REFLECTIONS ON THE END OF HISTORY FOR CORPORATE LAW

Henry Hansmann
Yale Law School

Reinier Kraakman
Harvard Law School

August 2011

Forthcoming in
Abdul Rasheed and Toru Yoshikawa, eds.,
Convergence of Corporate Governance: Promise and Prospects
(Palgrave-MacMillan 2012)

I. INTRODUCTION

Our essay on *The End of History for Corporate Law*[1] was originally written for a conference at Columbia University in 1997 that was organized to address a question that was then just beginning to attract substantial attention: "Are Corporate Governance Systems Converging?" There can of course be as many answers to that question as there are interpretations of the question itself. At a macro level, however, it seemed to us that there was an important sense in which the answer to this question was clearly "yes." In our essay -- with its hyperbolic title and somewhat more modulated text -- we sought to expound that view.

Before we can ask whether, 15 years after the *End of History* essay was written, the claims it makes still manage to hold up,[2] we first have to ask what those claims are. That is, just what did we claim was coming to an end?

There are, in fact, at least three different types of claims that our essay might be interpreted as making. We'll label them the *ideological* claim, the *efficiency* claim, and the *factual* claim. We'll take them in turn, offering a few thoughts about the content and continuing credibility of each.

II. THE IDEOLOGICAL CLAIM

The strongest and clearest claim we make is an *ideological* or *normative* claim. It says that there is increasing consensus among the relevant actors, around the globe, that what we term the "standard shareholder-oriented model" ("SSM") of the business corporation is the most attractive social ideal for the organization of large-scale enterprise. We asserted that the SSM has four principal elements:

> [First, T]he ultimate control over the corporation should rest with the shareholder class; the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders; [second] other corporate constituencies, such as creditors, employees, suppliers, and customers, should have their interests protected by contractual and regulatory means rather than through participation in corporate governance; [third] noncontrolling shareholders should receive

---

[1] Henry Hansmann and Reinier Kraakman, *The End of History for Corporate Law*, 89 GEORGETOWN L. J. 439 (2001) [hereinafter "End of History"], reprinted in JEFFREY GORDON AND MARK ROE, EDS., CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE (2004).

[2] We undertook an interim assessment of the prescience of our *End of History* essay a few years back in *How Close is the End of History?*, 31 JOURNAL OF CORPORATION LAW 745-51 (2006). The comments offered here draw upon and update that earlier assessment.

strong protection from exploitation at the hands of controlling shareholders; and [fourth] the market value of the publicly-traded corporation's shares is the principal measure of its shareholders' interests.[3]

But if this is the SSM, what are the alternative models that make the SSM seem particularly compelling? Here our article set itself a limited, but not trivial, standard by comparing the SSM to (1) a state-oriented model, (2) a labor- (or, more broadly, stakeholder-) oriented model, and (3) a manager-oriented model. Looking back, we might have added a fourth "model," the corporation with an unconstrained controlling shareholder or family that thrives in an environment of lax regulation and intimate ties to the state. Such corporations are commonplace around the world, but no one suggests they are a positive model of good governance or an efficient means to create social wealth. Their social effects depend in large measure on the ambitions and reputations of their wealthy controllers.

As against these alternatives (including the fourth model), our ideological claim is holding up extremely well. For example, Japan, once a standard-bearer for the state-oriented model, has slowly moved toward the managerialist model as the state has withdrawn from centralized planning. In the new Japan, the Ministry of Economy, Trade, and Industry (METI) has shifted from economic planner to mediator in possible conflicts between the interests of shareholders and managers. For example, it has released a "Corporate Value Study" proposing guidelines for takeover defensive tactics that are based on the "corporate value standard" and "the interests of shareholders as a whole," and that are explicitly patterned on Delaware law.[4] While hostile takeovers remain difficult in Japan, the reasons appear to be cultural rather than legal, since Japanese law on its face remains friendlier to hostile bids than Delaware law.[5] This embrace of the SSM on the books is also illustrated by reforms adopted after publication of our paper by the Tokyo Stock Exchange, which allow Japanese companies to adopt an American-style board with mandatory outside directors and an independent audit committee or, alternatively, to retain the traditional Japanese board, dominated by inside directors and monitored by internal auditors.[6] Thus far, few Japanese companies have switched, but this may say more about the power of default provisions and incumbent managers than about the public's wider perceptions regarding board legitimacy.

Today's champion of the state-oriented model is no longer the Japan of the 1960's or the South Korea of the 1970's but China of 2011, soon to become

---

[3] *End of History* at 440-441.

[4] English translation at http://www.j.u-tokyo.ac.jp/~kanda/english.htm. For thoughtful commentary see Curtis Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171 (2005)

[5] Bull Dog decision,

[6] Kraakman, et al., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, (2[nd] ed.) , 68-69 (2009).

the world's largest economy. The SSM as a model is hardly an explicit part of China's state ideology, and is, to put it mildly, in tension with China's fading Marxist heritage. Nevertheless, the Chinese economic elites that matter (which include economists, wealthy businessmen, individual entrepreneurs, and commercial lawyers) probably already embrace the SSM. While we claim no expertise in modern Chinese company law, it bears a family kinship to the laws of other Asian and European jurisdictions that derive from classical German company law. This law, like most continental European company law, gives ideological primacy to the corporate entity rather than to its shareholder constituency. Nevertheless, shareholders constitute, and can dismiss, the supervisory board on their own motion, which satisfies law professors in the continental tradition while remaining compatible with the SSM in China. (In Germany itself, codetermination qualifies corporate governance.) As in Germany, moreover, China's most profitable firms today are the privately-held companies of the *Mittelstand* that derive legitimacy not from abstractions but from the ability to flourish in highly competitive export markets.

More interesting for our purposes are China's numerous large companies that were appendages of state ministries only forty years ago. Today most of these state-owned enterprises ("SOE's") have significant private equity ownership, and in many, the state—or more accurately, various state organs--retain only minority equity stakes. These former SOE's may never be completely privatized. After all, they are represented as following the state-oriented model, which prioritizes the state's economic plans and social goals over the SSM's objective of maximizing long-term shareholder value. But insofar as former SOE's win wide autonomy from the state to make profits (and suffer losses), they edge away from the state-oriented model and toward the SSM. State organs that hold large equity blocks feel the pain of poor economic performance, as do less powerful shareholders who often include noisy foreign institutions, hundreds of thousands of individual Chinese investors, and even other state bodies with their own political agendas. Largely for this reason, we conjecture that over time the state—and whichever holding company, municipality, or other political unit is the company's largest shareholder—will come to prefer economic returns over political returns bought at the expense of other shareholders.[7]

Turning now to the labor-oriented model, consider Germany, its most prominent advocate in company law if not necessarily its most active practitioner.

---

[7] Indeed, some commentators claim that the Central Chinese government, if not all of its regulatory bodies,have already shifted de facto to the SSM model and seek to maximize shareholder value. The state-oriented model remains the exclusive ideology at all levels of government, however. See Charlie Xiaochuan Weng, *Lifting the Veil of Words: An Analysis of the Efficacy of Chinese Takeover Laws and the Road to the Harmonious Society*, forthcoming in 24 COLUMBIA J. ASIAN LAW ___ (2012).

Two decades ago quasi-parity codetermination[8] was so entrenched—so fundamental a part of the German "social contract"—that it was seldom even discussed. By contrast, the past decade has seen a swelling of academic commentary critical of codetermination as reducing shareholder value.[9] Simultaneously, scandals involving the apparent bribery of union directors and accusations of collusion between labor directors and management at the expense of shareholders have made public criticism of codetermination acceptable.[10] Indeed, as we note below, Germany has, in effect, already abandoned mandatory codetermination for firms that do not already have it.

And now consider the U.S., the original home of the managerial model. The last two decades are pockmarked with the efforts of shareholder activists, institutional investors, and entrepreneurial politicians to increase the accountability of officers to corporate boards and the accountability of boards to shareholders.[11] Some battles are won by shareholder reformers and some by management's champions, as when a panel of the D.C. Circuit recently struck down a Securities and Exchange Commission Rule allowing, under certain circumstances, 3% of a company's shareholder base to nominate candidates for board seats in a public company on the company's own proxy.[12] Such skirmishes might seem of little consequence to most European observers who are accustomed to much more sweeping shareholder powers. But anyone with long experience with U.S. public companies can attest that a sea change in director and shareholder relationships has occurred over the last two decades. Although there are a few dissenters, for all practical purposes the SSM has come to dominate discourse about corporate governance in the U.S. This is not to say, that SSM always guides corporate governance in a shareholder friendly direction. It is to say, however, that even advocates of greater managerial autonomy no longer defend the managerial paternalism popular in the 1950s. Instead they argue that seemingly pro-shareholder reform such as proxy access actually undercuts the SSM by empowering atypical shareholders such as hedge funds

[8] Quasi-parity codetermination refers to the legal requirement that German supervisory boards of large companies include equal numbers of shareholder and labor directors. In the event of a tied vote, the issue may be brought up at a second meeting of the board, in which case the board chairman, who is always a shareholder representative, receives two votes—and at least in theory, shareholders will prevail. Anecdotal evidence suggests, however, that German supervisory boards will go to great lengths to avoid split board decisions.

[9] E.g., Frank Schmidt and Gary Gorton, *Capital, Labor, and the Firm: A Study of German Codetermination*, 2 J. EUROPEAN ECON. ASSOC. 863 (2004).

[10] Consider the scandal arising from the tacit support given by a union director for the allegedly illegal payment of large sums as rewards to Mannesmann's management for extracting a large premium in exchange for selling the company to Vodafone. Another recent scandal arose at Volkswagen, where labor directors enjoyed tropical vacations and subsidized prostitutes at company expense.

[11] There remain, of course, prominent and thoughtful commentators who buck the trend. Margaret Blair and Lynn Stout, for example, continue to extol the virtues of managerialism, in the name of protecting stakeholders. Yet even they are fairly restrained in the degree of entrenchment they seem willing to sanction.

[12] Business Roundtable and Chamber of Commerce v. SEC, D.C, Circuit (July 22, 2011).

and union pension funds to feather their own nests at the expense of shareholders as a class.

We should emphasize that the SSM does not impose upon corporate managers a legal obligation to maximize financial returns to shareholders without regard to the consequences for third parties. Rather, the SSM simply requires that corporate managers act as faithful agents of the corporation's shareholders. That is, managers should do what the shareholders, as a group, would prefer them to do. And it's reasonable to assume that most shareholders prefer that their corporations behave according to the same ethical norms that guide the shareholders themselves in their own activities as individuals. Shareholders presumably do not want their corporate managers to cheat customers, abuse workers, or foul the environment even if doing so would be both legal and profitable. Managers, consequently, are not in violation of their duties under the SSM if they follow conventional morality in acting fairly and even generously toward constituencies other than shareholders. What distinguishes the SSM from the labor-oriented model (or stakeholder models in general) is not that managers can be generous toward employees only under the latter, but rather that it is the norms of the shareholders, and not those of the employees, that determine the appropriate level of this generosity. Thus, under the SSM, employees are not given the power to choose the corporation's directors, nor do employees have a corporate law right to call managers to account for breach of fiduciary duties. Rather, these means of controlling managers are reserved exclusively to the shareholders.

Admittedly, even when the SSM is understood in this broader sense, it continues to arouse some substantial disquiet, particularly in continental Western Europe. The perceived problem, at its core, seems to be that this model gives excessive rein to market forces in general -- in the share market, the labor market, the product market, and elsewhere – and that the result is excessive social instability. In part, this seems just protectionist pleading for special interests – favoring of workers who have jobs over those who do not, of shareholders who hold controlling interests over those who do not, and so forth. To that extent, these concerns are unlikely to maintain broad normative appeal, but rather be accepted sooner or later as no more than window dressing for continued favoritism toward entrenched interests.

But this disquiet may also reflect a broader concern about social efficiency. For many individuals, increasing social stability may be worth sacrificing a meaningful amount of productivity as measured -- as it conventionally is -- in terms of the net value of market transactions. If so, the legitimacy of the SSM may suffer in the long term, however much it may be in ascendance now. To probe this possibility a bit deeper, we must turn to the efficiency claim.

III. THE EFFICIENCY CLAIM

The *efficiency* claim holds that the standard shareholder-oriented model is the most efficient way to organize large-scale industry, and will remain so for as far as we can see.

Can the efficiency claim be false if our claim that jurisdictions are converging on the ideology of the SSM is true – even if, for want of a better measure, we take (Kaldor-Hicks) social efficiency as our rough normative standard? The answer could be yes, if current ideology is mistaken about what's efficient. Of course, as suggested at the end of the previous section, if that is the case, then the current normative consensus may not be long-lived. We may all subscribe to an ideology today that purports to establish that we've reached the end of history, but someday, when we understand the facts better, we're going to change our minds, and the endpoint of history will then recede into the distance.

Our article proceeded a bit gingerly in pressing the efficiency claim. It implied, however, that there were good reasons to accept that claim. One reason was survival: firms (and societies) organized along the standard shareholder-oriented model seemed to be out-competing those that were organized differently. Other reasons went more to logic, and to experience with particular components of competing models. First, parliamentary institutions behave poorly as compared to markets in aggregating the preferences of a heterogeneous group. Voting control over a firm is, consequently, nearly always confined to a highly homogeneous group. This means that sharing of voting control between investors of capital and other stakeholders is generally very costly. Second, fiduciary rules are even less suitable as a means of achieving a workable balance between conflicting interests; hence, imposing affirmative fiduciary duties on management to protect simultaneously the interests of two or more groups is unworkable. Third, thoroughly entrenched managers will too often mismanage or overinvest. Fourth, it is not possible to have state control without imposing on the corporation various objectives that are unrelated to productive efficiency. Since nothing in the foreseeable future seems likely to change these constraints on the organizational forms that are productively efficient, the principal competitors to the SSM will remain badly handicapped or gradually morph into something very much like what the SSM might prescribe, as we (perhaps rashly) predicted above that they will in the future of China's state-controlled firms.

The most serious argument against the efficiency claim has a rather broader basis, however. As suggested in the previous section, the argument is that the SSM involves too steep a tradeoff between material prosperity and social order. That model may be fine for Americans, who are intensely individualistic and place an exceptionally strong value on personal liberty. But for other societies -- including Western Europe -- that place a higher value on stability, the market forces unleashed by the SSM may be excessively corrosive of personal expectations, social relations, and even dependable financial institutions. It is not crazy to feel that a leisurely daily walk to a dependable workplace in the well-preserved medieval city of one's birth is preferable to lower prices on smartphones. If the current organization of business in a given society perpetuates the dominant role of workers, powerful families, managers, or the state, that may be seen not as a vice but as a virtue – a workable means of reinforcing the society's legitimate structure of authority. It is from this perspective that the end of history claim is weakest. Nevertheless, we expect that the desired level of social order will generally be more effectively obtained through prudent regulation of the markets in which corporations act -- including the markets for labor, capital, real property, and consumer products -- than through regulation of the corporate form itself.

A last critique of the efficiency of the SSM turns on the difficulty of implementing this model in the complex environment of large enterprises. As a norm or ideology, there are good reasons why the SSM does not turn on any particular ownership structure. All jurisdictions including the U.S. exhibit an evolving distribution of ownership structures. Although the U.S. is rich in diffusely-held large firms, its mid-cap and small-cap public companies split between diffuse and controlled ownership structures. All jurisdictions have distributions of ownership structures. Given the need for elasticity in implementing the SSM, we expect that directing managers or controlling shareholders will always manage to bend the rules to their advantage on the margins. Thus, the ultimate point of convergence in practice will not be on the SSM itself, but on some point that is more or less off-center, allowing managers and controlling shareholders just a bit more discretion than the model prescribes. To the extent that the model is optimal, history will end at a point that is suboptimal.

But again, while acknowledging that inefficiencies will continue even if the SSM finds universal acceptance, we predict these inefficiencies will be smaller over the longrun than those that might result from strict and ideologically driven efforts to implement either the state-oriented or the stakeholder-oriented models. Indeed, what may save large German firms from the full costs of codetermination is their ability to coopt labor directors. Similarly, the splintered ownership of former state-owned enterprises in China may protect these firms from the full costs of becoming the pawns of state bureaucrats. The agency problem can work two ways. Managers with compensation tied to profits may begin to mimic true owners. Finally, we are quite certain that firms operating under the SSM regime are more efficient that their feral cousins, the large but controlled companies that operate in jurisdictions where there are few constraints on self-dealing or other means of exploiting minority investors.

IV. THE FACTUAL CLAIM

Our *factual* claim is that, whatever is the case with respect to ideology and efficiency, practice and law are, as a matter of fact, converging on the standard shareholder-oriented model. Our article implied that the factual claim was true, but carefully avoided offering any time frame for future convergence.

As it happens, convergence in fact has proceeded quite quickly in the years since we wrote – even faster than we might have predicted if we'd been so adventurous as to try. Major corporate jurisdictions have adopted a wide range of shareholder-oriented corporate reforms, including stronger public and private enforcement, stricter controls on market manipulation and insider trading, improved disclosure, regulation of both affirmative and defensive tactics in takeovers, and limitations on unequal voting structures.[13] A very large hurdle to convergence was at one time the numerous differences between national accounting regimes. That difference is on the verge of disappearing. Already when we wrote our initial Article, it was clear that accounting worldwide would be governed by one of two Anglo-Saxon, shareholder-oriented regimes: GAAP and International Financial Reporting Standards (IFRS), which has been adopted by most jurisdictions other than the U.S. On November 15, 2007, the SEC voted to permit foreign cross-listers on U.S. exchanges to disclosure their IFSR financials without attempting to reconcile them with GAAP. The express purpose of allowing IFSR disclosure to satisfy American reporting requirements was to encourage worldwide convergence on a single set of accounting standards. The momentum continues to build for such a convergence, especially since recent academic literature demonstrates that despite the "rule versus standard" methodological distinction between GAAP and IFSR, the two accounting regimes provide identical information on firm performance to the American capital markets.[14]

We could provide many more specific instances of convergence toward the SSM with a slight tilt favoring management or controlling shareholders over shareholder interests. The U.K.'s takeover code has been altered to strengthen the hands of target managers defending against hostile takeovers after Kraft Foods' successful takeover of Cadbury p.l.c.[15] This added precisely the sort of managerialist tinge that we had anticipated in general to the U.K.'s usually stalwart allegiance to the SSM. But more examples are unnecessary. The interesting question here is not whether there is convergence toward the

[13] *See, e.g.*, Ehud Kamar, *Beyond Competition for Incorporations* 11-27 (ECGI Working Paper, 2005); Marc Goergen, Marina Martynova, and Luc Renneboog, *Corporate Governance Convergence: Evidence From Takeover Regulation Reforms in Europe* (Forthcoming : OXFORD REVIEW OF ECONOMIC POLICY).

[14] E.g., Yongtae Kim, Haidan Li, and Siqi Li, *Does Eliminating the Form 20-F Reconciliation from IFRS to U.S. GAAP Have Capital Market Consequences?* (forthcoming in J. Accounting and Econ.)(2011).

[15] Takeover Panel Response Statement, *http:// www.thetakeoverpanel,org.uk/wp-content/uploads/23008/11/2010-22.pdf.*

standard shareholder-oriented model—there clearly is-- but rather how far it will go and how long it will persist.

Surely the corporate reforms that we see have been driven in substantial part by the particular international economic and political context of the past two decades, which is characterized by strong international capital markets. We've been here before – namely, in the decades before the First World War. Those were, in fact, the decades in which the joint stock company, in the same basic form we know it today, came to be the standard form of organization for large-scale enterprise in all major economies. As Rajan and Zingales have emphasized[16], war and depression subsequently led to substantial autarchy in the capital markets. That isolation, together with the turmoil of the times, allowed special interests to achieve vested power in corporate structures—with the full assistance of the Allied Powers after the Second World War. It was at this point that the nonstandard corporate models first arose: employee participation as in Germany, state corporatism as in France and Japan, the deliberate dismantling of large family-centered enterprises in Japan, the ascendency of family dominance in Sweden, and the rise of managerialism in the U.S. Only recently have world capital markets again opened up, and this surely goes far in explaining the recent rapid convergence toward the standard shareholder-oriented model.

If and when, once again, something happens to close down the world's international capital markets – continued economic stagnation following the financial crisis of 2008, perhaps, or further paranoia about terrorism, or new confrontations between the great powers – then, even if the standard shareholder-oriented model of corporate capitalism is efficient, leading societies may once again start moving away from it, adopting corporate structures that give the state and/or important private interests more control. Today we see both China and Russia struggling with the tradeoff between state control of enterprise and access to capital on the international markets. Though, in recent years, both of those countries have, with occasional backsliding, resolved this tradeoff in favor of access to capital and hence movement toward the standard shareholder-oriented model, it might not take much of a shock for either or both to decide that they prefer strong state control.

Ancient Rome, it appears, had by the end of the Republic developed a widely-used entity form with publicly traded shares that was close in structure to a modern joint stock company.[17] The form was then abandoned under the

---

[16] Raghuram Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the 20th Century*, 69 JOURNAL OF FINANCIAL ECONOMICS 5 (2003).

[17] Ulrike Malmendier, *Roman Shares*, in WILLIAM GOETZMANN AND K. GEERT ROUWENHORST, EDS., THE ORIGINS OF VALUE: THE FINANCIAL INNOVATIONS THAT CREATED MODERN CAPITAL MARKETS 31-42 (2005); ERNST BADIAN, PUBLICANS AND SINNERS: PRIVATE ENTERPRISE IN THE SERVICE OF THE ROMAN REPUBLIC (1972). We note, however, that a recent scholar of Roman Law, Dr. Andreas Fleckner, cautions against equating Roman entities too closely with the corporate form since the evidence is sparse and ambiguous on this point.

Empire, in important part because the emperors wished to centralize state authority, and hence nationalized the activities that had been conducted by those large companies. Subsequently, nothing like the business corporation reappeared until a thousand years later, when the merchant-dominated Italian city-state of Genoa, facing a highly competitive international market, resumed the experiment.[18] As we march toward the end of history, further interruptions of this sort may await us. Or, to put it differently, one's faith in reaching the end of history for corporate law may be closely tied to one's faith in achieving Fukuyama's original "End of History" in politics.[19]

V. MECHANISMS FOR CONVERGENCE

The End of History for Corporate Law explicitly took issue with the argument, prominently offered by Lucian Bebchuk and Mark Roe, that convergence in corporate law would be blocked indefinitely in many countries by controlling shareholders who are among their countries' economic and political elites. The society-wide economic gains to be had from escaping such blockage would, we predicted, lead societies to find ways to avoid it. A particularly promising strategy to this effect, we suggested, is to establish, parallel to the existing (weak) system of corporate law, an alternative regime that follows the standard model with its strong protection of minority shareholders. Firms can then choose which regime they will be governed by, subject to strong constraints on a firm's ability to shift from the stronger to the weaker regime. Established firms with dominant controlling shareholders can then continue under the old regime, unthreatened by reform, while firms -- and particularly new firms -- seeking to raise equity capital on favorable terms can choose to be governed by the newer and stronger regime.

As an example of this strategy -- subsequently termed "regulatory dualism"[20] -- we focused on Germany's *Neuer Markt*, which established special, more rigorous standards for new firms in high technology industries. After the publication of our essay, the *Neuer Markt* failed spectacularly, owing to a combination of problems in design, management, and circumstance.[21] As it was failing, however, Brazil was establishing its own approach to regulatory dualism with its *Novo Mercado*, which avoided the mistakes of its German predecessor and has been a stunning success, effectively breaking a century-old blockage of

---

[18] *See* Guido Ferrarini, *Origins of Limited Liability Companies and Company Law Modernisation in Italy: A Historical Outline* (2002).

[19] FRANCIS FUKUYAMA, THE END OF HISTORY AND THE LAST MAN (1992). Although the suggestion is tempting, the link between the SSM and liberal political regimes lies well beyond the scope of this casual essay. See note __ supra.

[20] Ronald Gilson, Mariana Pargendler, and Henry Hansmann, *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the U.S., and the EU*, 63 STANFORD L. REV. 475 (2011).

[21] *Id.* at 502-7.

corporate reform and facilitating the rapid development of new and growing firms.[22] Moreover, Brazil's success with this strategy has not escaped the attention of other developing nations.[23] In the language of this essay, the *Novo Mercado* has added to the old regime, comprised of lightly regulated and often opportunistic controlled companies, a new generation of firms with a more dispersed ownership structure and a much stronger commitment, both ideological and factual, to the SSM

Meanwhile, the EU as a whole has implemented a form of regulatory dualism that has overcome the political obstacles to corporate law reform in Europe and is rapidly bringing convergence in corporate law to the EU member states. In its *Centros* line of cases, the European Court of Justice has given firms formed in a member state of the EU the right to incorporate in any other member state. But the ECJ and the EU parliament have not removed obstacles to cross-border reincorporation or merger that render it difficult for established firms to change their current state of incorporation and hence escape restrictions (such as codetermination) imposed by that state.[24] For established larger firms, the EU has also created an EU-wide form, the Societas Europaea (SE), that continues to leave some aspects of corporate governance governed by the law of the member state where the firm is registered, but allows the firm to change its registration to another member state. For firms governed by codetermination rules, however, specific provisions require that a firm reorganized as an SE must retain the level of codetermination that it formerly had. This means that German firms with more than 2000 employees must continue to have worker representatives constitute half the members of their supervisory boards. Firms with between 500 and 2000 employees, however, must continue to have worker representatives constitute one third of supervisory board members, but not a larger fraction, and firms with fewer than 500 employees at the time they convert to an SE need never have any worker representatives on the governing boards at all, no matter how many persons these firms may subsequently employ.[25]

We predicted in *The End of History* that codetermination – by far the most conspicuous instantiation of the labor-oriented model of corporate law -- would not spread, and that at most it might remain a politically entrenched oddity of German law. And now, even faster than we expected, it is clearly on its way out, and European law and practice as a whole are moving quickly toward the standard shareholder-oriented model of the firm.

The European experience has, however, been a surprise for us in one respect. We predicted that neither explicit harmonization nor regulatory

---

[22] *Id.* at 482-501.

[23] *See, e.g.,* Danilo Gregório & Simone Azevedo, *Inspiration for the East: Encouraged by the Novo Mercado's Success, the Philippines and India Create Special Listing Tiers in Their Own Stock Exchanges*, REVISTA CAPITAL ABERTO, Aug. 2009, at 38.

[24] *See* Marco Becht et al., *Where Do Firms Incorporate? Deregulation and the Cost of Entry*, 14 J. CORP. FIN. 241, 243 (2008).

[25] *See* Gilson et al., *supra* note 20.

competition were likely to be important mechanisms for convergence in corporate law, which would instead advance by different means. But convergence in Europe has been strongly promoted by the regulatory competition established under the *Centros* line of cases, at least for closely-held or "private" companies as they are termed in the U.K. This unexpected development is a reflection of the extraordinary activism of the ECJ, which has been able to act with conspicuous independence from state-level political constraints.

VI. IS CORPORATE LAW DECONSTRUCTING?

In our more recent work, we have focused on the long-term evolution of organizational law, and on its likely future development.[26] As we've emphasized there, the law of commercial entities has become ever more flexible, to the point where today an entity with the special form of asset partitioning provided by the corporate form – strong entity shielding[27] and full limited liability – can be given any desired pattern for allocation of control and earnings, and in particular need not accept the type of governance structure characteristic of the traditional business corporation. These more flexible forms are, moreover, being widely used; the Limited Liability Company, in particular, is quickly surpassing the business corporation in numbers of new entities formed. At the same time, intra-firm asset partitioning is becoming ever more fragmented and complex, as firms create increasing numbers of subentities, which themselves have a variety of different ownership and control structures.[28]

Might one conclude from this that commercial entities are deconstructing? Is the simple standard publicly traded business corporation -- with earnings and control rights allocated uniformly across a single class of common stock, with governing authority delegated to a simple shareholder-elected board, and with all of the firm's assets assembled in a single pool to back the firm's general obligations – simply a transitory form, well suited only for the particular phase of industrial and social technologies of the past two centuries? Might we see – to take just one possibility -- that the monolithic business corporations of today will give way to fluctuating sets of overlapping alliances of protean form, as sociologists have been inclined to see in high tech industries?[29]

---

[26] Henry Hansmann, Reinier Kraakman, and Richard Squire, *Law and the Rise of the Firm,* 119 HARV. L. REV. 1335 (2006); Henry Hansmann, Reinier Kraakman, and Richard Squire, *The New Business Entities in Evolutionary Perspective*, 2005 ILLINOIS L. REV. 5 (2005).
[27] Or "strong form affirmative asset partitioning," as we dubbed it in Henry Hansmann and Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L. J. 387 (2000).
[28] *See, e.g.,* Richard Squire, *Strategic Liability in the Corporate Group*, 78 UNIVERSITY OF CHICAGO LAW REVIEW 605 (2011).
[29] *E.g.,* Walter Powell, *Inter-Organizational Collaboration in the Biotechnology Industry*, 152 J. INSTITUTIONAL & THEORETICAL ECON. 197 (1996).

The answer, we suspect, is no. The increased flexibility offered by the new forms – which, in any case, does not represent a great leap beyond what could already be done in practice with the close corporation – will continue to be used largely by closely held firms. Publicly traded firms will continue to have the simple standard structure of ownership, control, and mandatory fiduciary duties.[30] There is likely to be more subpartitioning of assets among classes of creditors than in the past. But there won't be much subpartitioning of earnings or control rights – of the type that was experimented with in tracking stock, for example – within any given publicly traded firm. Nor will closely held firms displace publicly traded firms as society's dominant producers of goods and services.

Of course, there may well be future changes in industrial and social technologies that will ultimately call for new forms of organization for productive enterprise that we have difficulty seeing today. Yet there have been large changes in these regards over the two millennia separating us from the Roman Republic, and we nevertheless organize our largest firms in a fashion that the Romans would apparently find familiar.

VII. A MATTER OF DETAIL

Finally, there's the question of the level of detail at which one sees convergence. Just how will nomination of directors be handled? What is the proper balance between public and private enforcement of manager malfeasance? How will mergers and acquisitions be regulated to prevent either too much managerial discretion or too much abuse by majority shareholders?

The *End of History* essay carefully avoided saying anything specific about such matters. And with good reason. There will probably never be perfect homogeneity in the approaches taken to these issues, not only across jurisdictions but even within any given jurisdiction over time. This is not only because the political power of the various interest groups involved will remain in flux, but also because, even from a pure efficiency point of view, the best approach depends heavily on background factors such as the patterns of shareholdings and the nature of the shareholders, and these in turn are likely to adapt to the prevailing rules in ways that either undermine the effectiveness of those rules or, conversely, reduce the importance of the problem to which the

[30] In this regard, it is particularly interesting that the Delaware corporate law is the only legal regime retaining mandatory structural elements and mandatory fiduciary duties with substantive content. All other business entities arising under Delaware's statutes (e.g., the LLC, LLP, LP, and business trust) permit their creators to opt out of all fiduciary duties except the duty of good faith—which seems to us to be no more than the minimum condition necessary to support longterm commercial commitments. Only a madman, it seems, would allow a business partner tocontract out of the duty of good faith. We suspect this extraordinary latitude to sidestep fiduciary obligations is meant to appeal to sophisticated and heavily lawyered agreements creating closely-held entities, and for this reason do not require standard form structures or fiduciary duties. Public corporations, by contrast require simple standard forms to reduce the information costs of investors and enhance the liquidity of shares.

rules were originally addressed. Indeed, one can see corporate law in general as effectively a delegation to the legislature and the courts of the continual reformation and reinterpretation, as circumstances and strategies change, of the indefinitely long-term relational contract among a corporation's shareholders, managers, and creditors that is constituted by the corporation's charter.[31]

Of course, it might be said that this leaves most of the important and interesting debates within corporate law today untouched by our thesis. And, yes, that's not an unreasonable thing to say.

VIII. SOME CONCLUDING REFLECTIONS

When our original essay was published in 2001, it stirred up far more interest and far harsher criticism that we had anticipated. Some of the criticism—and perhaps the interest too—arose from misunderstandings. Many readers assumed that we identified the standard shareholder-oriented model with the widely-held American corporation as it came under increasing pressure to pursue shareholder interests. We did not. We always believed that ownership structures were partly endogenous and partly responsive to the larger economic world in which they were situated. Our point was that the SSM was adaptable to all ownership structures, as long as shareholders as a class enjoyed identical claims on firm cashflows. Thus, non-exploitative, regulated controlling shareholder structures fell well within the SSM. We did not predict their disappearance in the U.S., much less in other jurisdictions. A second misunderstanding understood us to claim that the SSM as implemented would be optimally efficient. Quite the contrary. We always assumed that the SSM as implemented would have a managerialist bias. Convergence is convergence, not convergence on optimal governance even by the criteria of the SSM.

Our principal goal was to illuminate what seemed to be obvious to us at the time and still seems obvious today: The SSM is the dominant ideology, or global normative standard, of corporate governance in this period, and is likely to remain so absent a cataclysmic event that reverses the economic progress of globalization. In particular, the SSM is more likely to succeed than the four most familiar alternatives: the labor-oriented model, the state-oriented model, the manager-oriented model, and the common phenomenon--if not the model--of controlling shareholders empowered to manage corporations free of strong legal protections for minority shareholders.

But this seems to us the easy part of analysis and prognostication. The more difficult part is to work out the details in implementing the SSM and continually re-adapting it to an ever-changing environment.

[31] *See* Henry Hansmann, *Corporation and Contract*, 8 AMERICAN LAW AND ECONOMICS REVIEW 1-19 (2006).