

INTERNATIONAL DIVERSITY IN SECURITIES REGULATION: ROADBLOCKS ON THE WAY TO CONVERGENCE

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INTRODUCTION

This Article is motivated by a seemingly growing gap between dominant themes in the international or comparative aspects of two closely related fields—securities regulation and corporate governance. While the dominant trend in securities regulation is harmonization and convergence of domestic national regimes, the opposite is true in corporate governance. The few initiatives toward convergence so far have failed, and current analyses either acknowledge or champion international diversity. Concentrating on international securities regulation, this Article critically assesses these conflicting trends of diversity and convergence and the degree to which they may be reconciled.

A noticeable trend among securities regulators and practitioners is a movement towards and support of harmonization or unification of securities regulation laws. A considerable number of such projects have been undertaken or are under way. By far the most internationally ambitious project is being undertaken by the International Accounting Standards Committee (“IASC”) and the International Organization of Securities Commissions (“IOSCO”) and is intended to produce a body of international accounting standards to be used universally for cross-border listings.¹

Less comprehensive in its membership but more effective and successful is the project of the Single European Market—the “1992 Plan” of the European Union (“EU”; formerly, the European Community). EU Directives promulgated as part of this plan

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¹ For a more detailed overview of the IASC/IOSCO project, as well as of European Union (“EU”) Directives and the MJDS, see *infra* Part I.A.

cover many of the major issues in securities regulation, including disclosure, antifraud, and broker-dealer and stock exchange regulation. In 1991 the Securities and Exchange Commission ("SEC") and securities regulators from three Canadian provinces established the Multi-Jurisdictional Disclosure System ("MJDS"). Under MJDS, disclosure statements of corporations from each jurisdiction are recognized by the others.

Academic theoretical analyses of securities regulation during most of the 1980s generally dealt with reforms in the domestic disclosure regime, for example, the introduction of shelf registration and insider trading law. Discussion of the international aspects of securities regulation started in earnest only after the SEC issued its 1987 report on the internationalization of securities markets.² The bulk of the academic literature³ considers regulatory diversity a component of international regulatory competition, with the familiar debate over the race for the bottom (or top) now taking place in the international arena. In this respect, it is worth noting that no matter where such a race may be heading, the important point is that race dynamics could lead to convergence among the racing jurisdictions, either at the top or at the bottom.

In corporate law, the only efforts toward harmonization were made in the EU and so far all have failed.⁴ Nevertheless, interest in the field within the academic and business communities has been increasing over the last decade or so. Earlier in the 1980s, the literature on corporate governance in the United States was mainly introspective—examining the traits of and advocating reforms in the domestic corporate law regime. Central topics included the desirable structure of takeover regulation (as part of the "race to the bottom" debate) and the appropriate degree of freedom in the production of corporate law by states and by entrepreneurs (the "contractual freedom" debates). By the mid-1990s, these topics were largely abandoned without a consensus having been reached on many, if not all, of them. Instead, the focus shifted to the ways in which other countries regulate such issues. "Comparative corporate governance" became a prevalent concept and theories about "path dependence" followed shortly thereaf-

² SEC, INTERNATIONALIZATION OF THE SECURITIES MARKETS: REPORT OF THE STAFF OF THE U.S. SECURITIES AND EXCHANGE COMMISSION TO THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS AND THE HOUSE COMMITTEE ON ENERGY AND COMMERCE (1987).

³ See *infra* text accompanying notes 22-24.

⁴ See *infra* text accompanying notes 40-46.

ter.⁵

A common theme in the comparative corporate governance literature is an acceptance of legal and structural diversity at the *normative* level. The emphasis is on the normative aspect since, as a descriptive argument, international diversity in corporate governance structures is neither surprising nor very interesting. Diversity becomes relevant when there are lessons to be learned from foreign systems for improving existing regimes or when new corporate governance systems need to be designed *de novo*.

A serious discrepancy exists between the international trends in corporate governance and securities regulation. Corporate law and securities law⁶ together constitute one larger body of law that governs the relationships between corporate constituencies. As this Article will show, the division between the two legal fields is tenuous at best. If diversity in corporate governance is so deeply rooted in national legal and economic systems, how can the counterpart securities regulation regimes be unified or even harmonized, when doing so would uproot all their unique distinguishing features?

Put more bluntly, the question is whether modern scholars are wrong in endorsing international diversity in corporate governance regimes (which might mean that there *does* exist a most efficient governance structure towards which all nations move or should move) or whether the harmonization projects in the securities field, most notably that of IASC and IOSCO, are misguided?

The stakes in answering this question correctly could be quite high for many countries. In the United States prominent scholars have advocated reforms in corporate governance-related laws, often with a view toward imitating a successful feature of foreign systems or facilitating the feature's emergence. In securities regulation there is a heated debate over the desirability and wisdom of lowering United States disclosure duties, either selectively or across the board, to accommodate foreign issuers and improve the global competitiveness of United States securities markets. The stakes even could be higher for developing and formerly communist countries that are now establishing market economies. Unlike the United States and other developed countries, such countries

⁵ See *infra* Part I.B.

⁶ In this Article I use *securities regulation* and *securities laws* interchangeably. *Corporate governance* sometimes is used interchangeably with *corporate law* when the context refers to the legal regime governing the structure of the corporation rather than the corporate structure itself.

often are starting from a clean slate rather than trying to improve an existing and functioning regime. For these countries, the decision is more critical as it involves not only the choice of independently good regimes but also a good match of complimentary legal regimes. Effective securities laws could remedy existing deficiencies in corporate laws. But if a deficient corporate law regime is supplemented by a deficient securities law regime that, for example, fails to curb self-dealing, the problem could go completely unchecked.

This Article offers a new perspective for analyzing current developments in international securities regulation by first exploring the relationship between corporate law and governance and securities regulation. This Article identifies two levels on which the legal fields interact. One level may be considered functional, for example, the manner in which the two fields together form an integrated regime for corporate affairs. The other level is more abstract—the canonical distinction between the private and the public, or private law and public law. This Article argues that distinguishing between securities regulation and corporate law may be difficult on both levels, but despite the considerable gray area they retain their independent character and their nature as public and private law, respectively.

Based on these observations, this Article then derives the implications for international harmonization and convergence in securities regulation. In light of the recent advances in the study of comparative corporate governance, this Article argues that rigidities and “sticky points” that exist in national corporate governance systems will affect the structure and content of their securities regulation counterparts and vice versa. From a regulatory viewpoint, corporate governance therefore should be seen as the normative basis for securities law, for example, as a template against which regulatory rules should be judged and later priced by the market. Furthermore, any program for inducing convergence through harmonization or for enabling convergence through regulatory competition must take this bidirectional effect into account. Thus, caution in implementing projects of this sort is warranted. This Article also advances a proposal for a “corporate governance impact analysis” for such programs.

As to the implication of the public/private distinction, this Article argues that for structural and substantive reasons public laws, including securities regulation, may be more susceptible to harmonization projects. Private laws in general, and company law in

particular, tend to be less so, as is evidenced by more than two decades of experience in the EU. Since the two fields are connected, the strong national character of company laws may be the factor that facilitates harmonization of securities laws by preserving the core national preferences that are embodied in the system. At the same time, this very factor may also limit the scope of securities law harmonization insofar as it bears directly on corporate governance.

Part I of this Article explores the recent convergence trends in international securities regulation and corporate governance, as well as the relevant academic analyses. Part II analyzes the legal and functional relationships between corporate law and securities regulation and the public/private dichotomy. Part III identifies several roadblocks on the way to international convergence of securities regulation regimes. It discusses the role of disclosure and insider trading regulation. Further, it assesses the prospects of harmonization projects and the importance of corporate governance as a normative basis for securities regulation. Part III ends with the implications of the public/private distinction on international convergence.

I. RECENT TRENDS

A. *International Securities Regulation*

A number of projects are presently under way with the shared goal of implementing harmonization and cooperation in securities regulation. The most ambitious international project is the International Accounting Standards ("IAS") project undertaken by the IASC, which is a London-based, independent, private sector body with the objective of achieving uniformity in accounting principles used by businesses and other organizations for financial reporting around the world.⁷ To date, IASC's standards have gained some measure of support mainly from non-United States companies that report according to IAS and several stock exchanges that allow or require issuers to present financial statements in accordance with IAS.⁸ The primary importance of IAS, however, stems from its potential to become the basis for a uniform disclosure regime set

⁷ See INTERNATIONAL ACCOUNTING STANDARDS 7 (International Accounting Standards Comm. 1997). As of January 1997, IASC membership included 119 members and six associated members of the professional accounting bodies in 88 different countries. See *id.*

⁸ See *id.* at 13.

by securities regulators around the world under the auspices of IOSCO.

In 1994 IOSCO reviewed the then existing IASC standards. IOSCO selected several of these standards and labeled them core standards. In addition, IOSCO identified additional standards that needed improvement. These standards, when finalized, would establish a common basis for multinational securities offerings and listings.

In July 1995 IASC signed an agreement with IOSCO on a work plan to be completed by the turn of the century, and in April 1996 IASC announced its intention to accelerate that plan with the objective of completing the core standards by March 1998.⁹ That deadline was not met. As of June 1998 most of the work plan had been completed but with certain thorny issues still open.¹⁰

While IASC concentrated on its IOSCO program for cross-border listings, it appeared that IASC was ignoring other types of enterprises.¹¹ IASC responded by stating that its IAS applied to the financial statements of all commercial, industrial, and business reporting enterprises, in both the public and private sectors. Thus, to the question whether "one size fits all," IASC's Board concludes that in most cases and with only minor exceptions the answer is "Yes."¹²

In October 1997, the SEC reported to Congress on the outlook of successful completion of IAS and stated that it may propose changes to its current reporting requirements for foreign private registrants.¹³ The SEC emphasized, however, that before implementing such changes it will closely scrutinize the core standards to ensure that they meet certain criteria.¹⁴ In this context, in one of the most problematic and contentious issues left on IASC's table, accounting for financial instruments (e.g., derivatives), IASC

⁹ See Michael H. Sutton, *Financial Reporting in U.S. Capital Markets: International Dimensions*, 11 ACCT. HORIZONS 96 (1997).

¹⁰ See Robert Bruce, *Tolstoy Would Have Been Proud of IASC*, TIMES (London), May 14, 1998, at 32; see also *Financial Assets and Liabilities: The Next Steps*, IASC INSIGHT, Dec. 1997, at 11; Karen M. Knoll, *Closing the GAAP?*, INDUSTRY WK., Nov. 3, 1997, at 61.

¹¹ See International Accounting Standards Comm., *One Size Fits All?*, IASC INSIGHT, June 1997, at 1.

¹² See *id.*

¹³ See SEC, REPORT ON PROMOTING GLOBAL PREEMINENCE OF AMERICAN SECURITIES MARKETS (1997) [hereinafter SEC REPORT].

¹⁴ The main criteria required from IASC standards are: (1) a comprehensive basis of accounting; (2) high quality standards that result in comparability and transparency, (3) full disclosure; and (4) rigorous interpretation and application of the standards. See SEC REPORT, *supra* note 13.

considered adopting the American rules so as to avoid direct confrontation with the SEC and secure its support.¹⁵ IASC members eventually voted against the proposal, apparently because it was too American.¹⁶

Insider trading is another area where one observes a convergence trend towards a common rule, albeit in a less comprehensive fashion than in the areas of disclosure. Less than twenty years ago, the United States' harsh insider trading laws were rather exceptional. Today, however, a growing number of countries have adopted laws which preclude insider trading, originally at the behest of the SEC and today largely under the auspices of IOSCO.¹⁷ These laws may differ in the scope of liability they impose and in other aspects. Nonetheless, they represent a growing acceptance among regulators of the need to regulate this conduct.

The EU championed another significant effort towards harmonization and cooperation. Initial steps in this direction started in 1979, but the major progress was made as part of its Single European Market plan. The plan envisioned as necessary the integration of the securities markets in all the member states.¹⁸ Its general strategy was to implement the principle of mutual recognition among member states' regulatory regimes, whereby licensing or regulatory approval by one national regulator would be recognized by all other regulators (the so-called "single passport" principle). In this framework, the EU passed directives¹⁹ with regard to regulation of corporate disclosure, insider trading, and regulation of stock exchanges and intermediaries. Relatedly, directives harmonizing the accounting profession were also promulgated.²⁰

¹⁵ See Robert Bruce, *A Fudge That Could Lead to an Alliance*, TIMES (London), Sept. 18, 1997, at 32.

¹⁶ See *America v. The World*, ECONOMIST, Jan. 17, 1998, at 58; see also Jim Kelly, *A Fair System for Financial Instruments*, FIN. TIMES (London), Jan. 8, 1998, at 10.

¹⁷ See Michael D. Mann et al., *International Agreements and Understandings for the Production of Information and Other Mutual Assistance*, 29 INT'L LAW. 780, 795 (1995).

¹⁸ See COMMISSION OF THE EUROPEAN COMMUNITIES, COMPLETING THE INTERNAL MARKET: WHITE PAPER FROM THE COMMISSION TO THE EUROPEAN COUNCIL 4 (1985). For an overview of stock market integration in the EU, see AMIR N. LICHT, STOCK MARKET INTEGRATION IN EUROPE (1998) (Harvard Inst. for Int'l Dev. CAER II Discussion Paper No. 15) [hereinafter LICHT, STOCK MARKET INTEGRATION]; BENN STEIL, THE EUROPEAN EQUITY MARKETS 1 (1996).

¹⁹ The EU Council of Ministers promulgates directives that require all member states to implement the EU provisions as minimum requirements in their municipal law, thereby achieving uniform minimum standards in the EU.

²⁰ For a convenient overview of EU legislation, see STANBROOK & HOOPER, KPMG HEADQUARTERS, A BUSINESS GUIDE TO EUROPEAN COMMUNITY LEGISLATION (Bernard O'Connor ed., 2d ed. 1995).

The SEC and securities regulators from three Canadian provinces undertook a somewhat similar initiative by establishing the MJDS, which also implements the principle of mutual recognition. Under this system, regulators from each jurisdiction recognize the disclosure statements of corporations from all other jurisdictions.²¹ This general description, however, is misleading. In practice, Canadian issuers that offer securities in the United States under MJDS must comply with generally acceptable accounting practices ("GAAP") of the United States and are subject to American liability duties. For them, the savings embodied in MJDS are mainly limited to avoiding the interaction with the SEC's bureaucracy in Washington, D.C.

Academic legal writing generally neglects this aspect of international securities regulation. By and large, academic attention focuses on the non-cooperative aspects of the field, namely, optimal rules for choice of law and assertion of extraterritorial jurisdiction in transactional securities cases,²² and international regulatory competition in securities regulation.²³ In the latter case, convergence could be a by-product of the race dynamics, but does not necessarily have to be so. According to regulatory competition proponents, encouraging regulatory competition could yield a diversified set of regimes from which market players could pick and

²¹ See Multijurisdictional Disclosure and Modification to the Current Registration and Reporting System for Canadian Issuers, Exchange Act Release No. 33-6902, 49 SEC Docket (CCH) 260 (June 21, 1991). For an assessment of MJDS, see Joel P. Trachtman, *Recent Initiatives in International Financial Regulation and Goals of Competitiveness, Effectiveness, Consistency, and Cooperation*, 12 NW. J. INT'L L. & BUS. 241, 303 (1991) [hereinafter Trachtman, *Recent Initiatives*].

²² See, e.g., Merritt B. Fox, *Insider Trading in a Globalizing Market: Who Should Regulate What?*, LAW & CONTEMP. PROBS., Autumn 1992, at 263 [hereinafter Fox, *Insider Trading*]; Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 MICH. L. REV. 2498 (1997); Donald C. Langevoort, *Schoenbaum Revisited: Limiting the Scope of Antifraud Protection in an Internationalized Securities Marketplace*, LAW & CONTEMP. PROBS., Autumn 1992, at 241; see also Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 NW. J. INT'L L. & BUS. 207 (1996) [hereinafter Choi & Guzman, *Dangerous Extraterritoriality*]; Gunnar Schuster, *Extraterritoriality of Securities Laws: An Economic Analysis of Jurisdictional Conflicts*, 26 LAW & POL'Y INT'L BUS. 165 (1994) (presenting an economic analysis of jurisdictional conflicts).

²³ See, e.g., James D. Cox, *Regulatory Competition in Securities Markets: An Approach for Reconciling Japanese and United States Disclosure Philosophies*, 16 HASTINGS INT'L & COMP. L. REV. 149 (1993); James D. Cox, *Rethinking U.S. Securities Laws in the Shadow of International Regulatory Competition*, LAW & CONTEMP. PROBS., Autumn 1992, at 157 [hereinafter Cox, *Rethinking U.S. Securities Laws*]; see also Richard C. Breen, *Foreign Companies and U.S. Securities Markets in a Time of Economic Transformation*, 17 FORDHAM INT'L L.J. S87 (1994); Bevis Longstreth, *A Look at the SEC's Adaptation to Global Market Pressure*, 33 COLUM. J. TRANSNT'L L. 319 (1995).

choose.²⁴

With few exceptions, there is little theoretical discussion of institutionalized international cooperation for harmonizing securities regulation regimes.²⁵ The bulk of the literature on these matters invariably revolves around the practical and administrative aspects of regulatory cooperation.²⁶ While these inquiries are important,²⁷ they leave unanswered the underlying issue of substantive regulatory diversity.

1. International Accounting

With regard to disclosure rules, accounting standards are closely related to securities regulation.²⁸ In principle, securities regulators are authorized to promulgate rules on disclosure, including methods of financial reporting. In practice, however, many regulators, including the SEC, defer to the rules promulgated by national accounting organizations. Generally the regulators accept GAAP by reference into their country's disclosure regime. For that purpose, the SEC reserves a say with regard to the content of evolving accounting rules as well as the structure and policy of the Financial Accounting Standard Board ("FASB").²⁹

²⁴ For a representative view, see Joseph A. Grundfest, *Internationalization of the World's Securities Markets: Causes and Regulatory Consequences*, in INTERNATIONAL COMPETITIVENESS IN FINANCIAL SERVICES 349 (Marvin H. Kusters & Allan H. Meltzer eds., 1991).

²⁵ See, e.g., Uri Geiger, *The Case for the Harmonization of Securities Disclosure Rules in the Global Market*, 1997 COLUM. BUS. L. REV. 241; see also Joel P. Trachtman, *Unilateralism, Bilateralism, Regionalism, Multilateralism, and Functionalism: A Comparison with Reference to Securities Regulation*, 4 TRANSN'T'L L. & CONTEMP. PROBS. 69 (1994) [hereinafter Trachtman, *Unilateralism*].

²⁶ See, e.g., Caroline A.A. Greene, *International Securities Law Enforcement: Recent Advances in Assistance and Cooperation*, 27 VAND. J. TRANSN'T'L L. 635 (1994); Paul G. Mahoney, *Securities Regulation by Enforcement: An International Perspective*, 7 YALE J. ON REG. 305 (1990); Michael D. Mann et al., *The Establishment of International Mechanisms for Enforcing Provisional Orders and Final Judgments Arising from Securities Law Violations*, LAW & CONTEMP. PROBS., Autumn 1992, at 303; Michael D. Mann et al., *International Agreements and Understandings for the Production of Information and Other Mutual Assistance*, 29 INT'L LAW. 780 (1995) [hereinafter Mann et al., *International Agreements*]; Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade*, 7 YALE J. ON REG. 149 (1990).

²⁷ See Scott H. Jacobs, *Regulatory Cooperation for an Interdependent World: Issues for Government*, in OECD, REGULATORY CO-OPERATION FOR AN INTERDEPENDENT WORLD 15 (1994); Anne-Marie Slaughter, *The Real New World Order*, 76 FOREIGN AFF. 183 (1997).

²⁸ See Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 COLUM. L. REV. 1335 (1996); Joel Seligman, *Accounting and the New Corporate Law*, 50 WASH. & LEE L. REV. 943 (1993) [hereinafter Seligman, *Accounting*].

²⁹ For a recent review of FASB's role and its relations with the SEC, see Martin

Regulatory intervention emerges when the SEC deems GAAP insufficient. Such intervention, however, occurs only at the margins.³⁰ As a consequence, international diversity in securities regulation regimes largely constitutes diversity among accounting regimes.

The vast field of international accounting cannot possibly be summarized here, although many topics of current research bear directly in the present context.³¹ Diversity prevails internationally in both GAAP systems and actual financial reporting practices, notwithstanding significant attempts to harmonize them.³² This diversity, however, has costs. One such cost stems from the need to reconcile financial statements prepared according to one form of GAAP with GAAP prevailing in other countries, for example, for the purpose of foreign listing of stocks. The New York Stock Exchange ("NYSE"), for instance, has been arguing for quite some time that the United States GAAP are too strict and deter foreign issuers from listing in the United States, thereby depriving domestic investors of lucrative investment opportunities and domestic markets of profitable business.³³ Empirical data suggest that a major consideration for multinational corporations in making the decision to cross-list their stock in foreign markets is foreign disclosure requirements.³⁴

Mayer, *FASB on Trial*, INSTITUTIONAL INVESTOR, Nov. 1997, at 78. The SEC's recent concern with FASB over the last few years has been to ensure the independence of its standard setters (the trustees). See also Paula Dwyer, *Hardball at the SEC*, BUS. WK., Sept. 29, 1997, at 50.

³⁰ An example is the requirement to disclose compensation schemes for the issuer's top five officers. See Regulation S-K, Item 402, 17 C.F.R. § 229.402 (1998).

³¹ See generally SIDNEY J. GRAY & LEE H. REDEBAUGH, INTERNATIONAL ACCOUNTING AND MULTINATIONAL ENTERPRISES (4th ed. 1997); GERHARD G. MUELLER ET AL., ACCOUNTING: AN INTERNATIONAL PERSPECTIVE (4th ed. 1997). For a recent review, see Shahrokh M. Saudagaran & Gary M. Meek, *A Review of Research on the Relationship Between International Capital Markets and Financial Reporting by Multinational Firms*, 16 J. ACCT. LITERATURE 127-59 (1997).

³² See sources cited *supra* note 31.

³³ See James L. Cochrane, *Are U.S. Regulatory Requirements for Foreign Firms Appropriate?*, 17 FORDHAM INT'L L.J. 558 (1994); James L. Cochrane et al., *Foreign Equities and U.S. Investors: Breaking Down the Barriers Separating Supply and Demand*, 2 STAN. J.L. BUS. & FIN. 241 (1996) (the authors are senior staff members at the NYSE); see also William J. Baumol & Burton G. Malkiel, *Redundant Regulation of Foreign Security Trading and U.S. Competitiveness*, in MODERNIZING U.S. SECURITIES REGULATION: ECONOMIC AND LEGAL PERSPECTIVES 39 (Kenneth Lehn & Robert W. Kamphius, Jr. eds., 1992).

³⁴ See Shahrokh M. Saudagaran & Gary C. Biddle, *Financial Disclosure Levels and Foreign Stock Exchange Listing*, in FREDERICK D.S. CHOI & RICHARD M. LEVICH, INTERNATIONAL CAPITAL MARKETS IN A WORLD OF ACCOUNTING DIFFERENCES 159 (1994); Shahrokh M. Saudagaran & Gary C. Biddle, *Foreign Listing Location: A Study of*

Another cost derives from the need to translate financial statements prepared under different GAAPs so that issuers may be compared with one another. When duplicated by a large number of market participants, such translations constitute a waste of resources. In a prominent survey of accounting professionals, Choi and Levich found that accounting differences significantly affect the capital market decisions of market participants.³⁵

Avoiding these costs may justify the harmonization of accounting rules. In addition to the IASC project discussed above, another concerted effort toward harmonization was made in the EU through several accounting Directives. A number of studies, however, indicate that the EU so far achieved only minimal harmony in its accounting practices and regulations.³⁶ Nevertheless, a growing practice of voluntary disclosure by multinational corporations, above and beyond their home country requirements, may be giving rise to spontaneous harmonization, although financial statements of these companies continue to reflect the primary orientation of accounting in their home countries.³⁷

In my view, concluding that market forces will lead to complete global harmonization anytime soon and, more importantly, that the convergence dynamics will lead toward a global optimum warrants caution. The American and London stock markets are the dominant international markets for equity securities. American investors who are likely to create a strong demand for U.S.-like disclosures, even if at a lesser degree than under United States GAAP, dominate those markets. In addition, the accounting industry, particularly with regard to international transactions, is

MNCs and Stock Exchanges in Eight Countries, 26 J. INT'L BUS. STUD. 319 (1995); see also James A. Fanto & Roberta S. Karmel, *A Report on the Attitudes of Foreign Companies Regarding a U.S. Listing*, 3 STAN. J.L. BUS. & FIN. 51 (1997); Susan Chaplinsky & Latha Ramchand, *The Rationale for Global Equity Offerings* (June 1998) (unpublished manuscript, on file with author). For an analysis of the famous pioneer listing of Daimler-Benz on the NYSE, see Lee H. Radebaugh et al., *Foreign Stock Exchange Listings: A Case Study of Daimler-Benz*, 6 J. INT'L FIN. MGMT. & ACCT. 158 (1995).

³⁵ See FREDERICK D.S. CHOI & RICHARD M. LEVICH, *THE CAPITAL MARKET EFFECTS OF INTERNATIONAL ACCOUNTING DIVERSITY* (1990). A considerable number of respondents, however, said that such difference in fact confers a competitive advantage upon those who bear the costs of comparison. But Choi and Levich rightly emphasize that this practice still represents a waste of resources. See *id.* at 13-15; see also Ravi Bhushan & Donald R. Lessard, *Coping with International Accounting Diversity: Fund Managers' Views on Disclosure, Reconciliation and Harmonization*, 3 J. INT'L FIN. MGMT. & ACCT. 149 (1992) (obtaining similar findings).

³⁶ See sources cited *supra* note 31 (surveying studies).

³⁷ See Marilyn Taylor Zarzeski, *Culture Clash?*, 117 ACCT. 70 (1996); Marilyn Taylor Zarzeski, *Spontaneous Harmonization Effects of Culture and Market Forces on Accounting Disclosure Practices*, 10 ACCT. HORIZONS 18 (1996).

continuously consolidating with American firms dominating the market.³⁸ This, in turn, tends to create a strong supply of U.S.-like disclosures. Such disclosure comports with the accounting practices with which these firms know how to comply and what they were educated to believe. We still lack proof that such disclosures are globally optimal and that the putative convergence trend is reaching its optimum.

B. *Comparative Corporate Governance*

Unlike the situation in securities regulation, the picture is different with regard to corporate law and corporate governance. Here, there has been relatively little (successful) activity toward institutionalized harmonization of corporate governance structures. Nevertheless, there is an exploding amount of academic literature on the subject.

Presently, the world exhibits an astonishing degree of diversity in corporate law and corporate governance structures, such as typical stockholding patterns and directors' affiliation. Some differences easily could be associated with the *level* of economic development—developing countries with small capital markets would tend to have less developed laws for governing capital formation and management. The *form* of economic development—namely, whether a country has a capitalist market economy or not—would have a similar influence. In this category one can find a large number of formerly communist countries and developing countries implementing market-oriented economic reforms. Finally, and most importantly, within the category of advanced market economies we still witness a very high degree of diversity. Considerable variation exists even among countries who share the same legal tradition, such as common law countries.³⁹

³⁸ This, admittedly, is by impression only.

³⁹ For non-U.S. common law countries, see Bernard S. Black & John C. Coffee, Jr., *Hail, Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997 (1994); F.H. Buckley, *The Canadian Keiretsu*, J. APPLIED CORP. FIN., Winter 1997, at 46; Betty M. Ho, *Restructuring the Boards of Directors of Public Companies in Hong Kong: Barking up the Wrong Tree*, 1 SING. J. INT'L & COMP. L. 507 (1997). Orderly documentation of international diversity in corporate governance is badly lacking. For an international survey of the connection between law and finance, see RAFAEL LA PORTA ET AL., LAW AND FINANCE (National Bureau of Econ. Research Working Paper No. 5661, 1996); see also Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997). Until recently, the comparative literature in English has concentrated on the United States, United Kingdom, Germany, and Japan and cannot be sampled here. For recent broader surveys, see COMPARATIVE CORPORATE GOVERNANCE: ESSAYS AND MATERIALS (Klaus J. Hopt & Eddy Wymeersch eds., 1997).

With respect to corporate law harmonization projects, the EU has been experimenting with such initiatives for some three decades now. However, the majority of these projects, particularly those that attempted to effect substantial reforms, proved stillborn while the remainder concerned only marginal issues. Those efforts have taken three forms: (1) harmonizing the company laws of member states; (2) developing a European Company (*Societas Europaea*) status; and (3) encouraging cross-border business combinations.⁴⁰ According to the Single European Market plan, the EU Commission abandoned its efforts to unify its member states' company laws and instead moved toward establishing a system of mutual recognition with minimum standards. These standards were promulgated with regard to rudimentary disclosures during incorporation, shareholder preemptive rights, equal voting rights (within the same class of shares), the content of annual financial statements, and the preservation of capital.⁴¹

Harmonization initiatives concerning the structure and control of publicly listed companies, takeover bid procedures, and employees rights have all failed. In particular, the most bitter battles were fought with respect to employees' rights. For example, the Draft Fifth Directive's⁴² two optional corporate structures require, among other (controversial) factors, the representation of employees on a company's board of directors. Despite numerous amendments, the Draft Fifth Directive encountered vehement opposition from certain member states, especially the United Kingdom, and was never adopted. In another failed attempt to empower employees, the EU Commission proposed that companies provide detailed information on its financial and business situation to its employees and allow them an opportunity to comment.⁴³ In

For recent comparative analyses in the political economy spirit, see THE SLOAN PROJECT ON CORPORATE GOVERNANCE AT COLUMBIA LAW SCHOOL, CORPORATE GOVERNANCE TODAY 629-738 (1998) (discussing corporate governance in England, Japan, Italy, France, and Germany).

⁴⁰ For thorough overviews of company law unification in the EU, see Terence L. Blackburn, *The Societas Europea: The Evolving European Corporation Statute*, 61 *FORDHAM L. REV.* 695 (1993); Terence L. Blackburn, *The Unification of Corporate Laws: The United States, The European Community and the Race to Laxity*, 3 *GEO. MASON INDEP. L. REV.* 1 (1994) [hereinafter Blackburn, *The Unification*]. See generally FRANK WOOLDRIDGE, *COMPANY LAW IN THE UNITED KINGDOM AND THE EUROPEAN COMMUNITY: ITS HARMONIZATION AND UNIFICATION* (1991).

⁴¹ See Blackburn, *The Unification*, *supra* note 40, at 698-99.

⁴² See Proposal for a Fifth Company Law Directive, 1983 O.J. (C 240) 2.

⁴³ See Commission Proposal for a Council Directive on Procedures for Informing and Consulting the Employees of Undertakings with Complex Structure, in Particular Transnational Undertakings, 1980 O.J. (C 297) 3.

May 1997 an expert panel concluded that the significant differences in national cultures foreclose the possibility of harmonization as originally envisaged. Consequently, there can be no single ideal system.⁴⁴

The second major harmonization project intended to create a "European Company," which would benefit from certain administrative and taxation advantages in business combination situations.⁴⁵ The entire union would recognize these European Companies, but the companies would be incorporated under and governed by the laws of particular member states. This proposal also attempted to include employee participation in the company's corporate governance structure. However, controversies between member states effectively blocked the proposal. In May 1997 the above-mentioned expert panel proposed alternative solutions to some of these problems but continued to enshrine a right of worker representation on the company's board of directors.⁴⁶ The future of these proposals seems unclear at best.

Other than in the EU, I am not aware of any similar concerted efforts in this area. The growing penetration of SEC rules under the Securities Act of 1933 and the Securities Exchange Act of 1934 ("Securities Acts") into the traditional field of corporate governance comes the closest, but it lacks the crucial element of agreement between players on the national level. Moreover, court decisions have established some limits on this process in the context of shareholder voting rights.⁴⁷ States' sovereignty over corporate governance issues was also underscored in the case of state anti-takeover statutes.⁴⁸

While the static picture of comparative corporate governance is quite clear in terms of the diversity it exhibits, there is some debate as to the dynamic picture, especially over the direction in which developments take place. Until the 1980s, American scholars tended to disregard foreign governance structures in their research. "[W]ith the American economy the world's leading economy, it was natural to associate most American institutions, such as a vibrant stock market and diffuse ownership of large firms, as

⁴⁴ See *Corporate Governance Update*, 5 CORP. GOVERNANCE: INT'L REV. 256 (1997).

⁴⁵ See Commission Proposal for a Council Regulation on the Statute for a European Company, 1989 O.J. (C 263) 41.

⁴⁶ See *Corporate Governance Update*, 6 CORP. GOVERNANCE: INT'L REV. 71 (1998).

⁴⁷ See *Business Roundtable v. SEC*, 905 F.2d 406, 410 (D.C. Cir. 1990) (vacating the SEC's one-share-one-vote Rule 19c-4).

⁴⁸ See *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 94 (1987) (validating state anti-takeover statutes).

both inevitable and efficient.”⁴⁹ Questions began to surface toward the end of the 1980s takeover era with the enactments of state anti-takeover statutes⁵⁰ and the one-share-one-vote affair.⁵¹ Suddenly American law began producing and preserving sub-optimal rules.

When the American economy went into recession during the early 1990s, scholars observed the then soaring economies of Japan and Germany and examined these countries' corporate governance structures with a view to adopt some of their successful features. In doing so, they put aside the “evolutionary” view of corporate governance, namely, that American corporate governance is at the apex of an evolutionary process in which the most fit—the most efficient in Law and Economics terminology—are also the most successful. Today, when countries in Eastern and Central Europe, as well as other developing countries, are establishing market based economies, they look at existing models as aides in designing their corporate governance regimes. With the U.S. market returning to its growth path and the Asian economies facing daunting difficulties, lessons can be taken from the former by the latter.⁵²

A related development is the growing prominence of political economy analyses within the mainstream of economic analysis of corporate law. This trend began with William Cary in 1974⁵³ and continues in the works of Mark Roe⁵⁴ and Roberta Romano.⁵⁵

⁴⁹ Mark Roe, *Comparative Corporate Governance*, in 1 NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 339-46 (Peter Newman ed., 1998).

⁵⁰ See generally FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 212-228 (1991); ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 52-85 (1993).

⁵¹ See *infra* text accompanying note 91.

⁵² See Ronald J. Gilson, *Reflections in a Distant Mirror: Japanese Corporate Governance Through American Eyes*, 1998 COLUM. BUS. L. REV. 203 [hereinafter Gilson, *Reflections in a Distant Mirror*].

⁵³ See generally William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974).

⁵⁴ MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* (1994); Mark J. Roe, *Backlash*, 98 COLUM. L. REV. 217 (1998); Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641 (1996) [hereinafter Roe, *Chaos and Evolution*]; Mark J. Roe, *German Codetermination and German Securities Markets*, 1998 COLUM. BUS. L. REV. 167 [hereinafter Roe, *German Codetermination*]; Mark J. Roe, *German “Populism” and the Large Public Corporation*, 14 INT'L REV. L. & ECON. 187 (1994). For a political account of the German system, see Katharina Pistor, *Co-determination in Germany: A Socio-Political Model with Governance Externalities*, Paper presented at the Conference, “Employees and Corporate Governance” (Nov. 22, 1996) (manuscript on file with author).

⁵⁵ ROMANO, *supra* note 50; Roberta Romano, *The Political Economy of Takeover*

This development soon gave rise to comparative corporate governance.

“In the last few years, comparative corporate governance—German and Japanese corporate governance in particular—has been a hot topic in U.S. law reviews and conferences.”⁵⁶ This interest came hand-in-hand with the growing prominence of institutional investors, such as pension funds and mutual funds. If the paradigmatic shareholding structure of the past was widely dispersed, thus creating severe collection action problems, the rise of institutional investors brought us closer to the large blockholders of other countries, such as the German *hausbank* and the Japanese main bank. While shareholder activism rose in visibility, scholars debated whether it could become as significant as it was (portrayed to be) in other countries.⁵⁷ Empirical evidence in this regard is mixed.⁵⁸

Statutes, 73 VA. L. REV. 111 (1987).

⁵⁶ Edward B. Rock, *America's Shifting Fascination with Comparative Corporate Governance*, 74 WASH. U. L.Q. 367, 367 (1996) (footnote omitted). The omitted footnote includes an extensive list of law review articles in this spirit that is nevertheless far from exhaustive. For additional references, see Roe, *Comparative Corporate Governance*, *supra* note 49, at 345-46.

⁵⁷ See Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992); Bernard S. Black, *The Value of Institutional Investor Monitoring: The Empirical Evidence*, 39 UCLA L. REV. 895 (1992); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991) [hereinafter Coffee, *Liquidity Versus Control*]; Jill E. Fisch, *Relationship Investing: Will It Happen? Will It Work?*, 55 OHIO ST. L.J. 1009 (1994); Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445 (1991); Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993).

⁵⁸ See TIM C. OPLER & JONATHAN SOKOBIN, DOES COORDINATED INSTITUTIONAL SHAREHOLDER ACTIVISM WORK? AN ANALYSIS OF THE ACTIVITIES OF THE COUNCIL OF INSTITUTIONAL INVESTORS (Charles A. Dice Ctr. for Research in Fin. Econs. Working Paper No. 97-2, 1997) (finding evidence consistent with the view that coordinated institutional activism creates shareholder wealth); Bernard S. Black, *Shareholder Activism and Corporate Governance in the United States*, in 3 NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW, *supra* note 49, at 459-65; Steven Nesbit, *Long-term Rewards from Corporate Governance*, 7 J. APPLIED CORP. FIN. 31 (1994) (finding a cumulative increase averaging 41.3% for each company over a five-year period subsequent to CalPERS's intervention, following a period of relative under-performance); Willard T. Carlton et al., *The Influence of Institutions on Corporate Governance Through Private Negotiations: Evidence from TIAA-CERF (1997)* (unpublished manuscript, on file with author) (presenting evidence that most of the voice exercised by institutional investors is effective but invisible); Catherine M. Daily et al., *Institutional Investor Activism: Follow the Leader?* (1996) (unpublished manuscript, on file with author) (finding no evidence suggesting that firms targeted by an activist fund were characterized by higher performance); see also Richard H. Koppes & Maureen L. Reilly, *An Ounce of Prevention: Meeting*

Then came path dependence. The point is relatively simple. Those who produce corporate law—legislatures, courts, and entrepreneurs—face similar problems, such as agency problems⁵⁹ and the impossibility of complete contingent contracts.⁶⁰ The corporate law producers, however, may solve these problems in different ways.

Various factors may account for such diversity. Included among these factors are the economic and financial environments in each country, such as the depth and liquidity of the stock market,⁶¹ industrial organization,⁶² and politics, as part of the political economy perspective on the production of corporate laws. Culture is yet another factor, although its effects are ambiguous.⁶³ Lastly, there is the view anchored in economic models, that events may happen simply due to chance or historical accident. Once in place, such systems may sustain and even proliferate due to increasing returns, network externalities, or tactical maneuvering.⁶⁴

In a related branch of the literature, scholars began designing corporate laws on a clean slate. These ideas mainly were conceived for export to developing countries and to former Communist countries that were establishing market economies. These countries often lack the required legal infrastructure, both in legislation and a functioning court system. They also lack historical paths, such as that of the United States, Japan, or Germany; and they may not have certain cultural patterns or habits which sup-

the Fiduciary Duty to Monitor an Index Fund Through Relationship Investing, 20 CORP. L. 414 (1995).

⁵⁹ See Roe, *Comparative Corporate Governance*, *supra* note 49.

⁶⁰ See Luigi Zingales, *Corporate Governance*, in 1 NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW, *supra* note 49, 497-503.

⁶¹ See, e.g., Coffee, *Liquidity Versus Control*, *supra* note 57; Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets*, 47 J. FIN. ECON. 243 (1998); Roe, *German Codetermination*, *supra* note 54.

⁶² See, e.g., Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871 (1993). See generally Ronald Gilson, *Corporate Governance and Economic Efficiency: When Do Institutions Matter?*, 74 WASH. U. L.Q. 327 (1996).

⁶³ See, e.g., Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 51 STAN. L. REV. (forthcoming 1998); Ronald J. Mann & Curtis J. Milhaupt, *Foreword*, 74 WASH. U. L.Q. 317, 323 (1996) (describing how path dependence assists in "unpacking the black box of culture").

⁶⁴ See, e.g., Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347 (1996). These ideas first appeared in the domestic United States context. See Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995); see also Ian Ayres, *Supply-Side Inefficiencies in Corporate Charter Competition: Lessons from Patents, Yachting, and Bluebooks*, 43 U. KAN. L. REV. 541 (1995).

port law obedience. To accommodate or overcome these obstacles, corporate law and corporate governance structures may need to be tailored differently from those in advanced market economies.⁶⁵

By necessity, any argument that locates the source of corporate governance structures in political economy accepts international diversity as a descriptive as well as a normative matter, whether explicitly or implicitly. If corporate governance and corporate law in general are indeed shaped by national political idiosyncrasies, then descriptively, they are likely to be different and, normatively they may need to remain different, notwithstanding possible improvements available through the importation of certain foreign features. As an empirical matter, it seems that generally, national corporate governance structures tend to be quite stable and resist fundamental reforms.

The lesson from this brief overview is that academia “legitimized” and sometimes even glorified diversity in corporate governance structures. Almost a century and a half after Charles Darwin,⁶⁶ corporate law scholars acknowledged that there can be many outcomes to evolutionary processes; that selection of the fittest does not necessarily mean selection of one fit.⁶⁷ Moreover, according to current views, even in advanced market economies diversity is likely to remain intact for a long time and, although not always, for good reasons.⁶⁸ Although one can find some hyperbolic views that foresee the imminent arrival of global convergence,⁶⁹ a more plausible conjecture is that corporate governance systems

⁶⁵ For excellent discussions, see MASAHIKO AOKI & HUNG-KI KIM, CORPORATE GOVERNANCE IN TRANSITIONAL ECONOMIES: INSIDER CONTROL AND THE ROLE OF BANKS (1995), and Bernard S. Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 911 (1996).

⁶⁶ See CHARLES DARWIN, ON THE ORIGIN OF SPECIES (1859).

⁶⁷ See, e.g., Ronald J. Gilson, Globalizing Corporate Governance: Convergence of Form or Function 9-10 (Dec. 5, 1997) (unpublished manuscript, on file with author) (paper presented at the conference “Are Corporate Governance Systems Converging?” at Columbia Law School) (citing evolutionary theorist Stephen J. Gould) [hereinafter Gilson, Globalizing Corporate Governance]. See generally Roe, *Chaos and Evolution*, *supra* note 54.

⁶⁸ See Bebchuk & Roe, *supra* note 63; see also THEODOR BAUMS, CORPORATE GOVERNANCE SYSTEMS IN EUROPE—DIFFERENCES AND TENDENCIES OF CONVERGENCE (Univ. of Osnabrück Working Paper No. 37, 1996).

⁶⁹ See Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law (Dec. 5, 1997) (unpublished manuscript, on file with author) (paper presented at the conference “Are Corporate Governance Systems Converging?” at Columbia Law School). Indeed, the collapse of the South Korean economy may have taken away a lot of the charm from its *chaebol* and the ongoing difficulties in Japan clearly cast a shadow on its *keiretsu*. See Gilson, *Reflections in a Distant Mirror*, *supra* note 52.

could converge functionally while continuing to maintain their diverse form.⁷⁰

II. THE RELATIONS BETWEEN CORPORATE LAW AND SECURITIES REGULATION

An underlying premise of any regulatory intervention is that it requires justification. The particular justifications for intervention and the exact manners in which the government should undertake it vary greatly. Inasmuch as economic activity is at issue, one major factor is the economic conditions in the market absent regulatory intervention, such as whether there are externalities or information asymmetries, which cannot be countered by market participants or the existence of dominant actors (monopolies or cartels). However, political considerations always override the economic ones. Depending on their political agendas, governments could abstain from intervention notwithstanding market failures that happen to benefit favorable interest groups. Governments could also take active interventionist measures to counter market-driven outcomes, even in the absence of demonstrable market failures, for redistributive purposes or for the promotion of other social goals.⁷¹

The standard justification invoked for securities regulation is investor protection. Volumes have been written on the subject with regard to the Securities Acts alone. But over six decades since the enactment of the Securities Acts, the debate over their "real" or "original" purpose has not abated.⁷² I do not wish to add yet more paper to this pile. However, it would be fair to say in a very small nutshell that the Securities Acts were intended to restructure the informational distribution among and between participants in the securities market, compared with the pre-existing regime that was based on the states' corporate and Blue Sky laws.

Although revolutionary in many respects, the *nouvelle regime* brought about by the Securities Acts did not altogether displace the *ancien regime* provided for by state corporate laws. Rather, it

⁷⁰ See Gilson, Globalizing Corporate Governance, *supra* note 67.

⁷¹ The statements in the text are related to the public/private distinction discussed *infra* Part II.B, in that under certain views the original conditions for market operation are also public, in other words, the outcome of political considerations. On the (un)desirability of correction through legal rules as opposed to redistribution through the tax system, see Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994).

⁷² For a recent treatment of this basic question and references, see Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047 (1995).

supplemented it with new rules and administrative oversight. This Part explores the relations between the two regimes with a view toward establishing them as a normative basis for assessing each regime's performance or efficiency. The analysis is conducted in a rather critical fashion and from different perspectives—all in an effort to test how real and meaningful is the distinction between the two bodies of law.

A. *Tenuous Distinctions*

Loss and Seligman trace the historical origins of the disclosure and anti-fraud components of modern securities regulation in the United States to the English Companies Act of 1844.⁷³ In that Act, Parliament enacted the first modern prospectus requirement.⁷⁴ A later version of that Act, the English Companies Act of 1929⁷⁵ ("1929 Act"), served as the foundation for Felix Frankfurter and his team in drafting the Securities Act of 1933.⁷⁶ Importantly, the 1929 Act was the source of two major components of the current American securities regulation regime, the concept of full disclosure⁷⁷ and the civil liabilities of the registrant, its officers, directors, and experts.⁷⁸

The importance of the legislative history goes beyond the mere anecdotal interest. After all, the 1929 Act's drafters were not the only ones to perceive the value of full disclosure; Frankfurter's team was indeed implementing President Roosevelt's policy, which championed full disclosure as the preferable remedy to the malaise of American financial markets at the time.⁷⁹ Roosevelt of-

⁷³ An Act for the Registration, Incorporation, and Regulation of Joint Stock Companies, 1844, 7 & 8 Vict., ch. 110 (Eng.).

⁷⁴ See 1 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 6 (3d ed. 1989). Interestingly, the need to regulate market professionals was perceived as early as 1285 A.D. See *id.* at 3.

⁷⁵ Companies Act, 1929, 19 & 20 Geo. 5, ch. 23 (Eng.).

⁷⁶ See 1 LOSS & SELIGMAN, *SECURITIES REGULATION*, *supra* note 74, at 180; JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET* 57 (Rev. ed. 1995); James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 34 (1959); Patrick Moyer, *The Regulation of Corporate by Securities Regulators: A Comparison of Ontario and the United States*, 55 U. TORONTO FAC. L. REV. 43, 46 (1997) ("Securities law in Canada evolved from the disclosure requirements imposed by English corporate law in the late 19th century. Securities regulation remained exclusively part of corporate law until Manitoba adopted the *Sale of Shares Act* in 1912.").

⁷⁷ See Landis, *supra* note 76, at 40; 1 LOSS & SELIGMAN, *SECURITIES REGULATION*, *supra* note 74, at 180.

⁷⁸ See Landis, *supra* note 76, at 35.

⁷⁹ See SELIGMAN, *supra* note 76, at 41-42.

ten referred⁸⁰ to Louis Brandeis's famous maxim: "Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."⁸¹ The significant point here is that the very principle that constitutes the central pillar of the securities regulation regime in one country was located, at virtually the same point in time, at the heart of another country's corporate law.

In a number of important cases, the courts were called to distinguish between corporate law and securities regulation. This happened when the outer boundaries of the Securities Acts needed delineation as an instrumental step towards discerning the degree to which they would preempt state corporate law. In *Santa Fe Industries v. Green*,⁸² the United States Supreme Court examined the extent to which the Securities Acts' anti-fraud provisions can be used for creating a federal law of fiduciary duties. The Court concluded that the language of section 10(b) of the Exchange Act gave no indication of an intention to prohibit any conduct that did not involve manipulation or deception.⁸³ Thus, an unfair transaction, without more, could not create liability under the Securities Acts and allow shareholders to recover under the Acts' remedies. The Court acknowledged that allowing such actions would federalize certain aspects of corporate law. Thus, the Court specifically declined to do so.⁸⁴ The Court later applied the rule and its logic to cases concerning fraud in proxy solicitations.⁸⁵

In *Amanda Acquisition Corp. v. Universal Foods Corp.*,⁸⁶ the United States Court of Appeals for the Seventh Circuit decided whether Wisconsin's "third generation" anti-takeover statute could stand in light of the federal takeover regulation regime un-

⁸⁰ *See id.*

⁸¹ LOUIS D. BRANDEIS, *OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT* 92 (1914).

⁸² 430 U.S. 462 (1977).

⁸³ *See id.* at 473.

⁸⁴ The Court stated:

[T]his extension of the federal securities laws would overlap and quite possibly interfere with state corporate law. Federal courts applying a "federal fiduciary principle" under Rule 10b-5 could be expected to depart from state fiduciary standards at least to the extent necessary to ensure uniformity within the federal system. Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden.

Id. at 479 (footnotes omitted).

⁸⁵ *See Schreiber v. Burlington N. Inc.*, 472 U.S. 1 (1985).

⁸⁶ 877 F.2d 496 (7th Cir. 1989).

der the Williams Act.⁸⁷ In upholding the state statute, Judge Easterbrook distinguished between “process,” which is the realm of the Securities Acts, and “substance,” the realm of states’ corporate laws.⁸⁸ This distinction, however, is far from clear, and the court did not elaborate on the implementation of the distinction in the specific takeover context or in the corporate law-securities law context in general.⁸⁹

The issue resurfaced when the SEC adopted Rule 19c-4⁹⁰ in an effort to prevent listed companies from diluting the voting rights of certain classes of stocks through dual class recapitalization.⁹¹ The United States Court of Appeals for the District of Columbia Circuit annulled the Rule, however, in an action brought by the Business Roundtable.⁹² The court stated that the SEC’s general authority to regulate corporate voting in the public interest did not permit it to regulate corporate law.⁹³ The court, however, did not provide a principled distinction between regulating corporate voting and regulating corporate law.

While the cases may provide specific rules in ad-hoc situations, it is difficult to extract a generalized rule regarding how to distinguish between the provinces of corporate law and securities law and the respective jurisdictional issues. The fact that the question repeatedly arises indicates that the answer is not self-evident. Thus, it appears wrong to conclude that a sufficient analytical effort could produce a clear separation of the fields.⁹⁴

The difficulties faced by the courts are understandable. From

⁸⁷ 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1994).

⁸⁸ See *Amanda Acquisition*, 877 F.2d at 503.

⁸⁹ Indeed, the court gives examples for cases where the distinction would be difficult to implement. See *id.*

⁹⁰ 17 C.F.R. § 240.19c-4 (1998).

⁹¹ See, e.g., Marcel Kahan, *Some Problems with Stock Exchange-Based Securities Regulation*, 83 VA. L. REV. 1509 (1997); see also George W. Dent, Jr., *Dual Class Capitalization: A Reply to Professor Seligman*, 54 GEO. WASH. L. REV. 725 (1986); Daniel R. Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. CHI. L. REV. 119 (1987); Ronald J. Gilson, *Evaluating Dual Class Common Stock: The Relevance of Substitutes*, 73 VA. L. REV. 807 (1987); Gregg A. Jarrell & Annette B. Poulsen, *Dual Class Recapitalizations of Antitakeover Mechanisms: The Recent Evidence*, 20 J. FIN. ECON. 129 (1988) (presenting empirical data); Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687 (1986).

⁹² See *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990).

⁹³ See *id.* at 414.

⁹⁴ Cf. Moyer, *supra* note 76, at 48 (“In the United States, historical accident and judicial statutory construction have produced a clear separation of corporate law and securities law.”). It thus seems wrong on Moyer’s part to decry the fact that “the boundary between the two [fields] has become blurred in Canadian law.” *Id.* at 46.

a substantive point of view, the distinction between corporate law and securities regulation is extremely tenuous. The issues that the two fields of law cover overlap considerably. More accurately, the current United States federal regime of securities regulation regulates aspects of corporate life that are much broader than just the issuing and trading of new securities—the problems that triggered the enactment of the Securities Acts. In effect, the regime attempts to regulate *every* context in which communication may take place between shareholders (or potential shareholders) and the company, its management, certain third parties, and other shareholders.

Thus, federal securities law regulates the core of the corporate governance system—the voting mechanism—through the proxy rules.⁹⁵ “Indeed, since voting rights are so fundamental to the process of corporate governance, there are few areas of securities regulation where both the interplay and tension between federal securities law and state corporation law are as vivid.”⁹⁶ Federal securities law also regulates all of the major forms of fundamental changes in corporate structure, such as going-private transactions⁹⁷ and hostile takeovers.⁹⁸ Finally, federal securities law directly regulates insider trading, perhaps the most contentious issue in the relationship between regular shareholders and company insiders.⁹⁹

Considering the way that legal academia classify and teach securities, corporate law provides a telling illustration of the overlap between these subjects. As a non-scientific experiment, some of the prominent textbooks and casebooks on corporations¹⁰⁰ and on

⁹⁵ Securities Exchange Act of 1934 § 13, 15 U.S.C. § 78m(a) (1994).

⁹⁶ JAMES D. COX ET AL., *SECURITIES REGULATION: CASES AND MATERIALS* 883 (4th ed. 1991).

⁹⁷ See section 13e of the Exchange Act and SEC Rule 13e thereunder. 17 C.F.R. § 240.13e-1 (1998).

⁹⁸ See the Williams Act, as embodied in Sections 14(d) and 14(e) of the Exchange Act and rules thereunder. Section 13(d) of the Exchange Act and rules thereunder should also be considered part of this regulatory scheme as an “early warning system.” COX ET AL., *supra* note 96, at 929.

⁹⁹ Section 16 of the Exchange Act regulates insider trading, but decision law of Rule 10b-5 is the primary source of the regulatory regime.

¹⁰⁰ See WILLIAM L. CARY & MELVIN ARON EISENBERG, *CASES AND MATERIALS ON CORPORATIONS* (7th ed. 1995); JESSE H. CHOPER ET AL., *CASES AND MATERIALS ON CORPORATIONS* (4th ed. 1995); ROBERT CHARLES CLARK, *CORPORATE LAW* (1986); EASTERBROOK & FISCHER, *supra* note 50; JOEL SELIGMAN, *CORPORATIONS: CASES AND MATERIALS* (1995) [hereinafter SELIGMAN, *CORPORATIONS*]; LARRY D. SODERQUIST, *CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES, MATERIALS, PROBLEMS* (4th ed. 1997); LEWIS D. SOLOMON & ALAN R. PALMITER, *CORPORATIONS: EXAMPLES AND EXPLANATIONS* (2d ed. 1994).

securities regulation¹⁰¹ were briefly examined. In each source, I checked whether its authors provide substantial discussion and analysis of six issues: three fundamental topics in securities regulation—disclosure, fraud, and insider trading—and three major issues of corporate law that are regulated under the Securities Acts—the proxy system, tender offers, and organic changes.

The results are illuminating. It goes without saying that all the books on corporate law cover all the corporate law topics mentioned above, and the same applies to the securities regulation sources. More interesting is the fact that all seven of the corporate law books extensively discuss insider trading, six of the books discuss the Securities Acts disclosure regime,¹⁰² and four cover the anti-fraud regime of the Securities Acts.¹⁰³ While all five of the books on securities regulation discuss the regulation of tender offers, three mention the proxy system,¹⁰⁴ and three (mostly different from the former three) deal with organic changes.¹⁰⁵

This survey reflects an interesting reality: Contemporary legal scholars in the United States believe that it is almost impossible to analyze corporate law without extensively covering securities regulation and vice versa. Such overlap exists even where the same authors have written on both subjects.¹⁰⁶ As a corollary, it is difficult to design and teach a course on one field without far-reaching intrusions into the other.¹⁰⁷

The invasion of federal securities law into the traditional areas of corporate law reaches beyond regulating tender offers and insider trading. According to Dean Seligman, federal securities law

¹⁰¹ See COX ET AL., *supra* note 96; THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* (3d ed. 1996); RICHARD W. JENNINGS, *SECURITIES REGULATION: CASES AND MATERIALS* (7th ed. 1992); LOUIS LOSS & JOEL SELIGMAN, *FUNDAMENTALS OF SECURITIES REGULATION* (3d ed. 1995); DAVID L. RATNER, *SECURITIES REGULATION: CASES AND MATERIALS* (4th ed. 1997) [hereinafter RATNER, *SECURITIES REGULATION*].

¹⁰² *But see* SODERQUIST, *supra* note 100.

¹⁰³ See CARY & EISENBERG, *supra* note 50 (failing to provide a discussion); CLARK, *supra* note 50 (same); EASTERBROOK & FISCHER, *supra* note 50 (same). Note that the latter two books are purposefully selective in their choice of topics. See CLARK, *supra* note 100, at xxi-xxiv; EASTERBROOK & FISCHER, *supra* note 50, at viii.

¹⁰⁴ See HAZEN, *supra* note 101 (failing to provide a discussion); JENNINGS, *supra* note 101 (same); RATNER, *SECURITIES REGULATION*, *supra* note 101 (same).

¹⁰⁵ See JENNINGS, *supra* note 101 (failing to provide a discussion); LOSS & SELIGMAN, *FUNDAMENTALS OF SECURITIES REGULATION*, *supra* note 101 (same).

¹⁰⁶ See, e.g., CHOPER, *supra* note 100 (co-authored by Coffee); JENNINGS, *supra* note 101 (also co-authored by Coffee); SELIGMAN, *CORPORATIONS*, *supra* note 100.

¹⁰⁷ Exigencies of time in actual courses would usually dictate some arbitrary division, but the text indicates how arbitrary such a split would be and what the authors perceive to be the ideal course structure.

has become "the new corporate law."¹⁰⁸ In particular, he argues that through disclosure standards and fraud cases federal securities law has made significant inroads into state corporate law by augmenting its fiduciary duty concepts. Dean Seligman documents a decline in state law standards regarding the duty of loyalty and the duty of care and argues that securities law, through its emphasis on preventive action and deterrence, has profoundly changed the content of these duties. As a consequence, that new corporate law has significant implications for the process of corporate governance.¹⁰⁹ Other scholars also acknowledge the importance of the mandatory disclosure regime under the Securities Act to the actual management of public corporations.¹¹⁰

The recent history of corporate law in the United States, at least by some accounts, is of supplementing corporate law with securities regulation. Securities law, however, will not completely supplant state corporate law anytime soon. Indeed, even according to proponents of federal preemption of state corporate law by enacting minimum standards,¹¹¹ securities law is not seen as the major vehicle for such intervention. Despite their overlap in scope, there is still a basic sense in which the two bodies of law are materially distinct. Inasmuch as the two fields relate to the same social and business activities, perhaps it would be better to depict them as two layers having considerable overlap between them while being definitely distinct from one another.

The discussion thus far reflects a deeper reality, namely, that the two fields are in fact highly integrated, as it is hard to imagine a good description of the law of business corporation while omitting one of them. Moreover, securities regulation and corporate law are interdependent in that one of them could remedy deficiencies

¹⁰⁸ Seligman, *Accounting*, *supra* note 28; Joel Seligman, *The New Corporate Law*, 59 BROOK. L. REV. 1, 2 (1993) [hereinafter Seligman, *New Corporate Law*]; cf. William T. Quillen, *The Federal-State Corporate Law Relationship—A Response to Professor Seligman's Call for Federal Preemption of State Corporate Fiduciary Law*, 59 BROOK. L. REV. 107 (1993).

¹⁰⁹ See Seligman, *New Corporate Law*, *supra* note 108, at 3.

¹¹⁰ See Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 BROOK. L. REV. 763 (1995); Lowenstein, *supra* note 28.

¹¹¹ Early calls in this spirit include RALPH NADER ET AL., CONSTITUTIONALIZING THE CORPORATION: THE CASE FOR THE FEDERAL CHARTERING OF GIANT CORPORATIONS (1976); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974); see also Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992) (offering a systematic analysis of the circumstances that may warrant federal intervention); Joel Seligman, *The Case for Federal Minimum Corporate Law Standards*, 49 MD. L. REV. 947 (1990); Seligman, *New Corporate Law*, *supra* note 108, at 60-62.

in the other.

This Article advances that a conceptual delineation of the distinction between securities regulation and corporate law should relate to property rights in information. The main and most prominent feature of the securities regulation regime in the United States is that it is a regime of information.¹¹² It is a legal framework for redistributing information (indeed, property rights in information¹¹³) from inner circles in the corporation—management and controlling shareholders—to the perimeter—such as shareholders, competitors, and other market participants.¹¹⁴ In enacting the Securities Acts, Congress perceived investors as being harmed from the lack of information and wished to remedy that situation. This gave rise to disclosure duties and stricter prohibitions on fraud and certain forms of informed trading in securities transactions. Later amendments, such as the integrated reporting system, shelf registration, and amendments to insider trading law, were also parts of this regime. To a certain extent, the third pillar of securities regulation, regulation of intermediaries and markets, was also concerned with this issue (with the establishment of the Intermarket Trading System (“ITS”).¹¹⁵

Issuance of new securities and secondary market transactions were the most straightforward contexts for implementing the new informational regime and preempting state company law. The ambit of the Securities Acts spreads further to other parts of corporate law—the proxy system, tender offers and organic changes—in so far as they involve communication with or between share-

¹¹² Cf. CLARK, *supra* note 100, at 366 (federal regulation of the proxy system focuses on “assuring that public investors have true and adequate *information* before they exercise their right to vote”). Dean Clark, however, generally argues that federal regulation is limited to issues of process. *Id.* This is part of a general debate over the proper reach of the SEC’s authority to regulate corporate law. I do not wish to enter this debate although the question is very important for practical purposes. As I argue in detail in this Part, a bright line distinction *separating* the two legal fields cannot be offered, thus making it a formidable task to delineate the authority of the regulatory agency.

¹¹³ See JONATHAN R. MACEY, INSIDER TRADING: ECONOMICS, POLITICS AND POLICY 1-6 (1991); Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059 (1990).

¹¹⁴ Other strategies for securities regulation, such as merit regulation, are beyond the scope of this discussion.

¹¹⁵ The ITS interconnects the national and regional stock exchanges through data links, features a consolidated ticker tape, and allows broker-dealers to view bid and ask prices and effect transactions from remote sites. It thus gives new content to the broker-dealer’s duty to the client to effect transactions at the best price. See 5 LOSS & SELIGMAN, SECURITIES REGULATION, *supra* note 74, at 2564-67 (describing the ITS); Yakov Amihud & Haim Mendelson, *A New Approach to the Regulation of Trading Across Securities Markets*, 71 N.Y.U. L. REV. 1411, 1414 (1996) (same).

holders (and therefore, informational problems).¹¹⁶ Symmetrically, the SEC has ceded jurisdictional ground in cases where it realized that its information regime in fact impedes the efficient working of the corporate governance system. The 1992 reform to the proxy rules exemplifies this.¹¹⁷

Arguably, the boundaries of the information regime under the securities laws also delineate the line distinguishing between securities law and company law or corporate governance. Inasmuch as information about the corporation is concerned, company law may have a say, but securities law usually has the final word. The reason might be that information is a public good; once an information item is disclosed, it is impossible to exclude others from using it, and there is no rivalry in its use. In other words, information cannot be physically used up, although its economic value may have a short life-span. Therefore, public or government intervention may be warranted and justifiable.

B. *The Dual Public/Private Character of Securities Law*

Given the interdependence between securities regulation and corporate law, one may wonder, notwithstanding the above discussion, why a universal pattern of securities regulation is springing out from the traditional corpus of corporate law and becoming an independent field. In the particular case of the United States, there was a perceived need for intervention at the federal government level while company law remained in the several states' jurisdiction. But securities laws have been and still are promulgated at the state level. Moreover, the separation between securities regulation and corporate law can be found in unitary countries, such as the United Kingdom, and at the sub-national level in federal countries, such as Canada.

This Part argues that securities regulation and corporate law differ in their basic character as public versus private law, respectively. Although seemingly simple at first glance, this statement is quite problematic. First, the public/private dichotomy in general is subject to strong critiques in the United States. Second, the classification of corporate law in itself as "public" or "private" has been

¹¹⁶ In addition to informational problems, the above mentioned issues exhibit various additional problems. For example, the regulation of tender offers under the Williams Act addresses more than just informational asymmetry and provides more than just information. For an overview, see CHOPER ET AL., *supra* note 100, at 887-1075.

¹¹⁷ See Exchange Act Release No. 34-31326, 52 SEC Docket (CCH) 2028 (Oct. 16, 1992). For further discussion, see *infra* part III.A.1.

unstable over time and similar changes may be discernible with regard to the younger field of securities regulation. The distinction, however, survives the jurisprudential challenge, if not at the conceptual level, then at least for practical purposes of analyzing diversity and cooperation in international securities regulation.

1. The Public Law/Private Law Distinction—The European Perspective

It is methodologically easier to begin with the continental European¹¹⁸ perception of the public/private distinction. The distinction between public law and private law seems to many continental European lawyers to be fundamental, necessary, and, on the whole, evident. Although the distinction is often attacked, the average continental lawyer *knows* that public law and private law are essentially different.¹¹⁹ The distinction thus has been dubbed “the mighty cleavage,”¹²⁰ a “great dichotomy,”¹²¹ and the “*summa divisio*.”¹²² It dates from antiquity, with its historical roots tracing back to the very early sources of Roman law,¹²³ and is prevalent today in all Civil Law systems.¹²⁴

European legal doctrine divides all law into private law and public law. Public law is the body of law that governs the relationships to which the state, in whatever capacity and shape, is a party. Private law, in contrast, applies to relationships between private persons, including legal entities, such as corporations.¹²⁵ Thus, public law is said to involve vertical relationships while private law concerns horizontal ones.

The ever-increasing expansion of administrative law, caused

¹¹⁸ The distinction is part of the basic jurisprudence of all the countries that belong to the civil law family of which continental European countries are the prominent examples.

¹¹⁹ See René David, *Introduction to 2 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW* 3, 10 (René David ed., 1971) (“[I]n the eyes of Romano-Germanic lawyers recognition of a distinction between public and private law is natural, just, and necessary.”); John Henry Merryman, *The Public Law-Private Law Distinction in European and American Law*, 17 J. PUB. L. 3, 3 (1968); see also RUDOLF B. SCHLESINGER, *COMPARATIVE LAW* 300 (5th ed. 1988) (“In a civilian mind, all law is automatically divided into private law and public law.”).

¹²⁰ Merryman, *supra* note 119, at 3 (citing T. HOLLAND, *THE ELEMENTS OF JURISPRUDENCE* (13th ed. 1917)).

¹²¹ SCHLESINGER, *supra* note 119, at 299.

¹²² Charles Szladits, *The Civil Law System*, in 2 *INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW*, *supra* note 119, at 15.

¹²³ The distinction is said to have been recognized by Ulpian and reflected in Justinian’s Digest. See SCHLESINGER, *supra* note 119, at 300; Szladits, *supra* note 122, at 15.

¹²⁴ See Szladits, *supra* note 122, at 20.

¹²⁵ See *id.* at 56.

by increased governmental interference in all spheres of social activity, led to the multiplication of encroachments upon the private law sphere. A new branch of law, a sub-part of administrative law, called "economic law," thus was defined. This resulted in a situation where the public/private distinction, although still effective in practice, became blurred by the interpenetration of public law and private law.¹²⁶

2. The Public/Private Distinction—The American View(s)

According to the great comparativist, René David, the distinction between public law and private law in common law countries is not rejected (as in socialist doctrine), it is simply unknown.¹²⁷ In English law, the distinction is not felt at all, having been traditionally denied by English practicing lawyers. Unlike continental Europe, there are no special courts for public law questions, only a few rules and remedies special to public law, and almost no distinctive attitude of mind.¹²⁸

Although the United States clearly exhibits the basic characteristics of a common law system, a related dichotomy—the public/private distinction—continues to gain much importance there. The discussion focuses on the validity of classifying social phenomena as public or private instead of on a classification of their governing legal fields.¹²⁹ In the eighteenth century, most American lawyers did not assume that all political and economic actors should be classified either as private parties or as public officials.¹³⁰ Instead, they recognized that a variety of institutions and organizations, including business corporations, most accurately were described as partly private and partly public in character.

In the nineteenth century, lawyers began to find increasingly problematic the fact that these organizations exercised special powers and privileges usually associated with governments, such as the powers of taxation and eminent domain. A movement has begun to separate the public and private "spheres," driven to a large

¹²⁶ See *id.* at 48, 75; see also Merryman, *supra* note 119, at 14-18. See generally FRANZ WIEACKER, A HISTORY OF PRIVATE LAW IN EUROPE (Tony Weir trans., 1995).

¹²⁷ See David, *supra* note 119, at 12.

¹²⁸ See Tony Weir, *The Common Law System*, in 2 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, *supra* note 119, at 77, 94-95.

¹²⁹ Cf. Randy E. Barnett, *Foreword: Four Senses of the Public Law-Private Law Distinction*, 9 HARV. J.L. & PUB. POL'Y 267 (1986).

¹³⁰ For the purpose of briefly recounting the history of the public/private distinction, the text draws liberally on AMERICAN LEGAL REALISM 98-129 (William W. Fisher et al. eds., 1993), and Morton J. Horwitz, *The History of the Public/Private Distinction*, 130 U. PA. L. REV. 1423 (1982).

extent by the ideology of classical liberalism. In this context, there was a "virtual obsession"¹³¹ on behalf of orthodox judges and jurists to create a legal science that would sharply separate law from politics. Just as nineteenth century political economy elevated the market to the status of the paramount institution for distributing rewards on a supposedly neutral and apolitical basis, so too private law came to be understood as a neutral system for facilitating voluntary market transactions and vindicating injuries to private rights.¹³² Towards the end of that century, a more formal and systematic distinction between public and private law began to be articulated.¹³³

The first half of the twentieth century saw the decline of the public/private distinction in the United States as a result of relentless attacks by the Legal Realist Movement. Morris Cohen argued that because the state enforced both property rights and contract rights, these rights were better conceived as delegated public powers, thus giving them as much of a public character as a private one.¹³⁴ Robert Hale argued that because respect to private property is backed by the government's use of force, and property determines the distribution of income, the free private market really is an outcome of public coercion.¹³⁵ This line of argument had an important political role in vindicating state intervention in the working of private markets and social reform in general, particularly during the New Deal and afterwards.

The distinction, however, refuses to die.¹³⁶ In many doctrinal contexts it seems alive and well.¹³⁷ In light of the impressive longevity of its Civil Law counterpart and notwithstanding the considerable strains it is withstanding in modern times, there is ground to believe that the distinction will not vanish from the legal landscape anytime soon. To be sure, the distinction is definitely malle-

¹³¹ See Horwitz, *The History of Public/Private Distinction*, *supra* note 130, at 1425.

¹³² See *id.* at 1425-26.

¹³³ See MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1870-1960: THE CRISIS OF LEGAL ORTHODOXY* 11 (1992).

¹³⁴ See Morris R. Cohen, *Property and Sovereignty*, 13 CORNELL L.Q. 8 (1927); Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553 (1933).

¹³⁵ See Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470 (1923).

¹³⁶ This is often decried by scholars of the Critical Legal Studies movement. See, e.g., Duncan Kennedy, *The Stages of the Decline of the Public/Private Distinction*, 130 U. PA. L. REV. 1349 (1982); see also Alan Freeman & Elizabeth Mensch, *The Public-Private Distinction in American Law and Life*, 36 BUFF. L. REV. 237 (1987).

¹³⁷ See, e.g., AMERICAN LEGAL REALISM, *supra* note 130, at 100.

able, and legal argument could abuse it.¹³⁸ But its vitality seems to reflect the fact that it provides some beneficial service in helping us orient ourselves in the legal landscape. False or inaccurate theories can nevertheless be quite useful for that purpose, once one acknowledges and takes into account their weaknesses.¹³⁹

3. Classifying Corporate Law and Securities Regulation

From a structural perspective, company law and securities regulation exhibit a number of differences that, taken together, support the classification of the two fields as private and public law, respectively. First, like all private law, company law emanates from the primary legislative body, such as the national parliament. Securities regulation is more complex, as its first principles are enacted by the legislature, but the greater part of its legal corpus is promulgated by a governmental ministry or administrative agency.

Second, company law, like other fields of private law, is administered and enforced primarily by retroactive dispute resolution within the court system (except for minor roles that do not involve disputes such as company registration). By contrast, securities regulation is administered primarily proactively by an administrative agency with only secondary resort to the courts.

Third, company law in general is enabling. It offers a set of default rules that can be changed by company organizers to fit their preferences. In contrast, securities regulation is mostly mandatory and often prohibits opting out of its provisions. These features, respectively, are characteristic to provisions of private and public law.

Fourth, in the United States, a difference exists between the two fields in what is regarded as the sources of legal content. A primary source of content for state company law is the American Bar Association's Model Business Corporation Act ("MBCA")¹⁴⁰ and similar codes for other business organizations. The MBCA resembles other codification projects in private law areas, foremost among them is the American Law Institute's Uniform Commercial Code ("UCC"). Although the MBCA and UCC do not have direct force of law without adoption by the states, they still attract

¹³⁸ For a fine demonstration of this malleability, see Kennedy, *supra* note 136.

¹³⁹ For example, the Apollo lunar mission was planned using calculations that were based on Newtonian physics. That theory is clearly false in light of Einstein's theory of relativity but was found to be sufficiently accurate for the "limited" purpose of getting to the moon and back. See Letter from Stephen Garber, NASA Headquarters History Office, to author (June 2, 1998) (on file with author).

¹⁴⁰ MODEL BUS. CORP. ACT (1991).

attention from academics and judges much like binding Codes from Civil Law countries. However, securities regulation, like other parts of public law, is not codified and consists of a large number of scattered laws and administrative rules and forms.¹⁴¹

The public law/private law distinction between securities regulation and corporate law generally holds at the substantive level as well. In continental Europe, the division between branches of public and private law varies across Civil Law countries and according to the various ends to be served by the classification of law.¹⁴² At the core of private law are the classic subjects (contract, tort, and property), which together with related subjects are invariably codified. Company law is usually classified as part of commercial law, the most private law beyond the inner core of civil law proper.¹⁴³ By contrast, securities regulation would be classified and located well within the boundaries of public law.

In the United States, the classification of company law has taken the shape of classifying the business corporation as “public” or “private.” Initially, business corporations were considered public entities. However, during the nineteenth century business corporations were perceived as private entities despite several waves of academic and political attacks. The following paragraphs recount this transformation and argue that the persistence of the “private” character of the corporation is due largely to the rise of securities regulation as the “public” companion of corporate law.

Until the eighteenth century, incorporated companies were relatively rare and were incorporated by a special charter (also called “grant” or “concession”) from the sovereign. As such, they were analogous to extensions of the state and had an unmistakable public character. The economic activities they pursued often had a public nature such as public utilities, transportation, and water works.¹⁴⁴ These corporations also enjoyed powers and privileges characteristic to public entities. This situation changed dramatically with the 1819 *Dartmouth College* case,¹⁴⁵ which held that the

¹⁴¹ This formal distinction should not be stretched too far. A serious effort to promulgate a Federal Securities Code was made in the 1970s by the American Law Institute (“ALI”). Congress showed no interest in even considering the Code and never formally introduced it, but some of its approaches were incorporated into American securities law. See DAVID L. RATNER, *SECURITIES REGULATION IN A NUTSHELL* 12-13 (4th ed. 1992).

¹⁴² See Szladits, *supra* note 122, at 21.

¹⁴³ See *id.* at 72.

¹⁴⁴ See JAMES WILLARD HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970*, 7-8 (1970).

¹⁴⁵ *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819).

state grant of a charter created an enforceable contract under the Contracts Clause of the United States Constitution.¹⁴⁶ Such corporations, therefore, had a private nature, distinct from municipal corporations that remained governed by public law. Once freed from the grip of regulatory public law, corporations and corporate law retained their private characters to this day.

The remainder of the nineteenth century witnessed great changes in the legal theory of the corporation. Corporations became more commonplace with the enactment of general incorporation laws. Two competing theories replaced the charter theory. One saw the corporation as a free contract among individual shareholders, akin to a partnership. "In this conception, the corporation was not a creature of the state but of individual initiative and enterprise. It was 'private,' not 'public.'"¹⁴⁷

The competing theory, which started to gain influence in the United States during the turn of the century, was drawing on the academic discourse in continental Europe about "corporate personality."¹⁴⁸ This theory elevated the corporation from its constituent individual shareholders and claimed that as a group it had a "natural," and "real personality." That theory also sought to represent the corporation as private by identifying it as a private association. Since individuals and not the state supplied the creative force that brought the group into existence, respect for individuals counseled against regulation.¹⁴⁹

While companies were solidifying their status as private entities during the late nineteenth century, they were also growing to non-human dimensions (first the railroad companies and later the mass production firms).¹⁵⁰ A major effort to regulate both corporate conduct and corporate structure was launched in 1890 with

¹⁴⁶ U.S. CONST., art. I, § 10, cl. 1.

¹⁴⁷ Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 184-85 (1985) [hereinafter Horwitz, *Santa Clara Revisited*]; see also William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1489-90 (1989) [hereinafter Bratton, *New Economic Theory*]; Gregory A. Mark, Comment, *The Personification of the Business Corporation in American Law*, 54 U. CHI. L. REV. 1441, 1463 (1987).

¹⁴⁸ German legal theorist Otto Gierke, whose 1887 book on German association was translated into English in 1900, pioneered the discourse. OTTO GIERKE, *POLITICAL THEORIES OF THE MIDDLE AGE* (Frederic William Maitland trans., 1900); see also Bratton, *New Economic Theory*, *supra* note 147, at 1490; Horwitz, *Santa Clara Revisited*, *supra* note 147, at 177.

¹⁴⁹ See Bratton, *New Economic Theory*, *supra* note 147, at 1490; Horwitz, *Santa Clara Revisited*, *supra* note 147, at 179.

¹⁵⁰ See generally ALFRED D. CHANDLER, JR., *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* (1983).

the enactment of the Sherman Anti-Trust Act¹⁵¹ and continued with the enactment of the Clayton Act in 1914.¹⁵² It took a considerable amount of time for this early antitrust regulation to mature and achieve real force, but for our purposes it was the harbinger of a more general strategy: If corporations and corporate law could not be penetrated and regulated from within, then regulation could come from other legal fields, external to corporate law.

The Legal Realist Movement did not pass over the question of nature of the firm. In an influential article, John Dewey argued that the whole debate about corporate personality was pointless and that either theory could be deployed to support both intervention and non-intervention.¹⁵³ While Dewey's argument could not be used to advocate one particular classification, it gave equal, albeit dubious, legitimization to both. Then, during the Great Depression in 1932, Berle and Means published their seminal book, *The Modern Corporation and Private Property*,¹⁵⁴ in which they first observed the separation between ownership of corporate shares and control over the corporation's assets. Shareholders were said to have retained the former but to have surrendered the latter to management.

The standard law and economics interpretation of Berle and Means demonstrates how the separation between ownership and control is an efficient regime for both investors and capital consumers. This, however, was not the point that Berle and Means wanted to drive home. They advocated for conceiving corporations as public again. They wrote that "by surrendering control and responsibility over the active property, [shareholders] have surrendered the right that the corporation be operated in their sole interest. . . . They have placed the community in a position to demand that the modern corporation serve not alone the owners or the control [group] but all society."¹⁵⁵

Their call was not answered, and after Dewey's article, the whole issue of corporate personality suddenly vanished from con-

¹⁵¹ 15 U.S.C. § 1 (1994).

¹⁵² 15 U.S.C. § 12.

¹⁵³ John Dewey, *The Historic Background of Corporate Legal Personality*, 35 YALE L.J. 655 (1926); see also Max Radin, *The Endless Problem of Corporate Personality*, 32 COLUM. L. REV. 643 (1932); Paul Vinogradoff, *Juridical Persons*, 24 COLUM. L. REV. 594 (1924).

¹⁵⁴ ADOLPH A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

¹⁵⁵ *Id.* at 166-67.

trovery.¹⁵⁶ This Article proposes that to a large extent this tension was defused by the enactment of the Securities Acts. Public individual investors were the constituency at the focus of public attention after the crisis in Wall Street. Instead of intruding into the perceivably private sphere of the corporation with no apparent tools to remedy problems, Congress preferred to envelope corporations with numerous disclosure duties that had an equivalent effect.¹⁵⁷ This new arrangement was convenient. It let management remain largely shielded from regulation in the private sphere of the corporation and allowed regulators to try to protect public investors through public law, i.e., securities regulation.¹⁵⁸

Recent theoretical developments in the theory of the firm, particularly Jensen and Meckling's depiction of the corporation as a nexus of contracts,¹⁵⁹ further strengthened the perception of corporations as private entities arising from numerous contractual arrangements. Easterbrook and Fischel, among others, later turned this vision into the central pillar of their theory of corporate law.¹⁶⁰ Although that perception is subject to attacks from progressive legal scholars,¹⁶¹ like its parent public/private distinction, the classification of corporations as private seems to hold.

The classification of securities regulation is also not clear. In its structure, the field exhibits all of the central features of public law as detailed earlier in this Part. As to its content (and title), the field is a classic example of modern regulatory law by which the state intervenes in legal relationships that are traditionally governed by private law. At the margins, however, some ambiguities exist.

First, the Securities Acts' antifraud provisions are in essence

¹⁵⁶ See Horwitz, *Santa Clara Revisited*, *supra* note 147, at 175.

¹⁵⁷ Such a strategy would have also involved constitutional difficulties for reasons of federalism.

¹⁵⁸ That arrangement did not resolve the tension with regard to the third public constituency beside consumers and shareholders, namely workers. The issue remains a thorny one to this day, but is beyond the scope of this Article.

¹⁵⁹ See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

¹⁶⁰ See EASTERBROOK & FISCHEL, *supra* note 50. Luigi Zingales recently argued that corporate governance is best understood as a set of solutions that overcomes the impossibility of complete contingent contracts. See Zingales, *supra* note 60, at 502.

¹⁶¹ For critical analyses, see Bratton, *New Economic Theory*, *supra* note 147; William W. Bratton, Jr., *The Nexus of Contracts Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989); David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201; Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215 (1992) (book review); see also Paul N. Cox, *The Public, The Private and the Corporation*, 80 MARQ. L. REV. 391, 391 n.4 (1997) (collecting references).

private law.¹⁶² Other pure regulatory provisions in the Securities Acts were given private law extensions whenever private causes of action were implied by the courts.¹⁶³ More broadly, scholars have argued for allowing market participants to pick the securities regulation regime of their choice, similar to choice-of-law provisions in private contracts, and thereby privatizing securities law considerably. Similar proposals were made with respect to international¹⁶⁴ and domestic¹⁶⁵ securities transactions.

Finally, the Securities Acts' public character has similarly been eroded somewhat over time in a line of cases about the arbitrability of litigation under the Acts. The issue of arbitrability is relevant because the Securities Acts, like other regulatory regimes, preclude the waiver of their protection. In the past, arbitration (and international arbitration in particular) was deemed inadequate for presentation and consideration of public law claims, including securities regulation ones.¹⁶⁶ Later, the Supreme Court narrowed the rule and held that a claim under the Securities Exchange Act of 1934 ("Securities Exchange Act") was arbitrable, provided that it arose from an "international" transaction.¹⁶⁷ More recently, the Court reversed the basic rule and held that claims under the Securities Exchange Act, both domestic and international, are arbitrable.¹⁶⁸ In so doing, the Court has given the Securities Acts a flavor of private law.

¹⁶² See Louis Loss, *The Assault on Securities Act Section 12(2)*, 105 HARV. L. REV. 908, 915 (1992).

¹⁶³ The scope of implied private causes of action under the Securities Laws has expanded and contracted over time. For an overview, see COX ET AL., *supra* note 96, at 1076-78; see also *id.* (Supp. 1996); Joseph A. Grundfest, *Why Disimply?*, 108 HARV. L. REV. 727 (1994); Joel Seligman, *The Merits Do Matter: A Comment on Professor Grundfest's "Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority,"* 108 HARV. L. REV. 438 (1994); Joel Seligman, *The Merits Still Matter: A Rejoinder to Professor Grundfest's Comment Why Disimply?*, 108 HARV. L. REV. 748 (1994).

¹⁶⁴ See Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Laws*, 71 S. CAL. L. REV. (forthcoming 1998); Robert W. Hillman, *Cross-Border Investment, Conflict of Laws, and the Privatization of Securities Law*, LAW & CONTEMP. PROBS., Autumn 1992, at 331. Although Hillman limits his proposal to private placements, these transactions do not always warrant invoking the protective umbrella of the Securities Acts, as was acknowledged by the Supreme Court in *Gustafson v. Alloyd, Inc.*, 513 U.S. 561 (1995).

¹⁶⁵ See generally Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998) [hereinafter Romano, *Empowering Investors*] (advocating a system of competitive federalism for securities regulation).

¹⁶⁶ See *Wilco v. Swan*, 346 U.S. 427 (1953).

¹⁶⁷ See *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

¹⁶⁸ See *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

In conclusion, the fact that corporate law and securities law cannot precisely be defined as “private” or “public” is hardly surprising. In light of their common source, early company law, and their mutual interpenetration today in terms of subject matter, such an effort is bound to be imprecise. But the wide penumbra in each field should not obstruct the observation that these fields have a solid, determinable core consisting of private and public law, respectively.

III. ROADBLOCKS ON THE WAY TO CONVERGENCE

This Part analyzes the implications for international regulatory cooperation and harmonization borne by the interdependence of corporate law and securities regulation, as well as their character as private and public laws. This Article argues that in relative terms, securities regulation should lend itself more readily to harmonization and cooperation than corporate governance regimes. At the same time, however, the tight relationship between securities law and corporate law implies that regulatory convergence and cooperation in securities regulation are likely to face more roadblocks than other regulatory areas. For the reasons briefly discussed above, the rules and structures of corporate governance are more likely to exhibit rigidities and inertia. Consequently, they impede convergence in securities regulation as well.

For the sake of clarity, the following discussion distinguishes between the influence of comparative corporate governance aspects and those of the public/private distinction. It should be kept in mind, though, that these aspects are intertwined and reinforce one another.

A. *Implications of Comparative Corporate Governance*

Part II.A. demonstrated that the distinction between corporate law and securities regulation may be tenuous and that the distinction line may be hard to discern, but that both are very stable, compelling, and refuse to go away. A movement toward global harmonization of disclosure regimes under a one-size-fits-all philosophy is currently underway. Regionally, in the EU, there is a movement toward broader harmonization of entire securities regulation regimes.¹⁶⁹ At the same time, however, efforts to harmonize corporate laws have not succeeded. Our present understanding of corporate governance legitimizes or at least acknowl-

¹⁶⁹ See *supra* discussion Part I.A.

edges diversity. Where appropriate, foreign corporate governance systems may be deemed a model for imitation even if not a source for direct importation of structural transplants. Could these trends be reconciled? My answer is a qualified "No."

While securities regulation and corporate law are distinct legal fields in certain aspects, they are also closely integrated. Ideally, securities regulation represents government intervention in corporate practices to the extent that public investors are involved. In the United States, it bears directly and significantly on corporate governance as well. Together, corporate law and securities regulation constitute a single legal regime for incorporated investment and business. In a healthy and functioning legal system, therefore, they must be balanced and coherent with each other.¹⁷⁰

By saying that corporate law and securities regulation are balanced and coherent, this Article means that in a normal national legal regime there must be a good fit between the two fields. Deficiencies in one field, such as corporate law, may be and often are filled out or corrected by provisions in the securities laws. Corporate law tends to be a deficient component mostly because it is often less attuned to the special features of public trading of securities. Because corporate law usually precedes securities law, it may exhibit traditional features that are less appropriate for modern securities trading, such as liability formulas for securities fraud that require actual reliance. However, being largely enabling by nature, corporate law may become less than optimal where mandatory rules are called for, for example, where information asymmetries are involved or where structural features of the corporation preclude effective and efficient bargaining.¹⁷¹ Finally, where corporate law is largely in the province of the states, as is the case in the United States, federal intervention in matters of corporate

¹⁷⁰ In other words, corporate law and securities regulation together constitute a "system" in the sense used in systems analysis. See Lynn M. LoPucki, *The Systems Approach to Law*, 82 CORNELL L. REV. 479 (1997) (reviewing the theory and its application to law-related systems). A theoretical definition cited by LoPucki defines a system as "a set of interrelated and interactive elements that work together to accomplish specific purposes." *Id.* at 485 n.26. Systems are composed of subsystems, such that corporate law and securities law are subsystems of one larger legal field. That field, in turn, is a subsystem of law-related systems of corporate governance. See *id.* at 487-89. The analysis and argument advanced in this Article thus may be seen as the normative step in a systems analysis; namely, the identification of potential inconsistencies between the goals of the system and what is being done to achieve them. See *id.* at 506.

¹⁷¹ In such cases direct amendment of corporate laws may be an alternative, but if problems were limited to publicly traded companies then it could be preferable to leave corporate law intact and intervene through the securities laws.

governance could be effected through the Securities Acts.

Company law does not have to be completely dysfunctional to warrant supplementation with securities law. When a company does not have a large number of shareholders publicly trading its shares, company law can do very well on its own. Sometimes a distinction between closely held corporations and larger ones needs to be made. This is the case in Germany, which has two separate statutes for the corporate forms.¹⁷² It is mainly the element of public trading, together with the regulation of markets (stock exchanges) and intermediaries, which gives rise to the need for regulation

The claim made above about balance and coherence is independent of the premise one may hold concerning the causes and sources of legislation. Under a public interest view of legislation, a benevolent legislature or administration enacts laws to further the public good and increase national social welfare. In unitary states, the locus for intervention equally could be found either in the country's corporations law or in its securities law. But the two instruments must work in harmony to further the legislative purpose. This should also be true in federal states in which authority over corporate laws and securities laws is split between the national government and the sub-states. There, national legislation and rule making should remedy deficiencies in the legal regime promulgated by the sub-states.

The competing view, usually called "public choice," holds that legal regimes tend to serve the goals of private interest groups. Compared with the general public, those groups suffer less from collective action problems and can thus further their interests more effectively through lobbying and less legitimate methods. Government agencies under this view are less attuned to the public interest but rather to self-aggrandizement, accumulation of power, and empire building. This view has also been applied in the area of financial regulation. For example, scholars argue that the SEC had initially acted to make insider trading illegal and pursued violators to enhance its public stature and power or to serve the interests of intermediaries.¹⁷³ Recently, public choice has been

¹⁷² See Hugh T. Scogin, Jr., *Withdrawal and Expulsion in Germany: A Comparative Perspective on the "Close Corporation Problem,"* 15 MICH. J. INT'L L. 127, 128-36 (1993) (discussing Germany's corporate law statutes).

¹⁷³ See MACEY, *supra* note 113; David D. Haddock & Jonathan R. Macey, *Regulation on Demand: A Private Interest Model with an Application to Insider Trading Regulation*, 30 J.L. & ECON. 311 (1987).

applied to international securities regulation.¹⁷⁴

For the present purpose, however, this does not matter. A public interest view of the law, would see company law and securities regulation as balanced and coherent, together serving the public at large and protecting public investors to the extent needed to maximize social welfare. The opposite, public choice view also sees company law and securities regulation as balanced and coherent, but this time in a way that furthers the interests of small business groups, bureaucrats, and politicians. Had it not been so, public choice theory would not have had much of a claim.¹⁷⁵ Thus, a "balanced and coherent" legal system need not be a perfect one; indeed, it rarely is one. It just has to be consistent within itself, which is something we can generally assume.

1. Disclosure Regulation

One can point out three different factors influencing a perceived need for a mandatory disclosure regime. The first factor stems from the need for a well functioning stock market. The standard justification for mandatory disclosure is that it provides investors with the information necessary for making an informed investment decision.¹⁷⁶ The economies of producing this information are such that it is more efficient to impose a mandatory disclosure duty on the issuer rather than have all market participants (under)produce it.¹⁷⁷

Rarely, however, does this reasoning stand alone. Generally, it is tightly coupled with Brandeis's "electric light policeman" element, which suggests that disclosure has a prophylactic effect in preventing overreaching by management and controlling share-

¹⁷⁴ See Enrico Colombatto & Jonathan R. Macey, *A Public Choice Model of International Economic Cooperation and the Decline of the Nation State*, 18 CARDOZO L. REV. 925 (1996).

¹⁷⁵ The only interesting case occurs if one legal field is more susceptible to public choice problems than the other. Developing this example is beyond the scope of this Article. Relatedly, scholars debate which government level may be more susceptible or resilient to public choice problems, the federal or the state, with regard to corporate laws. See Bebchuk, *supra* note 111; Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843 (1993).

¹⁷⁶ See, e.g., John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984); Mahoney, *supra* note 72.

¹⁷⁷ See Coffee, *supra* note 176. This is not the only justification for nor the only opinion, regarding mandatory disclosure. Some scholars see it as an efficient arrangement for positive externalities among issuers. See, e.g., EASTERBROOK & FISCHER, *supra* note 50, at 145-62. But see, e.g., ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 118-40 (1993); George J. Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 AM. ECON. REV. 132 (1973).

holders. In modern economic parlance, this is the agency problem's justification for mandatory disclosure. This justification is conceptually different than the one based on information economies.¹⁷⁸ Aimed against the agency problem, mandatory disclosure goes to the foundations of corporate governance, which attempts to overcome this very problem. Indeed, disclosure duties under the Securities Acts constitute a major part of what Dean Seligman calls "the new corporate law."¹⁷⁹

Now, recent studies of comparative corporate governance reveal that there could be more than one way for mitigating the agency problem in large corporations. Stricter fiduciary duties, coupled with an effective enforcement infrastructure, might be one way. Large blockholdings that increase the value of monitoring also may work at least vis-à-vis management. Where there is an unreliable legal infrastructure and untrustworthy, large blockholders, structural arrangements such as cumulative voting may succeed. In addition, another viable method for mitigating the agency problem may be the promulgation of stricter disclosure duties. These strategies for mitigating the agency problems, however, are only partial substitutes. A corporate governance system, namely a combination of a legal regime and a prevalent stockholding structure, with large blockholders and relatively weak disclosure duties imposed on the issuer, may roughly be equivalent (agency problem-wise) to a system with dispersed ownership and stricter disclosure duties.

To take another example, a country may believe that it is beneficial to reduce tensions between a company and its employees. Formally adjusting the board of directors and establishing co-determination, as the case is in Germany,¹⁸⁰ is one possible way to achieve this goal. Staffing the board with a large number of former employees, as is commonly done in Japan, is yet another viable option. Finally, the law, through a disclosure system, may allow employees access to large amounts of information. Such open disclosure may ease the employees' suspicions toward management. One may believe that this is the case in the United States.¹⁸¹

¹⁷⁸ See generally Mahoney, *supra* note 72.

¹⁷⁹ See Seligman, *New Corporate Law*, *supra* note 108.

¹⁸⁰ See Mark J. Roe, *German Codetermination and German Securities Markets*, 1998 COLUM. BUS. L. REV. 167 (special symposium issue) (discussing codetermination in Germany).

¹⁸¹ I do not claim that the United States, Germany, and Japan share values regarding employees' rights, nor that the three alternatives mentioned are equivalent, but only that some of the effects of co-determination and its like could be partially achieved in other

To a certain extent, a high level of disclosure could prove detrimental to the working and effectiveness of alternative systems of corporate governance. An example from the American market is the 1992 reform in the proxy rules. As originally conceived, the SEC intended the proxy rules to protect public investors by imposing a prospectus requirement whenever shareholders were communicating with respect to voting.¹⁸² The goal was to formalize the process of proxy solicitation and to provide shareholders with the standard disclosure deemed necessary to reach an informed decision. With the emergence of large institutional investors, the proxy rules, as interpreted and implemented by the SEC, actually impeded active monitoring by them.¹⁸³ What might have been warranted in the context of numerous public shareholders proved counterproductive to institutional monitoring—and, eventually, to public shareholders—because it meant that every communication among institutional investors could be claimed to be subject to a prospectus requirement and expose institutional investors to litigation. The SEC responded accordingly and adjusted the proxy rules to fit the new reality.¹⁸⁴

The above claim is independent of the possible claim that there could be too much disclosure. Disclosure requirements that were argued to be destructive to issuers include the reporting of results with a line-of-business breakdown and, more recently, exposure to market risk.¹⁸⁵ The claim here is that a disclosure regime that is theoretically appropriate for a market with widely dispersed ownership could be too burdensome, in certain aspects, for a corporate governance system with large blockholders.

2. Insider Trading

The same theme emerges in insider trading, a major element in many securities regulation regimes. Insider trading is an illusive concept. While the core nature of it may be intuitively clear, its

ways.

¹⁸² See generally Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520 (1990).

¹⁸³ See *id.*; John Pound, *Proxy Voting and the SEC: Investor Protection Versus Market Efficiency*, 26 J. FIN. ECON. 241 (1991).

¹⁸⁴ See Exchange Act Release No. 34-31326, 52 SEC Docket (CCH) 2028 (Oct. 16, 1992).

¹⁸⁵ For a discussion of line-of-business reporting, see Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 BROOK. L. REV. 763, 792-98 (1995). For a discussion of exposure-to-risk disclosure, see Merton H. Miller & Christopher L. Culp, *The SEC's Costly Disclosure Rules*, WALL ST. J., Apr. 25, 1996, at A14.

perimeter is not.¹⁸⁶ Worse yet, in the United States a debate has been ongoing for over three decades regarding whether the United States should prohibit or regulate insider trading in the first place, notwithstanding the legal ban on it.¹⁸⁷ This Article does not attempt to resolve that debate here, as this debate may very well be unresolvable. Our current understanding of the effects of insider trading, in light of recent economic analyses, is such that insider trading regulation has an element of choice to it. By choice this Article means that regulating insider trading would be an imposition of certain previously held beliefs and values with regard to that conduct, as opposed to an imposition of one efficient regime by the law.

Like the case of disclosure regulation, one can identify two separate rationales for the prohibition on insider trading. These rationales derive from two possible harms allegedly caused by insider trading. The first rationale is market oriented and deems insider trading an "offense against the market," something that compromises market integrity. Under this rubric, the debate is framed as whether insider trading impedes the functioning of the market as a price discovery mechanism intended to provide updated and reliable prices.

Proponents of insider trading argue that insider trading does not harm anybody since all market participants are aware of the potential of trading with an insider and hedge accordingly.¹⁸⁸ Moreover, these scholars further claim that insider trading improves market functioning by helping the market to move toward the price that reflects the new information. These arguments are subject to the general critique that insider trading is a second best solution to direct and prompt disclosure of information.¹⁸⁹ Moreo-

¹⁸⁶ The literature on insider trading is too voluminous to cover here. For a recent discussion of the borderlines of insider trading and their underlying theories, see Roberta S. Karmel, *Outsider Trading on Confidential Information—A Breach in Search of a Duty*, 20 CARDOZO L. REV. 83 (1998).

¹⁸⁷ For major contributions, see DONALD C. LANGEVOORT, *INSIDER TRADING REGULATION* (1991); HENRY G. MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966); Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322 (1979); Dennis Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857 (1983); Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309.

¹⁸⁸ See, e.g., MANNE, *supra* note 187; Carlton & Fischel, *supra* note 187.

¹⁸⁹ See James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School"*, 1986 DUKE L.J. 628 [hereinafter Cox, *Insider Trading and Contracting*]; Ronald J. Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984).

ver, economic models give reason to believe that only large market players can hedge against insider trading and that the gains from informed trading come at the expense of small individual traders.¹⁹⁰

The other view of insider trading sees it as an “offense against the corporation.”¹⁹¹ Under this view, insider trading is an issue of corporate governance. Proponents of insider trading consider it to be an efficient form of executive compensation and a mechanism for encouraging managers to assume risks.¹⁹² The opponents’ response is that insider trading is an inefficient form of executive compensation because it is obscured from the market and cannot be evaluated correctly.¹⁹³ Moreover, the opponents argue that managers preferring their private interests over the company’s would manage it sub-optimally or exploit it to their benefit.¹⁹⁴

¹⁹⁰ See Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 VA. J. INT’L L. 563, 606-07 (1998) [hereinafter Licht, *Regulatory Arbitrage for Real*].

¹⁹¹ This view underlies traditional Supreme Court jurisprudence regarding the liability theory for insider trading, the Fiduciary Theory. See *Chiarella v. United States*, 445 U.S. 222 (1980); *Dirks v. SEC*, 463 U.S. 646 (1983). By endorsing the requirement for pre-existing relationships of trust and confidence, the Court rejected the Equal Access Theory, a theory that requires general parity of information among market participants. Since it focuses on market participants as those potentially harmed, it may be interpreted as reflecting the offense-against-the-market view of insider trading. For a critical discussion, see CLARK, *supra* note 100, at 263-357. If this is a correct interpretation of American liability theory of insider trading, then the theory may be inconsistent with the current American jurisprudence regarding extraterritorial application of the Securities Acts. There, the underlying reason for asserting jurisdiction is the possible adverse effects on the market. See *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968); see also *Langevoort*, *supra* note 22.

In its recent decision in *United States v. O’Hagan*, 117 S. Ct. 2199 (1997), the Supreme Court upheld an alternative liability theory, the misappropriation theory. Under this theory, one who misappropriates confidential information for securities trading in breach of a duty owed to the source of the information also violates section 10(b) of the Exchange Act, without a need to show a fiduciary duty. See *id.* at 2207-08. In so holding, the Court has blurred the distinction suggested in the text and moved closer to a market protection theory by broadening the scope of harmed interests and liable persons. However, the Court did not adopt a general fraud-on-the-market theory. See Karmel, *supra* note 186; see also *The Supreme Court, 1966 Term—Leading Cases*, 111 HARV. L. REV. 410, 416 (1967).

¹⁹² See Carlton & Fischel, *supra* note 187.

¹⁹³ See CLARK, *supra* note 100, at 274-75; Cox, *Rethinking U.S. Securities Laws*, *supra* note 23, at 157.

¹⁹⁴ See, e.g., CLARK, *supra* note 100, at 263-357; Cox, *Insider Trading and Contracting*, *supra* note 189 (stating that transparency of management compensation justifies insider trading regulation); Easterbrook, *supra* note 187 (discussing that insider trading decreases the incentives to disclose and produce information); Robert J. Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation*, 80 MICH. L. REV. 1051 (1982) (observing insider trading’s tendency of obstructing the orderly flow of information in the firm); Saul Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 VA. L. REV. 117 (1982).

More recent economic models of the impact of insider trading rules on the corporation reach a mixed answer: allowing insider trading could sometimes prove beneficial to the firm while in other circumstances it may not.¹⁹⁵

Importantly, every discussion of insider trading also involves considerations of fairness. The ethical argument against insider trading holds that “it’s just not fair,”¹⁹⁶ reflecting fundamental concepts of justice and distribution of wealth.¹⁹⁷ As such, it explains the public interest in insider trading scandals and the fervor with which “American jurisprudence abhors insider trading.”¹⁹⁸ Public opinion that despises insider trading in turn drives politicians to respond by enacting anti-insider trading measures, using the most expressive language to describe insiders as “thieves.”¹⁹⁹

Concentrating for a moment on insider trading as an offense against the corporation, countries may have different takes as to the desirability of prohibiting this conduct. First, in a country where insider trading is not deemed by the public to be morally sinful, engaging in insider trading could constitute an implicit part of compensation packages for management. Investors in such a country could believe that it is efficient to do so in light of certain economic models. However, they may also acknowledge that such extraction of private benefits is inefficient per se but also very difficult to monitor and detect. Thus, they could prefer to deny in-

¹⁹⁵ See LUCIAN ARYE BEBCHUK & CHAIM FERSHTMAN, THE EFFECT OF INSIDER TRADING ON INSIDERS’ REACTION TO OPPORTUNITIES TO “WASTE” CORPORATE VALUE (Harvard Law Sch. Program in Law and Econs. Discussion Paper No. 76, 1990); Lucian A. Bebchuk & Chaim Fershtman, *Insider Trading and the Managerial Choice Among Risky Investment Projects*, 29 J. FIN. & QUANTITATIVE ANALYSIS 1 (1994); Lucian Arye Bebchuk & Chaim Fershtman, *The Effects of Insider Trading on Insiders’ Effort in Good and Bad Times*, 9 EUR. J. POL. ECON. 469 (1993); Michael Manove, *The Harm from Insider Trading and Informed Speculation*, 104 Q.J. ECON. 823 (1989).

¹⁹⁶ See Kim Lane Scheppelle, “It’s Just Not Right”: *The Ethics of Insider Trading*, LAW & CONTEMP. PROBS., Summer 1993, at 123.

¹⁹⁷ See James Boyle, *A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading*, 80 CAL. L. REV. 1413 (1992).

¹⁹⁸ Cox, *Insider Trading and Contracting*, *supra* note 189, at 628 (“American jurisprudence abhors insider trading with a fervor reserved for those who scoff at motherhood, apple pie, and baseball.”) (footnote omitted).

¹⁹⁹ See *The Insider Trading Sanctions Act of 1983: Hearing on H.R. 559 Before the Subcomm. on Sec. of the Senate Comm. on Banking, Hous., and Urban Affairs*, 98th Cong. 1 (1984) (statement of Sen. Alfonse D’Amato) (“I concur wholeheartedly with John Fedders, the Director of the SEC’s Division of Enforcement[,] that insider traders are thieves.”). For an analysis of the interaction between politics and corporate governance and corporate law, see MARK J. ROE, STRONG MANAGERS, WEAK OWNERS—THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994) (arguing that political response to public distrust in capital concentration has shaped the present American model of separation between ownership and control).

siders other, more observable perks.²⁰⁰

But the problem is broader. Countries, such as the United States, that view insider trading as a modern form of sin may still suffer from overzealous prohibition of that conduct in certain circumstances. Where corporate governance systems feature large blockholdings, such large stockholders usually would possess knowledge about the company beyond the level of publicly available information. Indeed, this is the very promise of institutional investors—that they have an increased incentive to monitor and collect information about their portfolio companies. But such an increased level of knowledge may be a double-edged sword. Should an institutional investor buy or sell securities of a portfolio company while in possession of non-public information, it may run afoul of the prohibition on insider trading;²⁰¹ given its large blockholding it might be deemed an insider.²⁰²

The fear of getting entangled in illegal insider trading is also one of the reasons why institutional investors in the United States avoid nominating directors in their portfolio companies.²⁰³ By doing so, they diminish their potential contribution as effective monitors toward mitigating the agency problem in the firm. Structural solutions, such as “Chinese walls” can be put in place, but they too have their costs, and apparently institutional investors do not see them as a complete solution.

Analyzing the problem from a clean slate—in other words, without a presumption that insider trading is unacceptable in principle—the tradeoff here is straightforward. In exchange for monitoring services by institutional investors, public investors may want to allow them to engage in some level of insider trading. The company, in turn, may enter into such a contract on behalf of pub-

²⁰⁰ See generally Fox, *Insider Trading*, *supra* note 22.

²⁰¹ The provision most likely to be breached is the prohibition on short-swing transactions under section 16(b) of the Exchange Act. Such a short-swing transaction may take place inadvertently, for example, when a large institutional investor with an indexing investment policy readjusts its portfolio or uses program trading to hedge against market volatility. Of course, trading algorithms in both cases could be adapted to avoid short-swing transactions, but such a rigidity would impose a cost on the institutional investor. This is exactly the point claimed in the text.

²⁰² See Coffee, *Liquidity Versus Control*, *supra* note 57, at 1330; John C. Coffee, Jr., *The SEC and the Institutional Investor: A Half-Time Report*, 15 CARDOZO L. REV. 837 (1994).

²⁰³ See Coffee, *Liquidity Versus Control*, *supra* note 57; George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 916. See generally Ronald J. Gilson & Reinier H. Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991). Another reason for not nominating directors is the fear of being sued for alleged directorial malpractice.

lic investors.²⁰⁴ Such an arrangement may be appealing to developing countries. It has been argued that developing nations should increase foreign investment flows into their economies by focusing on encouraging relational investment, as a substitute for foreign direct investment, foreign debt, and portfolio investment.²⁰⁵ In such cases, institutional investors may be a promising solution to corporate governance problems where stock markets are underdeveloped.²⁰⁶ Independently, those countries could still ban insider trading by individual insiders.

3. Harmonization

Securities regulation is tightly connected to and directly influenced by the prevailing corporate governance system in each country, in other words, the legal regime as set by corporate law and actual governance structures. Corporate law and corporate governance exhibit features of adaptability to national economic, political, and cultural circumstances, and in general exhibit considerable path dependency. National corporate laws also are fairly resilient to harmonization efforts that would move them away from their beaten path. In light of all this, what could be the logic behind the movement to harmonize securities laws and disclosure rules in particular? Further, what are the prospects of this harmonization succeeding? In what follows, this Article offers some speculative answers.

One possibility is that IOSCO members are blissfully unaware of the corporate governance implications of their disclosure harmonization project. This requires a strong assumption ascribing considerable naïveté to these regulators. Under this scenario, the one-size-fits-all philosophy championed by IASC is simply wrong—a fact that would render the project severely misguided. The fact that materials available from IASC and IOSCO fail to provide a thorough analysis of corporate governance aspects supports this conjecture.²⁰⁷ Although such a possibility seems remote,

²⁰⁴ See Stephen Thurber, Note, *The Insider Trading Compensation Contract as an Inducement to Monitoring by the Institutional Investor*, 1 GEO. MASON L. REV. 119 (1994) (arguing that institutional investors' incentive structure can be improved by permitting them to exchange monitoring services for rights to engage in insider trading).

²⁰⁵ See, e.g., Enrique R. Carrasco & Randall Thomas, *Encouraging Relational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis*, 34 COLUM. J. TRANSNAT'L L. 539 (1996).

²⁰⁶ See *id.*; see also MITSUHIRO FUKAO, FINANCIAL INTEGRATION, CORPORATE GOVERNANCE, AND THE PERFORMANCE OF MULTINATIONAL COMPANIES (1995).

²⁰⁷ In 1989 a working party of IOSCO issued a ground-breaking report on international equity offers that can be seen as the inception of IOSCO's disclosure harmonization proj-

it cannot be ruled out completely.

At the same time, however, one could conjecture that some securities regulators may be interested in revamping their country's corporate governance regimes through the use of securities regulation. After all, the SEC has penetrated the states' company law turf for years, and other regulators may have similar agendas. Some degree of regulatory power seeking also is not unthinkable. But it should be re-emphasized that whether the public interest or public choice causes motivate such an agenda is an independent issue.

A second possibility is that the IASC accountants conducting the IAS project and the IOSCO securities regulators endorsing it are fully aware of the implications (and complications) of their project in terms of corporate governance. In pursuing their harmonization project, therefore, these parties also intend to advance a corporate governance agenda as well, aimed at mitigating the agency problem mainly by increasing the amount of disclosure. Nothing in the public materials of IOSCO (or IASC) suggests that this is the case either.²⁰⁸ A hidden agenda of such a scale is somewhat unlikely and also would be unethical.

If this were true, however, then the project would be fighting an uphill battle against highly powerful forces since corporate governance systems have enormous inertia. In addition to being difficult to reform or harmonize directly, they are also likely to interject rigidities into the harmonization projects of securities regulation regimes. Regulators would thus find it difficult to implement the harmonized framework. Even more likely, compliance with the harmonized rules could be lower than expected.

If this occurs and IOSCO endorses IASC's standards, then the consequences may be similar to the previous scenario. When these

ect. See INTERNATIONAL ORG. OF SECURITIES COMM'NS., INTERNATIONAL EQUITY OFFERS (1989). The report stated:

While the securities laws and regulations applicable in the jurisdictions represented on the Technical Committee [of IOSCO] cover a broad spectrum, both in substance and procedures, all share the fundamental goals of:

- Protecting investors from fraud.
- Promoting efficiency of the market for raising capital and secondary trading.
- Establishing and maintaining fair and honest markets.
- Assuring the stability of market systems.

Id. at 4.

While this is a conventional definition of goals for securities regulation regimes, what is absent is an acknowledgment that such regimes have a significant impact, either by design or as a de facto consequence, on issues of corporate governance. A later report reflects a similar unawareness to corporate governance. See *id.* at 4-6.

²⁰⁸ See generally *id.*

rules reach their implementation phase they will encounter strong resistance. Standards that do not fit local corporate governance systems are likely to be breached, watered down, or simply ignored. In any event, these standards will require much more determination and regulatory resources for effective implementation and enforcement. In the extreme, they might even harm reporting companies if the duties imposed by them were to erode beneficial corporate governance features.

Finally, the current IASC/IOSCO project may be irrelevant as it purports to impose a regime that has no effect on corporate governance. Currently, the project focuses on financial reporting issues that may be deemed less relevant to corporate governance concerns than non-financial reporting. Nonetheless, such a project would have substantial merits. Inasmuch as it is a focal point solution to a coordination problem of choosing one standard from several possibilities, it can bring about considerable savings in the transaction costs of preparing multiple statements and reconciling with foreign GAAP. Alternatively, but still with little relevance to corporate governance, the project could constitute an effort on behalf of advanced markets, notably the American one,²⁰⁹ to use IOSCO as a leverage mechanism for imposing uniform disclosure rules so that its hegemonic leadership would not be eroded. This scenario is highly probable.²¹⁰

Similar speculations can be made about insider trading issues. Currently, developing countries seem to be signing on to the ban on insider trading within the framework of IOSCO. It is not clear, however, whether they have gone through the calculus set forth above. Maybe they perceive insider trading as an offense against the market and the harm caused by insider trading to be greater than its putative benefits if institutional investors were allowed to engage in it. This possibility seems doubtful. Although insider trading generally should be banned, mainly due to its adverse effects on the market, it seems that what is happening in IOSCO is largely in response to American hegemonic pressures, deriving mainly from ideology.²¹¹ In this regard, it should be repeated that a

²⁰⁹ The title to the SEC's report to Congress on the progress of the IASC/IOSCO project, "Report on Promoting Global Preeminence of American Securities Markets," is telling. See SEC REPORT, *supra* note 13.

²¹⁰ For a critical analysis of the scenarios mentioned in the text, see Amir N. Licht, *Games Commissions Play: 2x2 Games of International Securities Regulation*, 24 YALE J. INT'L L., pt. IV.A (forthcoming Winter 1998) [hereinafter Licht, *Games Commissions Play*].

²¹¹ See *id.* pt. IV.C.

limited permission for institutional investors to trade on non-public information is not equivalent to a sweeping permission for everybody to do so.

In any event, it is evident that the discussion of harmonization of securities regulation regimes so far has been devoid of a thorough analysis of its corporate governance implications. It would seem beneficial to add this dimension as a major consideration of harmonization projects of this sort. One may think of a "corporate governance impact analysis," akin to an environmental impact analysis, as something that securities regulators may be required to take into account as part of the regulatory process. Such an analysis would specify how the harmonized measure fits into the larger system of securities regulation and company law, while regarding the prevailing structures of corporate governance.

Another conclusion from the analysis is that caution is warranted if, in an environment of regulatory competition, company law and securities law were uncoupled, and entrepreneurs and investors were able to "mix and match" their favored regimes of company law and securities law. Recent proposals in this spirit advocate the establishment of free regulatory competition in securities regulation both in the United States²¹² and internationally.²¹³

Should such a system be established, the assumption that company and securities laws are balanced and coherent may lose its basis. This might open new opportunities for the agency problem by creating loopholes that neither regime governs. It is difficult to estimate the severity of the problem on either a theoretical and a practical basis. But legislators and regulators should be aware of the potential danger and might want to form a policy for addressing the problem in advance. It would seem beneficial, for instance, to include a corporate governance impact analysis in any regulatory reform that endorses regulatory competition as part of its internationalization strategy. Regulators also could limit the set of securities regulation regimes that would be available to their regulatees, similar to the idea of "opting out is possible but only to

²¹² See Romano, *Empowering Investors*, *supra* note 165 (advocating state competition in securities regulation without federal preemption; similar to that of state competition in corporate law).

²¹³ See Choi & Guzman, *Dangerous Extraterritoriality*, *supra* note 22 (advocating international competition in securities regulation to be available irrespective of the company's country of origin). *But see* Darrel Hall, Note, *No Way Out: An Argument Against Permitting Parties to Opt Out of U.S. Securities Laws in International Transactions*, 97 COLUM. L. REV. 57 (1997).

an equivalent or a higher league.”²¹⁴

4. Corporate Governance as a Normative Basis of Securities Regulation

The internationalization of securities markets, through foreign listing and cross-border trading, creates a world of interacting securities markets and interacting securities regulation regimes. Where investors price securities according to several applicable legal regimes, one regime could enhance as well as erode the value that another regime confers upon the security.²¹⁵ The question left open is what normative basis investors should use for passing judgment on the effect that one regime might exert on the other, for instance, whether the former would enhance or erode the value created by the latter. Such a theory would primarily aid investors in pricing a foreign-listed or cross-traded security. Consequently, it could serve as a guide for regulators as to what to expect when their system is about to interact with a foreign one, such as when a security is cross-listed or cross-traded to or from their jurisdiction.

In light of the analysis in this Article, comparative corporate governance emerges as the primary candidate for such a normative basis. When a foreign securities regulation regime interacts with a domestic one, several questions emerge. First, in what corporate governance system was the foreign regime promulgated? Second, what deficiencies is it purported to remedy? More generally, how does it complement that corporate governance system? An external point of view—that of foreign regulators—reflects the notion that corporate governance and securities laws fit together to create a balanced and coherent system.²¹⁶

If the foreign securities law is purported to remedy problems that are also common in the domestic market, then its effect could be either positive or nil. For example, if management in both countries is perceived as prone to outreach by awarding itself excessive compensation, a rule that required disclosure of top offi-

²¹⁴ Howell Jackson, *The Selective Incorporation of Foreign Legal Systems: A Concept Paper on Nepalese Financial Reform (1997)* (unpublished manuscript, on file with author).

²¹⁵ See Licht, *Regulatory Arbitrage for Real*, *supra* note 190.

²¹⁶ To be sure, the legal regime affecting a security comprises of more than just securities and company laws. Other laws, such as tax law, civil procedure, and criminal law, may also be relevant in assessing the total effect of the legal system on the security's value. Those laws, however, are much more peripheral compared with securities and company law (coupled with the prevailing corporate governance structure) so their marginal effect on security prices is lower.

cers' compensation schemes would be deemed beneficial in both countries. It could be the case, however, that the effect of such a rule would be negative. Consider a domestic market where the setting of executive compensation is dominated by conventions and traditions that put an effective cap on it, but also make its disclosure a matter of great embarrassment. Here, the foreign disclosure rule might have a negative effect on managers without having the redeeming virtue of constraining management excesses.

Diametrically, in a regulatory "mix and match" environment hypothesized in Part III.A.3., gaps may emerge that result in a decrease in security value. For example, consider a company from a foreign market that opts out of its securities regulation regime and adheres to the domestic one. The conventions and traditions that were the basis for the domestic regime bear no relevance to the foreign management that is oblivious to them. The likelihood of excessive management compensation would rise somewhat and stock value would decrease accordingly.

A corporate governance impact analysis of the kind suggested above should be useful in this context. Although security prices are believed to reflect all publicly available information, there is reason to believe that they do not do a perfect job in pricing the effect of foreign legal systems.²¹⁷ In discussing the corporate governance premises underlying the securities regulation regime, such an impact analysis may prove helpful in identifying potential points of friction, such as cases where applying a foreign regime in addition to or in lieu of the domestic one might engender problems in terms of corporate governance.²¹⁸

B. *Implications of the Public/Private Distinction*

The now standard story about the causes of path dependence in corporate governance systems mainly focuses on a political economy with some cultural garnish. It recounts how historical

²¹⁷ See, e.g., Licht, *Regulatory Arbitrage for Real*, *supra* note 190.

²¹⁸ Recently, James Fanto made a somewhat similar proposal with respect to cultural differences among countries affecting corporate governance. See James A. Fanto, *The Absence of Cross-Cultural Communication: S.E.C. Mandatory Disclosure and Foreign Corporate Governance*, 17 NW. J. INT'L L. & BUS. 119 (1996). His proposal is more problematic than the one put forward here because cultural differences are more difficult to spell out in a determinable fashion. Moreover, under Fanto's proposal, issuers would disclose to foreign investors their own cultural peculiarities. It is doubtful whether this is a feasible requirement. Such peculiarities may be of a relative nature and issuers, as well as the people preparing the disclosures for them, may themselves be biased by them and thus unaware of their full extent. Here, international markets may have better success in analyzing the problem.

and political forces, coupled with popular cultural tendencies and operating in particular economic circumstances, shaped the laws affecting corporate governance and broke the path for their future development. This Part adds another dimension to the story of path dependence by considering the implications of the public/private distinction. It then explains the differences between corporate governance and securities regulation as they relate to harmonization and regulatory cooperation, while focusing on why harmonization of company laws mostly has proven stillborn and the harmonization of securities laws continues to proceed.

Company law and securities regulation can be described as the private law and public law components of one legal field. To be sure, the public/private distinction, both in general and with respect to the corporation in particular, could be shown to be completely malleable and endlessly flippable.²¹⁹ Nevertheless, it resurrects after every attack. Company law has some basic features of private law, while securities regulation retains the character of public law. At the very least, this means that these distinctions may have an instrumental value as tools in predicting and explaining legal phenomena.

1. Structural Aspects

One reason why it is easier to harmonize securities laws stems from the structural differences between private and public law. Recall that a primary legislative body, such as parliament, enacts company law as well as all private laws. The courts then administer the company law on a case by case basis. In securities law, only its primary principles are enshrined in primary legislation. As in other fields of public law, these principles are then fleshed out by a regulatory agency. This structural difference means that there is "someone in charge," an entity that serves as a point of contact for addressing foreign concerns and for cooperation.

While parliaments cannot meet, negotiate, or harmonize their laws, the members of parliaments may, of course, meet and exchange views. This occurs, however, only at the personal level and has no effect on the institutions. In principle, a state can communicate its concerns with another state's laws, but this is a cumbersome process and never involves the parliaments directly. On the other hand, regulators can and do meet, they discuss regulatory policies, and most importantly, they negotiate (although in differ-

²¹⁹ Cf. Horwitz, *Santa Clara Revisited*, *supra* note 147, at 176.

ent ways than the states).²²⁰ In the field of securities regulation, there exists an extensive regulatory network that spans the entire globe. The most prominent institution is IOSCO, which had nearly 135 members in 1996.²²¹ Securities regulators in the EU also meet regularly, both formally and informally, to discuss common problems.²²² Finally, a thickening network comprised of bilateral Memoranda of Understanding (“MOUs”) is developing among securities regulators in various countries around the world.²²³

Why securities regulators *want* to meet, cooperate, and harmonize their regulations is a question that exceeds the scope of this Article.²²⁴ As securities markets become more internationalized, regulators may encounter problems involving foreign elements more frequently. It is possible that, as a consequence, regulators would be more willing to engage in dialogue and cooperation with their foreign counterparts to ensure the effectiveness of their performance at home. The point advanced here is that as a structural matter, securities regulators are better equipped than are the institutions that are in charge of company law.

2. Substantive Aspects

A second reason why securities laws may be more susceptible to cooperation and harmonization than company law stems from their different substantive status as public and private law, respectively. A simplistic view would hold that company law, as a part of the body of private law, deals with horizontal relationships among entrepreneurs, investors, and other factors providers, most importantly workers. This is the standard nexus-of-contracts model of the corporation. Securities regulation, on the other hand, is more of a technical service provided by the government to ensure and facilitate the orderly functioning of securities markets. It is also limited to the relationship between suppliers and consumers of capital as opposed to other factor providers. Securities regulation

²²⁰ For a discussion of regulatory networks in general, see Slaughter, *supra* note 27, at 189; see also Sol Picciotto, *Networks in International Economic Integration: Fragmented States and the Dilemmas of Neo-Liberalism*, 17 NW. J. INT'L L. & BUS. 1014 (1997).

²²¹ See INTERNATIONAL ORG. OF SECURITIES COMM'NS., ANNUAL REPORT 1996, at 1. The report also provides an overview of IOSCO's activities. See also A.A. Sommer, Jr., *IOSCO: Its Mission and Achievement*, 17 NW. J. INT'L L. & BUS. 15 (1996).

²²² See LICHT, STOCK MARKET INTEGRATION, *supra* note 18, at 36-37.

²²³ An updated list of MOUs in force can be found at the IOSCO web page (visited Sept. 30, 1998) <<http://www.iosco.org/>>. For an overview of the MOUs phenomenon from an American perspective, see Mann et al., *International Agreements*, *supra* note 26; see also Trachtman, *Unilateralism*, *supra* note 25.

²²⁴ See Licht, *Games Commissions Play*, *supra* note 210.

thus represents a vertical intervention in, but a partial section of, the nexus of horizontal relationships governed by company law. To be over-simplistic, company law belongs to the people, whereas securities regulation belongs to the government.

Why the above description is over-simplistic (some would say plainly wrong) has been explained above.²²⁵ But the fact remains that the same countries that are reluctant to reform their company laws, so as to effect their convergence toward a harmonized model, express readiness to revamp substantially their securities regulation regimes toward that end. It seems that states are more willing to cede ground in what belongs to the government but not in what belongs to the people. It thus results that even if the public/private distinction has a dubious analytical basis, it nonetheless serves as a strong heuristic model for the dynamics in the field.

A somewhat similar argument has been recently expounded with respect to core private law in Europe, where the public/private distinction retains much bite. In a thoughtful article,²²⁶ Daniela Caruso argues that a state's control over its private law is laden with ideological significance and is tied historically to the very notion of sovereignty.²²⁷ She further observes:

In spite of Europe's transformation, the core of Member State private law remains guarded in the jealous hands of national institutions, and these institutions are quite conscious of their "national" character. Furthermore, in spite of the effort to harmonise the black-letter law of the different legal systems and—where possible—to bring them into complete uniformity, the procedural rules and judicial remedies of each state retain diverse national features.

. . . Because of the lasting centrality of civil codes in most Member States' self-perception, control over civil adjudication may be the one national border that Brussels does not, and indeed must not, cross. In the legal culture of Europe, private law is perceived as and may actually function as a bulwark against the flood of European regulation, a sort of antidote to the dilution of regional identities.²²⁸

Caruso's argument can be extended beyond the inner core of private law to company law as well. Most of the arguments advanced by European national courts and lawyers against harmo-

²²⁵ See *supra* text accompanying note 153.

²²⁶ See Daniela Caruso, *The Missing View of the Cathedral: The Private Law Paradigm of European Legal Integration*, 3 EUR. L.J. 3 (1997).

²²⁷ See *id.* at 5.

²²⁸ *Id.* at 4.

nizing private law are doctrinal. They claim that such interference breaches the internal doctrinal coherence of the civil codes. From this aspect, company laws generally cannot claim the same degree of doctrinal sophistication and coherence. Furthermore, from a doctrinal perspective, company law may be more amenable to changes when compared with the core Civil Law. This is due to its classification as commercial law, which has its origins in the ancient Law Merchant. That field traditionally has been more flexible.

The evidence so far, however, does not show such flexibility. With the rise of the subsidiarity principle in the EU and in light of its forthcoming enlargements, one may assume that company law in the EU will remain ununified and country-specific.²²⁹ The admission of more member states (particularly Eastern European ones) means higher diversity and subsidiarity means more deference to national and local preferences. The recent developments with regard to the Draft Fifth Company Law Directive will most likely lead to its abandonment, and prospects of the European Company status may not be too rosy either. Meanwhile, the EU has succeeded in harmonizing large parts of securities laws. This evidence calls for a deeper, more substantive explanation.

Private law codes represent a large scale national bargain developed generations ago by a wide array of social constituencies. They are politically, socially, and culturally in equilibrium as much as they are doctrinally so.²³⁰ This is their connection to the "very notion of sovereignty." In this substantive respect, company law is on equal footing with the very core of private law. It too represents a delicate bargain devised by a large number of different constituencies in light of the nation's historical, political, and economic realities. As such, we would expect it to be as resilient to harmonization efforts as regular private law. Evidence from the EU supports this idea.

Note how close this argument is to the argument raised earlier concerning path dependence. Both lines of reasoning explain the stability of corporate governance systems by considering factors that are external to the corporation's boundaries, such as history, politics, and other factors. The public/private distinction argument

²²⁹ See Erik Berglöf, *Corporate Governance, in THE EUROPEAN EQUITY MARKETS* 147, 166 (Benn Steil ed., 1996).

²³⁰ Whichever gets the upper hand in that bargain is a separate question that need not be resolved here. Legal interpretation of the codes, however, has been constantly used to readjust the implicit bargain so as to adopt to new economic and political realities.

can be interpreted as a transformation of the basic path dependence argument into more legalistic terms. While this characterization has a grain of truth to it, the two arguments do not completely overlap.

First, the public law/private law distinction can reinforce the effect of those factors that give rise to path dependence, thereby deepening the path. This happens wherever the distinction has bite, and in civil law countries it has a great deal of bite. In continental Europe, for example, path dependence of corporate governance systems may also stem from, or at least be exacerbated by, the nature of company law as private law. In common law countries, where the public law/private law distinction does not enjoy the same status, that quality of company law by itself tends to have a smaller effect. One should not dismiss the distinction as irrelevant though, since the underlying public/private distinction is known and influential, at least in the United States.

The somewhat archaic practice of classifying legal systems has recently gained new vitality with the work of La Porta.²³¹ He argues that civil law countries, most notably those belonging to the French law family, have inferior business laws as compared with common law countries, as judged by a wide array of factors. But this argument is only static in the sense that it is limited to a description of a current situation. In light of the debate about the "end of history in corporate law,"²³² one may be interested in the dynamic aspect as well.

Under the reasoning presented here, the legal tradition to which countries belong may not only influence the static picture of corporate governance systems that these countries have, but also may influence the dynamic picture with regard to the speed and nature of adaptations. Specifically, one can hypothesize that the characterization of a country's legal system as civil law and the classification of a legal field as private law would have a negative effect on the speed and scope of adaptations in its corporate governance system. In this respect, it is interesting to note that the country that most staunchly objected to the Draft Fifth Directive and to the European Company Regulation is the United Kingdom, where common law originated. This objection, however, was in response to efforts on behalf of continental European countries to fixate their own corporate governance systems through EU

²³¹ Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997).

²³² Hansmann & Kraakman, *supra* note 69.

mechanisms, perhaps in order to shield them from erosion.²³³

Second, the argument advanced here is broader than the standard path dependence story in that it relates both to corporate governance and securities regulation and to the relations between them. The upshot of the argument is that national company laws and corporate governance systems in general will introduce an *additional* drag or rigidity into harmonization efforts of securities regulation regimes. This is because they are so closely connected with the latter and since they are private in nature.

Finally, the argument is narrower than the general scope of the path dependence argument. It applies more forcefully to concerted reforms in corporate governance attempted by harmonization initiatives and the like. It is in these instances that countries may entrench positions in their private law in response to perceived encroachments from the outside. Since Japan and the United States, for example, were not part of such an initiative, the present argument cannot be directly applied to them.

The argument would similarly be less applicable with respect to changes induced by global competitive pressures in capital markets, product markets, or labor markets.²³⁴ Changes of this kind may induce adaptations in the private spheres of the law as much as they may induce regulatory response (although it is difficult to make categorical statements that are so general). Therefore, the public law/private law argument has little to say either about Japan and why it may or may not retain its unique *keiretsu* structure in response to erosion in lifetime employment,²³⁵ or about the prospects of institutional investors in the United States acquiring a status akin to the German *hausbanks*.

CONCLUSION

Until now, international diversity and convergence primarily have been topics for debate only with respect to corporate law and corporate governance. This Article extends the debate to securities regulation as well, in a way that connects it with corporate governance. It also bridges the gap between these two fields with regards to fundamental concepts of legal theory—the concepts of

²³³ An empirical testing of the hypothesis would look for actual changes in corporate governance systems over time and would rightly ignore the identity of political players.

²³⁴ See Gilson, *Globalizing Corporate Governance*, *supra* note 67; Hansmann & Kraakman, *supra* note 69.

²³⁵ See RONALD J. GILSON & MARK J. ROE, *LIFETIME EMPLOYMENT: LABOR PEACE AND THE EVOLUTION OF JAPANESE CORPORATE GOVERNANCE* (Columbia Law Sch. Ctr. for Law and Econ. Studies Working Paper, 1998).

public and private law. After an overview of recent international trends in corporate governance and securities regulation, the Article proceeds to analyze the relations between corporate law and securities regulation. The two fields are distinctive and different, but a large overlap exists between them. A better view sees them as two integrated components of one larger field. Corporate law and securities regulation can also be classified as private law and public law, respectively.

Building on these observations, this Article proceeds to point out some roadblocks on the way to international convergence, primarily of national securities regulation regimes and of corporate governance systems. First, it demonstrates how the inertia and relative stability of corporate governance systems, today understood in terms of path dependence, may interject similar elements into processes of international convergence in securities regulation. In particular, this Article argues that the project currently under way under the auspices of IASC and IOSCO does not demonstrate a sufficient awareness of these aspects. This may put a question mark over the project and its prospects for success. More generally, this Article urges regulators to conduct a corporate governance impact assessment on a general basis.

Turning to the public law/private law distinction, the Article shows how it may further exacerbate path dependence dynamics where the distinction carries legal weight as in many Civil Law countries. The special status of private law in these countries may render company law more resilient to convergence through harmonization by dint of this status. Fields of public law, including securities regulation, are less susceptible to this type of problem. Evidence from the EU during the last three decades arising from initiatives to harmonize securities law and (unsuccessfully) to harmonize company laws are consistent with this argument.