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A Model Company Act and a Model Company Court

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Stanford Law School

A Model Company Act and a Model Company Court

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A MODEL COMPANY ACT AND A MODEL COMPANY COURT

Ronald J. Gilson[*]

This paper is a contribution to a symposium on the European Model Company Act ("EMCA") in which I argue that a model company court powerfully complements the EMCA. A particular characteristic of company law complicates the intermediating role of a model act in a federal system. Because complex corporate transactions inevitably are associated with significant uncertainty, especially when they present conflicts of interest, transaction designers and legislative drafters tend to frame applicable contractual and legal rules as standards, such as fairness and equal treatment, rather than as rules. In turn, the effectiveness of a standard in the face of complexity and uncertainty depends on the experience and expertise of the reviewing court. The outcome is that a model company court complements a model company code. The analysis proceeds as follows. Part I considers alternative approaches to addressing related party transactions between a controlling shareholder and a corporation with minority shareholders: self-dealing may be addressed ex ante through structural prohibitions on the characteristics associated with private benefits. Alternatively, it can be addressed ex post by substantive review of the terms of related transactions. Part II then shifts attention to the role of courts: The effectiveness of a statutory strategy will depend on the quality and experience of the associated courts. Part III then reprises the argument that harmonization of the quality of judicial enforcement of corporate statutes may be more important than harmonization of the substantive law. In this respect, an EU level company court into whose jurisdiction a corporation may opt into is powerfully complement to a model company act. Recognizing that an optional E.U. level company law court is may not be established however powerful the supporting logic, Part III then endorses Michael Klausner's soft law approach (in this volume) to providing some of the benefits of a sophisticated company law court available to all member state companies through on ongoing role for the EMCA drafters.

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INTRODUCTION

Model acts can operate to balance the tension between the centripetal and centrifugal forces inherent in a federal system. Pulling the states together to capture the scale benefits from a single legal regime drives a familiar effort to harmonize at the federal level. In terms of corporate law, early European Union's harmonization and the European Commission's more recent efforts to chart the future course of European company law have this goal.[1] In the United States, federal securities law and other federal statutes displace and so standardize state law across a number of public corporate law issues, ranging from voting rules to board of directors and board committee composition.[2]

At the same time, we observe the decentralizing logic of responding to local conditions that bears on why a federal rather than a unitary state was chosen in the first place. The subsidiarity principle in the European Union and the reservation of power to the states in the U.S. pushes the choice of rules down to member states, to the end of capturing local knowledge and responding to different business practices and histories. Italy is different from the United Kingdom; New York is different from Nevada.[3] As well, we learn from the results of different strategies undertaken by different states. Here Justice Brandeis' famous framing is typically invoked: a "state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."[4]

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[1] For recent efforts, see, e.g, Green Paper, The EU Corporate Governance Framework (COM(2011)164 (final); Action Plan: European Company Law and Corporate Governance: A Modern Legal Framework for More Engaged Shareholders and Sustainable Companies (COM(2012) 740/2 (Dec. 2012).

[2] *See, e.g.*, Mark J. Roe, *Delaware's Competition,* 117 Harv. L.Rev. 2491 (2005).

[3] By way of example, Nevada requires less disclosure that other states, protecting Nevada's large gambling industry. Prior to the implementation of the Thirteenth Directive, the U.K's takeover law was crafted and enforced by an industry group rather than a state agencey. France, reflecting the role played by state ownership, imposes duration weighted voting.

[4] New State Ice Co. v. Liebman, 285. U.S. 262, 311 (1932). Restated in terms of regulatory competition, the "state as laboratory" reflects the race to the top framing. One can have simultaneous races to both the top and the bottom as the emergence of Nevada as a reincorporation destination in the U.S. evidences. Michal Barzuza, *Market Segmentation: The*

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Model statutes thus work the interstices of a federal system, responding to the gravity of uniformity but easing the repellant of local differences. States are provided a means to coordinate their legal rules with those of other states, but each reserves the power to adjust the model to fit its particular needs.[5] This has been the pattern in the United States with the Model Business Corporation Act, [6] various American Law Institute Restatements,[7] Uniform Acts such as the Uniform Commercial Code,[8] and the hybrid ALI product *Principles of Corporate Governance: Analysis and Recommendations*, which sought both to restate the best of existing state law and to propose state statutory reform.[9]

Rise of Nevada as a Liability-Free Jurisdiction, 98 VA. L. REV. 935 (2012) (asserting that Nevada provides a lax corporate law that "may create competitive pressures toward the bottom").

[5] Of course, model acts are not the only tools that operate in federalism's mid range. Corporate law in particular has made increased use of "soft law"—the promulgation of codes of best practice by non-governmental organizations like the Organization for Economic Co-operation and Development, by country level groups like the U.K. Cadbury Committee, and increasingly by large institutional investors such as the California Public Employees Retirement System and Blackrock. *See* OECD Principles of Corporate Governance (2015); ADRIAN CADBURY, REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE (1992), http://www.ecgi.org/codes/documents/cadbury.pdf; *see e.g.*, CAL. PUB. EMPLOYEES' RET. SYS., GLOBAL PRINCIPLES OF ACCOUNTABLE CORPORATE GOVERNANCE (2015), https://www.calpers.ca.gov/docs/forms-publications/global-principles-corporate-governance.pdf. In contrast to these soft law efforts, model acts aspire to become law and therefore distinguish themselves from soft law by their ambitions. The hard-soft distinction, however, is fractal, as illustrated by mandatory comply or explain requirements. I take great advantage of Michael Klausner's soft law suggestions with respect to the EMCA in Part III. Michael Klausner, *A View of the EMCA from the U.S.,* this volume.

[6] MODEL BUS. CORP. ACT (2008).

[7] *See, e.g.*, RESTATEMENT (THIRD) OF AGENCY (AM. LAW INST. 2006); RESTATEMENT (THIRD) OF TRUSTS (2003–2008).

[8] *See, e.g.*, U.C.C. (AM. LAW INST..& UNIF. LAW COMM'N 1977).

[9] AM. LAW. INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (1994). There is an interesting early history to model acts in the United States that predates the American Law Institute and the uniform law efforts. In the 1850s, New York started toward becoming a civil law system through the adoption of civil law-style "codes"." This effort, reflected in the drafting effort undertaken by David Dudley Field, culminated in the preparation of a civil code, which was ultimately rejected in a wicked political fight. *See* LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 391–403 (2d ed. 1985). While ultimately rejected in New York, Field's code found a home in the western United States. The needs of newly admitted states, especially California, to impose some sort of order on the conflicting legal traditions found in the western states coincided with Field's effort. In effect, the New York effort, after being rejected in the state for which it

In my contribution to this symposium on the European Model Company Act ("EMCA"), I address a particular characteristic of company law that complicates the intermediating role of a model act in a federal system. Because complex corporate transactions inevitably are associated with significant uncertainty, especially when they present conflicts of interest, transaction designers and legislative drafters tend to frame applicable contractual and legal rules as standards, such as fairness and equal treatment, rather than as rules. In turn, the effectiveness of a standard in the face of complexity and uncertainty depends on the experience and expertise of the reviewing court.[10] The outcome, I will argue, is that a model company law court can complement a model company code.

The analysis proceeds as follows. Part I considers alternative approaches to addressing related party transactions between a controlling shareholder and a corporation with minority shareholders: The potential for self-dealing may be addressed *ex ante* by means of structural prohibitions on the characteristics that create or sustain control or through which control is used to extract private benefits. Alternatively, it can be addressed *ex post* by substantive review of the terms of related transactions. Part II then shifts attention to the typically understated role of courts in crafting the substance of company law: The effectiveness of a statutory strategy will depend on the quality and experience of the associated courts. Part III then reprises the argument that harmonization of the quality of judicial enforcement of corporate statutes may be more important than harmonization of the substantive law.[11] In this respect, a model company law court is powerfully complementary to a model company act. Recognizing that an optional E.U. level company law court may be unlikely to be established however powerful the supporting logic, Part III then endorses Michael Klausner's very useful (and clever) soft law approach to providing some of the benefits of a

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was prepared, served as a model act, with California adopting it in its entirety in 1872. The history of this early model act and its serendipitous relation to the development of Silicon Valley is told in Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. Rev. 575, 614–17 (1999).

[10] *See* Ronald J. Gilson, Charles Sabel & Robert E. Scott, *Text* and *Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23, 57 (2014).

[11] *See* Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms Versus Ex Post Transactional Review*, 169 J. INST. & THEORETICAL ECON. 160, 164–65 (2013).

sophisticated company law court available to all member state companies through on ongoing role for the EMCA drafters.[12]

I. *EX ANTE* CONTROL MECHANISMS VERSUS *EX POST* TRANSACTION REVIEW IN CORPORATE STATUTES

Corporate statutes can regulate corporate conduct in two general ways: *ex ante* regulation and *ex post* adjudicative transaction review. An obvious and important example concerns the potential for self-dealing by controlling shareholders. On the one hand, controlling shareholders can play an important governance role. They have the incentive and often the experience to monitor (or themselves direct) the corporation's performance more effectively than market-based monitoring mechanisms like independent directors, hostile tender offers, activist investors and proxy fights.[13] This is particularly the case where the controlling shareholder is the company's entrepreneurial engine.[14] But there is also a dark side to the controlling shareholder force: She may have an incentive to take a disproportionate share of the corporation's profits, most obviously through related party transactions whose terms favor the controlling shareholder. Intuitively and empirically, the incentive increases as the difference between the controlling shareholder's voting power and her equity increases.[15]

Thus, the regulatory design problem confronting company act drafters is how to craft a structure that causes the controlling shareholder's impact on the corporation to be net positive—meaning the increase in performance from the controlling shareholder's participation as a monitor or operator should exceed her private benefits of control. *Ex ante* regulation, whether though prohibiting related party transactions altogether,[16] barring

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[12] Klausner, supra note 4.

[13] *See, e.g.*, Ronald J. Gilson & Jeffrey Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 791–92 (2003).

[14] See Zohar Goshen & Assaf Hamadi, *Concentrated Ownership Revisited: The Idiosyncratic Value of Corporate Control*, 125 YALE L.J. 560, ___ (2016) (forthcoming).

[15] Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641 (2006) (reviewing the empirical literature).

[16] This approach was tried and abandoned early in U.S. corporate history. Into the twentieth century, related party transactions were voidable by the corporation regardless of their fairness. See JESSE CHOPER, JOHN C. COFFEE, JR. & RONALD J. GILSON, CASES AND MATERIALS ON CORPORATIONS 111 (7th ed. 2008).

techniques like dual class stock that increase the incentive to misuse control by increasing the difference between voting and economic rights, or imposing a mandatory bid rule thereby reducing the ability of a shareholder to acquire just control, reflects limited ambition in addressing the controlling shareholder benefit/cost tradeoff.

Prohibiting related party transactions gives up the potential benefits from the shareholder's deep knowledge of the company's business and reflects the hope that other sources of private benefits of control will be sufficient to compensate the controlling shareholder for the costs of lost diversification and the effort that effective monitoring requires. Restricting the divergence between the controlling shareholders' equity and vote does reduce the incentive to siphon private benefits. However, it provides no reason to predict that the particular reduced incentive chosen (including at the limit one vote-one share) will secure the best tradeoff between better controlling shareholder monitoring/operating and private benefits. In turn, a mandatory bid rule functionally prohibits a controlling shareholder from holding more than the triggering percentage unless the holding preceded the company's going public. None of these *ex ante* mechanisms aspire to differentiate between related party transactions in a fashion that would cause the controlling shareholder's net contribution—increased company performance less private benefits of control—to be positive.

That *ex ante* regulation is a crude measure should come as no surprise. A single rule applying to all companies regardless of industry or circumstances will lack context and flexibility. Nor is there an easy way to make the *ex ante* rule more context-related. Precisely because drafters cannot predict a company's future circumstances, rough categorization—no related party transactions, no leveraged control, no controlling shareholder—is about the best that can be done *ex ante*.

This is where *ex post* transaction review and courts take center stage. In contrast to *ex ante* regulation, *ex post* review of the terms of a particular related transaction by reference to a standard has the obvious advantage of being contextual.[17] The assessment is made with respect to a particular controlling shareholder, controlled company and transaction. Moreover, at the time of review, knowledge about how the transaction operates normally

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[17] Michael Klausner makes the same point with respect to the EMCA. Klausner, supra note 4.

will be available. If courts can apply a standard that takes context into account in an accurate and predictable way, it is bound to be better than *ex ante* prohibitions because the controlling shareholder benefit/cost tradeoff depends on the context. Judicial review of the terms of a related transaction under a standard typically applies a heightened level of scrutiny to the fairness of the transaction terms (or how the standard is framed in a particular jurisdiction). In the U.S., the Delaware standard is styled "entire" or "inherent" fairness whereby the court compares the terms of the related transaction to those that would have resulted had the parties negotiated at arms' length; the controlling shareholder bears the burden of demonstrating the fairness of the deal.[18] Luca Enriques surveys the generally higher review standards applied by member states in the EU.[19]

Statutes and courts thus create, and courts apply, standards to assess the terms of related party transactions.[20] The basic question the standards pose is whether the terms of a related party transaction sufficiently resemble the terms that would obtain from arms' length bargaining in the same transaction type. A commercially sophisticated and experienced court can

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[18] Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971).

[19] Luca Enriques, *The Law on Company Directors' Self-Dealing: A Comparative Analysis*, 2 INT'L & COMP. CORP. L.J. 297 (2000).

[20] A different approach to contextual review is to require disinterested shareholder approval of related party transactions, who presumably can assess the fairness of the transaction assuming disclosure and immunize from judicial review those transactions that are approved. The extent to which shareholder approval effectively substitutes for sophisticated judicial review is a separate question. For present purposes it is sufficient to note that the outcome depends critically on the distribution of shareholders in a public company. With widely distributed equity holdings, rational passivity on the part of shareholders strains reliance on shareholder approval as a means to assure that a controlling shareholder's participation results in net positive benefits to shareholders. More recently, the widespread intermediation of equity has resulted in institutional investors holding collectively sufficient equity to make it feasible for them to evaluate controlling shareholders' behavior. This phenomenon has given rise to stewardship codes pursuant to which institutional investors will be expected to act like "owners" and to the EC 2014 proposal to amend the Shareholders Rights Directive in a fashion that addresses directly the obligations of institutional shareholders. Here I note only that exhortation to stewardship and to greater institutional investor engagement with their portfolio companies may pay too little attention to the agency costs resulting from the business models of large asset managers that must compete for assets under management. See Ronald J. Gilson & Jeffrey Gordon, The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights, 113 Col. L. Rev. 883 (2013); Ronald J. Gilson & Jeffrey Gordon, Agency Capitalism: Further Implications of Equity Intermediation, in Research Handbook on Shareholder Power (J. Hill & R. Thomas eds., 2015).

analyze the relevant context in order to answer this question with respect to a particular transaction. Hence, such courts could effectively police controlling shareholder self-dealing by applying the arms' length test or its equivalent. As such, a sophisticated court review, unlike the terms of the company act, serves to identify, in effect, whether a particular transaction leaves the minority shareholders net better off because of the controlling shareholder's participation in monitoring or operating the company.

At this point, however, the analysis becomes more complicated. Once we focus on *ex post* transaction review, courts, as opposed to substantive law, take center stage, and we can no longer assume away the quality of their performance, as I have done in the preceding paragraph. Professors Guido Ferrarini and Paolo Giudici stress this point with respect to the Parmalat scandal, which involved large transfers of private benefits through related party transactions:

> "[I]talian substantive rules cannot be blamed for what happened. Indeed, we argue … that the existing Italian substantive rules that were in place during Parmalat's last decade were sufficient and, somewhat surprisingly, were even more severe than those in the US. If Italian gatekeepers were undeterred, do not blame Italian substantive rules, blame enforcement."[21]

Put simply, the standard cannot be more effective than the courts that enforce it and the underlying procedural rules through which enforcement takes place.

II. THE COSTS OF *EX POST* TRANSACTION REVIEW: JUDICIAL ERROR

Ex post transaction review by courts comes with characteristic costs. In addition to the associated litigation costs, there is always the risk that the judge will err in applying the standard, whether in its legal interpretation of the standard or in its understanding of the related party transaction's

[21] Guido Ferrarini & Paolo Guidici, *Financial Scandals and the role of Private Enforcement: The Parmalat Case*, *in* AFTER ENRON: IMPROVING CORPORATE LAW AND MODERNISING SECURITIES REGULATION IN EUROPE AND THE US 159, 160 (J. Armour & J. McCahery eds. 2006).

structure. Depending on the direction of the error, costs are imposed on either the controlling shareholder or the company. If parties anticipate that the risk of error is high when deciding how to craft their relationship in the first place, one or both of two bad things can happen.

First, controlling shareholder ownership structures may be unintentionally discouraged, at the cost of less effective monitoring or operation. Second, because the likelihood of error will reduce controlling shareholders' capacity to credibly commit to limiting private benefits of control, a lemons market of sorts can result, with controlling shareholders who will not extract an inefficient level of control unable to distinguish themselves from controlling shareholders who will extract more than the efficient level of private benefits. The result will be to lower the value of minority shares and so increase the cost of equity capital for companies with a controlling shareholder.[22] We observe this result in the larger discount applied to minority shares in countries with ineffective law.[23] Indeed, the possibility that the judge will err can lead to litigation based on the chance of judicial mistake (the party disfavored by fate litigating in the hope of winning the judicial error lottery).[24]

The upshot of this analysis is that the effectiveness of *ex post* review of related party transactions depends on the quality of the reviewing court. The more effective the courts, the more a jurisdiction will have value-enhancing controlling shareholders and the less it will have value-decreasing controlling shareholders. As a result, minority share discount and the cost of equity capital will be lower. The converse is also true.[25] If the expected judicial performance is poor enough, then ex ante structural restrictions may be better in practice, despite the conceptual advantage of ex post review.

The capacity of experienced company law courts to effectively apply a standard, even as complexity increases, provides the basis for the proposal in the next Part. A sophisticated company law court that applies standards, when coupled with timely enforcement, allows controlling shareholders to

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[22] Ronald J. Gilson & Alan Schwartz, *Corporate Control and Credible Commitment*, 43 INT'L REV. LAW & ECON. 119, 120 (2015).
[23] *See* Gilson & Schwartz, supra note 10.
[24] In effect, judicial error creates a litigation put whose value increases with the variance (the likelihood of error) of judicial error.
[25] Gilson & Schwartz, *supra* note 22, at 120–21.

commit credibly to a level of private benefits that can support an efficient controlling shareholder regime: that is, controlling shareholders and companies with a smaller minority shareholder discount and a lower cost of equity capital.

But the promise of controlling shareholders—that they can increase the value of minority shareholders' investment by more than the private benefits they receive—is a mirage for a corporation that is chartered in a jurisdiction without an effective, experienced judicial system. Absent expertise, standards are workable over a narrower range of complexity, so the efficient outcome may not be feasible as the commercial environment becomes more complex.[26] For these jurisdictions, it follows that the logical response is to rely more heavily on *ex ante* structural restrictions and on rule-like constraints, with the result that corporations are denied access to control structures that may be efficient if only the controlling shareholder could credibly commit to cap its consumption of private benefits. To be sure, recommending that a state develop an effective judicial system in the short or even moderate term also may be a well-meaning illusion. Crafting the institutions and norms that support an effective judicial system takes substantial time.[27] In the meantime, companies incorporated in a jurisdiction without such a system, precisely the circumstances in which the Law and Finance literature predicts controlling shareholders dominate,[28] will bear a higher cost of equity capital because of the controllers' inability to commit credibly to an observable limit on private benefits.

III. THE (NAIVE) CASE FOR A MODEL CORPORATE COURT AND THE (PRACTICAL) ROLE FOR SOFT LAW

Now consider the position of a controlling entrepreneur in a EU member state that does not yet have experienced company law courts and recall that concentrated control can be expected to dominate in just this situation. Assume that she does not want to take more than the efficient level of private benefits, perhaps because commercial success depends on lower capital costs or because the transactions most effective at extracting private

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[26] Gilson, Sabel & Scott, *supra* note 10, at 73.
[27] *See* Jens Dammannn & Henry Hansmann, *Globalizing Commercial Litigation*, 94 CORNELL L. REV. 1, 3, (2008).
[28] See Rafael La Porta, Florencio Lopez-de-Silane, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, J.POL. ECON. 113 (1998).

benefits of control are commercially inefficient compared to arm's length transactions and so reduce the company's competitive position. The entrepreneur might then choose to incorporate in a jurisdiction other than her home jurisdiction that has an experienced court system. For example, she might incorporate in the U.K., where shareholders would have recourse to the commercial division of the Queen's Bench, a signal of a credible commitment to limited private benefit diversion. But there appear to be significant barriers to choosing a jurisdiction in which to incorporate based on the quality of its courts (the strategy that best explains Delaware's dominance in the U.S.) despite the freedom offered by *Centros*[29] and its progeny. The literature suggests that a European equivalent to Delaware and its Court of Chancery has not developed because of high practical barriers to incorporating in other than one's home state.[30] Without more, the entrepreneur's alternative is then to swallow the lemons problem and pay a higher cost for equity capital while waiting for effective local courts to evolve. This is a particularly troubling result in those EU countries without fully developed commercial courts and in which entrepreneurial activity through SMEs may be an especially important source of growth. Put simply, entrepreneurs with control are saddled with higher costs of equity and without recourse to the most straightforward way of lowering those costs through credible commitment.

To address this circumstance, Alan Schwartz and I elsewhere have recommended that the European Union facilitate controlling shareholders' credible commitment to limit private benefits by creating an EU-level specialized company law court that could efficiently review related party transactions in the face of complexity.[31] The intuition is that an EU-level company law court can take advantage of the scale economies associated with a court's developing commercial experience and expertise in just the settings where the payoff is likely to be the greatest. Such a "model" company law court roughly parallels the intermediate federal logic of the EMCA—it is an alternative, not a requirement, and so occupies much the same space in a federal system.

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[29] Case C-212/97, Centros Ltd v Erhvervs-og Selskabsstyrelsen [1999] ECR I-1459.
[30] See Luca Enriques, *EC Company Law and the Fears of a European Delaware,* EUROPEAN BUS. L. REV. 1259 (2004).
[31] Gilson & Schwartz, *supra* note 11, at 179.

Rather than harmonizing substantive corporate law, an EU company law court would simply stand available for individual corporations to use – through electing in their articles of incorporation – for review of related party transactions rather than the courts of the jurisdiction under whose laws the corporation is organized.[32] And because opting into effective legal enforcement would be more expensive to those controlling shareholders who intend to extract more than an efficient level of private benefits, an opt-in EU-level company law court supports an effective signaling regime. Opting in to the court's jurisdiction allows our well-intentioned entrepreneur to send a credible signal of her commitment to limiting private benefits. The EU court would then apply the substantive law of the state of incorporation. Indeed, that substantive law might well be the EMCA: the same shortage of local experience and expertise that gives an EU company law court the capacity to support an entrepreneur's credible signal also would make the availability of an optional sophisticated corporate statute attractive to member states in this situation. Further, the EU-level company law court would offer greater speed and expertise, and therefore lower error rates in the face of complexity, than likely could be mustered in the courts of the home state during the period when the commercial expertise of a member state's judicial system is developing.

Like the EMCA, the EU model commercial court proposal differs greatly from the thrust of prior EU efforts to address company law. Unlike most EU company law directives, the creation of an EU commercial court would not impose mandatory rules that harmonize substantive corporate law; individual corporations would have to opt into its jurisdiction and the substantive corporate law would remain that of the state of incorporation.[33] And unlike the direction of the EU harmonization effort, an EU-level optional commercial court has particular relevance to the circumstances confronting some newer member states and their entrepreneurs.

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[32] The expertise and efficiency of the Delaware Chancery Court, rather than any special character of substantive Delaware company law, remains the best explanation for the persistent preference for U.S. public corporations to incorporate in Delaware. See Gilson, Sabel & Scott, supra note 10, at 73.

[33] Elements of the Thirteenth Directive on Takeovers has this opt-in like characteristic. *See e.g.*, Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2005 on takeover bids , art. 12, 2004 O.J. (L 142) 12. However, the Thirteenth Directive is nonetheless directed at substantive law.

I recognize that the political economy barriers to creating an EU level commercial court to complement the EMCA may be insurmountable. This reality brings us, full circle, back to the EMCA. In his contribution to this volume, Michael Klausner has suggested a very useful soft law approach that importantly ameliorates the absence of effective courts in some jurisdictions. If we cannot immediately create a single sophisticated company law court whose jurisdiction an entrepreneur can opt into, then the second best alternative may be to catalyze the development of judicial expertise in those jurisdictions. Klausner suggests creating a permanent EMCA committee whose task is not just to update the EMCA in response to changing conditions, but to offer advise on how particular issues should be resolved under the EMCA. In some cases this may take the form of comments on how as yet unresolved issues should be resolved, and in others on explaining where outcomes in particular jurisdictions are unsatisfactory. This clever approach uses soft law to overcome political barriers that do not apply to a private organization, captures some of the scale economies associated with a central body addressing common legal issues, and makes adoption of the EMCA even more attractive to jurisdictions that do not have a rich company law history. Adopting the EMCA with this add on function both provides a statute and a companion device that will speed up the development of local courts.

IV. CONCLUSION

Model acts play a special role in a federal system, operating as a platform for state-level trade-offs between the desirability of uniformity and the necessity of attention to local circumstances. A model company act presents a special case because the sensible use of standards in facilitating controlling shareholders' credible commitment to efficient limits on private benefits of control requires sophisticated company law courts to implement. Thus, I have argued that a model company law court is an important complement to a model company act, especially in a federal system with significant diversity in commercial sophistication and judicial effectiveness across member states. Indeed, that diversity presents an ever more serious development problem as the quest for a single market makes progress. The technocratic case for a federal level optional court, however, is insufficient to predict that such a court might appear. A federal system is inherently and intentionally political. But the potential for the EMCA to provide a soft law

vehicle that can accomplish some of what an EU level commercial court could, as Michael Klausner suggests, be a realistic alternative.