The limits of *n.g.* are not easy to define, because at times in its history (and, at least implicitly, in some quite recent French decisions) it has been allowed to spread beyond its classical limits and function as a remedy for unjust enrichment. Stoljar allows himself to some extent a similar expansionism. This is another reason for the length of the chapter. But one wonders what the relationship is to be between this and the other sixteen projected chapters in the volume.

To sum up, Stoljar's chapter is 'encyclopedic' in its range and provides a valuable survey, but it should be regarded, at least in its Common law parts, more as arguing a controversial thesis than as propounding current orthodoxy.

INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW. VOL. XIII (COMPANY SYSTEMS AND AFFILIATIONS), Ch. 7: BUSINESS AND PRIVATE ORGANIZATIONS. By Ulrich Immenga. The Hague, Paris: J.C.B. Mohr, 1985. Pp. 107.

*Reviewed by Tamar Frankel**

Company Systems and Affiliations ("the Study") compares the laws governing corporate conglomerates in European countries, England, and the United States. The Study is a valuable addition to a sparse literature on the subject. Even though conglomerates have existed for more than a quarter of a century, scholars in the United States have not focused on them as a legal subject, separate from general corporate law. Since Professor Conard's classic work in 1976,[1] the only comprehensive and yet unfinished work on corporate groups is that of Professor Philip Blumberg.[2] The United States courts have not done much better. Even when they singled out corporate groups as a special case, they applied to these groups general principles of corporate law. A comparative study is therefore useful for determining whether corporate systems should be treated as a separate branch of corporation law. More importantly, such a study educates the reader about problems arising in the context of corporate systems. More broadly, a comparative study helps demonstrate how social, cultural and economic institutions in which legal systems develop relate to the way problems are defined and solutions for them are chosen.[3]

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1. Conard, *Corporations in Perspective* (1976).

2. Blumberg, *The Law of Corporate Groups, Bankruptcy Law* (1983); *The Law of Corporate Groups, Procedural Law* (1985). See also Blumberg, "Limited Liability and Corporate Groups," 11 *J. Corp. L.* 573 (1986).

3. Kahn-Freund, "On Uses and Misuses of Comparative Law," 37 *Mod. L.* 1-27

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The task undertaken in the Study is formidable. The Study follows company systems from birth to death. It starts with the business strategies which produce corporate groups, the legal organizational forms which they can take,[4] and the methods of establishing affiliated groups, such as enterprise agreements, interlocking directors[5] and reciprocal shareholdings.[6] A special section is devoted to the regulation of takeovers and other methods of changing corporate control[7], including mechanisms based on voting rights.[8] A substantial portion of the Study is devoted to a detailed description of the special regime designed in the Federal Republic of Germany and proposed in the E.E.C. for regulating corporate systems.

A theme running throughout the Study is the protection of passive capital providers, minority shareholders and creditors, ("investors"). This theme is quite rightly viewed by its author, Ulrich Immenga, as central to general corporation laws as well as to the special laws regulating corporate systems. I will focus on this theme.

To evaluate the advantages and disadvantages of legal systems, one can compare them on different levels of generality. But most valuable comparisons are built on common denominators that are sufficiently loose to avoid less significant variations among the systems that are examined, but sufficiently specific to produce meaningful comparisons.[9] In addition, a comparative study should take into account the different contexts, cultural, social and economic environments in which the legal rules operate in each country.[10] Judgments made in the abstract are less helpful.

The common denominators among different systems can be extrapolated from the similarities as well as the differences among them. Such common denominators may involve situations that are perceived as problems in each country, and the solutions chosen by each country from the available options. As we shall see, the material contained in the Study indicates that the legal systems under comparison are very similar in their underlying philosophy of polit-

(1974); Tomanov, *Comparative Law, Legal Systems* (1985): Glendon, *New Family and the New Property* 6 (1986).

4. The Study at 13-15.

5. Id. at 30-35. At 36-41 the Study deals with corporate control and its effect in general company law, including circumvention of basic principles of company law, and the consequent expansion of disclosure requirements.

6. Id. at 42-45.

7. Id. at 13-29.

8. Ibid.

9. Zweigert & Kotz, *An Introduction to Comparative Law* 31-44 (1977).

10. For example, how strong is market supervision of management? Is there a market for the shares, offering shareholders an "exit?" Do shareholders have the power to veto corporate reorganizations? Are other laws beside corporation law applicable to corporate groups? See German law providing shareholders with the right to approve modifications of inter-unit contracts within corporate systems, the Study at 71-72, and the incorporation into German corporation law of provisions which appear in the United States in the securities acts. The Study at 71, 81.

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ical economy, and the fundamental policies and general direction of their corporate laws. Yet, the systems are very different in how they define the problems they address and what solutions they choose for them. There may be many reasons for these similarities and differences. The materials in the Study and the patterns of the various legal designs suggest two interrelated explanations. One explanation involves the acceptable risk level of the aggregate body of investors in the particular country, and the other relates to the country's political philosophy regarding government interference in the conduct of business and economic affairs.

For comparison the Study selected a number of legal systems: the British, French, West German, Italian, the E.E.C. and the United States. It is clear that these countries have much in common. All have capitalist economies. In all countries corporations developed during the nineteenth century, and corporate groups appeared during the past twenty five years, appoximately at the same time.

The materials in the Study indicate that the legal systems in these countries also have much in common. All have adopted corporate laws providing protections to investors. While all these systems grant minority shareholders appraisal rights ("exit rights") when corporations reorganize, no system prohibits units within corporate groups from having investors (except in few unique cases[11]). Significantly, all systems focus on the behavior of controlling shareholders and managements, and regulate this behavior to protect investors. These similarities seem to reflect certain judgments and policies: first, that conflicts of interest of controlling shareholders and managements pose risks to investors; second, that these risks pose a problem, because they are undesirable as a matter of national policy; third, that the exposure of investors to these risks is a problem which the law should address.

These judgments and policies are not self-evident in market economies. After all, parties to market exchanges are expected and encouraged to fend for themselves while acting in their own interest, subject to the "rules of the game." Presumably this pattern of behavior will enrich the parties as well as the society. Why the protectionist attitude for investors? One explanation is that in capitalist societies it is essential to maintain public confidence in the financial system. Otherwise, capital (savings) will not flow to productive uses by the borrowers.

Passive capital providers take substantial risks when they hand over their funds to those who control corporations. Not only do they relinquish control over their money, but they also hand it over to persons who may have interests conflicting with their own and whose liability for corporate debt and for mismanagement is limited

11. See, for example, The Public Utility Holding Company Act of 1939 and the Investment Company Act of 1940 in the United States.

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in law[12] and in reality. Unless investors believe that they would get enforceable fair bargains, they would hoard their savings rather than invest them.

For economists who view appropriate returns as the only incentives necessary to induce investors to take investment risks, this argument will be put differently, but with the same result. The desired level of risk determines the returns which investors charge. If they believe that the probability of getting their money back is very low, they will extract high returns. They will assess not only the borrower's credit risk but also the risk of losses from conflicts of interest with controlling factions in the corporation, or from breach of agreements concerning trades in securities. As enforcement costs rise, so will the returns which investors will demand. At some point the level of these returns will make it unlikely that the borrowers will remain profitable. Such circumstances are as detrimental to the economy as is hoarding. Yet in many countries, that is what happens. The greatest obstacle to the establishment of securities markets and the flow of capital to productive use is a lack of investors' trust. In those countries investors decline to hand their money to publicly held corporations at any price. Put differently, they demand immediate 100% return.

The aggregate risk level that investors are willing to take in a particular country is important even if the investors can diversify their portfolios. When investors in country "A" desire a lower risk level (or perceive the risk to be higher) than investors in country "B" desire, investors in country "A" will simply hold less risky investments in their portfolios to reach their desired level of risk. In country "A" demand for risky investments will be lower than in country "B". Enterprises in country "A" will tend to act in a less risky manner in order to raise capital. If country "A" desires as a matter of public policy to encourage risk taking enterpreneurs, the legislatures in country "A" will seek to provide stricter protective laws to reduce investors' risks from the controlling factions within the corporations.

According to this explanation, legal intervention in corporate governance to protect investors is neither altruistic nor paternalistic, and the effect of corporate laws is to facilitate the flow of funds into the economy by reducing it to a level which is acceptable to investors.[13] This acceptable level may be affected by cultural factors, and the institutions and laws which are put in place. Consequently, differences among corporate laws in various countries may stem from the differences among the risk levels acceptable to investors in these countries.

These inferences emerge from the similarities and differences

12. With few exceptions, shareholders' liability is limited to their investments. Managements are viewed as fiduciaries, not guarantors.

13. See Stokes, *Legal Theory and Common Law, Company Law and Legal Theory* 165-73 (Twining ed. 1986).

among the legal systems covered in the Study. The similarities indicate that investor protection is considered the operating principle underlying corporate laws.[14] The differences in the ways the laws protect investors seem to reflect the investors' different acceptable risk levels in the various countries.

General observations suggest that European investors risk tolerance is lower than that of their American counterparts. Europeans have preferred debt to equity investments, and have tended to calculate even their return on equity as they would on debt. They also sought dividends rather than internal corporate growth.[15] American investors seemed to accept higher risk for higher returns. They have distinguished between debt and equity securities and until recently, they considered growth to be similar, if not equivalent, to cash dividends. These distinct attitudes may also reflect differences in income tax provisions in each country[16] and distinct institutional arrangements, such as liquid and efficient securities markets. These attitudes may be affected also by the nature of financial intermediaries. In Germany commercial banks serve as broker dealers, whereas in the United States commercial and investment banking are separate. This separation seems to have produced more active and liquid securities markets than in Germany. Since United States bankers had less influence on markets, their traditionally cautious attitudes did not dominate the markets' activities. Whatever the reasons, one observes that German investors act as if they tolerate lower risk levels than American investors.

Another explanation for the differences in legal implementation of similar general policies to protect investors relates to the countries' political philosophies regarding the role of government and the extent of its legitimate intervention in business activities. In the United States corporate law intervention in business is kept in check through active competition among the regulating states, and the freedom of corporations to choose the regulatory system which is to govern them.[17] Belief that markets are the best allocators of capital resources seems to be weaker in Western European countries and in England, where socialist parties have from time to time gained a majority.

These different philosophies may be reflected in the legal systems regulating corporations. The country with more risk taking in-

14. The Study at 46-55.

15. Skeptics may value dividends, a bird in hand, so to speak, more than retained earnings. Demand for cash dividends may also reflect uncertainty about the future of the economy and tax provisions.

16. Taxation may affect the valuation of retained, as opposed to cash dividends. In the United States taxation may have had an impact on the preferences of shareholders for growth. With the increase in capital gains taxes, Americans, too, may demand higher cash dividends.

17. See Romano, "The State Competition Debate In Corporate Law," 8 *Cardozo L. Rev.* 709 (1987); Frankel, "The Dual State-Federal Regulation of Financial Institutions—A Policy Proposal," 53 *Brooklyn L. Rev.* 53 (1987).

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vestors, in which freedom from government intervention in business affairs is highly valued, will find solutions that minimize this intervention even at the expense of reduced investors' protection. Of course, these two interrelated characteristics are not static. When investors' confidence wanes, government protective intervention may increase, as it did in the United States after the Great Depression. Today, however, Americans tend to be risk takers and their resistance to government intervention is greater than in the past. In contrast, European investors continue their traditional tendency for risk aversion and their greater tolerance for government intervention in business.

The materials in the Study support these observations and suggest that investors' acceptable risk levels and the countries' political philosophy on government regulation of business may explain the differences between the legal provisions in each legal system under examination. Rules protecting investors differ in their degree of protection and the degree of government interference in business arrangements. The more protective laws allow for greater government intervention; the less protection laws allow for less intervention. The most protective laws appear in Germany and the least protective laws in the United States.

A selected number of examples demonstrates these patterns.

a. *Differences in the perceived source of the risk to units within company systems.* Professor Immenga attributes the source of investors' risk in corporate systems to loss of "economic independence" of the units, and considers this independence to be a fundamental principle of company law, equal in importance to safeguarding corporate legal independence. Consequently, the greater the loss of a unit's independence, the greater will be the risk of its investors. This is the view taken in German law and, less explicitly, in other European legal systems. Once the source of the problem is thus identified, the solutions focus on ways to maintain the units' independence, or to establish a regulatory system that compensates as closely as possible for the perceived loss of benefits from the units' independence.

While the author of the Study suggests that all legal systems under comparison share this perception I list it as a dissimilarity because my interpretation of American law differs from his. In a number of American cases the courts view the source of risk to investors not in the loss of corporate independence but in the rule of limited liability (for corporate shareholders and other corporate units in the group). If the unit is depleted by its parent corporation, the rule of limited liability increases the direct risk to lenders and indirect risk to its shareholders. Defining the risk in these terms leads to a different solution to the problem: using the vague principles which the courts apply for piercing the corporate veil and making the whole corporate group liable as shareholders for the debts of the units that compose it. That solution would put creditors of all units and the holding company on an equal footing, and offer minor-

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ity shareholders of units indirect but substantial guarantees that the units will be operated with minimum (though not maximum) profitability.[18]

b. *The various systems give different weights to investors' rights as against majority shareholders rights.* For example, in German law, a parent corporation is required to take into account the interests of investors in its subsidiaries. France imposes a general principle of shareholders' equality,[19] while England provides statutory protections to minority shareholders as alternative remedies.[20] These countries also offer elaborate protections for creditors of units within the corporate system.[21]

American law tends to protect the investors at the approximate level of their reasonable expectations, as defined by the courts. These protections do not necessarily amount to equal rights with the majority or to protection of the minority's preferences which conflict with those of the majority. American courts are more receptive to the argument that imposing on the corporation a course of action to satisfy the minority's interest results in an unjustifiable denial of the majority's desires. American courts have little sympathy for minority shareholders who bought their shares with notice of the corporate system structure and the prior policies of allocating benefits to each unit within the system. These shareholders are deemed to have agreed to reduced "independence" of the unit within the group. Disclosure rules rather than substantive regulation is used to protect investors in these cases.

Thus, German and other European laws provide a more sweeping and less conditional protection to investors, and are less deferential to the desires of the majority than American law. These tendencies comport with the explanation that American law exposes investors to a higher risk than does the German law. If the purposes of all laws is to maintain investors' confidence in the system, it seems that Americans today might be higher risk takers than the Germans.

c. *Some legal systems view the risk to investors to be higher or at least different if the corporations are controlled by other corporations than if the corporations are controlled by individuals.* Hence, some systems, such as the German system, accord investors to units within corporate groups a special protective legal regime. Supporting the German solution, Immenga argues that traditional corporate law does not provide adequate protection to investors in the context of corporate groups.[22] It is costly for investors to enforce the operating principle of corporate law, the *maintenance of independence* of

18. In any event, in the United States at least 70% of the corporate systems are wholly owned. They pose risk mainly to creditors rather than minority shareholders.

19. The Study at 50.

20. Id. at 46, 50, 52.

21. Id. at 53-55.

22. Id. at 56-7.

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the subsidiary's interests. Investors are forced to supervise controlling shareholders or managements on an on-going basis. In addition, the author is disappointed by judicial deference of managements' business decisions, a deference which limits the effect of the "independence principle." He concludes that adherence to traditional corporate law will simply allow the parent holding company to subordinate the interests of the units within the group to the group's interests, to the detriment of the units' investors.[23] Further, in his opinion, the elimination of investors from corporate units, even on equitable terms, is not an acceptable solution unless the minority shareholders agree to sell their shares. The Study shows that most systems provide minority shareholders with the option of withdrawing from the enterprise, including buy-outs by controlling shareholders.[24] Immenga therefore rejects as inadequate the traditional corporate law protections for investors in corporate systems units.

There are, however, counter-arguments. The risks to investors are not fundamentally different or unique to the corporate system. Traditional protections are inadequate only if the risks to which investors in corporate systems are exposed are higher than the risks of investors in corporations controlled by individuals. It is unclear whether that is so. Individual controlling shareholders (and the managements which they elect) may have agendas that conflict with those of the investors. Indeed, company systems may pose lower risks to investors. There are greater chances that share ownership of the holding company will be dispersed, in which case investors will be exposed to the conflicts of interest of managements. Managements of holding companies may have less incentive to render any unit in the group unprofitable because the losses, reflected in the consolidated balance sheet of the group, may affect the managements' interests adversely. In practice, both in Germany and the United States holding companies rarely allow their subsidiaries to fail. Therefore, unless it is shown that the risks to investors from controlling individual shareholders are lower than risks to investors in units in company systems, why should the latter obtain greater protections?

As a matter of public policy, the rights of investors in units within the corporate groups should be less protected than investors in corporations owned by individuals. If the corporate group as a whole benefits from reduced profitability of a unit, it may be desirable to allow the management to allocate resources to increase the profits of the whole, even at the expense of its part. In such a case, rather than force the group to maximize the profits of disparate units it may be better to permit an equitable exit for investors in the units.

The solution of providing investors with equitable exit terms has been accorded different weights in the different systems. In

23. Id. at 58.

24. Ibid. It is true, however, that lenders seem to have less choice in these cases.

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American law appraisal rights are considered an important and sometimes the exclusive protection for minority shareholders in reorganizations. Minority shareholders' rights to continue their participation in the corporation are subordinated to the welfare of the enterprise, as determined by the controlling shareholders or managements rather than as determined by the courts. Furthermore, when markets for the units' shares are liquid, the determination of the value of minority shareholders' shares is left to the markets rather than to the courts. German law seems to accord appraisal rights lesser value. The Study gives these rights little discussion.[25]

The insistence on maintaining the independence of the unit within the group points to greater protection of investors and a relatively heavy handed government treatment of business structures. The American solution, tending to assure investors an equitable departure from the unit in the corporate system, shows lower investor protection and lighter pressure of the government's guiding hand. Here is an example of different legal balancing of the interests of investors and controlling groups. It suggests that American law is less intrusive in corporate reorganizations and less protective of American investors. Presumably, American investors are willing to take the legal risks involved in investing in units within corporate groups.

d. *A number of systems resorted to legislative protections for investors in corporate groups while the United States system left the solution to the courts.* German and Brazilian laws, for example, created an elaborate formal special regime for corporate systems, superimposed on corporate law for simple units (whose controlling shareholders are individuals). Although it leaves details to the parties, the regime imposes protective rules for investors. Other countries "muddle through" by adjusting corporate law to special problems in the context of corporate systems, and applying its provisions on a case by case basis.[26] Immenga believes that a formal legal structure for corporate systems is preferable,[27] because it is less costly, being more general, and because it provides a standardized framework by law, rather than leaving each group to design the arrangements for itself. Yet, corporate law is such a formal structure, mandatory in part and permissive in part. The additional formal structure imposed by German law is simply another layer of "standardized contract" regulation. To the extent that the structure is mandatory, it further reduces the flexibility of businesses to experiment and change their organizations. This formal structure involves greater costs to the enterprise, because it requires a contractual arrangement among the units in the group. When legal and business

25. See the Study at 97-100, dealing with the forced elimination of minority shareholders (usually of 90% held subsidiaries).

26. Id. at 83.

27. It seems that this view is shared by the drafters of the E.E.C. proposed law on corporate systems.

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structures conflict or differ, there are costs to the enterprise. It is therefore desirable to align these structures as much as possible. Flexibility and timeliness of business restructure are valuable to the well being of the enterprises. Therefore, the net costs of additional formal structures may be greater than meets the eye.

The formal and informal solutions to protecting investors in units within corporate groups demonstrate vividly the different acceptable investors' risk levels and different cultures of the various countries. The formal solution gives at least a "feel" of certainty, uniformity, and predictability. It seems to reduce the legal risks of the case by case adjustments of the law. On the other hand, it introduces rigidity and substantial legal intervention in business arrangements. The solution of "muddling through,' and of using various and vague principles when injustice seems to have occurred, may achieve the same purpose with more flexibility but poses greater legal uncertainty (risk).

The formal solution is not unambiguous. Control, on which the system is based, is an illusive fact, resulting from a multitude of legal and factual situations. Control may depend on the individual actors rather than on the institutional role which they play. Perhaps it is less difficult to ascertain control in a more homogeneous culture than in a multi-cultural society. Thus, a system based on the concept of control may be more suitable for Germany than for the United States. In addition, the German system does not eliminate the case by case determination altogether, because it provides for judicial review both for contract regimes and for *de facto* regimes.[28] Nevertheless, this judicial review may be more limited than the judicial review of managements' decisions in the United States.

It seems that for a country in which investors are risk averse and in which business accepts more interference by government, a more explicit and seemingly rigid regime may be preferable. For a country with less risk averse investors, which tolerates, and in fact values, diversity and freedom of action by business persons, this solution is less desirable. It is not surprising that Germany created a formal solution, while the United States left the law adjustable on a case by case basis.

The Study is organized along functional lines, and offers a wealth of comparative materials on definitions, problems, proposals, arguments and solutions. It leads us through tortuous paths to the incredibly diverse techniques and solutions that legal systems adopt for the same perceived problems. The Study fully answers the needs of the reader who seeks to compare systems on the level of positive law. For the reader who moves beyond positivism to the relation between law, politics, economics and culture, the Study provides the raw materials, but leaves to the reader the task of discovering the context in which these legal systems operate, design-

28. Id. at 83.

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ing the common denominators against which they can be compared, and providing the analysis for comparisons.

For me, the greatest contribution of the Study is that it provides a broader understanding of how the various legal systems work including our own, and of how they tend to resolve perceived problems. The material in the Study suggests that the degree of corporate law intervention in the management and power structure of corporations reflects differences in the various countries' investors' risk levels, the degree of investors' trust in the financial markets and the financial system, as well as the different political philosophies and institutional arrangement limiting the law's interference in business decisions.

INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW. VOL XVI (CIVIL PROCEDURE), Ch. 6: ORDINARY PROCEEDINGS IN FIRST INSTANCE. By B. Kaplan, K.M. Clermont, A. Kohl, H. Schima, H. Hoyer, E. Wengerek, P.O. Ekelöf, E. Vescovi, M. Cappelletti, & B. Garth. Tübingen: J.C.B. Mohr; The Hague: Martinus Nijhoff, 1984. Pp. 268.

*Reviewed by William B. Fisch**

This impressive and valuable contribution deals with the structure of a typical civil lawsuit as practiced in most of the major modern legal systems: in what manner it is commenced, prepared for trial, tried, and decided, as well as how procedural and financial responsibility for the various steps in the process is allocated among the participants. "Ordinary" civil proceedings, presumably, are those which take place in the tribunals of most general competence, neither so specialized in subject-matter as to call for treatment by expert tribunals, nor so complex as to require unusual techniques of judicial administration. Proceedings which occur "at first instance" either enter the judicial system at this stage or are treated as if they had; they are designed to produce a final result, but may be subject to review or reiteration in hierarchically superior courts. The actual scope of the chapter is somewhat more limited than the title may suggest, however, since several important aspects of first-instance procedure are set aside for detailed treatment in other chapters of the volume: evidence, parties, remedies, the effect of judgments, enforcement of judgments, and such attacks on judgments as may be available in the rendering court.

As a topic for comparative treatment, judicial procedure presents particularly poignant problems of method: in most systems

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