Modern Company Law Concept in Comparative Perspective: The Role of Contractarian Theory

Dr Tauseef Iqbal[*], Dr Muhammad Mumtaz Ali Khan[**], Asim Iqbal[***]
Ikram Ullah[****]

ABSTRACT

In comparative legal scholarship, particularly comparative corporate law, the major studies are directed towards comparing the current legal provisions, while legal developments of these provisions are sporadically investigated. Still where such an attempt has been made, the arguments therein are rarely substantiated with any descriptive analysis of statutory laws. This article explores the substantive legal provisions of jurisdictions of the US, England, France and Pakistan in neo-liberalism era i.e. post-1980s. After reviewing the studies regarding the developments of company laws in above-mentioned countries, it is concluded that three factors i.e. economic scholarship, political economy and globalization of finance, are the prime reasons for the developments of company law in this era. These factors are common irrespective of legal family the country under study belongs to.

Keywords: Company law, comparative law, corporate governance, directors' duties, legal history

Introduction

The contemporary studies have focused on the current issues of comparative corporate law such as impact of shareholders' activism on board decisions or shareholders' litigations for the enforcement of their rights etc. However, the developments of legal solutions of these issues especially in comparative perspective are utterly missing in legal discourse. The current research discusses comparative legal developments of company law, in particular director's duties in modern times. For this purpose, four leading jurisdictions, namely US (Delaware), England, France and Pakistan, have been selected to figure out the factors which underpinned the development across these jurisdictions. By including countries from both civil and common lawfamilies, the research aims to demonstrate that there are hardly any differences in these countries regarding corporate law developments. The various legislations and case laws of each era are substantially consulted to support the thesis of this work. The research primarily centres upon director's duties as well as the changing concept of company in modern history. Since modern legal developments roughly expand over last two centuries, the research is divided into three phases that correspond to the shift in the understanding of the concept of company. The first phase roughly expands mid-19th century to first decade of 20th century, the second from 2nd decade to 8th decade of 20th century while the last phase starts from 1980 and still continues.[1] This article deals with third phase that is also referred to as *era of neo-liberalism* in political economy.

In this period where company is theorized as nexus of contracts or contractarian theory of firm started in the last quarter of 20th century and is still dominant. The landmark article in 1976 "*Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structur*e" was co-authored by Michael Jensen and William H. Meckling. The contractarian theory adjusts both shareholder and stakeholder model of corporate governance. At the same time and of paramount relevance was contemporary politico-economic development at both national and international level. In addition, the globalization of capital renders it mandatory for host country to make laws that are more investor's friendly and company as a nexus of contracts fulfils that end as well.

The long period of powerful directors in *era of managerialism*[2] coupled with collapse of merger movement of 70s and 80s resulted in general belief that directors tend to serve their own interests. The prevalent stakeholder approach had grown a sense of irrelevance in shareholders who wanted their due part in company's profit instead of distributing the same with other stakeholders. The scholars tended to show that even where directors were efficient towards stakeholders, but their decision of injecting money in low profit projects would eventually bring greater harm to these stakeholders.[3]

1. Conceptualization of Company as *Nexus of Contract*

[*] Dr Tauseef,Iqbal, Senior Assistant Professor at Law Department, Bahria University, Islamabad. Email: tauseef_adv@hotmail.com
[**] Dr Mumtaz Ali Khan, Director (Research and Development), Punjab Higher Education Commission, Lahore Email: mumtaz.ali@punjabhec.gov.pk
[***] Dr Asim Iqbal, Assistant Professor of Law, International Islamic University, Islamabad. Email: drmaiqbal@live.com
[****] Dr Ikram Ullah, Assistant Professor of Law, International Islamic University, Islamabad

[1] See Lorraine Talbot, *Critical Company Law* (Routlege-Cavendish 2007) chs 1&2.
[2] This era between 1910-1980 is coined *the era of managerialism* because of immense powers of directors and managers over the affairs of company and its business.
[3]Henry Hansmann and Reinier Kraakman, 'End of History for Corporate Law, The' (2000) 89 Georgetown Law Journal 439, 444.

The contractarian theorists reasserted that primary goal of the company is profit maximization alone, and hence director's duties must be directed towards that goal. The theory promoted by law and economic movement in Chicago School of Economics. They advocated for free market being ensured by law wherein the different players can enter into commercial contracts freely.

The theory was first articulated by Ronald Coase in his article *The nature of the Firm*[4] but got its popularity with the publishing of the article *Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure*.[5] The theory postulates, from the legal point of view, that relationship between managers and shareholders of public corporations is contractual. It emphasizes on the role of market that forces optimal contracts between different players of the company when latter goes public. Once company goes public, the pre-IPO[6] entrepreneurs/shareholders offer promises to post-IPO shareholders that company would yield better profit, and the corporate governance of the company would focus at future profit of the firm. Resultantly the corporate contracts would provide governance structure that, in the words of Easterbrook and Fischel, "*most beneficial to investors, net of the costs of maintaining the structure"*[7].

Jensen and Meckling invented the term now popularly referred to as *nexus of contract* which is a set of transactions between persons involved in company's business. As a company is only legal fiction, the managers should act as agents of the shareholders and not that of company. The managers are hired as agents for the services of shareholders as principals. If both parties pursue their utility, there is likelihood that agents would not always act in the best interest of the principle. The principle can limit divergent interests by offering incentives to agents and by incurring monitoring cost or agency costs.[8] This cost can be reduced by mutually agreed contract between principle and agent and both parties look their respective incentives and interests.[9]

Kraakman and Hansmann enumerated certain arguments in favour of this contractarian theory contending that this theory exits because of its *force of ideological convergence.* They argue that this model has survived because of failure of alternative models, competitive pressure of global commerce and rise of shareholder class. The managerial model lost its attraction due to collapse of conglomerate movement of 1970's and 1980's. Labour oriented model can't go along with the large-scale enterprise as the divergence of priorities of interests of both employer and employee would hinder the progress of the company. In addition, the collective bargaining to resolve problems between them, lies behind the ambit of corporate law.[10]

The state-backed interventionist model, popular after WWII, was no longer viable as economy had expanded and shareholders had increased manifolds. The principle instrument of this model was wide discretionary powers of government bureaucrats that also lied beyond the scope of corporate law. Lastly the stakeholder model was also no more attractive being quite resembling with labour oriented model.[11]

Similarly, global competitive environment also favoured this contractarian model. Logically, they argued, this model is more efficient and widely viable. In the same way, countries with this model have comparatively performed better, and internationalization of both product and financial market has increased competition and this model is favoured due to its efficiency. Equally important factor in favour of this model is public shareholder class that would invest into company's equity if they expect good returns on the investment.[12]

An important aspect of contractarian model is its compatibility with stakeholder and shareholder approach. In shareholderism three propositions are widely accepted: firstly, that shareholder should have control; secondly that duty of managers is only to serve the interest of shareholders alone; and thirdly that object of the firm should be the maximization of shareholder's profits. Stakeholderism, on the other hand, would propose that many other groups have their stake in the firm besides shareholders. They object to above three propositions and argue firstly that all stakeholders have a right to participate in corporate decisions; secondly that managers have duties to all stakeholder groups; and thirdly that object of the firm should be the promotion of all stakeholders and not merely shareholders.

The contractarian theory is commonly referred to as shareholderism but normatively it would not resist stakeholderism as it emphasizes on the contracts irrespective of focusing any particular group in the company. All stakeholders may contract with the firms by way of bargains to protect their rights. The main concern of each group is to safeguard its firm specific interest and both shareholder and stakeholder approach may be applied in this context. It's interesting to note that both approaches may collide with each other, but each may be aligned with contractarian

[4]Ronald H Coase, 'The Nature of the Firm' (1937) 4 economica 386.
[5]Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305.
[6] IPO denotes Initial public offering of a company when its offers if shares for public purchase.
[7]Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991) 1–39.
[8]Jensen and Meckling (n 5) 308.
[9]ibid 310.
[10]Hansmann and Kraakman (n 3) 4436445.
[11]ibid 446–448.
[12]ibid 4496452.

theory.[13] However the dominant contractarian approach at present is shareholderism where object of the company is to earn maximum profit for shareholders.

Contractarian theory is an economic theory and legal scholars are not at ease to accept it completely and it is not immune from criticism. Firstly, critics say that corporation is not creation of contract as claimed by contractarian theorist rather it is the State that creates the corporation. The individual involved in a company apply to the state for such entity creation. The fact that State readily grant permission doesn't entail that such permission is not altogether required. The theory also minimizes the role of State which despite its generation long rhetoric is incorrect. The State prerogative in amending different rudimentary and mandatory provisions of company law shows that State still intervenes to regulate the so-called contracts between parties.

The American Law Institute[14] drafted Principles of Corporate Governance. During the development of these principles, the controversy arose between contractarian school and their opponents. The former was in support of market-based approach to law while latter was in favour of mandatory legal rules. After their consistent debates, contractarians were at least successful to convince dominant mandatory rules supporters about the ability of market forces to regulate company's affairs. Thus, the final draft included not only contractarian's conception of corporation as private property, but it also had the provision on moral aspects and social responsibility of the corporations.[15] In the wake of academic scholarship regarding contractarian theory of company, we find leading jurisdictions to introduce a form of corporation in which contractual agreements between corporate players played crucial role.

1.1 Business Organization Forms based on Contractarian Approach

In the year 1992, Delaware State introduced Limited Liability Company[16] which was based on contractarian idea. Delaware law requires an operating agreement to form a limited liability company(LLC) and that agreement may be made effective before or after the date of formation or any date specified in the agreement of an LLC.[17] The law provided a flexible legal framework for business organization which was a hybrid of partnership and corporation.

Except for certain mandatory provisions, the LLC is based on the agreement mutually reached by the parties involved in the company. LLC is separate legal personality[18] distinct from members and mangers, and neither did the managers or member liable for the debt or liabilities of LLC.[19] For the purpose of taxation, it is considered a partnership and each partner is taxable on his/her pro-rata share of profit or loss.[20] The management of the company is also dependent on the agreement between the parties which provide that unless otherwise provided in company's agreement, management of the company shall vest in members or managers.[21]

In France the SAS (*société par action simplifiée)* is a hybrid form of business organization wherein we found the contractual approach of company. The company was introduced by Law of 1994[22] influenced from Delaware's hybrid LLC. Previously available for legal persons only, the Law of 1999[23] opened this company to natural person too. There are few mandatory rules applicable on SAS, say for example the prohibition of offering shares to public etc., nonetheless it enjoys considerable freedom regarding its constitution. As regards the management of the company, the Law requires only the presence of a chairman, while executive director/officers may also be stipulated holding the same powers as chairman.

The entity was devised to overcome the rigidities of French SA (*société anonyme)*[24] and SARL (*société à responsabilité limité)*[25]. The contractual freedom offers shareholders with an option to add their specific rights in articles of incorporation or through shareholders' agreements. In the same way, directors may be compelled to certain types of duties specifically agreed in the article of association.

The similar business vehicle in UK came in 2000 after the passage of Limited Liability Partnership Act.[26] The entity too is a hybrid form possessing qualities of both company and partnership. Although initially conceived for professionals, it scope was not however limited. The LLP shall be treated as body corporate separate from its member

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[13]John R Boatright, 'Contractors As Stakeholders: Reconciling Stakeholder Theory with the Nexus-of-Contracts Firm' (2002) 26 Journal of Banking and Finance 1837, 1839.

[14]Founded in 1923 ALI is an independent organization made of prominent legal scholars, lawyers and judges. It drafts, discusses, reviews, revises both American and international law, restatements of the Law, model statutes and principles of law. Its work is quite influential for the legislature and courts. Its publishes

[15]William W Bratton, 'Private Equity's Three Lessons for Agency Theory' (2008) 3 Brooklyn Journal of Corporate, Financial & Commercial Law 1, 879.

[16] 68 Del. Laws Ch. 434(1992)

[17]*Id.* tit 6 §. 18-201(d)

[18]*Id.* tit 6 §. 18-201(b)

[19]*Id.* tit 6 §. 18-304

[20]*Id.* tit 6 §. 18-1107(a)

[21]*Id.* tit 6 §. 18-402

[22] Law 94-1 of 3rd January 1994.

[23] Law 99-587 of 12th July 1999

[24] SA is equivalent of public company.

[25] SARL is equivalent of a private company.

[26] Limited Liability Partnership Act 2000 CHAPTER 12

after its incorporation.[27] The operating instrument is the incorporating document. For the purpose of taxation, like its predecessors, LLP is subject to partnership taxation.

The relationship between the persons involved may be governed by the mutual agreement and any prior or posterior agreement may resolve any conflict between parties.[28] For the purpose of internal governance, the LLP is flexible in that it leaves partners free to agree according to their own circumstances. Thus, the emergence of this entity reflects the presence of contractarian perspective despite being antagonized by the legal scholars.

In Pakistan, the much-awaited legislation of hybrid form of business structure was introduced in July 2017. The Limited Liability Act(LLP)[29] also provides for agreement between partners which could determine rights and duties of partners.[30] Late arrival of LLP in Pakistan is caused by various reasons for instance lack of interest on the part of legislature, business community and corporate law scholars. Another important reason is low corporatization trends in the country for instance only 80,000 companies are registered with SECP[31] which is .03 percent of population whereas this share is 5 percent in UK.

1.2 Insider Trading and Contractarian Theory

The insider trading is an issue that was not immune from the influences of nexus of contract approach. The insider trading has travelled from the complete ban to lesser ban. The question as to whether to allow or not an insider trading is the matter in context. Those who favour complete prohibition argue that insider trading, if allowed, might induce directors/managers to take decision involving more risk that shareholders might not necessarily assent to. In all circumstance an insider would get benefit from the information he holds at the cost of the company or shareholders.

In a risky project, for instance, director/manager would be the first to know about the possible success or otherwise of that project. Where he knows that the project would succeed, he would buy the company share for an ulterior sale at a higher price. On the contrary if he knows that the project would fail, he would sell his existing shares before the information of project failure becomes public and likely diminishing of share prices. Hence whether a project succeeds or fails, directors/managers can get profit or avoid loss. Thus, prohibition of insider trading often resurfaces from shareholders' groups.

But complete prohibition may inhibit director/directors to take risk that is itself is not less important for any business. Although high risk may result into firm's failure, no risk would halt or stagnate its progress. Therefore, a less moderate approach to insider trading would balance the situation in the form of express contract allowing insider trading. Additionally, director/manager may be offered high compensation to dissuade them to get undue profit from insider trading. These contractual provisions are inspired from the nexus of contract approach. Thus, all jurisdictions don't prohibit insider trading rather provide for the disclosure of such transaction including compensation plan for director/manager.

2. Politico-Economic Factors

Next important factor that contributed in the change of company's concept is politico-economic situation in countries under study. The relationship of international flow with economic growth of a country is widely acknowledged. According to Chung-Hua Shen et al., foreign direct investment has a positive impact on economic growth in a country where population is middle income and shareholders are protected. Whereas in case of foreign portfolio investment, the factors like financial liberation, wealth of country and market governance contributed toward economic growth.[32]

International flow of capital as a percentage of World GDP has tripled between 1980 and 2005. All type of international capital flow i.e. banks and money market flow, portfolio and other debt related flows[33], portfolio equity flows[34] and foreign direct investment[35], have seen an increase.[36] Hence the investor of one country went beyond their country for profit making and, at the same time, boosting economic activity of the receiving country.

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[27] *Id.* §.1(2)

[28] *Id.* §.5

[29] Limited Liability Partnership Act, No 25 of 2017 (Pak.).

[30] Schedule of the Act provides for a default agreement applicable to all partnerships but the same is subject to any agreement of parties.

[31] Security and Exchange Commission of Pakistan is the corporate regulatory authority in Pakistan entrusted, amongst others, with the registration of companies.

[32] Chung-Hua Shen, Chien-Chiang Lee and Chi-Chuan Lee, 'What Makes International Capital Flows Promote Economic Growth? An International Cross-Country Analysis' (2010) 57 Scottish Journal of Political Economy 515, 543.

[33] Portfolio and debt flows/investment mean investment in the form of corporate bond. The investors' concerns are only to the extent of their profit without participating in the business operation.

[34] Equity portfolio flow is the investment in the corporate equity and investor, like portfolio debt investment, does not participate in business operation of company.

[35] This investment is made in the equity of foreign company and acquiring significant control and influence over investee company. It may be done by setting up subsidiary or associate company or by merger, acquisition or joint ventures. 10% equity investment is accepted as threshold by OECD

The liberal state policies coupled with denationalization movement gave boost to foreign investment in this period. Additionally, big businesses needed more capital which was catered by both national and international capital flows. Public started investing in stock markets. Similar surge of stock ownership by institutional investor can also be seen. Thus, the influence of managers and dominant shareholders subsided and that of general shareholders arose. The protection of these shareholders was but natural and new liberal economic ideas went a long way to protect such rights.

The political economy in each country moved toward liberalism, whether mediately or immediately. It is argued that American model goes in favour of individual power and fears collectivism. It keeps taxes and social spending low and government intervention minimal. Europeans prefer care for citizen through high taxes, social spending and achieving economic goals through democratic way. This conclusion is based on American exceptionalism that argues that particular circumstance of settlers in America led to an individualist society and pro-market culture.[37]

Similarly, England and US in post-WWII era had leftist policies and people being wary of them, easily accepted an alternative in the form of neo liberalism. In England, the strong labour party in government in pre-Thatcher Era was complemented with stronger labour unions that were ready for strikes. In US, the political agenda of 1970 had the ends of full employment, price control and guaranteed income plan. The state policies were more redistributive and less business friendly. Similar is the case of Pakistan where socialist policies dominated during the 70s as well as more powerful labour unions.

In France the situation was other way round, where tax structure was regressive and business policies were more business friendly. The nationalist governments in pre-1980s followed policies that put the national goals ahead. Moreover, the redistributive system extended income within the class rather than across the class i.e. the poor-making France as one of the most inegalitarian country in developed world. Resultantly the neo liberal reformers came rather slowly in France.[38]

Thus, in this period the denationalization and minimal State intervention can be seen. Thatcher came in power in England in 1979 and is still considered a symbol of privatization and deregulation. In her regime, Margaret Thatcher aggressively pursued the privatization of state owned enterprise. France was not an exception to privatization, however, with slow space and state controlled. What France accomplished in 20 years to privatize state holdings, Britain did in 3 years.[39] France had 3550 stated owned companies in 1986 and it decreased to 800 by the end of 2008.[40]

The US didn't have much state ownership of public industries but had, as said earlier, regulatory regime to the detriment of business. However, in 1987 first federal privatization was done by the sale of Conrail[41] and episode continued with the creation of President's Commission on Privatization in the same year. As a matter of fact, deregulation had become a popular phenomenon in 1970s where it was directed at protecting consumers at the expense of businesses. But President Ford and importantly President Reagan turned this deregulatory movement in the interest of business.[42]

The nationalization of Pakistani enterprises was undone after the deposition of Socialist leader Zulfiqar Ali Bhutto in 1979. The new military leader Zia-ul-Haq adopted the policy of denationalization and returning the enterprises to their original owners.[43] The real acceleration in privatization, however, was observed in 1991 under the Nawaz Sharif as Prime Minister of Pakistan when he formed privatization commission. Since then privatization remained on the agendas of successive government.

3. Legislative Responses in Countries

Because of contractarian concept and politico-economic developments, the position and prominence of shareholders grew. Legislature, therefore, did legislation that safeguarded/promoted the interests of shareholders by requiring directors to be vigilant and dutiful in their functions. Following paragraphs shall briefly discuss some of the important legislative references of this era to substantiate my arguments.

3.1 England

To make the liability of directors/managers more strict, certain provisions were divorced from the company law by making separate legislation on those subjects. On the recommendation of Cork Committee[44] the Insolvency Act 1986[45]

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[36]Mr R Battalino, Assistant Director Financial Market (Australia) addressing to *6th APEC Future Economic Leaders Think Tank*, Sydney, 28 June 2006. Can be accessed at http://www.rba.gov.au/publications/bulletin/2006/jul/1.html

[37] 'What, Exactly, Is "American Exceptionalism"?' (21 October 2016) <http://theweek.com/articles/654508/what-exactly-american-exceptionalism> accessed 27 April 2018.

[38]Monica Prasad, *The Politics of Free Markets: The Rise of Neoliberal Economic Policies in Britain, France, Germany, and the United States* (University of Chicago Press 2006) 3.

[39]ibid 12.

[40]Hervé Loiseau, 'Quinze années de mutation du secteur public d'entreprises : 1985-2000' (31 January 2011) 1 <http://www.epsilon.insee.fr/jspui/handle/1/426> accessed 20 February 2014.

[41] Consolidated Rail Corporation was the primary Class I railroad in the Northeastern United States between 1976 and 1999

[42]Prasad (n 38) 63.

[43] Transfer of Managed Establishment (P.O. 12 of 1978)

[44]Cork Committee on Insolvency Law and Practice (1982)

was passed that, inter alia, provided that directors/officers are to provide assistance and information in respect of mismanagement for a company that has been ordered to be wound up.[46] The Act also provided for personal liability of director in case of wrongful trading and debts arising out of contravention of reuse of company's name.[47] Similarly Act provided that director/officer to make good any loss for making any undervalued transaction or any preference while company is under administration or liquidation.[48]

Similarly, a separate law for director disqualification was passed in 1986 known as Company Directors Disqualification Act 1986.[49] The Court, under the Act, was given extensive powers to disqualify any convicted director/officer (and in certain circumstance even without conviction) to become a director/officer for any time period depending on particular situation mentioned in the Act. The matters for disqualification relates to the promotion, formation, management, liquidation or striking off a company etc.[50] The person disqualified can't continue to be director except with the leave of the court.

Many new provisions as well as EU directives[51] were incorporated in main company law i.e. company act 1980[52], 1985[53] and 2006 to further strengthen the emerging shareholders.

Powers of shareholders were strengthened regarding issuance of capital and thus directors are required to obtain shareholder authorization to allot capital.[54]

Additionally, shareholders would have pre-emptive right on new issuance according to their proportion of shares.[55] Certain further restriction regarding dividend were also made stipulating that dividend is to be distributed out of realized profit after deducting realized losses, which would result in considering losses of previous years as well.[56]

In response to Maxwell and Polly Peck scandals,[57] a reform committee under the chairmanship of Sir Adrian Cadbury was constituted that, in 1992, published its report titled *Financial Aspects of Corporate Governance.* The report set the foundation for best practices for large companies not only in UK but in rest of the world. The recommendations of this report are popularly known as *Code of Best Practices*. The most striking feature of the report was to recognize shareholders as owners of the company and board's ultimate accountability to them.[58] This code now called *Combined Code of Corporate Governance* was revised many times and latest update took place in July 2018. These Codes helped increase the shareholder say in the company.

The current Companies Act 2006[59] came out of extensive overhauling of previous company act. Rights of shareholders were further enhanced with more information, use of electronic communication and rights relating to proxy voting. The Act contains the codification of director's duties that was being recommended for more than half century. Directors in the performance of their duties are to consider what is known as *Enlightened Shareholder Value* whereby director/managers of the company should act in the long-term interest of shareholders having regard to other stakeholders like employees, suppliers, and customers. The approach adopted is not pluralist and nor pure classical shareholderism and lie perhaps between both but tilting towards latter.

3.2 Delaware

In Delaware both legislature and State judiciary remained active in formulating new laws and legal principles. Although generally courts in Delaware support *Business Judgement Rule,* they also protected the rights of shareholders. Legislature at different times did significant changes in laws relating to corporation by providing immense flexibility to lure investors. The rights relating to voting, proxy and control over important corporate decision of shareholder were enhanced.[60] In 1981 amendments[61], the quorum required for shareholder meeting was fixed half of shares entitled to vote unless anything contrary in certificate of incorporation or bylaws, but it must not be less than one third.[62]

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[45]Insolvency Act 1986 CHAPTER 45(The Act was passed in 1985 but was delayed and revised by government till the new Insolvency Act 1986)

[46]*Id.* §.235, 236

[47]*Id.* §§. 214, 216-217

[48]*Id.* §§. 238, 239

[49]Company Directors Disqualification Act 1986 CHAPTER 46

[50]*Id.* s 2

[51] Council Directive 77/91, 1977 O.J. (L 26)

[52] Companies Act 1980 CHAPTER 22(hereafter referred to as 1980 Act)

[53] Companies Act 1985 CHAPTER 6 (hereafter referred to as 1985 Act)

[54]Companies Act 1980 §.14

[55]*Id.* §.17

[56]*Id.* §.39

[57] Polly Peck International (PPI) was a small British textile company which expanded rapidly in the 1980s. It raised to UK listing index but collapsed in 1991 with debts of £1.3bn.

[58]Adrian Cadbury, 'Financial Aspects of Corporate Governance' (1992).

[59]Company Act 2006 CHAPTER 46 (hereafter referred to 2006 Act)

[60] Important amendments to corporation law were made in 1981, 1986, 1987, 1990, 1994, 2000, 2003, 2005, 2010, 2013 and 2015.

[61] 63 Del. Law §. Ch. 25(1981)

[62]*Id.* §.6

An important 1986 amendment[63] to Code lessened the contemporary personal liability suits against directors and officers. Thus, the certificate of incorporation may provide for eliminating or limiting breaches of fiduciary duty of director. However, the amended section 102(b)(7) provides that directors shall not be so exempted for breach of duty of loyalty, for acts or omission not in good faith, intentional misconduct or deliberate violation of law, payment of unlawful dividends or unlawful stock repurchases or redemptions, or for the transaction in which he has obtained personal benefits.[64] 1987 amendment[65] relates to the procedural uncertainties regarding notice to shareholder**,** taking of action by shareholder with their consent or entitlement to dividend etc.[66]

Legislature in Delaware remained cognizant of the merger of companies. Through the 1994 amendments[67], it provided that where any company has merged/consolidated under the law, each shareholder of such merged/consolidated companies shall be entitled to be notified about her/his new rights either before or within 10 days of such merger or consolidation.[68] For the appraisal right[69] in merger proceedings, only stockholder on record (registered in company's book) were authorized to access court. 2007 amendments extended this right to the beneficial owners (common shareholder) to have access or withdrawal from these appraisal proceedings.[70]

A rather innovative idea spurred in 2000[71] for allowing companies to have restricted securities complying with the formalities of the law. In the year 2005, different classes of shareholders gained important powers to appoint their own directors by providing in certification of incorporation to represent and secure their interests on the board. The term of office or even voting powers might also be regulated by shareholders.[72]

The proxy rights of shareholders for director's election were enhanced in 2009 amendments.[73] The recent Delaware amendments in 2013[74] overturn certain court rulings relating to ratifications of defective corporate acts. It added two new sections whereby any defective corporate act may be ratified by board of directors and shareholders or court of chancery.[75] Thus, an act of the corporation couldn't be challenged solely on the ground of any defect if that has been ratified following the provision of newly added sections 204 and 205. Court of Chancery however is vested with powers to settle any dispute in respect of such ratifications.

Although the laws of corporations in US are State domains, but securities laws are within the federal jurisdiction. Sarbanes-Oxley Act(SOX)[76] was enacted in 2002 in response to contemporary financial scandals and amended or supplanted the existing legislation dealing with securities regulations. The Act required an enhanced disclosure requirement by mandatory external auditor's opinion on the internal control and financial reporting of the company. The Act also imposed criminal penalty for certain acts. For example, anyone involved in providing untrue statement to public agencies would be liable up to 20 years of imprisonment.[77] CEO or CFO[78] may also be penalized if they don't comply with the legal requirement regarding financial reporting.[79] Regarding management, the Act required directors and senior management to be more responsible for the internal control of the company.

In response to Great Recession, another legal reform for financial sector came in 2010 titled *Dodd Frank Reform and Consumer Protection Act.*[80] It was big piece of legislation covering many aspects of financial law. Important matter pertaining to corporate governance related to executive compensation, proxy access, whistle blower's protection and disclosure regarding combination or otherwise of the office of CEO and Chairman. Shareholder gained more say on executive's pay especially in extraordinary transactions.[81]

3.3 France

French legislation in post-1980's had global neo-liberal as well as stakeholder trends. Since civil code defines company as both a private concern for the owners and its role towards other stakeholders including society at large.

[63] 65 Del. Law §. Ch. 289(1986)
[64] *Id.* §.2
[65] 66 Del. Law §. Ch. 136(1987)
[66] *Id.* §. 213
[67] 70 Del. Laws. Ch. 363 (1996)
[68] *Id.* §.22
[69] Appraisal right is the right available to shareholders of merging companies to apply to Delaware Chancery Court to ascertain the fair value of company's share.
[70] 76 Del. Laws. Ch. 145 (2007) §.13
[71] 72 Del. Laws. Ch. 123 (2000)
[72] 75 Del. Laws. Ch. 30 (2005) §.1
[73] 77 Del. Laws. Ch. 14 (2009)
[74] 79 Del. Laws. Ch. 72 (2013)
[75] Section 204 defines scope of defective corporate acts: i) any act lacking authorization according to Delaware corporation law, certificate or incorporations, bylaws or any other agreements ii) an over-issue of shares iii) defective election of appointment of directors
[76] Pub. L. No. 107-204, 116 Stat. 745 (2002)
[77] *Id.* §.802
[78] Chief financial officer of the company.
[79] *Id.* §.906
[80] Pub. L. No. 113-203, 124 Stat. 1276 (2010)
[81] *Id.* §.951-955

Thus, this double responsibility is evident in various reports and law reforms. Moreover, French government is not that much active in legislating law, rather it threatens legislative measure so that business community could bring forth self-regulatory schemes. Reports from AFEF[82] and MEDEF[83] are the notable examples in this regard.[84]

In the year 1996, a reform report was presented by Senator Marini entitle *"The Modernizing of Law on Financial Activities".* The report made recommendations on three broad themes; first related to laws applicable on companies; second to management of companies and third to laws for internal control of companies. The report tilts towards contractual notion of the company inspired from nexus of contract theory. The recommendations of Senator Marini were implemented in French law in piecemeal.

First partial reform took place in 1998 and the Law[85] covered both economic and financial aspects in particular relating to matters of buy-back shares by company. Next important legislation came in 2001 generally known as New Economic Regulation.[86] The Law partially enacted the recommendation of Viénot Reports.[87] The Law did a good job in elucidating the role of different actors of company i.e. board of directors, chairman and CEO, the role which was previously opaque.

Shareholders rights were also strengthened by the Law. They could participate in general meeting through videoconference and requirement of share ownership to attend company meeting was abolished.[88] Similarly an intermediary might act as proxy representative for foreign owners of shares of listed companies.[89] The law at the end is considered as enhancing the powers of shareholders at the cost of management.

Next law in the wake of corporate governance reforms at global level came in August 2003 and is known as Financial Security Law.[90] Main reforms related to financial sector by providing more corporate information to directors, shareholders and public at large, strengthening regulation of auditing etc.

French law in 2004, inspired from Anglo-American law, recognized the preferred shares by reforming the securities law.[91] 2005 Law reforms provided for more disclosure regarding the executive pay details to be provided in annual company report.

Besides legislature, French listed companies also refer to soft law provisions. Different codes have been developed by professional organizations like MEDEF[92] and AFEP[93] with the name of Viénot Report 1 and 2 respectively, as well as Bouton reports. Though these codes have no formal legal sanctions still they impliedly have such a sanction. Any company not complying with these codes is questioned by AMF to explain as to why it has not so complied (comply or explain rule). Viénot 1 report, published in 1995, dealt with board of directors of public limited companies and their effectiveness. It also made its recommendation on independent directors, board committees etc.

In 2008 a combined Corporate Governance Code was adopted which was later revised in 2010, 2013, 2016 and 2018. The latest Code, like its predecessors, provides that board should assume more responsibility regarding the strategy of the company and accountability toward shareholders.

3.4 Pakistan

In Pakistan, on the recommendation of Company Law Commission, new Companies Ordinance was promulgated in 1984.[94] The ordinance consolidated relevant laws and added new provisions. The Ordinance sets summary procedure for the matter under the company ordinance and to hear the cases, absent extraordinary circumstance, on daily basis. The court was also bound to dispose of the matter within 90 days. The appeal against the order of the court shall also be disposed of within 90 days after submission thereof.[95]

Regarding board of directors some new additions were made. Only natural person would become director of the company, and term of office of director was fixed three years.[96] Through a contractual arrangement, creditors might also appoint their director on the board.[97] The CO 1984 enumerated the powers of director by providing that board would exercise all powers not vested in the general meeting of the meeting. Thus board, in its resolution, would make

[82] Association française des entreprises privée is an association of largest French entrepreneurs.
[83] Mouvement des entreprises de France is the largest employee organization in France**.**
[84]Christine A Mallin, *Handbook on International Corporate Governance: Country Analyses* (Edward Elgar Publishing 2011) 105.
[85] Law no 98-546 of 2 July 1998
[86] Law no 2001-420 of 16 Mai 2001
[87] MrMarc Viénot was, at the time of making that report, chairman of Société Général, one of the leading French Companies.
[88]*Id.* art 115
[89]*Id.* art 119
[90] Law no 2003-706 of 1st August 2003
[91] Ordinance no 2004-604 of 24th June 2004
[92]*Mouvement des Entreprise§.de France* is the largest union of employees in France. It was created in 1998 and replaced the old employee association.
[93]*Association Française des Entreprises Privée* is an association of largest French entrepreneurs.
[94]XLVIII of 1984 (hereinafter referred to CO 1984)
[95]*Id.* §.9-10
[96]*Id.* §.175, 180
[97]*Id.* §.182

calls for unpaid shares, to issue shares or debentures, to borrow money or invest company's fund or make loans. The shareholder of a public company, however, continued to authorize sale or lease of substantial property of the company.[98]

The office of chief executive was created by this law partly due to abolition of managing agent and partly due to the requirement of modern company law trends. In the post privatization period and for a more transparent offering of company shares to public, the Corporate Law Authority[99] made Companies (Issue of Capital) Rules 1996.[100] The rules applied to companies offering shares to public, issuing right shares, bonus shares etc. To cater the need of shareholders, the powers of company to have difference classes of shares was recognized in 1999.[101]

Next significant changes to company law took place in 2002 through two amendments. While first amendment[102] brought changes in the text of ordinance while second amendment added a new part VIII A by introducing non-banking financial companies (NBFC) to cater the need of financial sector.[103] The 2007 amendments[104] to CO 1984 also affected certain changes especially regarding NBFCs.

To improve capital market and inviting both local and foreign investors in Pakistan, SECP also issued Code of Corporate Governance. The code is part of listing regulations of stock exchanges[105] and applies to listed companies on *comply or explain* basis. The first code was issued in 2002 while the latest revised versions came in 2017. Like other codes, it emphasis upon the neutrality of the board to ensure effective corporate decisions.

Despite recurrent amendments to the company law, company ordinance was unable to meet the expectation of an optimum regulatory environment for the corporate sector, thus need for overhauling of the legislation[106] which was realized with the enactment of Company Act 2017.[107] The Act was enacted after vast study of different jurisdictions including UK, India, Australia, Hong Kong, New Zealand, Malaysia and Singapore. The Act of 2017 ensure maximum participation of members in decision making process of the company through use of modern electronic means of communication and aims to address the issues relating to protection of interest of minority shareholders and creditors. The Act of 2017 provides adequate measures against fraud, money laundering and terrorist financing and necessary provisions have been proposed regarding powers of the Commission to investigate including joint investigation and provisions requiring officers of a company to take adequate measures to curb such violations.

Conclusion

In this period of company law developments, it is revealed that predominantly three factors played most important role in formulating company law and director's duties. At the first place comes the economic and legal scholarship in the form of contractarian theory of corporate entity which postulates company as a set of contracts between different actors involved in the business. The theory is underpinned by market forces in which business actors in the market agree on certain terms by mutual bargain. The theory influenced corporate legislation globally and we find different novel organizational tools directly inspired from the theory. LLC in Delaware, SAS in France and LLP in England and Pakistan are the candid examples of contractarian theory of firm. The normative approach in all these entities is to give freedom to commercial actors to reach on mutually agreed contracts whereby they could secure their respective interest. What is important in the formation of these legal entities is to have an incorporating document registered with the governmental officials that contain provisions for the rights of individuals involved as well as modalities of the operation of the entities.

At the second place comes the influence of globalization of the economies. The technological advancement in transportation decreased the distances between countries of the world, hence the movement of both human and commodities. There is hardly any country in the world that is unaffected by the globalization of both financial and non-

[98] *Id.* §.196

[99] This was regulatory authority of companie§.in Pakistan till 1997 when it was replaced by more vigorous body known as Securities and Exchange Commission of Pakistan)

[100] The Gazette of Pakistan Extraordinary, Part II, Feb. 10, 1996

[101] Finance Act 1999 (Act IV of 1999) & Share Capital (variation of rights and privileges) Rules 2000

[102] Companies(amendment) Ordinance 2002 of 26th Oct 2002

[103] Companies (Second Amendment) Ordinance 2002 of 15th Nov 2002

[104] Finance Act 2007 (Act IV of 2007)

[105] Listing Regulation of Karachi Stock Exchange (as amended on Jan. 3, 2014) Chapter XI

[106] For the purpose of reforms, Corporate Laws Review Commission ("CLRC") was constituted in the year 2005, headed by the former Chief Justice of Pakistan, Mr. Justice (R) Ajmal Mian and other renowned professionals including Mr. Hameed Chaudhri, Mr. Razzak Dawood, Ms. Musharaf Hai, Mr. Sohail Hasan, Dr. Tariq Hassan, Mr. Tahsin Iqbal Khan, Mr. Qazi Jamil, Mr. Razi-ur-Rahman Khan, Mr. Rashid I. Malik, Dr. Khalid Ranjha and Mr. S. Salim Raza. The commission decided to enact a new company law. The commission was replaced by a new commission in 2012 but still the work of the commission remained sluggish. However, in 2015 the commission resolved to complete the lingering project and thus finalized draft bill by the end of 2015. The bill ultimately was converted into enactment in July 2017.

[107] Companies Act, No 19 of 2017 (Pak.)

financial sector. To boost domestic economies, countries needed capital, both foreign and local. Thus, new investor, especially the foreigners, would invest in countries where their money and legal rights are better protected. Thus, all legislation under studies favoured and added shareholder friendly provisions in corporate and securities law that primarily pursued shareholder's interest.

At the third place comes the role played by political economy of each country. States adopted more liberal economic policies that favoured free market trends. Similarly, State intervention in business decreased that gave way to new shareholder class and thus corporate law would protect this new class of shareholders. A trend of privatization of state owned enterprises is visible in all the countries under studies. The trend had started in last quarter of last century and continues; thereby ownership is transferred to private persons. Thus, new entrepreneur friendly regulatory regimes were but mandatory in the wake of privatization.

Thus, it is observed that factor that contributed in the developments of company law in above jurisdictions were common irrespective of the fact that countries belonged to different legal families. However, the situation may be different in authoritarian states e.g. socialist countries that would be worth investigating.

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