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Global Forces of Corporate Change and European Path-Dependencies: A Review of *After Enron* (McCahery/Armour eds.)

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GLOBAL FORCES OF CORPORATE CHANGE AND EUROPEAN PATH-DEPENDENCIES: A REVIEW OF *AFTER ENRON*

**Abstract:** The book under review, *After Enron*, edited by John Armour and Joseph McCahery, and published by Hart in 2006, presents an excellent and timely collection of observations of the Enron debacle, provided by some of the most astute and informed scholars, and masterfully integrated by two of the finest academics in this field. The editors, Dr John Armour, originally of the Faculty of Law at the University of Cambridge and Member of the Cambridge Centre for Business Research, since 1 July 2007 the Lovells Professor of Law and Finance, and Professor Joseph McCahery, formerly at the University of Tilburg, now of the University of Amsterdam, have succeeded in collecting, conceptualizing and organizing a most comprehensive and intriguing collection of excellent writings on Enron and its aftermath. Their book can aptly serve for a first-blush as for a more in-depth analysis of the problems, whether in research or in teaching of company law courses. Yet, beyond this achievement, the editors are also importantly contributing to a debate, which has for some time now emphasized the need to take a deliberately comparative viewpoint when analyzing the trajectories of corporate law development around the world.

**Keywords:** Enron, Accounting Standards, Comparative Corporate Governance, Corporate Governance Reform, Path Dependency

**JEL Classification:** G34, J29, J53, K22, K33

**Forthcoming in:** American Journal of Comparative Law (2008)

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GLOBAL FORCES OF CORPORATE CHANGE AND EUROPEAN PATH-DEPENDENCIES: A REVIEW OF AFTER ENRON (MCCAHERY/ARMOUR EDS.)

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I.

Edited academic collections on topics that by their mere name-mentioning alone have entered the public consciousness well beyond scholarly circles, constitute a risk for the editors, the authors and the publishers. In a fast-evolving world of academic publishing with a constant increase in paper-based and online venues of disseminating expert knowledge, the status of a carefully edited volume of substantive content and length remains ambiguous. This explains why many pieces included in a volume like the one here under review will have previously appeared in academic journals or, often, as working papers on the omnipresent Social Sciences Research Network. Why then take on in this volume the task – as editor and, indeed, as publisher – of assembling previously published articles and of soliciting further original work from some of the most renowned experts?

While such general observations might be prompted by the appearance of the 700 page volume that convenes some of the leading scholars in the field of US and European corporate law with a focus on the assessment of the 2000 crash of “Wall Street’s darling”, the Enron corporation, any such

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doubts over the need for this publications are quickly brushed aside once the volume is opened.

*After Enron* presents an excellent and timely collection of observations of the Enron debacle, provided by some of the most astute and informed scholars, and masterfully integrated by two of the finest academics in this field. The editors, Dr John Armour, originally of the Faculty of Law at the University of Cambridge and Member of the Cambridge Centre for Business Research, since 1 July 2007 the Lovells Professor of Law and Finance, and Professor Joseph McCahery, formerly at the University of Tilburg, now of the University of Amsterdam, have succeeded in collecting, conceptualizing and organizing a most comprehensive and intriguing collection of excellent writings on Enron and its aftermath. Their book can aptly serve for a first-blush as for a more in-depth analysis of the problems, whether in research or in teaching of company law courses. Yet, beyond this achievement, the editors are also importantly contributing to a debate, which has for some time now emphasized the need to take a deliberately comparative viewpoint when analyzing the trajectories of corporate law development around the world. This debate has only more recently begun to explore the existing differences in greater depth and with view to the historical, political and socio-economical context of company law regulation. This move to a “deeper reading” of the contextual conditions of the regulatory framework of companies’ activities in advanced and developing nations is unlikely to be reversed in the near future, given the growing awareness that company law rules – like many other legal regimes – form part of a complex regulatory environment, which is historically grown and continues to develop along co-evolutionary lines of official/unofficial, hard/soft law legislation, and

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2 Jeffrey N. Gordon/Mark J. Roe (Ed.), *Convergence and Persistence in Corporate Governance*, 2004).


involves modes of public and private ordering with direct and indirect regulatory effects. For their valuable contribution to the study of “comparative corporate governance”, the editors deserve applause.

II.

What was Enron? Emerging in the 1990s as an overwhelmingly successful corporate actor with a keen sense for the transforming political climate, marked by a forceful embrace of large-scale deregulation and privatization policies, Enron emerged as the arguably smoothest player in a fast unfolding energy trading game – before in late 2001, its name quickly became a worldwide-known formula for a plethora of regulatory failings, personal misconduct and largest-scale financial and existential losses. Enron’s fall from the global capital market’s grace was brought about by its management’s outrageous collaboration in deducing corporate assets and misstating the company’s financial status. Enron’s dealings, which led to wide-reaching criminal persecution, have been among the prime homework-providers for corporate law regulators in just about every jurisdiction worldwide.

Within the last few years, the US Congress’ Sarbanes-Oxley (aka SOX) legislation of 2002 would become a short formula for similar-minded corporate governance law reform worldwide. Today, where SOX is attracting criticism for allegedly unreasonably raising compliance costs,
the Act’s section 404 and other countries’ likeminded regulations\textsuperscript{12} are under heightened scrutiny. Section 404 requires the creation of extensive policies and controls within public companies to secure, document, process, and verify material information dealing with financial results. Essentially, it requires that each annual report filed with the SEC – overseeing ‘reporting companies’ with at least 300 shareholders and minimum assets of US$500 million – contain an internal control report. That report must detail management’s responsibility for establishing and implementing adequate procedures for financial reporting, including an assessment of internal control structures and procedures and disclosing eventually adopted codes of ethics. One of the clearest signs of the Act’s retaliatory nature is its requirement that the company’s Chief Executive Officer (CEO) and Chief Financial Officer (CFO) personally certify the report’s accuracy.

Interestingly enough, the Act’s emphasis on individual, personal misconduct is not precisely what SOX’s critics seek. Instead, it is the law’s creation of a compliance regime, which is altogether being perceived as burdensome, counterproductive and ineffective. To be sure, the degree to which the issue of personal guilt of CEOs and CFOs remains within the purview of ongoing corporate law reform, both professionally and in popular discourse, is reflected for example in the attention given to aspects of management remuneration, which alone has prompted a long worldwide debate.\textsuperscript{13} And it is here where the contributions in Armour’s and McCahery’s volume constitute a much-needed and welcome advance in the current debates over corporate governance. The authors of their collection provide excellent insights into the much more complex regulatory framework surrounding corporate governance.

\textbf{III.}

The contributions to the volume are divided into four sections. They are preceded by an introduction essay by the two editors, who assume the ever


\textsuperscript{13} Hereto, see the critical remarks by William W. Bratton, \textit{The Academic Tournament over Executive Compensation}, 93 CAL. L. REV. 1557 (2005)
more rarely assumed task of actually ‘editing’ the work of their contributors. Armour and McCahery provide a roadmap through the volume by engaging with each of the chapters and by placing them in the context of the larger debates to which they contribute. This will particularly help those readers who have either no prior firmer knowledge of the Enron debacle nor of the various regulatory responses, and who are particularly interested in corporate law reform from a distinctly comparative perspective. Given the predominantly Anglo-Saxon focus of much of the volume, it succeeds in mapping and further facilitating a dialogue, a dialogue no longer merely between scholars of different jurisdictions, but moreover between differently conceived and evolved regulatory cultures.

The first of the four sections of the book, “Stock Markets and Information”, contains two longer articles by Ronald Gilson and Reinier Kraakman, and Don Langevoort respectively, who inquire into the emergence and valiance of traditional evaluatory instruments to measure a firm’s worth as the decisive signal to stock market investors. In light of the inevitable rise of stock market capitalism in the US and the UK, and the pressure on stakeholder capitalist regimes such as France, Germany and Japan, the editors are correct in asking how Enron could so long hide its destructive dealings before the capital market’s “eye that sees all”. Inviting two of the field’s leading scholars to build on their previous work on the role of stock market institutions in soliciting, interpreting and disseminating information and to pursue this focus within the contemporary capital market environment provides for an intriguing overture to the book’s inquiry. It is particularly helpful because Gilson’s and Kraakman’s article provides for a sober view on how much irrationality still exists in our attempts to read the stocks. The section’s second article by Langevoort on its face adds to this picture of remaining uncertainty and irrationality even where in fact more information had been available to investors. Both sections put in context some of the basis of the regulatory retaliation after Enron that emphasized the need for better disclosure.

The second section is dedicated to the exploration of “Corporate Scandals in Historical and Comparative Context” and collects papers on the US (David Skeel Jr.), the UK (Simon Deakin and Suzanne Konzelmann) and Italy (Guido Ferrarini and Paolo Giudici). These are preceded by a summarizing evaluation of “Why the US and Europe Differ” (John Coffee). This section’s contributions underscore the importance of seeing beyond the demands of the day when responding to crisis.

In tracing the different aspects of various corporate scandals in the investigated countries’ history, the authors in this section illuminate key connections of the way in which scandals were and are being perceived and responded to. They succeed in raising some doubt as to the adequacy of some of the regulatory responses.

This discussion becomes particularly interesting, when the responses are being reviewed in the context of the specific corporate governance regime in which they unfolded. It is here, then, where the differences between a shareholder and stakeholder oriented corporate governance regime are apparently put to the test. If scandals do indeed take place in either regime, the analysis of their scope and the regulatory response speaks well beyond the concrete scandal to the nature of the respective corporate governance regime. The authors’ inquiry into the reasons why – to take the case of Italy for example, where rules even more stringent than SOX failed to prevent fraud or why – measures to prevent corporate fraud often fail, ultimately reveals the great need for deeper comparative work.

The chapters provide a powerful illustration of why discussions over convergence versus divergence of corporate governance regimes will eventually fail in the face of the particular dynamics of regulatory change that we can observe in the various jurisdictions. While a first-cut distinction between “outsider” and “insider” corporate governance regimes is helpful in identifying some of the base variances in regulatory design,\(^{15}\) we need to direct our attention to the environment in which corporate law regulation is unfolding. This environment involves a transnational proliferation of norm authors and norm setting sites, changing political

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\(^{15}\) Klaus J. Hopt, *Common Principles of Corporate Governance in Europe?*, in: Corporate Governance Regimes. Convergence and Diversity 175 (McCahery/Moerland/Raaijmakers/Renneborg Ed. 2002), 175.
coalitions\textsuperscript{16} and an intricate mix of regulatory approaches.\textsuperscript{17} It is from such a reformed investigative agenda, that we can hope to find more helpful answers to the conundra of Enron, WorldCom, Parmalat, and other scandals.

The third section, entitled “Evaluating Regulatory Responses: The US and UK”, brings together papers by such luminaries as Lucian Bebchuk and Bill Bratton, among others. It focuses on the SOX, particularly its regulatory aspirations as well as its blind spots and omissions. Given its thematic orientation, this section could likely be taken as the shortest-living with regard to its concrete engagement with specific elements of an evolving regulatory regime. Yet, the individual papers reach beyond their contemporary confines by either building on existing or unfolding a further-looking research agenda and discussion. To take an example, Lucian Bebchuk’s paper forms part of his recent proposals to strengthen shareholder rights within the corporation. Likewise, the paper by Bill Bratton contributes to an ongoing discussion over the rules versus principled-based approach in designing accounting rules.

The final, fourth section of the volume, which takes up more than a third of the book’s space, is entitled “Reforming EU Company Law and Securities Regulation”. It constitutes a perfect orchestration of the most interesting voices in the current discussion in Europe. It is this part of the book that arguably carries the greatest weight in deepening the transatlantic dialogue over corporate regulation. The papers - authored by Paul Davies, Klaus Hopt, John Armour, Gérard Hertig, Joseph McCahery, Eilis Ferran and Luca Enriques - bring to the table the leading voices in the current European Community (EC) company law reform debate. This, at the same time, might be seen as the section’s weaker spot, if at all. What


is shared among these authors and, again this gives testimony to the editors’ conscious design of their book and of their commitment to telling a coherent story, is a particular perspective on corporate law reform, which is ultimately a perspective on the corporation itself.

All authors in this section have in various ways been personally involved in advisory or even law proposal commissions within the EC in recent years, and are thus the last to be accused of being naïve of the challenges of corporate law reform. Yet, their astute understanding of the European intricacies of multilevel lawmaking and negotiation might also explain their reluctance to engage in a more fundamental inquiry into the greater political goals of corporate law reform. Such an inquiry would inevitably lead them to reconsider the broader role of business corporations in society. The book’s editors and their authors are well aware of this connection, clearly expressed for example by Simon Deakin’s and Suzanne Konzelmann’s chapter. Yet, their brief presence (the paper is a pithy five pages) paradoxically also underlines the absence of another set of issues and approaches, which the volume could profitably have alluded to and which the editors could have sought to integrate in their collection.

Clive Schmitthoff, writing in 1973, provided a succinct and highly sensitive account of the challenges facing corporate law reform in Europe. He already then pointed to the particular intricacies arising for law reform from a complex political economy of an integrating Europe. Europe – like Enron – is an enigma, a conundrum, a formula, which always stands for more than a given observer can perceive. If one thing is certain about European company law reform, however, it is its

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18 For an illustration, see only the chapter by Hertig and McCahery on Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition (at 545); see also the interesting account by Christian Kirchner/Richard W. Painter, Takeover Defenses under Delaware Law, the Proposed Thirteenth EU Directive and the New German Takeover Law: Comparison and Recommendations for Reform, 50 AMERICAN JOURNAL OF COMPARATIVE LAW 451 (2002).

19 See only the contribution in this volume by K.J. Hopt, Modern Company and Capital Market Problems: Improving European Corporate Governance After Enron (at 455).

20 Corporate Governance after Enron: An Age of Enlightenment (at 155).

inseparability from the greater process of European Integration and how Europe relates to its global environment. The coming years will show to which degree the participants in the debate are able to reflect on the correlation between policy choices and theoretical models to explain the business corporation. It is certain, and the reviewed book is a much needed illustration of this insight, that Europe is still in evolution and that the study of corporate law reform is taking place in a vibrant, 24-7 open conceptual and experimental laboratory.