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THE ROLE OF CORPORATE LAW IN THE ADAPTATION OF FRENCH ENTERPRISES

James A. Fanto*

I. INTRODUCTION

The Article addresses the role of corporate law[1] in the adaptation of French enterprises. It argues that the law has been, and will continue to be, important in the adaptation, although it attempts not to overstate the law's significance.[2] This role of French corporate law makes sense only in relation to the financial and economic circumstances of French business.

The Article has the following theoretical and normative assumptions. First, economic circumstances as broadly defined (*e.g.*, availability and distribution of resources, technology, methods of capital-raising, transaction costs) largely influence business enterprise structure.[3] Businesses that adapt to the circumstances have the best chances of

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[1] French corporate law and securities law are not separate areas, but are part of the same legal code. All references to French corporate law are to CODE DES SOCIÉTÉS (Paul Le Cannu ed., 13th ed. Petits Codes Dalloz 1996) (Fr.).

[2] *See also* JAMES A. FANTO, CORPORATE GOVERNANCE IN AMERICAN AND FRENCH LAW (1997); James A. Fanto, *The Role of Corporate Law in French Corporate Governance,* 31 CORNELL INT'L L.J. (forthcoming 1997).

[3] *See generally* ALFRED D. CHANDLER, JR., SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM 14-46 (1990).

surviving. Second, the law of business associations, which establishes the legal relationships between principals and agents in enterprises (*i.e.*, corporate governance[4]), should help businesses in their adaptive efforts and should resolve most efficiently (*i.e.*, provide the lowest cost solutions for) the inevitable problems arising in these relationships.[5] A discussion of French corporate law should thus present the economic circumstances facing that country's businesses, the businesses' responses to the circumstances and the law's contribution to the adaptive responses.

A third set of assumptions is that individuals are value maximizers and remarkably adaptive to circumstances,[6] but adaptation is not automatic, and individual and social constraints may hinder it and produce human conflict. Individuals may not know that change has occurred, and, even if they perceive it, they may not know whether the change is temporary or permanent and how they should respond to it.[7] Business people, lawyers and legal scholars also have collective or "cultural"[8] ways of seeing and understanding phenomena and motivating their actions.

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[4] *See generally* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,* 3 J. FIN. ECON. 308-10 (1976).

[5] Law and corporate governance are only several among many factors of concern to firms in their adaptation. *See* MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE xi (1994). Yet law, like any other constraint on or facilitator of business, matters to firms. *See* Ronald J. Gilson, *Corporate Governance and Economic Efficiency: When Do Institutions Matter?,* 74 WASH. U. L.Q. 327, 334, 345 (1996); RAFAEL LA PORTA, ET AL., LAW AND FINANCE 40 (National Bureau of Economic Research Working Paper No. 5661, 1996) (suggesting that law helps determine the financial structure of a country's firms).

[6] *See* Michael C. Jensen & William H. Meckling, *The Nature of Man,* J. APPLIED CORP. FIN., Summer 1994, at 4, 5-6.

[7] *See* Mark J. Roe, *Chaos and Evolution in Law and Economics,* 109 HARV. L. REV. 641, 650, 652 n. 21 (1996) (describing the rationality of resistance to change). *See also* OLIVER E. WILLIAMSON, THE MECHANISMS OF GOVERNANCE 36 (1996) (describing "bounded rationality").

[8] *See, e.g.,* CLIFFORD GEERTZ, THE INTERPRETATION OF CULTURES: SELECTED ESSAYS 89 (1973).

There are thus social constraints on adaptation.[9] Because of individual and cultural perspectives, people may resist the need for change and the rise of others better suited to respond to it. New economic circumstances can thus bring about human conflict and the inevitable demise of some and the triumph of others.[10] An explanation of the role of French corporate law in French enterprise adaptation should begin to address such issues.

On the basis of these assumptions, the Article proceeds as follows. Part II presents French enterprises as responding to post-war economic and business circumstances under the oversight of the French State and argues that French corporate law took on a Statist character to contribute to this response. Part III suggests that the economic and political circumstances facing France during the past two decades have changed and require an enterprise adaptation that is generally incompatible with the Statist approach. It argues that this adaptation has begun, but that continuing State influence on enterprises, family ownership of firms and management opportunism in the new environment threaten a market capitalism that is important in the firm adaptive process.

Part IV argues that, during the same two decades, French legal policy-makers modified French corporate law, particularly securities law, to help enterprises adapt to the new economic circumstances by creating a basic legal environment conducive to market capitalism. It observes that such reforms are only the first step, for the more difficult task is to address the above impediments to capital market investing. Finally, Part V explains how a recent

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[9] *See* Jensen & Meckling, *supra* note 6, at 10 (pointing out that the social exists in a dialectic with the individual and does not dictate individual decision-making).

[10] *See* Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems,* 48 J. FIN. 831, 847-50 (1993). *Cf.,* YVES DEZALAY & BRYANT G. GARTH, DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER 15-29 (1996).

proposal, the Marini Report,[11] is an important contribution to discussion about reform to French corporate law since it advocates eliminating the law's Statist legacy and contributing to enterprise adaptation by facilitating market capitalism. The Part shows, through a few examples dealing with the board of directors, how the Report, while valuable, does not adequately address the obstacles to this capitalism.

II. STATE INVOLVEMENT IN THE FRENCH ECONOMY AND CORPORATE LAW

This Part briefly identifies the path that French business and the law have already followed and an important cultural feature influencing that path. It limits its historical account essentially to the three decades of the post-war years (*"Les Trente Années Glorieuses"*), a story familiar to French economic and business historians.[12]

After 1945, France rebuilt a war-devastated country and transformed its primarily rural economy into a modern industrial one.[13] France met this challenge with

[11] *See* PHILIPPE MARINI, RAPPORT AU PREMIER MINISTRE SUR LA MODERNISATION DU DROIT DES SOCIÉTÉS (13 juillet 1996) (hereinafter, the "Marini Report"). *See also* CONSEIL NATIONAL DU PATRONAT FRANÇAIS, ASSOCIATION FRANÇAISE DES ENTREPRISES PRIVÉES, THE BOARD OF DIRECTORS OF LISTED COMPANIES IN FRANCE (July 10, 1995) (hereinafter, the "Viénot Report" (named after Marc Viénot, the chairman of the committee that drafted the report and chief executive of the French bank, Société Générale)).

[12] *See, e.g.,* WILLIAM JAMES ADAMS, RESTRUCTURING THE FRENCH ECONOMY: GOVERNMENT AND THE RISE OF MARKET COMPETITION SINCE WORLD WAR II 4-7 (1989); JEAN-FRANÇOIS ECK, HISTOIRE DE L'ÉCONOMIE FRANÇAISE DEPUIS 1945 4-39 (1992); RICHARD F. KUISEL, CAPITALISM AND THE STATE IN MODERN FRANCE: RENOVATION AND ECONOMIC MANAGEMENT IN THE TWENTIETH CENTURY 187-271 (1981).

[13] *See* Maurice Lévy-Leboyer, *The Large Corporation in Modern France, in* MANAGERIAL HIERARCHIES: COMPARATIVE PERSPECTIVES ON THE RISE OF THE MODERN INDUSTRIAL ENTERPRISE 117-160 (Alfred D. Chandler, Jr. & Herman Daems eds., 1980) (explaining that the typical modern, vertically-integrated firm producing consumer-oriented or technologically sophisticated goods, with numerous product lines and a

considerable success, achieving a rate of growth during this period that eventually surpassed those of its European partners and creating businesses that successfully competed in international markets. State involvement and influence in the economy and State ownership and control of many large French enterprises characterized this period.[14] The State's role was partly due to the general post-war discrediting of French industrial and financial elites because of their collaboration during the Vichy period.[15] The State economic involvement or "*dirigisme*" also had a cultural explanation, for, since at least the seventeenth century, large French economic undertakings have received aid from the State and State-formed elites.[16] State ownership and control efficiently solved enterprise financing in the post-war years: since investors, traumatized by pre-war market volatility and wartime losses, were reluctant to participate directly in the capital of large enterprises and in the stock market, the State acted as the necessary financial intermediary. During this time, the State owned, directly or indirectly, major industrial and financial businesses and even exercised considerable influence over the policies of non-State-owned enterprises.[17]

This economic environment and the Statist response pushed French corporate law down a path that furthered State intervention in business enterprises; a "Statist"

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coordination among operating divisions, appeared in France only after World War II).

[14] *See generally* ADAMS, *supra* note 12, at 257-59 (describing the significance of major French enterprises in the French economy during this period); James A. Fanto, *The Transformation of French Corporate Governance and United States Institutional Investors,* 21 BROOK. J. INT'L L. 1, 28-40 (1995) (describing the evolution of State control and ownership).

[15] *See generally* ALAIN BELTRAN & PASCAL GRISET, L'ÉCONOMIE FRANÇAISE 1914-1945 24-25 (1994).

[16] *See* CHARLES P. KINDLEBERGER, WORLD ECONOMIC PRIMACY: 1500 TO 1990 110 (1996).

[17] *See* ECK, *supra* note 12, at 13-14. *See also* Fanto, *supra* note 14, at 33 n.93 (presents statistics on State ownership of enterprises); Andrea Goldstein, *Privatizations and Corporate Governance in France,* BNL Q. REV., Dec. 1996, at 455, 458 (presenting more recent statistics).

corporate law contributed to the State's post-war involvement in large firms.[18] An example from the major 1966 codification of French corporate law makes the point.[19] Commentators often observe that a typical French chief executive exercises nearly royal or emperor-like powers over an enterprise and generally receives little supervision from (and pays little attention to) the board of directors or shareholders, except in an extreme crisis.[20] While this power is certainly due to the expertise and informational

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[18] *Cf.*, LA PORTA, *supra* note 5, at 19-20, 34-35 (concluding that corporate law in France and in countries following the French legal tradition does not provide much legal protection to investors and that ownership of corporations in such countries is thus concentrated, for large owners are better able to control management in these circumstances); Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 769-70 (1996) (finding corporate governance systems to have different combinations of concentrated ownership and legal protections for shareholders). During the post-war years, the State had many ways of controlling enterprises remaining in stock company form (*i.e.*, the *société anonyme*). *See generally* JEAN KERNINON, LES CADRES JURIDIQUES DE L'ÉCONOMIE MIXTE 73-81 (1992) (describing State's authority to select a controlling majority of the members of the board of directors and the chief executive and to conduct inspections). The State also selected managers and directors with a State educational and professional background that made them sympathetic to State enterprise goals. *See id.*, at 80. *See generally* MICHEL BAUER, LES 200: COMMENT DEVIENT-ON UN GRAND PATRON? 123-197 (1987) (describing traditional State career path to executive positions).

[19] Since French corporate law, unlike U.S. law, is national, rather than regional, and, as is characteristic of civil law systems, is codified (rather than part of a common law development), it is particularly susceptible to State influence. *Cf.*, ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 128-33 (1993).

[20] *See, e.g.*, Colin Gordon, *The Business Culture in France, in* BUSINESS CULTURES IN EUROPE 58, 99-100 (Collin Randlesome et al. eds., 1990). French law provides two forms of board structure for the *société anonyme*: a board of directors (*conseil d'administration*) that selects one of its members as the chairman and chief executive (*président directeur général* or "PDG"), *see* C. SOC., Loi N° 66-257 du 24 juillet 1966, arts. 89-117 (Fr.), and a supervisory board (*conseil de surveillance*), which names an executive board (*le directoire*) and selects a president thereof, *see* C. SOC., Loi N° 66-257 du 24 juillet 1966, arts. 118-152 (Fr.).

advantage that are hallmarks of centralized management,[21] the PDG also has a statutory basis for his dominance that overlaps with the board's authority.[22] Since this executive power, whose origin lay in Vichy France,[23] supported a firm governance of hierarchical control, and, to put a positive spin upon it, of technical expertise, not of deliberation and oversight, it furthered State ownership when the State selected management.[24]

III. CHANGING FRENCH BUSINESS CIRCUMSTANCES AND OWNERSHIP STRUCTURE

Economic and political circumstances facing French businesses over the last twenty years differ from those of the post-war years. To use Jensen's characterization,[25] industry and finance have been in an ongoing restructuring since the 1970s (not coincidentally, at the end of *Les Trente Glorieuses*). Technological developments, particularly in communications, permit lower-cost completion of certain economic tasks and linkages between previously separate work, all of which produces industrial overcapacity and obsolescence. The technology also permits a different

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[21] *See* ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 8-9 (1977).

[22] *Compare* C. SOC., Loi N° 66-257 du 24 juillet 1966, art. 113 (Fr.) (providing that the PDG has extensive powers to act in any circumstance on the company's behalf) *with* art. 98 (stating, in identical language, that the board has the same power).

[23] *See, e.g.*, CLAUDE DUCOULOUX-FAVARD, SOCIÉTÉ ANONYME, AKTIEN GESELLSCHAFT, SOCIETÀ PER AZIONI 101 (1992). *See also* André Tunc, *Le gouvernement des sociétés anonymes: le mouvement de réforme aux Etats-Unis et au Royaume-Uni*, 1 REVUE INTERNATIONALE DE DROIT COMPARÉ [R.I.D.C.] 59 (1994) (explaining power as a legal response to the dysfunctional boards of directors and warring shareholder factions characteristic of pre-war French capitalism); Olivier Pastré, *Les dix commandements du gouvernement d'entreprise, in* RAPPORT MORAL SUR L'ARGENT DANS LE MONDE 1996 201, 204 (1996).

[24] This executive power was "over determined" since it is also compatible with family ownership of large French firms. *See infra* Part III.

[25] *See* Jensen, *supra* note 10, at 835-47.

enterprise organization that replaces elaborate hierarchies of decision-making with flexible, flatter work environments that can rapidly respond to product changes and customer needs.[26] These changes heighten product market competition, and at the same time, other events, such as the breakdown of the Socialist block and lessening of worldwide trade barriers, produce *global* competition.

The technological changes also provide large firms different methods of corporate finance. They can raise financing outside their home market and have access to a range of financial products designed for their needs and investor preferences.[27] Similarly, investors, whether individually or through financial intermediaries, have diverse investment opportunities throughout the world. The companies best able to take advantage of new capital-raising opportunities in world capital markets gain a competitive advantage by having a lower cost of financing and a more efficient and strategic use of their financing ability.[28] A company must then find ways of financing from capital market investors.[29]

For various reasons, the State may not and cannot manage well a firm's adaptation to these new circumstances.[30] Over the past two decades, therefore, it

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[26] *See* "A fortress against change", *A Survey of Business in Europe*, ECONOMIST, Nov. 23, 1996, at 3-5.

[27] *See* Lawrence J. White, *Competition versus Harmonization--An Overview of International Regulation of Financial Services, in* INTERNATIONAL FINANCIAL MARKETS: HARMONIZATION VERSUS COMPETITION 5, 5-6 (Claude E. Barfield ed., 1996); Ingo Walter, *Global Competition and Market Access in the Securities Industry, in* INTERNATIONAL FINANCIAL MARKETS: HARMONIZATION VERSUS COMPETITION 84, 84-86 (Claude E. Barfield ed., 1996).

[28] *See, e.g.*, Frank H. Easterbrook, *International Corporate Differences: Markets or Law?*, J. APPLIED CORP. FIN., Winter 1997, at 23, 27.

[29] *Cf.* Shleifer & Vishny, *supra* note 18, at 769; Marco Pagano et al., *Why Do Companies Go Public? An Empirical Analysis*, 53 J. Fin. 27, 60-61 (1998) (observing that competitive world-class companies must use domestic and global capital markets).

[30] *See, e.g.*, John Vickers & Vincent Wright, *The Politics of Industrial Privatisation in Western Europe: An Overview, in* THE POLITICS OF

progressively liberated French companies from rigid adherence to its own policies and gave executives the market-based goal of competing successfully and internationally in their companies' product markets.[31] To enhance financing flexibility, it opened the capital of these companies to outside investors, with an ambitious privatization program beginning for two years in 1986 and resuming in 1993.[32] As a result, the State's direct and indirect ownership of large firms declined.[33]

If culture matters in firm ownership, a French market capitalism, similar to that in the U.S., would not immediately replace State ownership. The State has created constituencies—not only employees in State-owned firms who find their jobs threatened by privatization and ensuing restructuring, but also State bureaucrats who

PRIVATISATION IN WESTERN EUROPE 1, 6 (John Vickers & Vincent Wright eds., 1989). *See also* Shleifer & Vishny, *supra* note 18, at 767-69 (describing problems of State ownership, *e.g.*, bureaucrats not focused on profit-making purpose; State policies (*e.g.*, employment) that may run counter to specific business success). *But see* Saul Estrin & Virginie Pérotin, *Does ownership always matter?*, 9 INT'L J. INDUS. ORG. 55, 62-63 (1991) (describing how the success of firms depends on the definition of goals); Goldstein, *supra* note 17, at 459-62 (observing that French State-owned firms were not all business failures). *See also* "What the ministry managed", *in A Survey of Business in Europe*, ECONOMIST, Nov. 23, 1996, at 5-7 (noting that European Union requirements restrict member state involvement in enterprises and demand the reduction of budget deficits that are often due to state aid to failing national industries).

[31] *See generally* Fanto, *supra* note 14, at 31-33, 41-46.

[32] *See generally* Goldstein, *supra* note 17, at 463-74 (pointing out that indirect privatization also occurred during Socialist control of the French National Assembly from 1988-1993).

[33] *See* OECD ECONOMIC SURVEYS 1996-1997: FRANCE 111-12 (1997) (hereinafter, OECD FRANCE) (listing government ownership of stock of private companies at 3.7%, but observing that this figure does not include all indirect government ownership); Goldstein, *supra* note 17, at 475 [identifying government ownership of listed companies (which are likely to be large firms) at 2%, but with the same reservation about indirect ownership]. *See also* Paul Windolf, The Governance Structure of Large French Corporations: A Comparative Perspective 19 (Mar. 17, 1997) (unpublished manuscript, on file with author) (observing that the State controls, with a greater than 50% shareholding, 32 of the 416 largest French firms).

suffer when the career opportunities provided by State-owned or controlled companies disappear. These groups can mobilize resistance to continued privatizations[34] and even join with many French citizens who, as the most recent French parliamentary elections show, still feel that the State is the best economic problem solver.[35]

Even without the State, ownership in large French firms is concentrated.[36] Families rank significantly among the concentrated shareholders,[37] which is not surprising since family ownership of major French firms has been almost as important a feature of French business as State ownership.[38] Business scholars note that family ownership did not give way in France, as it did in other countries, to

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[34] *See, e.g., A Case of the Dts,* ECONOMIST, Nov. 23, 1996, at 19-20; *Privatisation Takes French Leave,* ECONOMIST, Dec. 9, 1995, at 59-60.

[35] *See Bad for Business?,* ECONOMIST, June 7, 1997, at 51 (describing recent French elections and the possibility that future privatizations will be delayed or abandoned). *See also* Fanto, *supra* note 14, at 57-58 (describing continued State influence in privatized companies).

[36] *See* OECD FRANCE, *supra* note 33, at 113 (noting that the 1995 weighted average percentage holding of the five largest shareholders of the 120 nonfinancial companies in a French market index was 48.2% (in comparison to comparable U.S. figures of 25.4%)). *See also* Windolf, *supra* note 33, at 17-19 (stating that 63% of the firms studied (*i.e.,* 262 out of 416 firms) have a majority shareholder, and 87% (373 firms) have one shareholder with a holding greater than 25%).

[37] *See* Goldstein, *supra* note 17, at 475 (citing OECD statistics that indicate household ownership (including through financial intermediaries) as 34% of listed company stock). *See* Windolf, *supra* note 33, at 19 (pointing out that wealthy individuals and families have controlling stakes (greater than 50%) in 29 companies and significant stakes (between 10% and 49%) in 56 others), at 18 n.25 (suggesting that this data understates family ownership, since many families own shares through control of non-financial companies), at 19 (observing that non-financial companies own controlling stakes in 59 companies).

[38] *See* BAUER, *supra* note 18, at 51-120 (describing family ownership tradition); Windolf, *supra* note 33, at 15-16. *See also* Morton Keller, *Regulation of Large Enterprise: The United States Experience in Comparative Perspective, in* MANAGERIAL HIERARCHIES: COMPARATIVE PERSPECTIVES ON THE RISE OF THE MODERN INDUSTRIAL ENTERPRISE 161, 164 (Alfred D. Chandler, Jr. & Herman Daems eds., 1980) (describing the primacy of family ownership of firms even in 19th century France).

specialized management and market capitalism,[39] but families developed members as future managers, recruited talented managers from the outside (including from the State) and undertook restructuring through family relationships.[40] Yet family firms need the same capital market financing as do other firms in current economic circumstances.

French financial institutions have also been important owners of French firms, but they have not generally been controlling shareholders;[41] rather, they have served as proxies for the State or as financial advisors to a controlling shareholder, be it the State or a family.[42] Financial institutions, however, have figured in the complex cross-shareholdings of French privatized companies, known as "*les noyaux durs,*" that the State helped create by private sales accompanying a public sale during a large firm's

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[39] *See* Alain Alcouffe & Christiane Alcouffe, *Control and Executive Compensation in Large French Companies,* 24 J. L. & SOC'Y 85, 88 (1997); Alfred D. Chandler, Jr. & Herman Daems, *Introduction, in* MANAGERIAL HIERARCHIES: COMPARATIVE PERSPECTIVES ON THE RISE OF THE MODERN INDUSTRIAL ENTERPRISE 1, 7 (Alfred D. Chandler, Jr. & Herman Daems eds., 1980).

[40] *See* OECD FRANCE, *supra* note 33, at 127 (listing good results of family-controlled companies, such as LVMH, L'Oréal, Carrefour, Castorama). *See also* Alcouffe & Alcouffe, *supra* note 39, at 88, 90 (observing that French corporate groups, the control of which predominantly rests with groups of family shareholders, can respond rapidly to market and technological changes).

[41] *See* Goldstein, *supra* note 17, at 475 (listing financial institution ownership as approximately 20%); OECD FRANCE, *supra* note 33, at 111 (showing that financial institutions owned 7.8% of total common stock as of 1994). *See also* Windolf, *supra* note 33, at 19 (noting that financial institutions are controlling shareholders in only 48 out of 416 companies in his database). Legal obstacles keep financial institution holdings at a noncontrolling level (*e.g.,* banks are generally limited to holding 10% of any nonfinancial company, and insurance and mutual funds to 5%). *See* Goldstein, *supra* note 17, at 477.

[42] *See* Goldstein, *supra* note 17, at 475-76; OECD FRANCE, *supra* note 33, at 111, 125; Windolf, *supra* note 33, at 16. *Cf.* MICHEL ALBERT, CAPITALISME CONTRE CAPITALISME 117-92 (1991), and OLIVIER PASTRÉ, LES NOUVEAUX PILIERS DE LA FINANCE 101-31 (1992) (both arguing that French financial institutions should take on a more active ownership role).

privatization.[43] These networks, which involve from 20 to 40% of a company's equity, insulate company management and company employees from capital market, and even product market, pressures[44] and free management from accountability to shareholders in companies where no controlling shareholder exists, with ultimately adverse consequences for the firm.[45]

Yet the number of capital market investors in large French firms has been increasing.[46] This is not surprising as market capitalism also has a French history.[47] Foreign investors in these companies, unless controlling shareholders or part of pan-European cross-shareholding

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[43] *See* FRANÇOIS MORIN & CLAUDE DUPUY, LE COEUR FINANCIER EUROPÉEN 46-54 (1993); François Morin, *Le règle capitaliste entre laxisme et détournement, in* RAPPORT MORAL SUR L'ARGENT DANS LE MONDE 1996 207, 210-11 (1996).

[44] *See* Viénot Report, *supra* note 11, at 14-15 (suggesting that networks will disappear when French companies can raise more equity capital from French and non-French investors). *See also* Pastré, *supra* note 23, at 203 (noting that networks permit "consensual" restructuring).

[45] *See generally* François Morin, *Privatisation et dévolution des pouvoirs: Le modèle français du gouvernement* D'ENTREPRISE, RÉVUE ÉCONOMIQUE 1253, 1263-66 (Nov. 1996). On the inevitable and sometimes destructive discipline of product markets, *see* Jensen, *supra* note 10, at 850-51. *See* OECD FRANCE, *supra* note 33, at 125-26 (noting that French privatized companies have recently been the least profitable of large French firms).

[46] *See* Raghuran G. Rajan & Luigi Zingales, *What Do We Know about Capital Structure? Some Evidence from International Data,* 50 J. FIN. 1421, 1448 (1995) (finding approximately 50% growth in stock market capitalization since 1986), at 1432, 1439 (observing that, from 1984 to 1991, the external financing of French companies, although low as a fraction of total financing, was primarily through equity sales). *See also* COMMISSION DES OPÉRATIONS DE BOURSE, RAPPORT AU PRÉSIDENT DE LA RÉPUBLIQUE ET AU PARLEMENT 1996 42, 63 (1996) (listing increase in stock market capitalization for the last 5 years and growth in the number of capital market investors).

[47] *See* ADAMS, *supra* note 12, at 249-54; Keller, *supra* note 38, at 164. *See also* William N. Goetzmann & Philippe Jorion, A Century of Global Stock Markets 19 (Dec. 1996) (unpublished paper, on file with author) (describing active market periods in France).

networks,[48] are also capital market investors, often from countries with strong traditions of market capitalism.[49] Since the State cannot meet the retirement needs of an aging population within European Union budget restrictions, private pension funds will soon be additional players in the French capital markets.[50] An important question regarding French enterprise adaptation is how French corporate law facilitates firms' access to capital market investors in the circumstances of State influence, family ownership and the new management power arising from cross-shareholder networks.

IV. FRENCH CORPORATE LAW IN ENTERPRISE ADAPTATION

For at least the past two decades, French legal policy-makers have created a French corporate law that contributes to enterprise adaptation by producing a legal environment favorable to capital market financing. These efforts focus primarily, but not exclusively, on securities law. Since laws developed for market capitalism are Anglo-American (because Anglo-American corporate finance generally involves raising money from capital market investors),[51] Anglo-American legal traditions often inspired French legal policy-makers.[52]

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[48] *See* Goldstein, *supra* note 17, at 475 (showing that foreigners own 20% of listed French firms); OECD FRANCE, *supra* note 33, at 111 (lists total ownership of common stock by foreigners at 11.1% as of 1994); Windolf, *supra* note 33, at 19 (data suggesting that foreign shareholder was a 75% shareholder in 72 firms).

[49] *See* Fanto, *supra* note 14, at 22-28.

[50] *See* CENTRE FOR EUROPEAN POLICY STUDIES, WORKING PARTY REPORT NO. 12, CORPORATE GOVERNANCE IN EUROPE 29-30 (1995).

[51] *See* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 78-82 (Transaction Publishers, Murray L. Weidenbaum & Mark Jensen, int., reprinted 1991) (classic statement on U.S. market capitalism).

[52] La Porta et al. conclude that French law has not promoted capital market financing, because it does not protect investors' rights, *see supra* note 5, at 27, and base this conclusion upon a few features of corporate

While laying the necessary legal groundwork for French market capitalism, the legal policy-makers accomplished the easier task. They did not have to face the difficult issue of the potential incompatibility of French corporate ownership traditions and a still Statist corporate law with market capitalism. In short, many parties favored, or did not strongly oppose, market capitalism and the basic legal reforms necessary to implement it. This is not to denigrate the significant efforts of French legal policy-makers, but to recognize them as only a first step in the law's contribution to enterprise adaptation.[53]

A few examples show that legal reforms are recent and favor capital market investing.[54] The primary French securities market regulator, the Commission des Opérations de Bourse (the "COB"), came into existence in 1967, with the mission of regulating and policing market transactions, such as stock offerings and trading.[55] Its powers to deal with market abuses (e.g., failure of a company to comply with disclosure requirements) that, if unaddressed, could undermine market capitalism, however, resulted only from major legal reforms in 1988 and 1989.[56]

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law without considering securities law developments. *See id.*, at 12-13. Yet securities laws, which protect capital market investors, are part of corporate law in France. Through its legal directives, the European Union also pushes its members to produce a legal environment friendlier to capital market investing. *See* Fanto, *supra* note 14, at 46-48.

[53] A general consensus on the need for market capitalism muted the conflict between those who had expertise in the finance and legal techniques of market capitalism and those whose skills lay in administering State enterprises. *See also* Yves Dezalay, Between the State, Law, and the Market: The Social and Professional Stakes in the Construction and Definition of a Regulatory Arena 14-20 (Jan. 27, 1995) (unpublished paper on file with author) (noting that the new legal and financial expertise was developed within the State).

[54] For a general work on developments in French corporate (including securities) law, *see* MAURICE COZIAN & ALAIN VIANDIER, DROIT DES SOCIÉTÉS (9th ed. 1996).

[55] *See* C. SOC., Ordonnance N° 67-833 du 28 septembre 1967, art. 1 (Fr.).

[56] Two legal reforms, the Loi N° 88-70 du 22 janvier 1988 and the Loi N° 89-531 du 2 août 1989, significantly increased the oversight,

Two other market authorities, successors to earlier self-regulatory organizations and regulators of stock exchange participants (e.g., brokers and listed companies), the Conseil des Bourses de Valeurs (now renamed the Conseil des Marchés Financiers ("CMF"), by Loi 96-597 du 2 juillet 1996), and the Sociétés de Bourses Françaises, were also established in 1988 and saw their powers extended in matters such as broker regulation, listing procedures and tender offers.[57]

The basic legal foundations of market capitalism accompanied the creation and empowerment of market authorities. On company disclosure, which addresses the fundamental information disparity between investors and management, the same law that created the COB also requires companies making public offers of their securities or listing them on an exchange to provide information on their operations in a prospectus (*note d'information*) in accordance with COB rules and with the document subject to COB review and pre-approval.[58] The COB also developed (and constantly refines) a system of continuous reporting based upon a company reference document (*document de référence*) used for listing and as an annual report.[59] Important in any company reporting are financial accounts, which reflect a company's past operations, and their accuracy. In France, an official company auditor (the *commissaire aux comptes*[60]) verifies a firm's financial results

investigatory and enforcement powers of the COB on disclosure and market manipulation. *See generally* THIERRY SCHOEN, THE FRENCH STOCK EXCHANGE: A PRACTICAL GUIDE FOR INVESTORS AND ADVISERS 4-10 (1995); Leslie Goldman, *The Modernization of the French Securities Markets: Making the EEC Connection,* 60 FORDHAM L. REV. S227, S237-S245 (1992).

[57] *See generally* C. SOC., CMF Règlement Général, Arrêté du 6 juillet 1988, art. 1, annexe (Fr.).

[58] *See* C. SOC., Ordonnance N° 67-833 du septembre 1967 (as amended), arts. 6, 7 (Fr.).

[59] *See* COMMISSION DES OPÉRATIONS DE BOURSE, 27ÈME RAPPORT AU PRÉSIDENT 23 (1995).

[60] *See generally* C. SOC., Loi N° 66-537 du 24 juillet 1966, arts. 218-35 (Fr.).

and internal controls and reports on any problems. French legal policy-makers substantially modified the law in 1984 to increase the verification responsibilities of the *commissaire* and to ensure his or her independence from management.[61] Similarly, in 1983 French corporate law accommodated capital market investors by allowing a shareholder to vote *par correspondance,* and in 1988 detailed rules were instituted regulating the manner of, and management's conduct regarding, this kind of voting.[62]

V. A RECENT PROPOSAL ON FRENCH CORPORATE LAW REFORM

The new laws encouraging French capital market financing were added to a legal code that, as suggested in Part II, favored concentrated ownership of enterprises, particularly by the State. Market capitalism, however, is incompatible with the State's (or another concentrated owner's) discretion to use a firm's assets for its own purposes. If French corporate law is to ensure that capital market investors remain in French enterprises, legal policy-makers must eradicate the law's Statist character. Such reform would counteract the State's continued ability, despite its lessening ownership of enterprise, to interfere in businesses and should also check the ability of managers, free of State oversight in companies without a dominant shareholder, but with protective *noyaux durs*, to promote

[61] *See* C. SOC., Loi N° 66-537 du 24 juillet 1966, arts. 219-22 (Fr.) (stating conflict-of-interest rules for *commissaires*). *See also* LA PORTA, *supra* note 5, Table 7 (noting high quality rating of French accounting).

[62] C. SOC., Décret N° 67-236 du 23 mars 1967 (as amended by Décret N° 86-584 du 14 mars 1986 and Décret N° 88-55 du 19 janvier 1988), art. 131-1 *et seq* (Fr.). *See* COZIAN & VIANDIER, *supra* note 54, at 310 (observing that, prior to these reforms, a shareholder could give his or her vote to a spouse or to another shareholder, or simply provide a "blank" power to management). *See also* Joel Chernoff, *Shareholder power grows: France's first proxy solicitations are big step forward,* PENS. & INV., June 10, 1996, at 19 (describing initial proxy solicitation efforts in France); LA PORTA, *supra* note 5, at 16-17, Table 1 (importance of laws governing shareholder voting for promoting market capitalism).

their own interests over those of shareholders. Finally, any corporate law reform favoring capital market financing would have to give investors confidence that the law addresses potential abuses from the controlling family shareholders important in French firms and may even erode such shareholders' dominance.

It thus makes sense to consider briefly whether a recent proposal for legal reform, the Marini Report,[63] would result in the necessary changes to French corporate law. In effect, the Report *is* a positive contribution to the debate over French corporate law reform because it proposes to eliminate the Statist aspects of corporate law and because it advocates an "adaptive" purpose for this law. It observes that the German influence on the 1966 corporate law reform supported an "institutional" nature of the corporation (particularly the large corporation) that promoted the Statist economic approach[64] and that led to

[63] *See* Marini Report, *supra* note 11. Another important proposal concerning legal and other reform of the French board of directors of listed companies is the Viénot Report, *see supra* note 11, which was written at the direction of private associations of companies, but at the encouragement of the State, and which generated numerous articles in France on the need for legal reform to address corporate governance issues. *See, e.g.*, Paul Le Cannu, *Légitimité du pouvoir et efficacité du contrôle dans les sociétés par actions*, BULLÉTIN JOLY 637 (juillet 1995). In response to the Viénot Report and the discussions that it stimulated in France, the former French Prime Minister, Alain Juppé, asked Senator Marini in early 1996 to conduct a study that would make recommendations for changes to French corporate law. *See, e.g.*, JEAN-JACQUES DAIGRE, ED., LA MODERNISATION DU DROIT DES SOCIÉTÉS: PREMIÈRES RÉFLEXION SUR LE RAPPORT MARINI (1996) (initial reactions to Marini Report by French legal scholars and practitioners).

[64] *See* Marini Report, *supra* note 11, at 5. *Cf.* LA PORTA, *supra* note 5, at 19-20 (noting that German corporate law is not especially favorable to capital market investors). The "institutional" view, exemplified by the concept of the "*intérêt social*" (loosely translated as "corporate interest"), suggests that, because of its legal personality, a corporation has interests or purposes that are different from, and superior to, those of its individual stakeholders, including the shareholders. *See* Claude Ducouloux-Favard, *L'histoire des grandes sociétés en allemande, en France et en Italie*, 4 R. I. D. C. 849, 862-67, 871-75 (1992). *See generally* COZIAN & VIANDIER, *supra* note 54, at 175-77. This view clearly

the rigidity and constraints in the law.[65] The Report argues that this Statist corporate law no longer functions well as the State recedes from its commanding position in the capital of large corporations. Not only does the law's rigidity prevent enterprises from adapting to changing economic circumstances, but managers, unchecked by the State, can now use outdated legal concepts strategically to pursue their own interests, generally at the expense of capital market investors.[66] Because corporate law handicaps French enterprises in the global capital market competition, it must be replaced by a law conducive to capital market investing and thus to enterprise adaptation, or these firms, and France, will suffer in global markets.[67] The Report recommends that French legal policy-makers again look to Anglo-Saxon legal traditions for inspiration.[68]

Following such inspiration would make French corporate law more contractual, flexible and friendly to capital market investors.[69] Companies and investors should find in corporate law possibilities of legal relationships that they

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supported, and justified; State control of an enterprise and even State influence on a non-State-owned company's operations, for State-sympathetic management could identify "corporate interest" with such non-firm-specific goals as promoting State policies and aims. *See* COZIAN & VIANDIER, *supra* note 54, at 192-93 (discussing court case in which the concept was used to allow French company to follow French State foreign policy).

[65] *See* Marini Report, *supra* note 11, at 18 (corporate law "remains constraining, very strongly marked by public order"). All translations of the Report are the author's.

[66] *See id.*, at 8-9.

[67] *See id.*, at 17 (noting that "*economic competition equally places in competition legal systems.* From this perspective, the weight and rigidities of French corporate law constitute a handicap.") (emphasis in original).

[68] *Cf.* ALBERT, *supra* note 42, at 7-26 (discussing France as something of a battleground between the German and Anglo-Saxon approaches to company management).

[69] *See* Marini Report, *supra* note 11, at 17 ("These considerations argue in favor of a *simplification* and, even more, of a *contractualization* [of the law].") (emphasis in original). *See also id.*, at 6 (noting that the presence of Anglo-Saxon investors in the capital of French companies adds weight to this reform).

can adjust to their circumstances, which would enable the companies to adapt better to the economic situation facing them. This approach considers corporate law as enabling, that is, as providing default rules for the relationship between shareholders and other corporate parties, and as occasionally mandatory where it needs to resolve certain structural abuses in the relationships.[70]

Despite its positive contribution to corporate law reform, the Marini Report does not adequately address existing deterrents to French capital market financing. Its weakness lies ironically in its embrace of the contractual perspective. The Report recommends reforms to French corporate law designed to improve the position of capital market investors, yet declines to make particular reforms mandatory, or even provide a form of default rules, given its assessment of the overall French market situation.[71] The state of affairs calls, however, for a different balance that would counteract the continuing influence of the State, the management power implications of the cross-shareholding networks, and the dominance of non-State owners.

A few examples related to the governance of large firms show the strengths and weaknesses of the Report. The Report recommends upgrading the board of directors, which is the main representative of shareholders in a firm and whose effectiveness in providing a counterweight to management and/or a controlling shareholder is critical for encouraging capital market investing. Legal and informal board developments in Anglo-American market capitalism designed to enhance board effectiveness include having a board separate from management, requiring that a board chairman not be a CEO, and recommending that the board

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[70] *See* Marini Report, *supra* note 11, at 9 ("[The] role of [the law] is less to prohibit than to permit."). *See generally* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991) (discussing enabling view of corporate law).

[71] The default approach means that companies would have the freedom, but would have to make an effort, to use other than the given rules. *See* Roberta Romano, *Corporate Law and Corporate Governance,* 5 INDUS. & CORP. CHANGE 277, 282 (1996).

mainly be composed of independent directors with a "lead" independent director representing the others and serving as a countervailing power to the CEO (if the latter is the chair).[72] While acknowledging that management control is a problem in France (but while not addressing dominant shareholder control),[73] the Marini Report generally declines to recommend legal mandatory or default changes to the board. Like the Viénot Report, it would give French businesses as wide a range of statutory choices regarding board structure and composition as possible, with the understanding that market forces should push companies towards the most suitable choices.[74]

With one exception,[75] the imposition of any particular board structure upon French companies is, in the Report's view, inconsistent with its contractual approach and not justified by evidence that one structure is best suited to all businesses in current economic conditions.[76] French companies can adopt a two-tiered board, which is already permitted under French corporate law,[77] or have a unitary board structure. Similarly, the Marini Report declines to

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[72] *See* MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 116-21, 143-44, 193-201 (1995) (for a summary of these developments).

[73] *See* Marini Report, *supra* note 11, at 39-40.

[74] *See, e.g.,* Marini Report, *supra* note 11, at 42 (discussing independent directors); Viénot Report, *supra* note 11, at 11 (observing that "the appointment of independent directors corresponds to market expectations, and is of a nature to enhance the quality of boardroom debate .... "). The Viénot Report recommends that, at a minimum, public companies have two independent directors. *See id.,* at 12.

[75] The Report recommends that existing State-owned enterprises have the two-tiered board structure (*i.e., conseil de surveillance* and the *directoire*) because that would encourage more board independence, which is necessary for companies that are soon to leave the State sector. *See* Marini Report, *supra* note 11, at 50. The Report thus recognizes that French companies were privatized without a management control structure being put in place, which led to managers' abuses of their power after privatization.

[76] *See also* Viénot Report, *supra* note 11, at 8-9.

[77] *See* C. SOC., Loi N° 66-257 du 24 juillet 1966, arts. 89-117 (Fr.), and C. SOC., Loi N° 66-257 du 24 juillet 1966, arts. 118-152 (Fr.).

support any statutory requirement that a company have a certain percentage of, or all, independent directors (*i.e.*, those without any interest in the company). It observes that management directors cannot now dominate a board because, under present law, they can occupy at most one-third of the board (not counting employee representatives).[78] The Report would increase company flexibility in the selection of "completely" independent directors only by recommending the removal of the current legal requirement that a board member also be a shareholder.[79]

It is understandable that, given its economically liberal perspective, the Marini Report leaves board structure and composition to market forces and individual company decision, especially since groups, like the Viénot committee, are informally advocating that the board include more independent directors and become more responsive to shareholders. While reliance upon market forces makes sense where market capitalism is advanced, it is less justified — and less likely to promote market capitalism — where other traditions of ownership and capitalism prevail. The Report would have been more effective, for example, by recommending that some features of board structure (*e.g.*, number of independent directors on the board) be default rules that companies and shareholders must expressly reject in their charters, which would have maintained its enabling focus while better countering the impediments to market capitalism.[80] This problem in the Report may reflect

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[78] *See* Marini Report, *supra* note 11, at 41. For the underlying law, see C. SOC., Loi N° 66-537 du 24 juillet 1966, art. 93 (Fr.).

[79] *See* Marini Report, *supra* note 11, at 35. For the underlying law, see C. SOC., Loi N° 66-537 du 24 juillet 1966, art. 95 (Fr.). It also recommends increasing the number of management-affiliated directors that an enterprise can have to one-half, rather than one-third, of the board, Marini Report, *supra* note 11, at 44, a somewhat surprising suggestion, given how much French corporate law already favors management control. The Report does recommend amending French law to allow a board member other than the PDG to be the board chairman. *See id.*, at 34.

[80] *See* Romano, *supra* note 71, at 282. Accordingly, some of the Report's objections to board reform (*e.g.*, that truly independent directors

either the inability of its drafters, immersed in the French situation, adequately to recognize the constraints of its ownership traditions or their awareness of the need to move gradually to laws favorable to market capitalism because of likely resistance to any rapid changes.

These few examples cannot do adequate justice to the Marini Report.[81] It has the great merit of stating the need for a reformation of the theoretical foundations of a Statist French corporate law so as to promote market capitalism in France and thus to facilitate enterprise adaptation. It is possible to disagree with the Report's specific recommendations and to feel that it does not adequately address French ownership structures that conflict with market capitalism.[82] Yet it is difficult to think of a better statement of the *true* purpose of French corporate law reform—to enhance enterprise adaptation.

VI. CONCLUSION

The Article traces how French corporate law helped large French companies adapt to changing economic circumstances. It concludes that French corporate law aided companies in the adaptation, primarily through laws

must be nominated by some body external to the company, but that this would create dissension in the firm) are beside the point. An independent director is a pragmatic effort to counteract, through one board device, management's natural inclination to nominate "friendly" directors and to control them through its information advantages. Both the Viénot Report and the Marini Report would have done better to focus upon compensation or other arrangements that would have aligned directors more with capital market investors, not management or controlling shareholder interests. *See* Romano, *supra* note 71, at 284 (discussing the importance of these arrangements in improving board performance).

[81] For more detailed discussion of specific recommendations of the Report, see generally FANTO, *supra* note 2; Fanto, *supra* note 2.

[82] *See, e.g.*, Marini Report, *supra* note 11, at 44, 50 (accepting the view that cross-shareholdings (the *noyaux durs*) are temporary in France and thus not recommending that the law prohibit them. It simply urges that existing cross-shareholdings be adequately disclosed and gradually eliminated and that the State not establish them in future privatizations).

facilitating capital market financing as the State receded from company ownership. A recent proposal, the Marini Report, would significantly improve the law's role in enterprise adaptation by having this goal inspire legal reform and by eradicating the law's Statist legacy. Yet the Report does not go far enough to promote capital market financing since it fails to recognize, or to acknowledge, that the French traditions of State-economic involvement and of family ownership, as well as new manager power, demand more mandatory, or at least default, laws protective of capital market investors.

While this overview of French corporate law is positive from the normative perspective, the immediate future of legal reform is uncertain. The political parties most favorable to legal reform lost control of the government.[83] The recent French elections are just one more example of the resistance from people who have human and physical capital invested in solutions no longer suited for changed circumstances. Although the reasons for the political result are complex,[84] and although the defeat of the French right owes much to its own failure to pursue legal and other reforms vigorously,[85] the triumph of the French left shows the continued strength of those whose expertise, beliefs and very existence lie in the State.

The outcome of any social struggle is never certain. The Article's prediction is, however, that the recent political outcome is a temporary setback in the ongoing adaptation of French business to economic circumstances and corporate law's contribution to this process; legal reform will eventually proceed.[86] As noted earlier, France is in the

[83] *See, e.g., The right rejected in France*, ECONOMIST, June 7, 1997, at 49 (describing the defeat of the conservative coalition by a leftist coalition led by the Socialist party).

[84] *See* Stanley Hoffman, *Look Back in Anger*, N.Y. REV. BOOKS, July 17, 1997, at 45.

[85] *See, e.g., Poor France*, ECONOMIST, June 7, 1997, at 16.

[86] *See* WILLIAMSON, *supra* note 7, at 234 ("inefficiency in the commercial sector invites its own demise--all the more so as international competition has become more vigorous"). The current

European Union that favors the elimination of State involvement in business, and French enterprises need capital market financing. Yet, as the elections show, adaptation to new circumstances does not come easily and ownership traditions often change slowly. This suggests that, when the political conditions are again propitious, French legal policy-makers should not delay corporate law reform.

French government has continued privatization (*e.g.*, France Télécom), although not as extensively as its predecessor.