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## RESPONSE

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### AMERICAN CORPORATE GOVERNANCE INDICES AS SEEN FROM A EUROPEAN PERSPECTIVE

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In response to Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263 (2009).

Since the 1990s, *The Economic Consequences of Legal Origins*<sup>1</sup> has become one of the most discussed research fields in corporate governance. Introduced in the landmark article by La Porta et al. (LLSV), this new method of empirically measuring the economic consequences of corporate governance rules promised to give completely new tools for research, investment, and rulemaking. As with all startups, conceptual difficulties, operational flaws, and stiff resistance by established players arose. In the meantime, however, much was improved,<sup>2</sup> and the indices and metrics (leximetrics) that were developed on the basis of this empirical research gained enormous influence. Yet the criticism continued. Some criticism was inherently concerned with how to improve the methods; other criticism was fundamental and claimed either a schism between economists and law-

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<sup>1</sup> Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46 J. ECON. LITERATURE 285 (2008).

<sup>2</sup> For examples, compare the changes and considerable refinements in La Porta, Lopez-de-Silanes & Shleifer, *supra* note 1, with the early 1997 and 1998 papers by LLSV cited therein.

yers or between America and the old continent.<sup>3</sup> Of course, the latter schism must be (1) studied against the backdrop of fundamental methodological controversies (which are always the most bitter); (2) seen in light of the vast divide between this new world and the old dogmas still predominant in continental European law; and (3) understood as a reaction to the empirical results that placed Anglo-American law in a preeminent position while disadvantaging continental Europe (and particularly France and other Roman legal orders), which many considered not only wrong but unfair.<sup>4</sup>

Against this backdrop, Bebchuk and Hamdani's article<sup>5</sup> is a great contribution that may help to bridge the gaps mentioned. The article may also open up a new legal and politics-of-law discourse between the disciplines as well as between the old and new worlds. This is true for two reasons. First, the authors reveal basic shortcomings of the leading American metrics—the corporate governance quotient, the anti-director rights index, and the anti-self dealing index—because they neglect to account for differences in shareholder structures—companies with (CS companies) and without (NCS companies) a controlling shareholder. Second, the attempt to empirically discover economic consequences of legal origin is not denigrated;<sup>6</sup> rather Bebchuk and Hamdani emphasize improving the methodology and using more objective criteria for the comparative evaluation of corporations and countries. While comparative law<sup>7</sup> has long sought to do

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<sup>3</sup> See José M. Garrido García, *Company Law and Capital Markets Law*, 69 RABELS ZEITSCHRIFT FUER AUSLAENDISCHES UND INTERNATIONALES PRIVATRECHT 761, 766-71 (2005) (F.R.G.) (describing criticisms of the LLSV approach).

<sup>4</sup> See generally JAN VON HEIN, *DIE REZEPTION US-AMERIKANISCHEN GESELLSCHAFTSRECHTS IN DEUTSCHLAND* (2008) (discussing the influence of American corporate law on German law since World War II as well as the reasons for such influence, including globalization, Americanization, and economic and political factors).

<sup>5</sup> Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263 (2009).

<sup>6</sup> See *id.* at 1270-71, 1306-07 (“Rather, our critique is constructive: we seek to advance the project of developing governance metrics based on objective and generally applicable criteria, not to abandon it altogether.”).

<sup>7</sup> See generally REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW* (2d ed. 2009) (exploring the structure of corporate law across jurisdictions); CURTIS J. MILHAUPT & KATHARINA PISTOR, *LAW AND CAPITALISM* (2008) (examining the relationship between law and “market-oriented economic institutions”); Klaus J. Hopt, *Comparative Company Law*, in *THE OXFORD HANDBOOK OF COMPARATIVE LAW* 1161 (Mathias Reimann & Reinhard Zimmermann eds., rev. paperback ed. 2008) (arguing that because corporate governance spans disciplines including corporate law and securities regulation, comparative company law is in effect the comparative study of corporate governance).

this, its methodology has been inherently elective and subjective since standards of good corporate governance vary considerably among scholars, practitioners, and countries. If, however, a valid link back to empirical data of the enterprises and financial markets can be established, this is a great step forward for research and practice. Ultimately, it fosters competition, not only among enterprises but also among countries and their rulemakers and legislators. Such competition is the driver of progress. Insofar as competition is concerned, Bebchuk and Hamdani are right in saying that their analysis has “wide-ranging implications for corporate-governance research and practice.”<sup>8</sup>

Bebchuk and Hamdani consider mainly American literature. Yet the index approach has had a considerable impact on the European discussion as well. Some papers have taken a primarily critical approach; others, however, have refined it by adjusting the methodology, taking into account European and worldwide experiences, or even developing new quantitative indices and methods on their own.<sup>9</sup> Greater dialogue among American scholars in both economics and law could be fruitful for both disciplines. The following observations on the relevance of three basic principal-agent conflicts (1) under different shareholder structures and (2) to criteria of shareholder pro-

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<sup>8</sup> Bebchuk & Hamdani, *supra* note 5, at 1268.

<sup>9</sup> See, e.g., John Armour et al., *How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor and Worker Protection*, 57 AM. J. COMP. L. 579 (2009) (demonstrating that civil law systems have shown substantial increases in shareholder protection over the years 1972–2005); John Armour et al., *Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis*, 6 J. EMPIRICAL LEGAL STUD. 343 (2009) [hereinafter Armour et al., *Shareholder Protection*] (arguing that common law systems protected shareholders better than civil law systems over the years 1991–2005); Priya P. Lele & Mathias M. Siems, *Shareholder Protection: A Leximetric Approach*, 7 J. CORP. L. STUD. 17 (2007) (building a shareholder protection index and coding the development of the law for five countries over three decades); Mathias M. Siems & Priya P. Lele, *Der Schutz von Aktionären im Rechtsvergleich: Eine leximetriche und ökonomische Untersuchung*, 173 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT UND WIRTSCHAFTSRECHT 119 (2009) (F.R.G.) (presenting two new, more accurate ways to analyze the effect of shareholder protection: a leximetric approach, which analyzes the development of shareholder protection laws in quantifiable terms, and an econometric approach, which analyzes the economic principles behind shareholder protection); Mathias M. Siems, *Legal Origins: Reconciling Law & Finance and Comparative Law*, 52 MCGILL L.J. 55 (2007) (challenging the methodology of the “legal origins” approach); Mathias M. Siems, *Shareholder Protection Around the World (Leximetric II)*, 33 DEL. J. CORP. L. 111 (2008) (examining the development of shareholder protection in twenty countries over the years 1995–2005); Mathias M. Siems, *What Does Not Work in Comparing Securities Laws: A Critique on La Porta et al.’s Methodology*, 16 INT’L COMPANY & COM. L. REV. 300 (2005) (arguing that established principles of comparative law render LLSV’s result questionable).

tection under different shareholder structures should therefore be understood as coming from a comparative European perspective and with full respect for the demanding work of the index community.

#### I. THREE BASIC PRINCIPAL-AGENT CONFLICTS AND THEIR RELEVANCE UNDER DIFFERENT SHAREHOLDER STRUCTURES

In the United States, the standard principal-agent conflict is between the *shareholders and management* since *NCS companies* seem to be the rule.<sup>10</sup> This is also true in the United Kingdom, though the more frequent presence of institutional investors may be an important difference. In continental Europe, *CS companies* are much more common.<sup>11</sup> There, the relevant principal-agent conflict is between *the minority shareholders and the controlling shareholder*. This conflict, known as minority protection, has been at the center of all continental corporate legal orders since their origins in the 1840s.<sup>12</sup> All group law development—represented by Germany and its *Konzernrecht*—is based on this insight and necessity of protection. So, from a European perspective, emphasizing the special corporate governance problems of CS companies as compared to NCS companies is preaching to the converted. The problems for the envisaged metrics have only begun.

Having separate scores for companies with and without controlling shareholders seems self-evident. But what is *control*?<sup>13</sup> For a European this is a central question, not only because of legally permissible arrangements like pyramids, dual-class shares, and other mechanisms to separate cash-flow and voting rights.<sup>14</sup> While in the

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<sup>10</sup> *But see* Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377, 1382-85 & tbl.1 (2009) (finding that ninety-six percent of his sample of U.S. public firms had blockholders and that they held, on average, thirty-nine percent of the sample's common stock).

<sup>11</sup> *But see infra* Section II.C.

<sup>12</sup> *Cf.* RIGHTS OF MINORITY SHAREHOLDERS: XVITH CONGRESS OF THE INTERNATIONAL ACADEMY OF COMPARATIVE LAW (Evangelos Perakis ed., 2004) (presenting general and national reports on the rights of minority shareholders).

<sup>13</sup> Bebchuk & Hamdani, *supra* note 5, at 1271, mention the problem of “a dominant shareholder with substantial influence but not a complete lock on control” but do not address it.

<sup>14</sup> *Id.* at 1313; *see also id.* at 1267, 1288 n.87, 1299 (describing the impact of control arrangements on both NCS and CS companies). The quest for one share–one vote was pursued unsuccessfully by the European Commission. *See* Klaus J. Hopt, *Obstacles to Corporate Restructuring: Observations from a European and German Perspective*, in PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION 373, 392 (Michel Tison et al. eds., 2009) (proposing a more stringent disclosure regime for control-enhancing mechanisms).

United States, and more specifically in Delaware, a shareholder with a stake of fifty percent and one vote may be able to do as she pleases with the company, this is not the case in Europe. Issues that are fundamental to the company are decided by supermajorities of two-thirds of the capital present at the vote, seventy-five percent, or even more.<sup>15</sup> At the other end of the spectrum, European takeover laws provide for a mandatory bid (i.e., early exit of minority shareholders if the bidder takes over) if the bidder obtains between thirty percent and one-third of the target's votes. This broader concept of control takes account of the low attendance rates at general meetings of public companies, where ad hoc majorities are often reached with far less than fifty-percent control.

Quite apart from these various notions and incidences of control, control alone may not describe the very different reality of the power distribution in a company. This is not just a reference to the problems of how to define and deal with "acting in concert" and, more generally, of group situations; instead, take for example the presence of an active institutional shareholder whose incentives differ from those of individual shareholders. The chairmen of the boards of certain European companies complain that they are called to the United States to report to such shareholders and comply with their wishes. But the incentives and behavior of minority shareholders also vary considerably. In Germany, for example, there is an acute problem of abusive minority shareholders who successfully hold up mergers and other fundamental changes and make shareholder resolutions in order to extract private benefits.<sup>16</sup>

Bebchuk and Hamdani, and all three of the indices that they profile, consider only or mainly the first two principal-agent conflicts. They disregard the principal-agent conflict between *shareholders and nonshareholders*.<sup>17</sup> In particular, nonshareholder creditors and especially those creditors who are nearest to the company—for example,

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<sup>15</sup> See Bebchuk & Hamdani, *supra* note 5, at 1299-1300, 1307 n.154 (discussing the effects of supermajorities on governance rights). While supermajorities are certainly helpful for shareholder protection in CS companies, *id.* at 1300, they can also be a useful protection device in NCS companies by granting a minimum level of protection to the shareholders against changes by a majority that, in the case of small general-assembly presences, may often be completely accidental or even driven by special interests.

<sup>16</sup> These maneuvers are known as "strike suits," or *Anfechtungsklagen*. For examples, see the references cited by Armour et al., *Shareholder Protection*, *supra* note 9, at 353.

<sup>17</sup> See KRAAKMAN ET AL., *supra* note 7, chs. 2.1, 4.2 (discussing agency problems and creditor regulation).

its employees—are not considered. Leaving creditors and creditor protection aside is strange, not only from the perspective of European law, under which the same protective devices often aim at minority shareholders as well as at creditors, but more generally in failing-company situations. While normally, the shareholders are the lenders of last resort, the nearer a company comes to failing, the more influence creditors have, and in the end they take the place of the shareholders as “owners” of the company.<sup>18</sup> Even before the formal opening of an insolvency procedure, banks very often take the lead in NCS companies as well as CS companies.

Labor is a special group of creditors.<sup>19</sup> Many sociological theories even treat them as “members” of the company. From a comparative company law view, the principal-agent conflict between the shareholders and labor cannot be left out, certainly not for countries where labor has an institutional presence on the board (codetermination). Even if labor has only a minority of seats on the board—a third, as in many European countries, or even only two seats on the board, as most recently in France—the information flow and the opinion forming on the board changes considerably. If codetermination is at (quasi) parity, as in Germany, the decisionmaking and power structure in the corporation is changed fundamentally.<sup>20</sup> Take, for example, the issue of minority representation on the board or the issue of independent directors, not only in the United States but also in Europe. If the European recommendation of February 2005,<sup>21</sup> which suggests maintaining a majority of independent<sup>22</sup> directors in the

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<sup>18</sup> See John Armour et al., *Transactions with Creditors*, in KRAAKMAN ET AL., *supra* note 7, at 115-16.

<sup>19</sup> See Beth Ahlering & Simon Deakin, *Labour Regulation, Corporate Governance and Legal Origin: A Case of Institutional Complementarity?* 10-11, 37-38 (European Corporate Governance Inst., Law Working Paper No. 72, 2005) (arguing that the complementarities between legal and economic institutions account for disparities across countries in labor regulation and corporate governance).

<sup>20</sup> As to effects of German labor codetermination, compare ELMAR GERUM, *DAS DEUTSCHE CORPORATE GOVERNANCE-SYSTEM* (2007); Klaus J. Hopt, *Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe*, 14 INT'L REV. L. & ECON. 203 (1994); Katharina Pistor, *Corporate Governance durch Mitbestimmung und Arbeitsmärkte*, in HANDBUCH CORPORATE GOVERNANCE 157 (Peter Hommelhoff et al. eds., 2003).

<sup>21</sup> Commission Recommendation 2005/162/EC of 15 February 2005 on the Role of Non-Executive or Supervisory Directors of Listed Companies and on the Committees of the (Supervisory) Board, Annex II, O.J. (L 52) 51, 63.

<sup>22</sup> Independence is required not only from the board but also from the major shareholder. See Bebchuk & Hamdani, *supra* note 5, at 1302 (“In sum, when one

three key committees (audit, nomination, and compensation), was implemented by Germany, there would be a de facto prevalence of labor, and more specifically unions, on the board to the detriment of the shareholders in CS companies as well as in NCS companies. In German NCS companies, there are even examples of coalitions between management and labor against the shareholders and in CS companies with a minority controlling shareholder (sometimes helped by a voting cap, as in the case of Volkswagen) against the other shareholders.

## II. CRITERIA OF SHAREHOLDER PROTECTION UNDER DIFFERENT SHAREHOLDER STRUCTURES AND BEYOND

### A. NCS Companies

The list of criteria that Bebchuk and Hamdani mention as primarily relevant in evaluating *NCS companies*<sup>23</sup>—contestability of control, shareholder voting procedures, allocation of power between the board and shareholders, executive compensation, and director independence—is also convincing from a European perspective as far as the relatively few NCS companies in Europe are concerned. As to the contestability of control and the disciplinary relevance of an active market for corporate control, I fully agree, and I join with Bebchuk in being a partisan of the British-style antifrustration rule.<sup>24</sup> Yet it is a well-known fact that just looking at the market for corporate control oversimplifies the situation. The product market, the market for directors, and other labor markets may be even more important depending on the case. Measuring one without the others may distort the outcome. As to executive compensation, I agree that suitable procedural rules are more important than substantive norms like “reasonable” remuneration or other legislative formulas.<sup>25</sup> There is no *ius-tum pretium* as claimed in antiquity, and in the Middle Ages by the

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evaluates the governance of CS companies, significant weight should be given to director independence from (or dependence on) the controlling shareholder.”).

<sup>23</sup> Bebchuk & Hamdani, *supra* note 5, at 1308-09.

<sup>24</sup> See generally Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002) (arguing that corporate boards should not be allowed to veto takeover bids where the shareholders favor a takeover); see also Paul Davies & Klaus Hopt, *Control Transactions*, in KRAAKMAN ET AL., *supra* note 7, at 225, 233-38 (discussing the advantages of the “no frustration” rule).

<sup>25</sup> See Bebchuk & Hamdani, *supra* note 5, at 1309 (“The assessment could include not only the substantive aspects of compensation arrangements but also the process for setting executive-pay schemes . . .”).

scholar Thomas Aquinas, despite the present-day financial-crisis discussion and legislation. Giving shareholders a “say on pay”<sup>26</sup> along the lines of the U.K. example, however, is a useful device, though legislators in both the United Kingdom and, in July 2009, in Germany have shied away from making it mandatory and not merely advisory.

### B. CS Companies

As to the *CS companies*, European experience is broader than in the United States since CS companies, belonging to a family or a group (*Konzern*), are still predominant on the continent.<sup>27</sup> Though here, too, the list of criteria drawn up for CS companies by the authors<sup>28</sup> captures the principal-agent conflict surrounding minority protection both in the separate company and in the *Konzern* rather well, some European observations may be of interest.

Bebchuk and Hamdani are right in stating that takeovers are most important for NCS companies. But takeovers are not irrelevant for CS companies.<sup>29</sup> This is particularly true in the case of companies with a controlling minority shareholder and more than one blockholder, as is still normal in continental Europe. (In the United States, to the contrary, 100 percent subsidiaries traditionally seem to prevail.) In such cases, takeovers—hostile or at a concerted price—happen first, and then the minority shareholders may be protected by an early-exit option under the mandatory-bid rule.<sup>30</sup> Contrast this with the later exit under the squeeze-out and sell-out rules for CS companies with a ninety to ninety-five percent controlling shareholder. The sell-out option of the minority shareholder against full compensation is clearly a

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<sup>26</sup> *Id.* at 1293.

<sup>27</sup> Therefore, it may not be a bad idea to investigate in more depth and possibly learn from German group law and the initiatives for building group law protection devices in the European Union. See Luca Enriques et al., *Related Party Transactions*, in KRAAKMAN ET AL., *supra* note 7, at 153 (canvassing the various legal strategies to constrain related-party transactions, such as executive compensation). For the European Union, see Klaus J. Hopt, *Konzernrecht: Die europäische Perspektive*, 171 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT UND WIRTSCHAFTSRECHT 199 (2007) (F.R.G.) (tracking the development of group law in Europe and discussing the benefits and difficulties of trying to apply group law principles in other legal systems).

<sup>28</sup> Bebchuk & Hamdani, *supra* note 5, at 1309-13.

<sup>29</sup> See *id.* at 1288 & n.87 (“For the level of investor protection at CS companies, therefore, the presence of arrangements providing protection against a hostile takeover or a proxy fight is neither good nor bad, but simply irrelevant.”).

<sup>30</sup> See Armour et al., *Shareholder Protection*, *supra* note 9, at 355 tbl.1 (addressing the mandatory-bid rule).



protective device. Yet even the squeeze-out at the initiative of the controlling shareholder may have indirect protective effects for the shareholders in the group: while the squeezed-out shareholders receive full compensation that they would not get in the open market, the shareholders of the parent (including the parent's minority shareholder) may benefit from the positive 100-percent-steering-control effect for the parent.

Voting procedures may also be relevant in special CS-company constellations. This is especially the case for German-style bank proxy voting. If the majority of common shareholders entrust their banks with voting rights, and if the latter vote in the shareholders' interest as they are obliged by law to do, this may render control by even a major blockholder more difficult to exercise. What is certainly true is that in CS companies, unlike in NCS companies, giving more power to the shareholders in relation to the board does not strengthen the (outside) shareholders—it weakens them. In this respect, the German rule of giving the management board a normal term of five years—a term that is much longer than those in the United States and in the United Kingdom and that is considered to be poor corporate governance in those nations—is an attempt to strengthen the independence of the management board vis-à-vis the supervisory board, which in turn, apart from labor codetermination, is elected by the majority shareholder. Independence requirements for the board or the key committees help if they are broadly drafted to require independence from the majority shareholder as well and if they are actually enforced.

An interesting example of differentiation between NCS and CS companies is the German reform of July 2009.<sup>31</sup> This disallows the changeover from the management board into the supervisory board<sup>32</sup>—a good corporate governance idea and useful for NCS companies if it is not exaggerated—unless permission is given by the general assembly upon a proposal of twenty-five percent of the shareholders. It is obvious that this quorum requirement for a proposal is easy to attain for a blockholder or in a family company but most difficult to reach in a company with fully dispersed ownership.

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<sup>31</sup> Gesetz zur Angemessenheit der Vorstandsvergütung [Law on Adequate Board Member Remuneration], July 31, 2009, Bundesgesetzblatt, Teil I [BGBl. I] at 2509, art. 1, § 3(c), amending Aktiengesetz [Companies Act], Sept. 6, 1965, BGBl. I at 1089, § 100, para. 2, sentence 1, No. 4.

<sup>32</sup> Similar issues include the separation of the positions of the CEO and the board (in Germany, management and boards) and of the requirement of separate meetings without the CEO present. Bebchuk & Hamdani, *supra* note 5, at 1303-04.

## C. Further Questions

Up to now the arguments have been that the criteria of shareholder protection under different shareholder structures could or should still be refined. Now the unavoidable question arises: are the shareholder structures, though of course an indispensable differentiation criterion for improving corporate governance metrics, the only or even the major criterion of differentiation? Think of *other parameters*—e.g., the role of independent gatekeepers like auditors or experts called in by the court for making special inquiries into the company's or the group's affairs. Can the metrics geared just toward corporate law catch the particularities, for example, of the traditional German bank-oriented inside system, without looking more fully at the banks' traditional panoply of influence?<sup>33</sup> And if this influence shrinks drastically, as with German banks in the last decade when they sold their blocks and retreated from supervisory boards, this movement away from the traditional insider system (Rhenanian capitalism<sup>34</sup>) is much more important for corporate law reality than many corporate law reforms of the last years possibly caught by the existing metrics. Even more generally, how meaningful are metrics geared toward company law alone, even if they take into consideration the shareholder structure, without evaluating the company law norms against the background of the securities-regulation regime and the financial system of the relevant country?<sup>35</sup> It is a truism that equity and debt financing<sup>36</sup> and company law and securities regulation are complementary,<sup>37</sup> and this complementarity may be more important than actual rules.

So is enforcement. Let me draw on the experience of the Hamburg Max Planck Institute in advising accession countries such as Bul-

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<sup>33</sup> The traditional role was fourfold: major lending, blockholding, sitting on the board, and voting the proxies (deposit vote) of shareholders, all in the same company.

<sup>34</sup> Cf. JEREMY EDWARDS & KLAUS FISCHER, *BANKS, FINANCE AND INVESTMENT IN GERMANY* (1994) (examining Germany's bank-based investment-finance system); *THE GERMAN FINANCIAL SYSTEM* chs. 7, 15.2-15.3 (Jan P. Krahn & Reinhard H. Schmidt eds., 2004) (surveying innovations in Germany's financial architecture).

<sup>35</sup> See, e.g., *THE GERMAN FINANCIAL SYSTEM*, *supra* note 34, ch. 11.2 (discussing the interaction between German corporate and securities law); Rafael La Porta et al., *What Works in Securities Laws?*, 61 J. FIN. 1 (2006) (arguing that securities laws requiring disclosure and facilitating private enforcement encourage stock-market development).

<sup>36</sup> See Eilís Ferran, *PRINCIPLES OF CORPORATE FINANCE LAW* 341-45 (2008) (exploring the relationship between equity and debt financing).

<sup>37</sup> See generally *CAPITAL MARKETS AND COMPANY LAW* (Klaus J. Hopt & Eddy Wymeersch eds., 2003) (examining the interrelationship between capital-market law and corporate governance).

garia, Romania, Croatia, or Serbia in adapting their corporate and capital-market law to E.U. standards (*acquis communautaire*). This is difficult enough but, in the end, is mere legal craftsmanship. Building up institutions, on the other hand, particularly a functioning court system with independent, knowledgeable judges, is a Herculean task.

#### CONCLUSION

Let me end with three remarks. First, the claim made in this Response is not that all the aforementioned refinements of the legal and factual elements that are relevant to investor protection and corporate governance should be integrated into the governance indices, even if they claim to be global. There is, of course, a perennial dilemma in comparing more than two objects. The broader the comparison, the more a reduction of complexity becomes necessary—a tightrope walk indeed. Governance indices are bound to simplify in order to be useful yet manageable.

Second, there are many technical problems with the dual set of metrics suggested by Bebchuk and Hamdani that are not dealt with here. Some of them have been mentioned by the authors themselves, though legitimately only in passing.<sup>38</sup> To begin with, what kind of companies should be included in the metrics? Only stock-exchange-listed corporations, or, even more generally, all stock corporations? This may be misleading for countries like Germany with approximately one million non-stock-exchange-listed limited liability companies, many of which are as important as large stock corporations. What shall be done with companies that may be between an NCS and a CS company, for example, a company with the various shades of control mentioned at the beginning of this Response? Which of the two scores applies, for example, to the Commerzbank, which faces serious problems after taking over the Dresdner Bank and has had to take huge federal credits, with a resulting strong dependency on the credit-giving government bodies and ultimately public politics? This raises not only the gray-area problem but also the problem of transition from CS to NCS company and vice versa.

This problem is multiplied if one proceeds to make comparisons of countries and legal systems that have profoundly changed during the last decade, as far as corporate governance, financial markets, and

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<sup>38</sup> Bebchuk & Hamdani, *supra* note 5, at 1271, 1307 (“For these companies, it would be necessary to appropriately combine elements of the two rating systems that we discuss below. We defer this additional task to another day . . .”).

enforcement are concerned. All this is technically difficult enough if one only takes different shareholder structures into consideration. But what if one goes further as suggested here? Having two different scores for NCS and CS companies may still do, though this is impractical, and the desire for integrating them somehow, at least on a national level, is probably irresistible. But having half-a-dozen different scores for shareholder structures, labor and creditor influence on the company, securities regulation, financial markets, enforcement, and so on is less than satisfactory.

Third, in all modern industrialized countries, the importance of financing at the equity markets and consequently changing from a mere CS company to a mixed one is quickly growing. On the other hand, in countries that traditionally have only had NCS companies, the rise of institutional shareholders and of private equity holding by forming groups of companies and by granting lavish stock options to board members and senior officers is important. While it is true that there are still major differences as to the prevailing shareholder structures in the United States and the United Kingdom on the one hand and continental Europe on the other, the trend toward convergence may make the quest for global standards less elusive than the authors believe today. In any case, whatever future metrics will look like, it should never be forgotten that they are only one instrument among others and that basing comparative, investment, and even policy decisions on them alone would be misleading indeed. Bebchuk and Hamdani's excellent article reminds us of this.

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