Codes and Model Laws: A EU-US Comparison of Their Role in Shaping Company Law

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This article analyses the particular role played by soft law instruments (such as codes of corporate governance, codes of conduct, model law and other non-binding instruments) in shaping the legal framework applicable to European and American companies. It concludes that soft law is a very popular and successful girl nowadays, for legitimate reasons, but one that brings about a series of concerns as well. This article finds that soft law instruments upset the traditional hierarchy of sources of law and the distinction between civil law and common law countries. It also observes that soft law converges, and, in turn, provokes further convergence of the legal framework. Finally, it exemplifies (and criticizes) instances of transformation of soft law into hard law, accompanied by a general phenomenon of hardening of the legal framework, including because instruments sometimes labelled ‘soft law’ are in reality closer in effect to hard law.

Keywords: soft law, company law, corporate governance codes, codes of conduct, directives, regulations, recommendations, green papers, comply or explain, EMCA, MBCA, ALI Principles

1. INTRODUCTION

Pursuant to the subsidiarity principle,1 European Union (EU) institutions have intervened in company law matters mainly by means of directives. There are also some regulations, as well as a number of recommendations, resolutions, and green papers. EU companies are also subject to financial markets law, which has more frequently taken the form of regulations, rather than directives. EU directives require implementing national legislation while EU regulations do not and produce direct effects in the EU Member States. Soft law neither requires implementation nor produces (direct) effects, whether it is of public or private origin.

Soft law of public origin emanates from EU and national institutions and authorities. EU institutions used soft law mainly in the field of corporate governance and audit (recommendations and green papers from the European Commission, as well as a series of resolutions of the European Parliament). EU supervisory authorities are also employing soft law instruments more and more frequently as well, as evidenced by the practice of the European Securities and Markets Authority (ESMA) or the European Central Bank (ECB).

Soft law of private origin is represented by a variety of codes drawn up by associations and private entities. They can be subdivided into two categories: corporate governance codes (Part I) and codes of conduct intended for various professionals (Part II). After discussing them in turn, including by reference to their US counterparts, I identify a number of common trends (Part III).

2. CORPORATE GOVERNANCE CODES

There is (at least) one corporate governance code in each EU Member State.2 These codes typically target public companies, although some specifically target private (unlisted) companies (e.g., the ecoDa3 and Buyss4 codes) and some apply to all types of companies.

While there is no European Corporate Governance Code (yet), a European Model Company Act (EMCA) was finalized recently, which claims to have been inspired by the American Model Business

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1 Article 5 of the Treaty on European Union (‘TEU’). The subsidiarity principle gave more legitimacy to EU interventions concerning public companies than private companies, because public companies have cross-border activities.


Corporations Law (MBCA). The US has very successfully used model laws, such as the MBCA, as a particular form of soft law. Upon adoption by the states, this soft law becomes hard law, but, for the states that do not adopt it, maintains its legal nature as soft law. It is the same with the emblematic Delaware General Corporation Law (DGCL), which is a form of hard law in Delaware, but, at the same time, a very persuasive form of soft law everywhere else in the US. Finally, the US also has a corporate governance code, represented by the American Law Institute (ALI) Principles of Corporate Governance (ALI Principles).5

In the EU, corporate governance issues have traditionally been regulated at the national level, through corporate governance codes, which have a series of unique advantages as compared to any form of hard law. First, they adapt to the diversity of corporate situations. Hard law necessarily subjects situations that may be extremely different to the same standard. This 'one size fits all' approach has often, and rightly, been criticized. In contrast, soft law allows the realities of each company to be taken into account, including based on the frequently employed 'comply or explain' approach: a company that decides to derogate from a rule contained in the code, which is applicable to it, must indicate both the existence of, and the reasons for, this derogation.6

Soft law also offers a flexibility that hard law does not allow, as it can be more easily revised to take into account relevant developments. Corporate governance codes are often revised in practice. Moreover, a current trend is the implementation of periodic evaluation and updating procedures for the corporate governance codes. In contrast, and as will be discussed in more detail below, changes to corporate laws take time and, if political willingness is not present, might not even be possible. This is true both at the EU level and at the national level of the EU Member States.

Very few legislators are able to make revisions to their hard laws at the speed of which revisions to the corporate governance codes are made.7 One such legislator is Delaware, in the US. Delaware uses a yearly amendment process of its corporate laws.8 In practice, amendments are often passed unanimously, which reflects the fact that this particular matter is not subject to partisan controversy.9 The rationale for this unusual situation is that, while Delaware is the second smallest American state, by population and surface, it is home to approximately 1.6 million legal entities, including many public companies (93% of all US initially publicly traded companies and nearly 68% of Fortune 500 companies10), which generate about 25% of the state’s general fund through corporate income taxes and franchise fees.11 These elements distinguish Delaware from any other US state or EU Member State. Other national legislatures lack the ability to follow suit, including on the point of being able to implement legislative amendments on a yearly basis. Soft law can.

Moreover, while hard law in principle has a limited geographical scope, soft law breaks free from territorial borders and reflects the globalization of the economy. Finally, while hard law encourages a formal approach based on textual compliance, soft law favours the appropriation of recommendations by stakeholders and thus constitutes the lever for a real change of practices.

The adoption of a European Corporate Governance Code would, in my view, promote convergence better than hard law. So far, that has not been possible. The main reason for this failure lies first and foremost in the differences between the EU Member States. Other than divergences on hot topics (for example, gender diversity and ‘say on pay’), other obstacles are the existence of a wide variety of legal forms of organization of business activities, of board structures, composition, and practices among EU companies, significant differences in investor ownership patterns, engagement practices among shareholders, and levels of shareholder activity.

Another reason for the failure is the lack of organization of employers at the European level, as compared to the national level. National employers have been extremely active with respect to the development and evolution of national company law, particularly in the area of corporate governance. Organizations of national employers are very active in proposing and demanding reforms, and the legislative measures adopted often follow these proposals. In contrast, the organizations that exist at the European level (BusinessEurope, CEEP, UEAPME, European Round Table of Industrialists) find it more difficult to make the employers’ voice heard, because the employers’ interests are very heterogeneous, and not uniformly affected by the EU construction.

These obstacles are not present in a federal country such as the US, despite the fact that corporate law is left to the state legislators (with the significant exception of federal securities regulation). This
is why the US has a corporate governance code, represented by the ALI Principles.

ALI is a research organization comprised of prominent judges, attorneys, and legal scholars whose objective is to clarify and modernize US law. ALI has published 'Restatements' of basic legal subjects, such as Agency, Contracts, Conflict of Laws, Property or Torts, meant to provide a unifying interpretation of what the law is, by synthesizing clear legal rules from the larger body of common law. Restatements primarily address the courts and are used as authoritative guides for both legal briefs and judicial opinions. ALI later developed a series of Principles, addressed primarily to administrative agencies and private actors, which focus on best practices for various public and private institutions, and cover topics such as Corporate Governance, Transnational Civil Procedure, or Compliance and Enforcement for Organizations.

The process leading to the adoption of the ALI Principles was not easy. It was described as a 'often bitter fourteen-year battle' from the start of the project in 1978 to the publication in final form in 1994. While ALI's Restatements had become very influential as reflections of existing law, the more suggestive nature of the ALI Principles was initially met with skepticism. Primarily, opponents suggested that they reflected corporate interests, rather than statements of law, while others suggested that they were too intrusive into business practice of corporations.

The ALI Principles consist of introductory notes, rules of law in black-letter format, corporate practice recommendations, and comments on the following main topics: (i) objective, conduct, and structure of the business corporation, (ii) the duty of care and fair dealing, (iii) the role of directors and shareholders in transactions in control and tender offers, and (iv) remedies. They explained and restated much of the corporate law as it existed, but also proposed reforms.

The ALI Principles illustrate well a reality that has also been documented at the level of EU company law: high quality soft law often turns into hard law over time. To take just one example, the Supreme Courts of at least two US States (Oregon and Maine), abandoned their common law doctrine on 'corporate opportunity' in order to embrace the test set forth in the ALI Principles. The force of this 'soft' law instrument is therefore unquestionable, to the point that, in 2019, ALI began the process of converting the ALI Principles into a Restatement of Corporate Governance. Although still 'soft' law, conversion from Principles to a Restatement will effectively 'harden' them, and give them additional persuasive force.

In my view, the success of the ALI Principles rests on three pillars. First, they are limited to corporations, to the exclusion of other business entities. Moreover, in the sections dealing with the structure of the corporation, they use varying drafting approaches (rules that a well-instructed court would likely embrace, recommendations intended for voluntary adoption, and recommendations for use as a statutory provision), and distinguish between large publicly held corporations, smaller publicly held corporations, and corporations that fit in neither category. Second, the ALI Principles are periodically reviewed and updated (three times per year). Third, they are accompanied by practically useful commentary directed to both legislatures and courts.

Further work towards a European Corporate Governance Code should be based on similar premises, and use the EMCA as a starting point. The EMCA was adopted and published in 2017, ten years after the start of the work, in 2007, on this project. It is the fruit of the efforts of a group of researchers from twenty-two EU Member States, and therefore does not have a legislative, or national sanction. As such, the drafters were independent from business organizations, from the governments of the EU Member States, and from the European Commission. However, representatives of European Commission were invited to attend drafting meetings.

The expressly stated objective of the EMCA is the harmonization or convergence of European Company Law, with an emphasis on the need to diversify the mechanisms used to achieve that purpose. The EMCA specifically referenced the inspiration provided by its American counterpart, the MBCA. A number of unique features characterize the EMCA.

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17 Klausner, supra n. 15, at 363.
18 Klinikki v. Lundgren, 298 Or. 662, 695 P.2d 906 (Or. 1985); Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146 (Me. 1995).
19 See https://www.ali.org/projects/show/corporate-governance/.
First, the EMCA was designed as a 'free-standing general company statute that can be enacted by Member States either substantially in its entirety or by the adoption of selected provisions'. The intent was not to resolve profound historical divergences between EU Member States, but rather encourage further harmonization and convergence (as opposed to uniformity) by allowing the EU Member States to adopt provisions selectively, based on the unique needs of the country.

Second, a deliberate decision was made that '[k]ey provisions of the EMCA consist of broad standards as opposed to specific rules'. That was because it was decided that flexibility should prevail so that specific rules would only apply if imposed by EU directives.

Third, the EMCA is a largely enabling statute with relatively few mandatory provisions. These features of the EMCA generally parallel US corporate law, with its three main components (MBCA, DGCL and ALI Principles).

As of today, the EMCA has not seen widespread adoption across EU Member States. That was to be expected because a structural change of national company laws requires complex choices and processes, and takes time. Another possible reason is the overly general content of the EMCA. In attempting to create a universal model, the EMCA became too diluted to have much practical use to complex legal frameworks that are already in place. The scope of application of EMCA is 'liability companies', which includes, in US terminology, corporations and LLCs, and, in European terminology, a variety of corporate forms at the national level. Other deficiencies that can be noted is the lack of a standing committee that would remain in place to write commentary meant to facilitate the adoption of the EMCA and its effective and evolving application. It was also suggested that the EMCA lacks the backing of a powerful court specialized to hear company law disputes, such as the Delaware Chancery Court in the US. Despite these shortcomings, the EMCA is cited more and more often, especially in cases that have based their laws on the MBCA. Delaware court decisions, based on the DGCL, are widely cited and followed even when Delaware law is not the applicable law. That is because, in part, the EMCA does not address all matters on which there is (abundant) caselaw in Delaware. However, the DGCL and the MBCA often look to each other and 'are good partners in a long-standing symbiotic relationship'.

There are major differences between the EMCA and its US counterpart, the MBCA. The MBCA was drafted in 1950 by the Committee on Business Corporations of the American Bar Association (ABA), currently known as the Corporate Laws Committee, in order to address variations in the law applicable to corporations among US states. Notably, the MBCA only applies to corporations and not to any other US business forms, such as LLCs and partnerships.

In contrast with corporations, laws governing LLCs vary greatly from state to state in the US, despite the existence of a Uniform Limited Liability Company Act, which has not been widely adopted. With respect to partnerships, the level of harmonization is somewhere in between corporations and LLCs, with the (Revised) Uniform Partnership Act, followed by most US states, and the Revised Uniform Limited Partnership Act. Although some harmonization was achieved through these uniform laws, the additional step of their adoption by the respective US states resulted in less uniformity than that existing for corporations.

Similarly, for the MBCA to be legally enforceable, it had to be adopted individually by each state via the relevant state legislature. However, the MBCA contains more mandatory provisions than its LLC and partnership counterpart statutes. Although initial adoption was slow, the flexible nature of the MBCA, allowing states to modify individual provisions, and its regular revisions, have ultimately made the MBCA attractive to US state legislatures. As of 2021, 32 US states, as well as Washington, D.C., have adopted the MBCA, either in part or in whole.

Universal adoption of the MBCA in the US remains doubtful due to Delaware's unique place. Although the DGCL is hard law in Delaware, it has become influential as a point of reference for other states and, as such, represents soft law in other US states, even in those that have based their laws on the MBCA. Delaware court decisions, based on the DGCL, are widely cited and followed even when Delaware law is not the applicable law. That is because, in part, the MBCA does not address all matters on which there is (abundant) caselaw in Delaware. However, the DGCL and the MBCA often look to each other and 'are good partners in a long-standing symbiotic relationship'. The MBCA may never be universally adopted in the US, but its role is, and will continue to be
influential not only in US corporate law, but, as discussed above, also in EU company law.

The European Commission also considered the corporate governance of private (unlisted) companies in a 2011 Green Paper. I believe that it is not for the EU institutions to develop specific rules on corporate governance for unlisted companies. Listed companies, with many unlisted subsidiaries, would become significantly less competitive if all the companies in the group were subject to rules in this area, and there is already an unfortunate trend towards national legislators applying rules designed for public companies to national joint-stock companies, and even limited liability companies. Therefore, if the EU institutions are to intervene, only the development of general principles and the promotion of the development and application of voluntary codes for unlisted companies would be desirable.

Despite the existence of these corporate governance codes and the many advantages they offer, there have been several EU interventions in the area of corporate governance in the last 20 years. The first EU interventions were in the form of soft law. The European Commission first adopted two recommendations concerning directors of public companies: one in 2004 concerning the remuneration of directors, and another in 2005 concerning the role of non-executive directors and board committees. In 2009, a recommendation was adopted on the issue of remuneration in the financial services sector. The European Commission also published two Green Papers: on corporate governance of financial institutions and on corporate governance in general. In 2012, the European Commission published its second European Company Law Action Plan, which also covered corporate governance.

Subsequently, the European institutions began to favour interventions through directives, generally of minimal harmonization, but nevertheless with binding effect. The Shareholder Rights Directive was adopted in 2007 and, ten years later, was reinforced through the Shareholder Engagement Directive of 2017. The measures contained in the Shareholder Engagement Directive have significantly changed the regulations applicable to public companies in the majority of EU Member States. The most emblematic, and problematic, are those relating to executive compensation and transactions with related parties.

The use of directives by the EU institutions no longer makes it possible to regulate these issues through soft law instruments. From this point of view, EU law is hardening, as is, indirectly but necessarily, national law. I would have preferred that certain matters that are now covered by the Shareholder Engagement Directive (including executive compensation and transactions with related parties) remained within the bounds of soft law. More generally, I believe that any future developments in the field of corporate governance should be the result of the interplay between market forces and self-regulation, rather than legislative intervention, whether at the EU or at the national level, given the advantages presented by soft law, discussed above.

The EU institutions are trying to avoid the trap of the 'one size fits all' approach through the adoption of minimum harmonization provisions. However, this type of intervention, which leaves a wide range of choices to EU Member States in areas characterized by deep divergence, will only deepen those disparities rather than lead to convergence. If the EU institutions believe that an accelerated convergence is necessary in this area, a preferable path to legislation would be to encourage the efforts to adopt a European Corporate Governance Code which, as discussed above, have so far been unsuccessful, or to promote the EMCA.

3. CODES OF CONDUCT FOR PROFESSIONALS

In addition to corporate governance codes, attempts at self-regulation can also be seen in a variety of codes of conduct, principles, best practices, guidelines or standards, intended for various professionals, particularly targeting public companies. Such instruments exist in the banking and insurance sectors (through a multitude of best practices), with respect to market

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44 See also Klausner, supra n. 15, at 364.
infrastructures (for example, Principles for financial market infrastructures\textsuperscript{45} at the international level), proxy voting advisors, credit rating agencies (for example, the IOSCO Code of conduct fundamentals for credit rating agencies\textsuperscript{46}), and institutional investors. There are also a variety of instruments that address corporate social responsibility, targeting particularly large multinational enterprises, which are often public companies, such as the ISO 26000 standard,\textsuperscript{47} the OECD Guidelines for Multinational Enterprises,\textsuperscript{48} and the UN Global Compact.\textsuperscript{49}

Some of these instruments of soft law have since turned into hard law, which is regrettable because the specific benefits of soft law are lost (flexibility as opposed to ‘one size fits all’, ease of modification to account for new circumstances or practices, voluntary compliance, etc.).

For example, in a public consultation, ESMA only asked the proxy voting advisors’ industry to develop a code of conduct, having found no evidence of a failure. The industry complied and the largest proxy voting advisors operating in the EU adopted a code of conduct in 2014\textsuperscript{50} to which ESMA gave a positive opinion.\textsuperscript{51} However, the EU institutions intervened in order to establish a ‘comply or explain’ type of application of the code of conduct and impose additional transparency obligations on proxy voting advisors, through the Shareholder Engagement Directive. This directive had the same impact with regard to institutional investors, who had also begun to organize themselves through the adoption of codes of conduct, such as those of EFAMA,\textsuperscript{52} Euromedion\textsuperscript{53} or ICGN\textsuperscript{54} or the UK Stewardship Code.\textsuperscript{55} The same phenomenon existed regarding the code of conduct on trade activities (relating to clearing and settlement),\textsuperscript{56} which eventually gave way to the EMIR Regulation\textsuperscript{57} and the DCT Regulation.\textsuperscript{58}

Moreover, in the areas covered by these codes of conducts for professionals, there is also an inflation of soft law that comes from EU and national supervisory authorities. Their soft law is not so soft in reality, because these authorities, under the cover of the soft law, often assume a law-making role. For this reason, the ‘soft’ law they produce is similar in effect, albeit not in name, to hard law. Soft law instruments emanating from supervisory authorities are often applied a ‘comply or explain’ or ‘name and shame’ basis approach, which makes them a powerful and effective tool of exerting pressure on their recipients. There are also many instances where supervisory authorities have attempted to empower themselves through using soft law instruments.\textsuperscript{59} One technique used by authorities is to use soft law instruments to interpret hard laws or regulations (often in a ‘creative’ manner) and thereby practically arrive to induce compliance with soft law by the recipients. This phenomenon is in a grey zone between the interpretative role that judges normally have, and the normative role that legislators normally have in civil law countries.

As such, the soft law that comes from supervisory authorities further erases the traditional differences between civil law countries (most of EU countries) and common law countries (such as the US). These supervisory authorities have assumed a quasi-judicial role akin to that of common law judges, which raises specific problems of democratic legitimacy, predictability and respect for fundamental rights, such as the right to an independent and impartial judge.\textsuperscript{60}


\footnotesize{46} IOSCO Technical Committee, Code of Conduct Fundamentals for Credit Rating Agencies (first published in Dec. 2004, as subsequently revised).

\footnotesize{47} See https://www.iso.org/standard/42546.html.

\footnotesize{48} See http://mneguidelines.oecd.org/mneguidelines/.

\footnotesize{49} See https://www.unglobalcompact.org/what-is-gc/mission/principles.


\footnotesize{60} Herve Synvet, Le so€ft law en matière bancaire et financière, 1 Rev. De Droit Bancaire Et Financier 18-21 (Jan. 2012).
Consequently, judicial review of soft law emanating from supervisory authorities is increasing.61

4. TRENDS
When considered collectively, a number of tendencies may be observed regarding the instruments of soft law. In a nutshell, soft law is a very popular girl nowadays, but not everybody loves popular girls, and they do tend to create drama and sometimes colour outside the lines:

1. One tendency is that soft law instruments multiply and diversify, thereby upsetting the traditional hierarchy of sources of law based on traditional legal instruments (EU directives, EU regulations, national laws, national regulations). The nomenclature of these instruments does not cease to evolve either: orientations, recommendations, green papers, instructions, positions, guidelines, practical guides, questions/answers, statements of good practices, codes of conduct, stewardship codes, policies, frameworks, etc. Given this abundance of new legal instruments, some national authorities undertook the task of trying to classify them in order to better reflect their place within the hierarchy of sources of law.62

2. Another tendency is the convergence of soft law, which, in turn, provokes further convergence of the binding legal framework. The adoption of a particular instrument of soft law by one country, or one sector has led to the adoption of similar instruments by other countries or by other sectors. As an example, the corporate governance codes for public companies (adopted by various national entities) have reached a spontaneous level of convergence simply because certain national drafters used the work product of other countries as their starting point. The French, British and Swedish corporate governance code have been very influential, in the absence of a European Code of Corporate Governance, having served as the starting point for the elaboration of national codes in other countries or having been voluntarily adopted by foreign companies. The adoption of the EMCA might, in time, contribute to further convergence as did the MBCA in the US. The role of soft law as a driver of convergence is particularly visible for public companies. Although corporate governance codes are typically voluntary as to their adoption by public companies, once adopted, they apply on a ‘comply or explain’ basis, which leads to convergence by encouraging voluntary compliance. Moreover, public authorities have started making reference, in their own instruments, to these corporate governance codes (which have a private source), to demand their respect and/or to interpret them in a certain manner.63

Lastly, many instances of transformation of soft law into hard law exist, accompanied by a general phenomenon of hardening of company law, including because instruments sometimes labelled ‘soft law’ are in reality closer in effect to hard law. This tendency exists both at the EU level and in EU Member States and can be observed particularly in the areas of corporate governance and regulation of market infrastructures. I discussed how the Shareholder Engagement Directive replaced the soft law contained in several recommendations of the European Commission, in national corporate governance codes, and in codes of conduct. I also discussed certain self-regulating codes of conduct gave way to EU binding instruments (directives or regulations). The examples could go on.

61 See e.g., Conseil d’État (France), 21 Mar. 2016 (Fairvesta decision no. 368084).
62 For example, the French supervisory authority for financial markets, the Autorité des Marchés Financiers (AMF), published Principes d’organisation et de publication de la doctrine de l’AMF (25 Oct. 2020), https://www.amf-france.org/fr/reglementation/doctrine/principes-de-doctrine.