative literature.[5] I then explore the political factors leading these otherwise similar legal and business cultures to part ways on the governance role of shareholders, and trace the consequences of this divergence for corporate governance theory and practice. I argue that external regulatory structures affecting the interests and welfare of other stakeholders in public corporations – notably the form and degree of social welfare protections available to employees – have had a decisive impact on the degree of shareholder orientation exhibited by corporate governance systems in the common-law world. Specifically, stronger stakeholder-oriented social welfare policies and legal structures have permitted the U.K. corporate governance

and "non Anglo-Saxon" corporate governance contexts, while acknowledging distinctions within the former category); John W. Cioffi, Public Law and Private Power: Corporate Governance Reform in the Age of Finance Capitalism 192 (2010) (describing German "ambivalence toward the Anglo-American variant of finance capitalism" following the financial crisis); Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. Fin. 1131, 1142 (1997) ("[C]ivil law families have much smaller stock markets than those in common law countries, presumably because of inferior investor protections."); Jean Tirole, *Corporate Governance*, 69 Econometrica 1, 3 (2001) ("The popularity of the shareholder value concept is much higher in Anglo-Saxon countries . . . .").

3 *See, e.g.*, Black's Law Dictionary 276–77 (6th ed. 1990).

4 *See, e.g.*, John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why? – The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 Geo. L.J. 1727, 1751 (2007); Geoffrey Miller, *Some Points of Contrast between the United States and England*, 1998 Colum. Bus. L. Rev. 51, 51 (1998).

5 *See, e.g.*, Ruth V. Aguilera et al., *Corporate Governance and Social Responsibility: A Comparative Analysis of the UK and the US*, 14 Corp. Governance: Int'l Rev. 147, 147 (2006) (observing that "[l]ess attention has been paid to differences in corporate governance within the 'Anglo-American' system").

system to focus more intently on shareholders without giving rise to political backlash. The same generally holds true, I argue, in other common-law jurisdictions including Australia and Canada, which pursue broadly similar policies both in their corporate governance systems and in the provision of state-based social welfare protections. Conversely, weaker stakeholder-oriented social welfare policies and legal structures have inhibited the U.S. corporate governance system from doing the same, resulting in a starkly different balance of power between boards and shareholders.

I begin with a discussion of methodological problems encountered in comparative study of corporate governance, problems widely ignored in the extant literature. The challenge, explored in Chapter 2, is to avoid two extreme postures, each of which effectively undercuts the utility of comparative study – strict functionalism on the one hand and strict contextualism on the other. By "functionalism" I mean an analytic approach that assumes that corporate governance regimes have been crafted to manage identical, or at least very similar, sets of broadly defined problems. This approach often animates economic theories of corporate governance, which accordingly style corporate governance as chiefly concerned with the minimization of agency costs. This assumption obscures very real differences in how various systems function, and diverts attention from the possibility that differing degrees of shareholder orientation reflect more deep-seated differences in social views and market structures. At the same time, however, excessive "contextualism" threatens to render meaningful comparison impossible by focusing heavily or exclusively on idiosyncrasies of history, culture, and politics. I aim to steer a middle course between strict functionalism and strict contextualism by selecting the prevailing politics of social welfare as my explanatory variable. In this manner, I effectively assume the common necessity in each country to achieve some form of broader political compromise addressing employee interests, while highlighting the potential for strikingly different forms of political equilibrium to emerge in various countries – with divergent impacts on their respective corporate governance systems.

Chapter 3 provides an overview of significant differences between the principal corporate governance models in the common-law world, emphasizing the far greater power and centrality of shareholders in Australia, Canada, and the United Kingdom relative to their counterparts in the United States. For example, whereas shareholders in the United Kingdom possess unqualified legal power and practical capacity to remove public company directors without cause and to accept hostile takeovers without board interference, U.S. shareholders – including in Delaware, the principal jurisdiction of incorporation for U.S. public companies – possess neither. Similarly, U.K. company law focuses quite intently on maximizing return to shareholders, defining this by statute to be the overriding purpose of the U.K. corporation. U.S. corporate law, by contrast, has long remained ambivalent regarding the degree to which shareholders' interests proxy for the larger public interest, adhering to an ambiguous formulation of fiduciary duties owed simultaneously to "the corporation and its stockholders," and giving boards substantial discretion to favor the interests of other stakeholders in responding to hostile takeover attempts. The practical upshot is that shareholders loom much larger in U.K. boardrooms than in U.S. boardrooms. Although U.S. shareholders undoubtedly possess far greater capacity to sue after the fact for breaches of fiduciary duty, the considerable corporate governance authority possessed by shareholders in Australia, Canada, and the United Kingdom permits more direct and substantial shareholder influence over corporate affairs than one finds in the United States.

The book then turns to the prevailing economic and political theories of comparative corporate governance, examining in some detail their strengths and weaknesses, and endeavoring in particular to expose the limits of their respective explanatory domains. Economic theories, explored in Part A of Chapter 4, tend to focus on minimization of "agency costs" arising from misalignment of the board's and shareholders' interests. The corporation is often depicted as a "nexus of contracts," with corporate law tending toward those rules that rational shareholders, employees, and other stakeholders would agree upon in a hypothetical *ex ante* negotiation. In these respects, such theories reflect an inherent functionalism grounded in the scientific pretensions of the "law and economics" movement, a tendency contributing to a convergence bias – an expectation that rational actors grappling with the same (or substantially similar) problems in different countries will eventually converge on the optimal regulatory response. This, I argue, is contradicted by enduring differences in levels of shareholder orientation across common-law jurisdictions, and particularly by the fact that the corporate governance system of the United States – the world's predominant capital market – has remained a consistent outlier in this respect for several decades.

The turn to politics, I argue, is inevitable, given the shortcomings of economic theories of corporate governance. However, while I acknowledge the relevance of certain institutional factors identified in the extant comparative literature – notably the earlier rise to power of U.K. institutional investors, and their greater proximity and homogeneity in the London marketplace – in Part B of Chapter 4 I explore the inability of prevailing political theories of corporate governance to provide a complete explanation for the core divergence that I identify. Theorists emphasizing historical origins – for example,