THE GLOBAL EVOLUTION OF CORPORATE LAW:
LESSONS FROM BRAZIL

Mariana Pargendler

Tese apresentada como requisito parcial para obtenção do título de Doutor em Direito pela Faculdade de Direito da Universidade Federal do Rio Grande do Sul, em co-tutela com a Yale Law School.

Orientadores: Carlos Klein Zanini (Universidade Federal do Rio Grande do Sul)
Henry Hansmann (Yale University)

Porto Alegre, 2011
© 2011 by Mariana Pargendler
All rights reserved.
To my parents, Maria Isabel and Ari, and to Carlos.
ACKNOWLEDGMENTS

This dissertation is the product of the collaboration between two law faculties in different hemispheres: the Yale Law School in the United States and the School of Law of the Federal University of Rio Grande do Sul (UFRGS) in Brazil. Professors Judith Martins-Costa, Carlos Klein Zanini, and Henry Hansmann have supported this joint enterprise since its inception, and for that I am most appreciative. The present work has benefited enormously from the resulting dialogue between these different legal cultures and styles of legal scholarship.

I owe my deepest gratitude to my supervisor, Professor Henry Hansmann, who has been the most inspiring, dedicated, and generous academic mentor possible. I am deeply honored and humbled for the privilege of both receiving his invaluable guidance throughout the elaboration of this thesis and collaborating on other academic projects during my doctoral studies.

I am also extremely grateful to my co-supervisor, Professor Carlos Klein Zanini. To him I owe not only the completion of this dissertation but also, as my first Business Organizations professor, my interest in corporate law that has accompanied me ever since.

I am, once again, profoundly indebted to Professor Judith Martins-Costa, my eternal advisor, whose example and generosity have spurred and shaped my academic trajectory ever since my undergraduate legal studies in Porto Alegre. This dissertation is yet another fruit of the lasting academic relationship and personal friendship that has been one of the highlights of my intellectual life.

The contributions of the readers of my dissertation committee at Yale and of my prequalification committee at UFRGS have also greatly enriched this work. Professor James Whitman’s thoughtful comments have not only helped strengthen my arguments, but also prompted me to pursue new and unforeseen (but ultimately fruitful) lines of inquiry. Professor Ian Ayres has also offered insightful and detailed feedback. Professors Cesar Viterbo Matos Santolim, Ronald Otto Hilbrecht, and Vera Maria Jacob de Fradera provided invaluable comments and suggestions during my prequalification exam. I am also grateful to Professors Ronald Gilson, Claire Priest, and Alan Schwartz for stimulating discussions.

I would also like to thank my current and former colleagues at Yale Law School for their friendship, support, and intellectual engagement during this process. For those within this group, I extend special thanks to Diego Arguelhes, Catarina Barbieri, Miguel de Figueiredo, Daniela Gabbay, George Georgiev, Mickey Hyman, John Morley, Fernando Muñoz, Jaclyn Neo, Thomaz Pereira, and Natasha Salinas.
Finally, I dedicate this dissertation to my family. My father Ari and my mother Maria Isabel have always been the most loving and supportive parents, as well as the best role models one could ever hope for. I owe everything to them. I am also deeply grateful to Carlos, my love and partner in life, without whose patience, collaboration, and constant encouragement this work would not have been possible.
# Table of Contents

Abstract ................................................................................................................................. x
Resumo ................................................................................................................................. xi

## Chapter I

### Introduction

Introduction .......................................................................................................................... 1

## Chapter II

**Politics in the Origins: The Making of Corporate Law in Nineteenth-Century Brazil**

I. Background: The State of the Law-and-Finance Debate .................................................... 12
II. Origins of Brazilian Commercial Law (1808-1850) ....................................................... 25
III. Adopting a Commercial Code (1850) ........................................................................... 36
IV. New Hurdles to Financial Development (1851-1881) ..................................................... 51
V. Boom, Bust and the Day After (1882 – 1900) ................................................................. 67
VI. Selective Transplants in the Twentieth Century ............................................................... 77
VII. Evaluating Early Transplants ...................................................................................... 87
VIII. Conclusion .................................................................................................................. 97

## Chapter III

**The Rise and Decline of Legal Families**

I. Introduction ...................................................................................................................... 103
II. Legal Family Taxonomies in Historical Perspective ...................................................... 113
III. From Comparative Legislation to Comparative Law ..................................................... 133
IV. Self-Image and Legal Transplants in the Nineteenth Century .............................................. 147
   A. Continental Influence in Early-Nineteenth-Century English and U.S. Law ............... 149
      i. England ............................................................................................................... 149
      ii. United States ..................................................................................................... 152
   B. Cross-fertilization in Company Law ................................................................. 154
   C. Legal Bricolage in Latin America ........................................................................ 157
V. Conclusion .................................................................................................................. 160

Chapter IV
The Brazilian State as Shareholder

I. Introduction: State Intervention in Nineteenth-Century Brazil ...................................... 162
II. The Rise of Mixed Enterprise ....................................................................................... 167
III. The Corporate Law Implications of Privatizations in Brazil ...................................... 197
IV. Corporate Governance under Continued State Ownership .......................................... 212

Chapter V
The Political Economy of State Ownership in Comparative Perspective

I. Introduction .................................................................................................................. 223
II. The State as Shareholder in Comparative Perspective ............................................... 236
   A. United States ....................................................................................................... 236
   B. China ..................................................................................................................... 251
   C. Continental Europe ............................................................................................... 259
      i. Italy .................................................................................................................... 262
      ii. France ................................................................................................................. 270
      iii. Germany .......................................................................................................... 274
III. Corporate Governance after the Wave of Privatizations .......................................... 278
IV. Addressing Conflicts of Interest ............................................................................... 284
   A) Ownership Strategies .......................................................................................... 285
Chapter VI
Conclusion

Conclusion ................................................................................................................................... 318

Bibliography

Bibliography .................................................................................................................. .............. 324
LIST OF TABLES

Table 1. Evolution of legal system taxonomies ................................................................. 129
Table 2. Comparative Legislation vs. Comparative Law ................................................. 146
Table 3. Europe’s 50 largest industrial companies (1977) .............................................. 260
Table 4. State ownership of listed firms in Italy ............................................................... 269
Table 5. Listed firms under State control in Italy ............................................................. 270

LIST OF FIGURES

Figure 1. Number of incorporations in Brazil (1850-1882) ............................................. 66
Figure 2. Privatization proceeds by year (in US$ billion) ............................................... 206
Figure 3. Telebras organizational chart prior to privatization ........................................... 207
ABSTRACT

This dissertation provides a case study of the evolution of corporate law in Brazil throughout the nineteenth and twentieth centuries. Its objectives are twofold: it aims to understand the Brazilian experience in its own terms, as well as to use the case of Brazil to test existing theories about the driving forces of corporate law institutions around the world. This study shows that no single theory can fully capture the complexity and nuances associated with legal evolution. Nevertheless, as between the competing “legal origins” and “politics” accounts of corporate law developments, the Brazilian case offers strong support to the latter, but discredits the former.

Ever since the nineteenth century, corporate law reforms in Brazil have been highly salient and politically contentious. Brazilian lawmakers in the nineteenth century resorted to a vast array of foreign legal models (including both common-law and civil-law jurisdictions), but borrowed different foreign rules selectively in order to best suit the interests of incumbent elites. The upshot was a patchwork legal regime that deterred financial development to a greater extent than each of the foreign legal models considered in isolation. In the twentieth century, the interests of the State as controlling shareholder of the country’s largest business corporations played an influential role in corporate law reforms.

Additionally, this dissertation draws lessons from the Brazilian case to contribute to the literature on the evolution of corporate law institutions more generally. By broadening the scope of analysis, it suggests that some of the patterns observed in Brazil were also present in other jurisdictions. In examining the intellectual history of comparative law and its taxonomic efforts, this study reveals that, contrary to conventional wisdom in the comparative law and the law-and-finance literature, the reification of legal family distinctions took place to a large extent in the twentieth century. Finally, this dissertation shows that, far from being unique to Brazil, the role of the State qua shareholder as a political actor in corporate law reforms is common to other jurisdictions having a significant number of mixed ownership corporations.
RESUMO

Esta tese lança mão de um estudo de caso sobre a evolução do regime jurídico das sociedades anônimas no Brasil nos séculos XIX e XX. Seu objetivo é duplo: de um lado, pretende-se resgatar e compreender o desenvolvimento do Direito societário no Brasil em seus próprios termos; de outro, busca-se utilizar as lições do caso brasileiro para avaliar o poder explicativo das duas principais teorias existentes na literatura sobre os fatores determinantes da evolução do Direito societário de um modo geral, a Teoria das Origens Jurídicas e a Teoria Política. Este trabalho revela que tais teorias são insuficientes para apreender as nuances e complexidade inerentes à evolução jurídica. No entanto, entre a Teoria das Origens Jurídicas e a Teoria Política, a experiência brasileira oferece apoio para a segunda, porém não para a primeira.

Desde o século XIX, o processo de desenvolvimento do Direito societário no Brasil foi altamente saliente e contencioso do ponto de vista político. Os legisladores oitocentistas valiam-se de uma ampla gama de modelos jurídicos estrangeiros (incluindo países de tradição tanto anglo-saxônica como romanista), mas importavam diferentes instituições de forma seletiva de modo a melhor atender os interesses das elites locais. Deste processo resultou um regime jurídico híbrido que era menos favorável ao desenvolvimento financeiro do que cada um dos modelos estrangeiros considerado de forma isolada. No século XX, os interesses do Estado como acionista controlador das maiores sociedades anônimas de capital aberto do país desempenharam um papel determinante na evolução do Direito societário brasileiro.

A par disso, esta tese procura aplicar as lições do caso brasileiro para refinar e qualificar as teorias existentes sobre os fatores determinantes da evolução do Direito das sociedades anônimas de forma geral. Ao ampliar-se o âmbito da análise, verifica-se que muitos dos padrões marcantes na experiência brasileira são também observados em outros países. Diferentemente dos entendimentos convencionais nos campos de Direito Comparado e Direito e Finanças (law and finance), o exame da história intelectual do Direito Comparado e de seus esforços taxonômicos evidencia que a solidificação do conceito de famílias jurídicas como categorias teóricas relevantes somente ocorreu no século XIX. Por fim, demonstra-se que a influência do Estado-acionista sobre o regime de Direito societário não é peculiar apenas ao caso do Brasil, mas comum a outros países que apresentam um número significativo de sociedades de economia mista.
CHAPTER I

Introduction

In recent years, a series of empirical studies has revived the notion that law – including corporate law – matters in financial and economic development. While the statistical evidence may be recent, there is a long historical pedigree to the idea that the business corporation is a key instrument for the modern capitalist economy. As early as 1932, Adolf Berle and Gardiner Means argued that while “the factory system, the basis of the Industrial Revolution, brought an increasingly large number of workers directly under a single management … the modern business corporation, equally revolutionary in its effect, placed the wealth of innumerable individuals under the same central control.”

French jurist George Ripert regarded the business corporation as “a legal machine as useful as those utilized by industry,” serving as a “marvelous instrument created by capitalism to channel savings to the creation and operation of business.”

Italian commercial law scholar Tullio Ascarelli maintained that the corporate form was “the most important and characteristic legal institution of the current economy.”

In Brazil,


2 GEORGE RIPERT, ASPECTS JURIDIQUES DU CAPITALISME MODERNE [Legal aspects of modern capitalism] 106 (1946). Unless quoted in the original language, all quotations from Brazilian, French, and Italian sources throughout this dissertation are the author’s own translations.

3 Tullio Ascarelli, I problemi delle società anonime per azioni [The problems of business corporations], 1 RIVISTA DELLE SOCIETÀ 3 et seq. (1956).
Fábio Konder Comparato viewed corporate law “as the authentic ‘constitutional law’ of economic activity in the private sector.”

The significance of business corporations in encouraging economic development seemed obvious; so too did the role of law in bringing about the institution of the corporation seem self-evident. The business corporation is a legal creation par excellence. The State provides it with its essential attributes – from legal personality and transferable shares to entity shielding and limited liability – once a valid corporate charter is registered. Legal formalities and registration requirements may be brought to a minimum, as under current Delaware law, but they still remain crucial for the successful establishment and legal status of a business corporation.

Starting in the 1970s, however, a series of works on the economic theory of the firm began to reinterpret the business corporation as a mere “nexus of contracts” among its various constituencies – shareholders, creditors, employees, consumers, suppliers, and so on. This view of the corporation as contract entailed a conception of corporate law as essentially indistinguishable from contract law. As a result, scholars began to see corporate law as relatively unimportant, perhaps even trivial.

---


All of this changed once again in the mid-1990s, when theoretical and empirical studies in institutional economics offered new evidence suggesting that corporate law institutions – especially those that offer protection to outside investors – play a critical role in fostering economic development.\footnote{See John C. Coffee, Jr., \textit{Privatization and Corporate Governance: The Lessons from Securities Market Failure}, 25 J. CORP. L. 1, 2 (1999) (discussing the revival of the concept that “corporate law matters” in the 1990s).} As more scholars took the view that “good” corporate law matters, the quest for the determinants of corporate-law regimes assumed paramount importance.

Broadly speaking, two main competing theories emerged to explain why jurisdictions worldwide adopt legal regimes that offer different levels of investor protection and, in turn, experience varying degrees of capital market development. The so-called “Legal Origins Theory,” borrowing heavily from traditional lessons of comparative law scholarship, attributes contemporary legal outcomes to legal families formed through involuntary processes of legal transplantation in the distant past as a result of conquest or colonization. Its principal competitor, here referred to as the “Political Theory,” credits legal and economic outcomes to the will of the people, or of its most influential interest groups, at any given point in time.\footnote{See Chapter II for an exposition of both theories with relevant bibliography.}

The literature evaluating these two competing theories has generally operated at a high a level of abstraction. While econometric studies covering a large number of jurisdictions have proliferated, case studies are comparatively rare – and even rarer for developing countries. Indeed, one of the main arguments that proponents of the Legal Origins Theory adduce in its favor is the simple fact that virtually all extant studies
supporting the Political Theory limit their research to the “Wealthy West.” At the same time, the Legal Origins Theory also owes its formulation to the Wealthy West, based on the experience of a small number of Western jurisdictions.

This dissertation tests both theories through a case study of the evolution of corporate law in Brazil. For its sheer size, economic significance, and rich financial history, Brazil is a clearly important but surprisingly understudied context. From the standpoint of law and finance, Brazil’s historical ups and downs make it an especially interesting case study. No less than five major corporate-law reforms were enacted between 1850 and 1900, with at least five more in the century thereafter. Capital market activity also fluctuated wildly. There were very few business corporations operating in the country until the mid-nineteenth century, but by the turn of the century Brazil had already witnessed a major stock-market boom and bust. Brazil faced declining capital markets and boasted one of the highest levels of private benefits of control worldwide in the 1990s only to become one of the most impressive historical examples of governance reform and rapid capital market growth in the last decade.

This dissertation’s purpose is twofold. It aims, on the one hand, to understand the development of corporate law in Brazil on its own terms. This seems to be a worthy endeavor in itself since “persons who have lost their memories no longer know who they are” — a thesis that proves to be equally applicable to countries. And a contextually-rich

---

10 Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, The Economic Consequences of Legal Origins, 46 J. ECON. LIT. 285, 311 (2008). For a recent exception to this trend, see Nicholas Calcina Howson & Vikramaditya S. Khanna, The Development of Modern Corporate Governance in China and India, in CHINA, INDIA AND THE INTERNATIONAL ECONOMIC ORDER 514 (M. Sornarajah & J. Wang eds., 2010) (finding that support for the “legal origins” view is weak and that the “politics” account seems more relevant in explaining stock market development in India and China).

11 H. PATRICK GLENN, LEGAL TRADITIONS OF THE WORLD: SUSTAINABLE DIVERSITY IN LAW 35 (4th ed., 2010) (also noting that “it is memory which is constitutive of identity”).
understanding of the country’s corporate history is essential for making educated policy proposals in the present. On the other hand, this dissertation also seeks to draw on the Brazilian experience to evaluate and refine conventional understandings about the driving forces behind the evolution of corporate law more generally. In doing so, I will not only formulate new hypotheses but also take a stab at testing their validity beyond the Brazilian context.

Before summarizing the structure of this dissertation, it is worth pausing to describe both the rationale and limitations of its methodological choices. Legal scholars and social scientists have now come to recognize the value of case studies as valuable complements to large-n surveys when it comes to analyzing phenomena as complex and multifaceted as legal developments. However, given a field as vast as corporate law and a period spanning over two centuries, no single study could cover everything, and further methodological choices were necessary.

First, the concept of law that is the object of this dissertation is confined to rules supplied by the sovereign and, in particular, by the legislative and the executive branches. This limitation is, to be sure, arbitrary. While corporate law is necessarily the product of statutes and contracts, in Brazil and elsewhere, it is still true that the judicial branch plays a major role in interpretation and enforcement. In the analysis of nineteenth-century developments, in particular, this shortcoming is partially mitigated through an analysis of decisions issued by the Conselho de Estado (Council of State) – which, while formally an

advisory body to the Emperor, effectively operated as a quasi-judicial and administrative tribunal. Moreover, corporate litigation has been surprisingly scarce in Brazil throughout its history, despite the emergence of a highly litigious culture and a massive influx of lawsuits in other areas of law. A systematic study of Brazil’s corporate jurisprudence in historical perspective, though likely to be illuminating in a variety of ways, is outside the scope of this dissertation.

Second, this study emphasizes different aspects of corporate law in its analysis of legal change in the nineteenth and twentieth centuries. The narrative of nineteenth-century developments focuses on the imposition, and later removal, of entry restrictions through stringent governmental limitations of access to the corporate form in general and to banking charters in particular. Access to the corporate form logically precedes more specific considerations about internal governance rules. It is thus understandable that in Brazil, as elsewhere, concerns about investor protection played a comparatively lesser role in shaping corporate law in the nineteenth century versus the twentieth century and thereafter.

The analysis of twentieth-century legal developments, in turn, will focus primarily on features of corporate law that operate as investor protection devices. Specifically, it will concentrate on the role of the State as controlling shareholder of some of Brazil’s

---

13 See, e.g., João Camilo de Oliveira Torres, O Conselho de Estado 130 (1965) (describing the Council of State as a body exercising administrative, judicial and political functions).


15 See Henry Hansmann & Mariana Pargendler, Voting Restrictions in Nineteenth-Century Corporations: Investor Protection or Consumer Protection? (2010) (unpublished manuscript, on file with the author) (noting that “even if investor protection considerations have arguably become paramount in the end of history of corporate law, they were certainly not as important in the beginning of history”).
largest corporations in shaping such features. To focus on the State as a shareholder is emphatically not to deny that other factors and interests have influenced Brazil’s corporate legal regime over time – they certainly have, as I and others have argued elsewhere.\textsuperscript{16} Instead, this emphasis on the interests of the government-shareholder in shaping the evolution of corporate law is due both to the neglect and absence of theorization of this phenomenon in the literature and to the particular dominance of listed state-owned enterprises in the Brazilian economy in the twentieth century.

Perhaps unsurprisingly, this detailed study of the Brazilian case shows that no single theory can fully capture the complexity and nuances inevitably associated with legal evolution. A number of outcomes were context-specific. Others were simply accidents of history. Nonetheless, there is little question that, between the Legal Origins Theory and the Political Theory, the Brazilian experience strongly supports the latter, not the former.

This dissertation also draws lessons from the Brazilian experience to complement and refine existing theories about the causes of legal and financial development. Although academic criticism to the Legal Origins Theory is undoubtedly forceful and voluminous, some of its most basic – and, it will be argued, faulty – assumptions have gone unchallenged by both legal and economic scholars. Similarly, existing accounts of the political economy of corporate governance – the bulk of which originates in the United States – have overlooked key variables that, while less relevant in contemporary America, are critical for understanding legal reforms in other jurisdictions worldwide.

\textsuperscript{16} See Ronald J. Gilson, Henry Hansmann & Mariana Pargendler, \textit{Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the U.S. and the EU}, 63 STAN. L. REV. (forthcoming 2011) (discussing the role of controlling families and the Brazilian Association of Public Companies in blocking investor-friendly legal reforms in Brazil).
This dissertation is organized thematically rather than chronologically in order to draw attention to its theoretical contributions to the literature. It is structured in two parts, each containing two chapters. Each part begins with a narrative of historical corporate developments followed by a chapter elaborating some broader insights that the Brazilian experience provides toward illuminating the driving forces behind the evolution of corporate law in general.

This study begins by exploring the various factors shaping the development of corporate law in nineteenth-century Brazil. Chapter II shows how corporate law rules were in constant flux throughout this period in response to different economic and political pressures. In a nutshell, Brazilian lawmakers conducted intensive surveys of a vast array of foreign legal systems, including both continental and Anglo-Saxon jurisdictions. Not displaying a sense of attachment to any given legal tradition, legislators picked and chose rules from different models to fit local needs and political interests. Nevertheless, taken as a whole, this patchwork approach to institutional development resulted in a legal system that restricted entry into industry by imposing government controls over formation of corporations to a greater extent than any of its foreign models taken in isolation. While much of the conventional wisdom on legal transplants emphasizes the importance of tailoring foreign institutions to local circumstances, these findings suggest that, in and of itself, adaptation may serve as a double-edged sword.

Chapter III builds on the Brazilian case, which suggested that nineteenth-century lawmakers and scholars paid little attention to legal family distinctions, and investigates the broad intellectual history of the effort to map the world’s legal systems into a handful
of legal families. This exercise reveals that legal family categorizations that are standard today, and widely employed both in the comparative law and the economic literature, are of remarkably recent origin. The now-conventional taxonomies of common law and French, German, and Scandinavian civil-law jurisdictions date back to as late as the 1960s.

By contrast, nineteenth-century comparativists generally held a far more cosmopolitan view of law and legal evolution than their successors. The ambitions of comparative law, then called “comparative legislation,” were generally practical (fostering legal convergence) rather than academic (understanding legal differences). A number of extralegal factors ranging from economic liberalism and free trade to anti-colonialist sentiment contributed to the relative neglect of legal traditions in the nineteenth century. This Chapter therefore spotlights the extent, previously overlooked, to which the reification of legal family distinctions is a twentieth-century phenomenon. While comparative law scholars have recently spilled much ink on the apparent decline of distinctions between legal families, the timing and reasons for their development are an equally interesting but so far neglected phenomenon.

**Chapter IV** highlights the State’s role as the most important shareholder in the Brazilian economy since the mid-twentieth century. It suggests that the State’s interests as a shareholder in Brazil have played a decisive role in corporate law reforms over time. Indeed, the federal government itself, with the acquiescence of controlling families, was responsible for what is arguably the worst corporate law reform in Brazilian history, at least from the perspective of minority shareholders. The primary goal of Law 9,457 of 1997, which amended Brazil’s Corporation Law, was to remove statutory protections
previously available to minority shareholders during control sales in order to maximize the State’s proceeds from privatization to the detriment of minority investors.

By introducing the role of State interests in the development of corporate law, these findings add to the literature on the political economy of corporate governance, which has so far failed to appreciate the political role of the government as shareholder. Existing models tend to focus exclusively on private owners, managers, and workers as the relevant political constituents in corporate governance reforms. As this Chapter argues, such a view provides too narrow a framework to analyze the political economy of the large (and growing) number of jurisdictions that exhibit a substantial number of publicly traded but state-owned firms. While the debate over State ownership has traditionally centered on its implications for corporate governance and performance at the firm level, this dissertation suggests that the very presence of the State as a controlling shareholder may impose negative externalities on the corporate governance environment applicable to purely private sector corporations.

Inspired by the Brazilian experience described in the previous chapter, Chapter V deploys a series of historical narratives from different jurisdictions to explore whether governments of other countries resorting to State ownership have also behaved as political actors in corporate law reforms. Drawing from experiments with government ownership in the U.S., China, and Europe, it shows that the Brazilian State was by no means exceptional in facing conflicts of interest arising out of its dual role as a shareholder and corporate governance regulator. The government’s pecuniary interest as a shareholder has shaped important features of corporate law in the nineteenth-century U.S., twentieth-century Europe and modern-day China. Although rare in the U.S.
(despite their unexpected appearance following the 2008 financial crisis), mixed enterprises are pervasive elsewhere in the world, but their structure and impact remain strikingly under-theorized. Given the continued and seemingly growing significance of State ownership of publicly-traded corporations, this Chapter ends by exploring the promise of different institutional arrangements to constrain the impact of the State’s interests as a shareholder on the corporate governance environment, concluding with specific policy recommendations.

Chapter VI concludes the dissertation by reflecting on how the lessons provided by Brazil’s corporate history can both illuminate contemporary corporate developments within Brazil’s borders and contribute to a richer understanding of the evolution of corporate law worldwide.
CHAPTER II

Politics in the Origins:
The Making of Corporate Law in Nineteenth Century Brazil

I. Background: The State of the Law-and-Finance Debate

There is growing consensus among economists that financial development matters for economic growth and that law, in turn, matters for financial development.¹ As economists have increasingly come to recognize that markets are not natural entities that always function well independently of legal and social institutions, the question of what determines the structure of legal institutions in the first place did not take long to surface. This inquiry into the sources of legal evolution is of course not new among legal scholars. Comparative lawyers, in particular, had a simple and ready answer; they had long acknowledged that “societies largely invent their constitutions, their political and administrative systems, even in these days their economies, but their private law is nearly always taken from others.”²


Since Alan Watson published his seminal book declaring “legal transplants” as “the most fertile source of [legal] development,” both the term and the underlying concept have played a central role in comparative law scholarship.3 But even as the success, failure, and mutation of foreign models have attracted significant scholarly attention, comparativists have largely overlooked the decision-making process leading to the adoption of legal transplants.4 The very author who turned legal transplants into a central theme of comparative law scholarship had a notoriously hermetic view of the law as an autonomous system which is a product of “purely legal history,” rather than a result of social, political, and economic considerations.5

These basic lessons of comparative law scholarship attracted the attention of economists Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny, who broke new ground by undertaking to measure the causal effects of investor and creditor rights on financial development – a longstanding assumption which however lacked empirical verification.6 Their pioneering article begins by citing Alan Watson and taking as its starting point “the recognition that laws in different countries are not written

---

3 Alan Watson, Legal Transplants: An Approach to Comparative Law [hereinafter “Legal Transplants”] 95 (1974). The concept of legal transplants is, of course, much older. The very term was used repeatedly by Brazilian lawmakers in nineteenth-century legislative debates. See note 302 infra and accompanying text.

4 In the few existing narratives about the background of legal transplants, the story often goes that public-spirited reformers sought to modernize the law of a backward society by importing “the best possible law” then governing a more developed nation. Id. at 92 (noting that law reform processes reflect “a conscious attempt to achieve the best possible rule”).


from scratch, but rather transplanted.”7 La Porta et al. then resort to another longstanding tenet of comparative lawyers – the notion that “commercial laws come from two broad traditions – common law, which is English in origin, and civil law, which derives from Roman law.”8

In their attempt to draw causal inferences from observational data, La Porta et al. took the approach of comparative law scholars one step further by rejecting the possibility of meaningful choice among different foreign regimes.9 In their words, “[c]ountries typically adopted their legal systems involuntarily (through conquest or colonization), and even when they chose a legal system freely, as in the case of former Spanish colonies, the crucial consideration was language and the broad political stance of the law rather than the treatment of investor protections.”10 Conveniently, La Porta et al. could then use legal origins as an instrumental variable to overcome a potential endogeneity problem, and show that investor protection laws cause financial development, and not the other way around.11 Specifically, these authors famously and

7 Id. at 115.

8 Id. La Porta et al.’s reliance on legal families is based on a steady stream of works within the comparative law literature. As James Whitman put it, they “cannot be blamed for believing what they read.” James A. Whitman, Consumerism Versus Producerism: A Study in Comparative Law, 117 YALE L. J. 340 (2007).

9 Comparatists generally use the term “transplants,” an expression implying passivity on the part of the recipient country, interchangeably with “borrowing,” a verb denoting an active stance on the part of the importing jurisdiction. See Watson, Legal Transplants, supra note 3. For an excellent study on the legal sociology of “reception” processes and legal borrowing patterns, see A. C. Papachristos, La Réception des Droits Privés Étrangers Comme Phénomène de Sociologie Juridique 141 [The reception of foreign private laws as a phenomenon of legal sociology] (1975) (arguing that the circulation of foreign models is primarily attributable to changes in the importing country’s socio-economic structure, rather than to a natural tendency towards legal convergence or to the will of certain societies to imitate foreign institutions).

10 La Porta et al., supra note 6, at 1126.

11 The very power of La Porta et al.’s empirical findings about the causal relationship between investor protection and financial development rests on the premise that legal origins are exogenous. Even though
controversially argued that common law countries have the highest and French civil law countries the lowest levels of investor protection and financial development, with countries of the Scandinavian and German legal families falling in between.\textsuperscript{12} Subsequent studies have expanded the use of legal families to explain cross-country variation in labor markets regulation, entry restrictions, government ownership of banks and the media, and military conscription.\textsuperscript{13}

Yet this view of private law as a “politically neutral endowment”\textsuperscript{14} is clearly at odds with both the basic intuition that modern law is the result of the will of the people (or the will of the King, or something in between), and the substantial body of literature that vindicates the role of local politics as a more powerful determinant of legal and financial development.\textsuperscript{15} While some works have suggested that different legal origins

\begin{thebibliography}{99}
\bibitem{12} La Porta et al., \textit{supra} note 6. Admittedly, the strength of these empirical findings has been questioned. \textit{See} Holger Spamann, \textit{The “Antidirector Rights Index” Revisited}, 23 REV. FIN. STUD. 467 (2009). \textit{See also} Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, \textit{The Law and Economics of Self-Dealing}, 88 J. FIN. ECON. 430 (2008), for a revised index correcting coding errors and conceptual ambiguities present in the original works of the law-and-finance literature.

\bibitem{13} \textit{See} La Porta et al., \textit{Economic Consequences, supra} note 11 (for a review of the contributions of what they call the “Legal Origins Theory”). \textit{But see}, for the argument that both civil law and common law emerged as efficient pro-market adaptations to the their surrounding environments in the nineteenth century, Benito Arruñada & Veneta Andonova, \textit{Civil Law and Common Law as Pro-Market Adaptations}, 26 WASH. U. J.L. & POL’y 81 (2008) (arguing that statutory limits to judicial discretion were introduced in France to promote rather than curb freedom of contract).

\bibitem{14} The expression comes from \textit{CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW AND CAPITALISM: WHAT CORPORATE CRISSES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD 22 (2008)}.

\bibitem{15} \textit{See}, e.g., Mark J. Roe, \textit{Political Preconditions from Separating Ownership from Control}, 53 STAN. L. REV. 539 (2000); Marco Pagano & Paolo F. Volpin, \textit{The Political Economy of Corporate Governance}, 85 AM. ECON. REV. 1005 (2005); Raghuram Rajan & Luigi Zingales, \textit{The Great Reversals: The Politics of}

\end{thebibliography}
might impact or constrain the operation of political forces, both comparatists and economists are largely silent on the influence of local politics on legal transplants. However, just as the existing scholarship on legal transplants downplays the role of politics, existing works on the political economy of corporate governance all but ignore transplants as a source of legal development.

In addressing the complexity of a single case not visible at a stratospheric level of generality, this study will begin to explore the “black box” of foreign model selection in finance. The apparent disconnect between legal origins and politics is at least partially attributable to the too narrow focus and high level of generality at which most of the existing literature operates. Both the law-and-finance literature and its competitors consist primarily of broad cross-country comparisons. Case studies are the exception, and even scarcer with respect to developing countries. Political economy works, in

---

16 Rajan & Zingales, supra note 15, at 43 (suggesting that civil law jurisdictions may be more susceptible to the influence of interest groups); John C. Coffee, Jr., The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control, 111 YALE L. J. 1, 65 (2001) (positing that the common law is more welcoming to private law-making than the civil law); Thorsten Beck, Asli Demirgüç-Kunt & Ross Levine, Law and Finance: Why Does Legal Origin Matter?, 31 J. COMP. ECON. 653 (2003) (arguing legal traditions differ in the weight they give to the interests of the state vis-à-vis individual investors, with the civil law jurisdiction favoring state power).

17 The view of the law as a-political stands in sharp conflict with another key proposition of the law-and-finance literature, which attributes the differences between common and civil law to the varying political conditions and degrees of centralization of power in England and France in the Middle Ages. See Andrei Shleifer & Edward Glaeser, Legal Origins, 117 QUART. J. ECON. 1193 (2002). See also PISTOR & MILHAUP, supra note 14, at 22.
particular, rarely go beyond the social-democracies of the “Wealthy West.” Similarly, mainstream comparative law – an inherently superficial enterprise – has traditionally focused on a handful of “parent” jurisdictions, and provided at best a synopsis of legal developments elsewhere. Legal scholarship around the world, still mostly doctrinal in nature, has also generally failed to fill in this gap.

This Chapter investigates the driving forces of legal evolution by looking at the early development of corporate laws in Brazil. Brazil makes a particularly important and understudied context, since both corporate laws and capital market development levels underwent significant changes throughout the country’s history. Brazil enacted no less than five major corporate law reforms between 1850 and 1900, and at least five more in the following century. Capital market activity also fluctuated wildly. There were very few business corporations operating in the country until the mid-nineteenth century, but by the turn of the century Brazil had already witnessed a major stock market boom and bust. Brazil faced declining capital markets and boasted one of the highest levels of private benefits of control worldwide in the 1990s, only to become one of the most

18 La Porta et al., Economic Consequences, supra note 11, at 311. For a recent exception to this trend, see Nicholas Calcina Howson & Vikramaditya S. Khanna, The Development of Modern Corporate Governance in China and India, in CHINA, INDIA AND THE INTERNATIONAL ECONOMIC ORDER 514 (M. Sornarajah & J. Wang eds., 2010) (for recent case studies concluding that the “politics” account best explains stock market developments over time in India and China).

19 F. H. Lawson, The Field of Comparative Law, 61 JURID. REV. 16, 36 (1949) (claiming that “a comparative lawyer is bound to be superficial”). See also the influential comparative law treatise of Konrad Zweigert & Hein Kötz, INTRODUCTION TO COMPARATIVE LAW 39 (1992). In providing guidance about the choice of which legal systems to compare, Zweigert & Kötz expressly urge comparatists to “ignore the affiliate [legal system] and concentrate on the parent system.” In this vein, they suggest that scholars interested in the Romanistic tradition focus exclusively on France and Italy, as “[t]he legal systems of Spain and Portugal (…) do not often call for or justify very intensive investigation.” Id.

impressive instances of governance reform and rapid capital market growth in the last
decade. Unlike previous works, which focused primarily on the law-on-the-books and
on corporate practice, this study also examines the debates, both in Parliament and in the
Council of State (Conselho de Estado), preceding the adoption and the official
interpretation of commercial laws – an obvious and valuable, but so far underutilized,
source for this type of analysis.

This effort reveals that the generalizations about Brazil in the existing literature
are not only superficial and imprecise, as is expected, but at times diametrically opposed
to actual developments. Following the comparative law works in which its taxonomy is
based, the law and finance literature classifies Brazil, like its Latin American peers, as a
French civil-law jurisdiction – an assumption that is taken for granted even in

21 For a description of recent developments in Brazil’s capital markets, see Érica Gorga, Changing the
Paradigm of Stock Ownership from Concentrated Towards Dispersed Ownership? Evidence from Brazil
and Consequences for Emerging Countries, 29 NW. J. INT’L L. & BUS. 439 (2008) (for a description and
analysis of changes in the ownership structure of publicly-traded corporations in Brazil in the last years);
Ronald J. Gilson, Henry Hansmann & Mariana Pargendler, Regulatory Dualism as a Development
Strategy: Corporate Reform in Brazil, the U.S. and the EU, 63 STAN. L. REV. (forthcoming 2011)
describing the rapid development of Brazil’s capital markets since 2004).

22 But see José Reinaldo de Lima Lopes, A Formação do Direito Comercial Brasileiro: A Criação dos
Tribunais de Comércio do Império [The Formation of Brazilian Commercial Law: The Creation
of Commercial Courts in the Empire], 6 CADERNOS DIREITO GV (2007) (for an excellent study of the creation
of Brazil’s merchant courts relying on primary historical sources, including legislative debates); JOSÉ
REINALDO DE LIMA LOPES, O ORÁCULO DE Delfos: O CONSELHO DE ESTADO NO BRASIL-IMPÉRIO [The
Oracle of Delphos: The Council of State during the Brazil-Empire] (2010) (for an in-depth study of the
general jurisprudence of Brazil’s Council of State). Neither of Lima Lopes’s works, however, focuses
particularly on business organizations.

23 To be sure, legal scholars have appropriately noted that Brazil’s civil code was also influenced by
Germany as well as other civil-law jurisdictions. See KENNETH W. DAM, THE LAW-GROWTH NEXUS: THE
RULE OF LAW AND ECONOMIC DEVELOPMENT 43 (2006) (citing Zweigert and Kötz for the proposition that
“in addition to the Code civil [of France] it [Brazil] was able to draw on the Portuguese and Italian
codes, as well as those of Germany and Switzerland. The structure of the Code, especially its ‘General
Part,’ is largely traceable to German influence.” Other comparatists remained confident that the
classification of Latin American countries as French-civil law jurisdictions is “less problematic.” See
Mathias M. Siems, Legal Origins: Reconciling Law & Finance and Comparative Law, 52 MCGILL L.J. 55,
69 (2007). Nevertheless, I will argue that even these critical assessments of the law-and-finance literature
have significantly underestimated the diversity of Brazil’s legal origins.
sophisticated case studies of Brazilian corporate history. In their influential work on modes of legal transplantation, Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard coded Brazil as an “unreceptive” jurisdiction, meaning that the transplanted laws were unknown in the country prior to their import and were not further adapted to fit local circumstances. As a Latin American country receiving the French legal system without an instructions manual, Brazil is expected to have misinterpreted the functioning of the French legal system as being overtly rigid and formalistic, with presumably detrimental consequences to its development. Nevertheless, a careful examination of Brazil’s legislative debates in the nineteenth century reveals that each of these assumptions is unwarranted.

I argue that the development of early corporate laws in Brazil is marked by three distinctive features: (i) politicized lawmaking, (ii) diverse origins, and (iii) selective transplants. First, in Brazil, as elsewhere, the design and enactment of early corporate

---

24 See Also Musacchio, Can Civil Law Countries Get Good Institutions? Lessons from the History of Creditor Rights and Bonds Markets, 68 J. Econ. Hist. 80 (2008) (justifying the choice of Brazil for a case study for “it is currently a French civil law country with a profile of inadequate creditor protection and contract enforcement”); Musacchio, supra note 134, at 2 (exploring how Brazil was able to develop fairly developed capital markets in spite of its relatively ‘adverse’ institutional heritage,” which included the “the French civil law system inherited from the Portuguese”). As we will see throughout this Chapter, French law was but one of the multiple influences on Brazil’s legal system, and the influence of French law on Brazilian law took place by and large after independence and was therefore not inherited from Portuguese colonizers.


26 John Henry Merryman, The French Deviation, 44 AM. J. COMP. L. 109, 116 (1996), posited that France’s strong rhetoric about a judge-proof law was misunderstood in developing countries, with dire consequences to their judicial systems (“[i]n France, where everyone knows how to do what needs to be done behind the separation of powers façade, misrepresentation of the judicial function does not have severe consequences. But when the French exported their system they did not include the information that it really does not work that way, and they failed to include a blueprint of how it actually does work.”)

27 Beck et al., supra note 16, at 655.
laws was not only conscious, but also highly salient and politically contentious. Second, the foreign law models considered for adoption were also much more diverse than one would expect given the ingrained assumption that “Anglo-American law was totally neglected in the civil law world.” 28 The cultivated members of the Brazilian elite who served as legislators in the nineteenth century carefully considered the content and effects of legal rules not only of civil law jurisdictions such as France, Portugal and Spain, but also of England, before enacting local laws. 29 In fact, English law’s influence on Brazilian lawmakers arguably rivaled that of French law throughout the nineteenth century. 30 Third, this deliberate and complex lawmaking process gave rise to selective legal transplants from foreign jurisdictions, thus resulting in an idiosyncratic regime that, while suitable to the interests of incumbent elites, was often less conducive to financial development than that of any of the foreign models taken in isolation.

These three key features of early corporate law developments in Brazil call for a reevaluation of conventional understandings about the relevance of legal families in explaining legal evolution. The very notion that Brazil belonged to the French legal tradition, and that its legal rules were somehow bound to follow those of its parent jurisdiction, seems to have escaped notice by Brazilian lawmakers. As argued in greater detail in Chapter III, legal family classifications as we know them are a product of

28 Ugo Mattei, Why the Wind Changed: Intellectual Leadership in Western Law, 42 AM. J. COMP. L. 195, 202 (1994) (citing the works of Joseph Story on conflicts of law as the only exception to the general neglect of Anglo-American law in civil law countries).

29 Clóvis Bevilaqua, Evolução Jurídica do Brasil no Segundo Reinado [Legal Evolution in Brazil in the Segundo Reinado], 46 REVISTA FORENSE 5, 9 (1926). Bevilaqua, the draftsman of Brazil’s Civil Code of 1916, noted that while in the first years of independence Portuguese law was the main source of inspiration, Brazil’s lawmakers soon turned to other sources, especially France, Belgium and England.

30 This was true not only in commercial law matters, but also with respect to more general features of the legal system, such as the structure of the judiciary and the availability of remedies against State oppression. See Part VII infra.
twentieth-century legal thought. Indeed, the embryonic classifications of legal systems employed by Brazilian authors in the nineteenth century recognized the patchwork nature of legal systems in Latin America and viewed them as belonging to a category separate from other Anglo-European groupings. To expect this later academic label of “French civil law jurisdictions” to have had a binding effect in the evolution of early Brazilian law is anachronistic.

An initial puzzle stemming from the law-and-finance literature is why French law had such deleterious effects in the periphery, while France itself seems to have fared quite well. Building on the lessons of comparative law scholars, Thorsten Beck, Asli Demirgüç-Kunt and Ross Levine have advanced the French Deviation hypothesis, according to which legal practice in France did not live up to French law’s highly formalistic rhetoric, while foreign jurisdictions fully incorporated France’s purported emphasis on separation of powers.31 This study supports the view that Brazilian law did indeed depart from French law in material ways, but challenges the reasons given to explain such deviation.

I argue that Brazilian elites did not misunderstand the French legal system, but rather consciously opted to depart from it (and from other foreign models) when it was in their interest to do so. For example, slaves did not even exist in the land of égalité, but they made it into the text of the Brazilian Commercial Code, which expressly ruled them out as a valid form of commercial collateral.32 Brazilian lawmakers were well aware that the French resorted to tradable limited partnerships (sociétés en commandite par actions)

31 Beck et al., supra note 16, at 655.

as a surrogate for existing restrictions to incorporations, but nevertheless opted to outlaw these business entities in Brazil. Local politics, not ignorance, explain the European deviation.

Brazil’s case also speaks to the literature addressing how the transplant process – rather than the identity of the exported legal system alone – determines legality and, consequently, economic development. Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard have posited that the manner in which the foreign law is transplanted and received is more important than the identity of its supplier in predicting the effectiveness of the resulting legal system. They find that countries which were already familiar with foreign laws or which further adapted them to local circumstances had superior results than those who blindly copied unknown legal orders. This line of reasoning sounds plausible, but the Brazilian case suggests that adaptation of foreign models, without more, cannot be deemed to be unambiguously positive. Because recipient countries are generally more unequal than exporting jurisdictions, there is in fact reason to fear that the political economy in the periphery might be less conducive to economic growth than that of parent jurisdictions.

This account of legal evolution in Brazil is consistent with the large economic literature underscoring the enduring consequences of early colonization strategies that create highly unequal social structures and entrench small elites to the detriment of the

33 See Part IV infra.
34 Berkowitz et al, supra note 25.
35 Id.
remainder of the population.\textsuperscript{36} Daron Acemoglu, Simon Johnson and James A. Robinson credit economic underdevelopment to the long-lasting character of extractive institutions imposed by European settlers facing high mortality rates in a given region.\textsuperscript{37} Calixto Salomão Filho attributes underdevelopment to the persistence of certain structures of concentrated economic power in ex-colonies.\textsuperscript{38}

The Brazilian experience however suggests that the relevant variable is not whether initial colonial arrangements persist, but whether the expropriatory nature of institution can be self-perpetuating despite apparent institutional change. Corporate laws, in particular, underwent considerable transformation over time, but such changes often reflected more the rent-seeking ambitions of the country’s small elite at any point in time than social welfare considerations. This view is consistent with the argument of Engerman and Sokoloff,\textsuperscript{39} which attributes institutional development to factor endowments and inequality, as well with subsequent work by Acemoglu and Johnson acknowledging that frequent institutional changes can coexist with the overall persistence


\textsuperscript{37} Acemoglu et al., \textit{Colonial Origins}, supra note 36.

\textsuperscript{38} \textit{CALIXTO SALOMÃO FILHO, HISTOIRE CRITIQUE DES MONOPOLES: UNE PERSPECTIVE JURIDIQUE ET ÉCONOMIQUE} [Historical critique of monopolies: A legal and economic perspective] 21 (2010). Departing from conventional accounts in the Brazilian literature, Salomão Filho attributes underdevelopment in Brazil to internal economic power structures leading to reverse distribution of wealth towards the wealthier segments of the population, rather than to trade imbalances and external dependence alone. \textit{Id.} at 26.

\textsuperscript{39} Engerman & Sokoloff, \textit{supra} note 36.
of an expropriatory regime.\textsuperscript{40} The present study argues that selective transplantation and conscious transmutation of foreign models were in fact one of the channels through which local elites recreated socially inefficient but private regarding institutions over time.

In addition to setting Brazil’s record straight, these findings have potentially broader normative implications. The legal origins thesis has been widely influential in policy circles, especially the World Bank.\textsuperscript{41} However, if politics matters and certain legal origins are not better or worse, much less decisive, the ongoing fight against the French civil law tradition has been the wrong one. In fact, overstating the importance of legal origins is not only inaccurate, but also self-defeating. Urging countries to repudiate their very “origins” – or their legal families, or traditions – is unlikely to be popular and, in any case, effective. If special interest groups have successfully blocked legal reforms enabling financial and economic development, their opposition should be met head on.\textsuperscript{42}

This Chapter proceeds as follows. Part II investigates the sources of Brazilian commercial law from the beginning of the nineteenth century until its codification in 1850. Part III describes the driving forces behind the adoption of the Brazilian Commercial Code and the decision-making process leading to its enactment. Part IV

\textsuperscript{40} Daron Acemoglu & James A. Robinson, \textit{De Facto Political Power and Institutional Persistence}, 96 AM. ECON. REV. 325 (2006).


\textsuperscript{42} For the description and analysis of “regulatory dualism” as a strategy to overcome political economy hurdles to growth-inducing legal reforms, see Gilson, Hansmann & Pargendler, \textit{supra} note 21.
examines how local politicians resorted to selective legal transplants and local innovations to repress corporate and bank formation in nineteenth-century Brazil. Part V explains how changes in underlying local and political conditions led to a reversal in corporate law rules and financial policies, which brought about the greatest stock market boom and bust in Brazilian history. Part VI provides an overview of the continuing importance of selective legal transplants throughout the twentieth century. Part VII evaluates the comparative importance of origins and politics in the making of early corporate laws in Brazil, and the implications for the law-and-finance literature. Part VIII concludes.

II. Origins of Brazilian Commercial Law (1808-1850)

As is the case with other developing countries, for most of its colonial history Brazil was an agricultural and, according to some commentators, quasi-feudal society.43 Brazil exported agricultural commodities produced by slave labor in local plantations to Portugal, and imported all requisite industrial goods from the metropolis. In typical colonial fashion, the establishment of local industries was expressly outlawed.44 A deliberate goal of this policy was to thwart the colony’s economic development in order to prevent its independence. As explained in the accompanying regulations to the ban,

“Brazil is the most fertile and abundant country in the world with respect to the land’s fruits and production. Its inhabitants have


44 Alvará (Royal Decree) (Jan. 5, 1875). For a detailed analysis of colonial monopolies and their economic consequence in historical perspective, see SALOMÃO FILHO, supra note 38, at 27 et seq.
through cultivation not only all that is necessary to sustain life, but also many extremely important articles to undertake, as has been undertaken, extensive commerce and navigation. If these uncontestable advantages are to include those of industry and arts for clothing, luxury and other facilities, its inhabitants will become totally independent of the metropolis.

Consequently, it is absolutely necessary to put an end to all factories and manufactures in Brazil."45

It was not until Napoleon’s impending invasion of Portugal, and the flight of the Portuguese royal family from Lisbon to seek refuge in Rio de Janeiro in 1808, aided by the British navy, that the colonial pact effectively came to an end. In what was the first and only time in history in which a colony became the headquarters of a European royalty, legal and institutional change became a practical imperative to accommodate the needs of the thousands of members of Portugal’s monarchy and bureaucracy that had moved to colonial Brazil.46 Only eight days after arriving in Brazil, the regent prince of Portugal put an end to its previous monopoly to Brazil’s international trade, hence opening Brazil’s ports and permitting it to directly trade with “friendly nations” – which meant, for most practical purposes, England.47 Just a few months later, Portugal abolished colonial prohibition on indigenous industries and manufactures in Brazil.48

45 Aviso (Notice) (Jan. 5, 1875).

46 Historians estimate that between 10,000 and 15,000 members of Portugal’s royalty and bureaucracy immigrated to Brazil around late 1807. See Boris Fausto, História Concisa do Brasil [Concise History of Brazil] 66-7 (2nd ed., 2008).

47 Alvará [Royal Decree] (Jan. 28, 1808), usually known as the royal charter for the “opening of Brazilian ports to friendly nations.” See also Waldemar Martins Ferreira, As Diretrizes do Direito Comercial Brasileiro [The Guiding Principles of Brazilian Commercial Law] 42 (1933) (noting that the regent prince pursued this path following the advice of economist and commercial law scholar José da Silva Lisboa, later Viscount Cairu).

48 Alvará [Royal Decree] (Apr. 1, 1808).
The year of 1808 also saw the creation of the very first Brazilian corporations – the first Bank of Brazil and an insurance company – by royal decree.\textsuperscript{49} This first Bank of Brazil (Banco do Brasil) was created eight years after the Bank of France and modeled after the Bank of England, with the goal of issuing the requisite currency to finance the monarchy’s expenses and develop indigenous trade and industry. The plan was to have the Bank entirely funded by private capital. Nevertheless, as the Bank initially failed to attract sufficient investor interest,\textsuperscript{50} the Portuguese royalty tried to lure additional investors by expending political favors, which ranged from royal titles to public offices, in exchange for share subscriptions. Substantial investor demand did not arise until the Bank started paying generous dividends (albeit of dubious origins) in addition to the governmental rewards.\textsuperscript{51} When the king of Portugal finally returned to Lisbon in 1821, he brought with him all of the Bank’s metal reserves. Still, the Bank remained largely profitable to its shareholders until 1827, and was ultimately liquidated upon the end of its initial twenty-year term in 1829.\textsuperscript{52}

\textsuperscript{49} Decreto [Decree] (Feb. 24, 1808) (chartering the Companhia de Seguros Boa-Fé, an insurance company); Alvará [Royal Decree] (Oct. 12, 1808) (chartering the Banco do Brasil). For a detailed description of the establishment of the First Bank of Brazil, see Chapter IV infra.

\textsuperscript{50} The subscription of the first 100 shares necessary for the inauguration of the Bank’s activities as required by its charter took 14 full months. The fact that insurance firms were growing rapidly during the same period suggests that the dearth of Bank investors was more due to the looming prospect of governmental expropriation than to cultural resistance to stock ownership. Elisa Müller & Fernando Carlos Cerqueira Lima, \textit{Moeda e Crédito no Brasil: Breves Reflexões sobre o Primeiro Banco do Brasil (1808-1829)} [Currency and Credit in Brazil: Brief Reflections About the First Bank of Brazil (1808-1829)], available at http://www.revistatemalivre.com/MoedaCredito.html (noting that, by 1815, the first four local insurance companies had attracted subscriptions in the amount of 2,000 contos de réis, compared to the 581 contos de réis directed to the Bank of Brazil).

\textsuperscript{51} It was not until 1817 that investors would have subscribed the entirety of the Bank’s initial capital of 1,200 réis, ending what was the first and most protracted share offering in Brazilian history. \textit{See AFONSO ARINOS DE MELO FRANCO, HISTÓRIA DO BANCO DO BRASIL} [History of the Bank of Brazil], VOL. I, 36 (1973).

\textsuperscript{52} Müller & Lima, supra note 50 (noting that shareholders earned an average return of 14.4% a year between 1815 and 1827).
A few other corporations were chartered by royal decree during the colonial period.53 Some of these charters were remarkably brief as well as silent as to the company’s internal governance structure. Others were longer and contained idiosyncratic provisions that addressed Brazil’s then prevailing economic and political structure.

The incorporation of the Companhia de Mineração de Cuyabá, a mining company, in 1817 is illustrative in this regard.54 As was then common in the U.S., the company offered to the Royal Treasury two shares entirely free of charge in exchange for a corporate charter.55 Most of its charter provisions were however particularly tailored to local circumstances and preferences.

The prominent role of slavery in the Brazilian economy was evident from the corporation’s capital structure. Each share subscription in the company was to be paid through the delivery of 100$000 in currency in addition to two duly suited and equipped slaves to work in the mining operations.56 Shareholders could not withdraw their capital contributions (including cash and slaves) during the company’s 30-year term, but could sell their shares to third parties provided that existing shareholders did not exercise their right of first refusal.57

The company’s internal governance structure was also peculiar. Its board of directors was composed by the twelve shareholders that “deserved greater respect from

53 See note 114 infra and accompanying text.

54 Carta Régia [Royal Charter] (Jan. 16, 1817).

55 Carta Régia [Royal Charter] (Jan. 16, 1817), Art. I. See Chapter V, Part II, for a description of the influence of the government’s financial interest in chartering decisions in the early nineteenth-century U.S.

56 Id., Art. XVI.

57 Id., Art. XV and XVII.
the local Governor (Governador e Capitão General),” with preference among those to be
given to shareholders that held a high number of shares and were present in Cuyabá –
thus rendering the economic interest in the company subordinate to political expediency
with respect to the allotment of board seats. A board of managers was composed of the
four most able directors, who would serve for an initial term of three years.58 Such
managers were exempted from military service and other public functions.59 The
Company’s charter also specified long-term performance incentives for employees, by
specifying that the administrators that received favorable recommendations for good
work from the board of managers after a period of eight years would be entitled to two
shares upon the delivery of two slaves without the payment of any additional premium.60

Brazil’s independence took place soon after the return of the Portuguese royal
family to Lisbon in 1821, which ignited local fears of recolonization. In sharp contrast to
its Latin American neighbors, which endured bloody independence wars, Brazil’s
emancipation process could hardly have occurred in a more conciliatory manner. The
very prince of Portugal declared Brazil’s independence and became the country’s new
emperor, in a move that combined the interests of the rural aristocracies and the absolutist
aspirations of the prince.

Unlike other countries in Latin America, Brazil retained territorial unity and
adopted a constitutional monarchy, rather than a republican government, after
independence. The local elite promoting independence had no interest in changing the

58 Id., Art. VI.
59 Id., Art. XII.
60 Id., Art XXII.
institutions of the colonial period.\(^{61}\) In this vein, an 1823 statute made clear that Brazil’s legal system remained otherwise entirely unaffected until the enactment of local legislation.\(^{62}\)

Throughout most of the colonial period, the laws of Portugal and Brazil alike were those of the Philippine Ordinances of 1603, based on Roman and Canon law.\(^{63}\) In 1769, however, the sources of Portuguese commercial law – and, accordingly, Brazilian law – became much more diverse. In that year, Portugal, under the influence of the Enlightenment, enacted what would be later called the “Law of Good Reason” (Lei da Boa Razão), which, among other things, ruled out Roman law’s authority as a subsidiary source of law in commercial matters.\(^{64}\) In its place, the Law of Good Reason directed courts to apply the laws of other “enlightened and polished Christian nations” to resolve commercial disputes in the absence of local rules. This habitual use of foreign legal sources, whether or not authoritative, to resolve domestic legal disputes would become a feature of Brazilian civil and commercial law for years to come.\(^{65}\)

---

\(^{61}\) FAUSTO, supra note 46, at 79.

\(^{62}\) Law of October 20, 1823. The statute made clear that all Portuguese laws as of April 25, 1821, which included the Philippines Ordinances and the Law of Good Reason, would continue to apply in Brazil until the enactment of national codes.


\(^{64}\) Law of August 18, 1869. See José Carlos Moreira Alves, A Panorama of Brazilian Law from its Origins to the Present, in A PANORAMA OF BRAZILIAN LAW 89 (Jacob Dolinger & Keith S. Rosenn eds., 1992) (attributing the enactment of the Law of Good Reason to the Enlightenment’s criticism to the excessive reliance on Roman Law).

\(^{65}\) This trend persists up to this day. Clovis do Couto e Silva, a prominent civil law jurist, coined the term “bartolism” to describe this form of reliance on legal doctrines from various different legal systems; this term is a reference to Roman law jurist Bartolo, whose opinions were a subsidiary source of law to fill in gaps in the Philippine ordinances. Clovis do Couto e Silva, O Direito Civil brasileiro em perspectiva histórica e em visão de futuro [Brazilian Civil Law in historical and future perspective], 40 REVISTA AJURIS 128 (1987). See also JUDITH MARTINS-COSTA, A BOA-FÉ NO DIREITO PRIVADO [Good Faith in
The Law of Good Reason provided no guidance for judges in choosing among the different laws of “civilized” nations, therefore granting local courts significant leeway in choosing their favorite solution depending on the interests at stake. An influential commentator noted that, in principle, the laws of any European country other than Turkey could become immediately eligible for import. The result is that, from the Law of Good Reason onward, foreign legal transplants in commercial law matters were not only explicitly welcome, but their sources were also multiple, as well as potentially conflicting. Whether by accident or intentional design, the existence of a large array of foreign law menus, and the ensuing possibility of arbitrary transplant choice, would subsist as a distinctive feature of Brazilian business law for years to come.

Under the Law of Good Reason regime, Brazilian judges picked and chose among the laws of different nations as they saw fit. France and England were the most influential foreign sources, but the laws of Spain, Portugal, and other European jurisdictions also applied at times. Because the laws of different “cultivated” jurisdictions varied substantially, the resulting uncertainty was a key motive behind the subsequent enactment of Brazil’s Commercial Code. Legislators cited the “shocking

---

Private Law] 241-246 (tracing the historical roots of bartolism and interpreting the phenomenon as an attempt to reconcile the tension between universal and regional interests).

66 JOSÉ HOMEM CORREA TELLES, COMMENTARIO CRÍTICO À LEI DA BOA RAZÃO [Critical Commentary to the Law of Good Reason] (1865). Telles, an influential commentator of the statute defined civilized nations as any European country other than Turkey, and resented the potential for arbitrary court decisions. Id. at 64.

67 Id.

amount of contradictory decisions” under the Law of Good Reason as “the worst evil that a nation could suffer from.”69

The notion that Brazilian jurists were inclined to resort to English as well as French law defies deep-seated assumptions of comparative lawyers, but it should not be all that surprising considering England’s economic clout in the region throughout the nineteenth century. England’s economic influence in post-independence Latin America dwarfed that of other European countries. Between 1860 and 1875, Britain accounted for more than 90% of investments by foreign enterprise in the region.70 Historians have long argued that the main consequence of Brazil’s independence was to make it a de facto British colony, rather than a Portuguese one – a view which was widely shared among contemporary observers.71

English predominance in Brazil, in particular, was also a function of its historically close relationship with Portugal, which afforded it preferential tariff and legal treatment. At least since the late seventeenth and early eighteenth centuries Portugal granted legal privileges to England, which included special courts conferring extraterritorial rights for its citizens in Portuguese territory – an institution that was

69 Senate Records, speech of Senator Clemente Pereira (May 27, 1848), at 276.

70 See ANA CÉLIA CASTRO, EMPRESAS ESTRANGEIRAS NO BRASIL [Foreign Enterprise in Brazil], 1860-1913 (1979). Between 1860 and 1889, 111 of the 137 new foreign firms authorized to operate in Brazil were English. See FRANCISCO M. P. TEIXEIRA E MARIA ELIZABETH TOTINI, HISTÓRIA ECONÔMICA E ADMINISTRATIVA DO BRASIL [Economic and Administrative History of Brazil] 86 (1989).

71 See, e.g., J.F. NORMANO, EVOLUÇÃO ECONÔMICA DO BRASIL [The Economic Evolution of Brazil] XII (1939) (claiming that “Brazil was during a long period a non-official member of Great Britain’s economic empire); GILBERTO FREYRE, INGLESES NO BRASIL [The English in Brazil] 77 (1948) (arguing that “the abolition of the apparent colonial system was no more than a mere change in the identity of the metropolis; Brazil ceased to depend on Portugal to become an English colony”); SALOMÃO FILHO, supra note 38, at 63 (noting the substitution of political metropolis, Portugal and Spain, for economic metropolis, England, in nineteenth-century Latin America). See also Senate Records, speech of Senator Vasconcellos (Jan. 18, 1850), at 249 (arguing that, following independence, “we passed a jury statute, as we under understood that, from Portuguese colonies, we turned from one day to another into English ones”).
extended to Brazilian territory in 1808. As a result of the close relationship between both countries, Portuguese law was itself heavily influenced by English law.\(^{72}\)

English presence in Brazil was such that it increasingly became a major rival of France in terms of cultural influence.\(^{73}\) Brazil’s first economist and commercial law scholar, José da Silva Lisboa (later Viscount Cairú), was an Anglophile and a self-declared disciple of Adam Smith, although his reading of the Scottish author’s lessons were tainted by his own worldview.\(^{74}\) Brazil’s first law schools, which supplied most of Brazil’s politicians during the nineteenth century, provided both French and English lessons,\(^{75}\) and taught French authors together with Jeremy Bentham and Stuart Mill.\(^{76}\) When the sixth edition of “Brazil and the Brazilians” came to press in 1866, the growing British influence among Brazilian politicians was clear. “Formerly their political theories were greatly influenced by French writers,” the authors noted, “but at the present time no

\(^{72}\) See Francisco José da Rocha, Sociedades em Comandita Segundo o Código Comercial do Império do Brasil 40-42 [Limited Partnerships according to the Brazilian Commercial Code] (1884) (noting that, “in commercial matters, Portugal had become used to take as a model its best friend, England, the sovereign of the seas and commerce, as she was dubbed”). See also notes 98 and 99 and accompanying text.

\(^{73}\) Id.

\(^{74}\) See José da Silva Lisboa (Visconde de Cairú), Princípios de Economia Política [Principles of Political Economy] (1804) (eulogizing Adam Smith and claiming to follow its lessons, while asserting that “[t]he principle of political economy is that the nation’s sovereign must consider itself as the head or chief of a vast family, and consequently support all of those in it as its children and collaborators to total happiness”) (cited by Caldeira). See also Jorge Caldeira, Mauá: Empresário do Império [Mauá: The Entrepreneur of the Empire] 120 (30th ed., 1993), for a detailed analysis of Cairú’s peculiar misinterpretation of Smith’s theories.

\(^{75}\) See note 240 infra and accompanying text.

\(^{76}\) Freyre, supra note 71, at 63.
foreigner so influences the minds of the younger and middle-aged Brazilian statesmen as John Stuart Mill.”

Brazilians increasingly studied English theories and embraced their customs. In addition to adopting tea, steak and potatoes, and water closets, a few Brazilians also emulated English business practices with considerable success. Historians attribute much of the success of Brazil’s legendary entrepreneur, Irineu Evangelista da Silva (later Baron and Count Mauá) – a self-made businessman who at some point controlled 17 firms and had amassed one of the greatest fortunes of the nineteenth century – to his experience as an apprentice of British firms from a very tender age. Mauá himself was astounded by the major differences between the Brazilian and the British impersonal way of doing business, and profited handsomely in following the latter.

Britain was by no means indifferent to the propagation of political and economic ideas to Brazil. Free trade ideals, including the Law of Comparative Advantage, were an integral part of its strategy to ensure captive demand and avoid future competition for industrialized products by convincing peripheral countries that commodity export was their “natural” vocation. Still, English influence on Brazilian law was arguably more a product of voluntary imitation than of external imposition. The Brazilian elite seemed eager, at least in principle, to emulate the nineteenth-century superpower, in the hope to

---


78 FREYRE, supra note 71.

79 CALDEIRA, supra note 74.
eventually achieve a similar status. By 1846, Brazilian legislators viewed contemporary France as no more than a “satellite of England.”80

It is not clear whether England had an interest in exporting its legal system in general, and its commercial laws in particular, to Latin America. To be sure, England’s significant commercial presence in the country made the serious deficiencies of Brazil’s judicial system a source of concern. Yet its initial reaction to this problem was not to encourage Brazil to reform its laws or improve its judicial system – even though England was hardly timid in pressing for domestic legal reforms in Brazil when this suited its interests.81 Instead, the British government ensured that its citizens had access to separate – and especially friendly – courts altogether. In exchange for British support in the Napoleonic war, Portugal agreed to extend its special extraterritorial courts for British citizens – the so-called the “Office of Judge Conservator of British Nation” (Juiz Conservador da Nação Britânica) – to Brazilian territory as well, a privilege which lasted until 1831.82

In fact, to the extent that the deficiencies in Brazilian law hindered the development of local financial markets, they did not constitute a commercial handicap for the English, but rather a competitive advantage. Access to cheap financing through London’s capital markets gave English merchants operating in Brazil a significant competitive edge compared to their local counterparts, who lacked impersonal financing.

---

80 Senate Records, speech of Senator Paula Souza (Aug. 12, 1846), at 414.

81 After a long period of local resistance, and the issuance of multiple threats, Britain eventually succeeded in persuading Brazil to abolish slave trade, for both economic and humanitarian reasons. See, e.g., E. BRADFORD BURNS, A HISTORY OF BRAZIL 128-9 (1970).

sources of any kind at least through the mid-nineteenth century.\footnote{CALDEIRA, \textit{supra} note 74, at 131-2.} The restrictive stance towards incorporations in Brazil discussed in Part IV likely benefited England, as it widened the financing gap even further. When the Companies Act of 1855 and 1862 liberalized the incorporation process and offered limited liability to joint-stock banks, many entrepreneurs rushed to form corporations in England and operate them abroad.\footnote{\textit{See} RORY MILLER, \textit{BRITAIN AND LATIN AMERICA IN THE NINETEENTH AND TWENTIETH CENTURIES} 130 (1993) (noting that soon after the Companies Act of 1862 permitted the formation of joint-stock banks of limited liability, several British banks were incorporated to operate abroad). \textit{See also} note 70 \textit{supra} and accompanying text.}

### III. Adopting a Commercial Code (1850)

Brazil’s first Constitution of 1824 prescribed the urgent adoption of civil and criminal codes.\footnote{Constituição Política do Império do Brazil [Political Constitution of the Empire of Brazil] (1824), art. 179, XVIII. Brazil’s Civil Code would not be enacted until 1916, that is, 92 years after the constitutional command.} The nation’s first Criminal Code was enacted in 1830.\footnote{PONTES DE MIRANDA, \textit{FONTES E EVOLUÇÃO DO DIREITO CIVIL BRASILEIRO} [Sources and Evolution of Brazilian Civil Law] 488 (1928) (noting that the Criminal Code, which was “quite severe,” was not a plain copy of the French model, which it altered, “partially due to Bentham’s influence, partly on its own account”).} Nevertheless, unlike other civil law jurisdictions (including France, where the \textit{Code civil} of 1804 paved the way for the \textit{Code de commerce} of 1807), Brazil’s commercial codification preceded its civil counterpart by a staggering 66 years.\footnote{Brazil’s Commercial Code was enacted in 1850. By contrast, a first draft of a Civil Code was submitted to the legislature in 1854, but Brazil’s first Civil Code was not enacted into law until 1916.}

The early impetus for the adoption of a Brazilian Commercial Code came from the chaotic state of affairs under the Law of Good Reason, and the uncertainties it
generated among merchants, an argument consistently made in the legislative debates preceding the Code’s adoption. In rebutting critics, an advocate of the Commercial Code argued that “the lack of a civil code should not lead us to refrain from adopting a commercial one, which is so highly requested.”

Indeed, the first initiative for the enactment of a Commercial Code in Brazil dated back to as early as 1809, when commercialist José da Silva Lisboa (later Viscount Cairú) was commissioned to draft such a codification, which however did not come into being.

Berkowitz et al. have described the adoption of the Brazilian Commercial Code as an instance of automatic and wholesale borrowing of French law without regard to local needs and circumstances. However, the backdrop of the enactment of Brazil’s Commercial Code – which followed numerous parliamentary debates, copious amendments, and a “blizzard of petitions” from commercial associations – could hardly have been more different from this stereotype. After lingering in Parliament for nearly two decades, the Commercial Code was finally enacted in 1850, not coincidentally

88 Senate Records, speech of Senator Clemente Pereira (session of May 15, 1846), at 66.

89 Brasílio Machado, Código Commercial do Brasil: Subsídios Históricos da sua Formação [The Brazilian Commercial Code: Historical Bases of Its Formation], 17 REVISTA DA FACULDADE DE DIREITO DE SÃO PAULO 1, 11 (1909) (noting that this first Commercial Code was commissioned as soon as the newly formed merchant courts were established in 1809). See note 74 supra and accompanying text on Viscount Cairú.

90 Berkowitz et al, supra note 25.

91 W. R. Swartz, Codification in Latin America: The Brazilian Commercial Code of 1850, 10 Tex. Int’l L. J. 347, 353 (1975) (quoting a remark by a House representative to the effect that that “there are so many amendments to this Code that they are the Code”).

92 Eugene Ridings, Business Interest Groups in Nineteenth-Century Brazil 286 (1994) (describing the significant involvement of commercial associations of Rio de Janeiro, Bahia, and Pernambuco in the legislative process preceding the Code’s adoption, with the latter petitioning six different times in seven years). The Senate’s legislative records contain multiple references to the significant pressure that various commercial associations then exerted for the adoption of a Commercial Code. See, e.g., Senate Records, speech of Senator Clemente Pereira, (session of Aug. 9, 1848), at 185.
the year of Brazil’s first minimally effectual statute prohibiting transatlantic slave trade.\textsuperscript{93} The abolition of slave trade was bound to release massive amounts of capital from its prior use, which entrepreneurs then sought to redirect towards financial and industrial ventures.\textsuperscript{94}

The Brazilian parliament received its first draft of the Commercial Code in 1833. The stated objective of its draftsmen was to produce a Code that at the same time reflected the benefits of international legal convergence and the importance of attending to particular local circumstances. In their words, “the Commercial Code shall be drafted under the legal principles adopted by merchant nations, in harmony with commercial uses and styles that gather under the same flag the peoples of the new and old world.”\textsuperscript{95} They argued, however, that “at the same time a Code should be suited to the special circumstances of the peoples for which it is designed.”\textsuperscript{96}

Brazil is said to have borrowed heavily from the Commercial Code of France (1808), Spain (1829), Portugal (1833) and the Netherlands (1838) to produce what local

\textsuperscript{93} Another statute outlawing slave trade had been enacted in 1831 exclusively to attend to English pressure, and was rarely enforced in practice. As time went by, international economic and moral pressure helped Brazil overcome the landowners’ resistance to the abolition of slavery. England, in particular, had a keen commercial interest in, and exerted significant pressure to, end slavery in Brazil. Burns, supra note 81, at 128-9.

\textsuperscript{94} See, e.g., Irineu Evangelista de Souza Mauá, Autobiografia: Exposição aos Credores e ao Público [Autobiography: Exposition to Creditors and the Public] (1942) (for a description of how Brazil’s leading entrepreneur of the time saw in the abolition of slavery the opportunity to channel old capital to industrial goals). See also, Buarque de Holanda, supra note 43, at 89.

\textsuperscript{95} J. X. Carvalho de Mendonça, Tratado de Direito Comercial Brasileiro [Treatise of Brazilian Commercial Law] V. 1 92 (1937). A similarly cosmopolitan view of commercial law was indeed prevalent in the nineteenth century. See Chapter III infra for a more detailed discussion.

\textsuperscript{96} Id.
commentators praised as the “first truly original commercial code in the Americas.” Rhetoric notwithstanding, this first draft was a close copy of the Portuguese code. Had it been adopted without modification, Brazil might well have fit into the existing stereotypes of careless borrowing of foreign law. Yet, not even a wholesale import of Portugal’s Commercial Code would have made Brazil’s commercial laws unambiguously French in origin or inspiration.

It is revealing that the Portuguese Commercial Code of 1833 was itself drafted in England. The cover letter to the Code by draftsman José Ferreira Borges, dated “London, June 8, 1833,” explicitly mentions his time in “exile.” As described in this document, the Code was influenced by the laws of Prussia, Flandres, France, Spain, England, Scotland, Russia and Germany, as well as by Italy’s draft code. English law’s influence on the Portuguese Commercial Code was particularly conspicuous. The Portuguese Code followed English law in not recognizing the limited partnership (comandita) as form of business entity, even though this business organizational form was prevalent in France at the time. Additional borrowings from English law included the very institution of the commercial jury, which Borges deemed to be “compatible with the current stage of Portugal.”

97 See also SPENCER VAMPRÉ, TRATADO ELEMENTAR DE DIREITO COMERCIAL [Elementary Treatise on Commercial Law], v. I (1922) (noting that the earlier South American Codes of Haiti (1829), Bolivia (1834), Paraguay (1844), Republica de S. Domingos [Dominican Republic] (1845) and Costa Rica (1850) were literal copies of either the French or the Spanish Commercial Codes). The commission in charge of drafting the Code presented an opinion in 1835 noting that Brazil would have “no reason to envy the laws of France, England, Portugal and Spain,” as its Code had “incorporated the best from all such codes and adapted them to Brazil’s circumstances.” Id. at 34.

98 See Part IV infra for an overview of the controversy surrounding the legality of limited partnerships in Brazil.

After many years, debates and amendments, not a single article of Brazil’s Commercial Code was a literal copy of the Portuguese model. The enactment of a Commercial Code was not deemed to be a technical matter, but a highly political one. The initial draft of the legislation moved around Senate and House committees for years, and since 1845 the parliamentary records contain numerous and lengthy debates about the relative merits of the Code’s adoption and the specifics of its provisions. The Code’s proponents had initially suggested a “global” vote on the draft, without detailed discussions about individual provisions, but this proposal was defeated. Some senators went as far as to advocate a separate discussion of individual provisions of the draft Code – a clearly impractical proposition given its more than 1,000 articles. The compromise solution was to put the different titles of the Code to separate processes of discussion, amendments and votes.

Despite the chaotic status quo, legislators did not take the need for commercial codification for granted. One representative of rural interests and fierce opponent of the proposed Code criticized the effort to override Brazil’s existing commercial jurisprudence. England, he argued, had the world’s “most industrious merchants,” but lacked such codification. He also repeatedly cautioned that his conservative party (the

---

100 Swartz, supra note 91, at 353 (also noting that, as enacted, Brazil’s Commercial Code contained 903 articles, less than half of the 1,860 articles of the Portugal’s Commercial Code).

101 Id. (noting that drafts of the legislation circulated in Senate and Chamber committees in 1835, 1836, 1837, 1839, 1843 and 1845).

102 The same was true with respect to civil codification, the constitutional mandate notwithstanding. As late as 1899, Inglez de Souza, a prominent scholar and draftsman of a project of Commercial Code (whose version however was never enacted), strongly resisted the enactment of a Civil Code. See Inglez de Souza, Convém Fazer um Código Civil? [Is it Desirable to Adopt a Civil Code?], 17 REVISTA BRASILEIRA 257 (1899) (arguing against the enactment of a Civil Code in Brazil).

103 Senate Records, speech of Senator Vasconcellos, at 234 (Aug. 11, 1848).
same of the Code’s proponents) would be to blame if the Commercial Code backfired, with detrimental consequences to future elections.104

Like its foreign counterparts, Brazil’s draft Commercial Code contained a specific section devoted to business corporations. Nevertheless, the country apparently could no longer wait for the adoption of the Code, so the emperor enacted Brazil’s first corporations law by decree in January 1849.105 The minister’s message preceding the enactment of the decree is illustrative of the continued force of the Law of Good Reason – and, consequently, of foreign laws – in shaping Brazil’s commercial law. He notes that “our legislation is silent in important respects as to economic and commercial matters: but given par. 9 of the Law of August 18, 1769 [the Law of Good Reason], which provides that in these cases there shall be resort to the laws of civilized nations; and given that the legislation of the former is uniform in requiring authorization for incorporations, there is no question that this is doctrine is, in the absence of a local rules, the law of the land.”106

The Council of State argued that incorporations without governmental approval were unlawful as well as unsound policy, considering what it saw as their inherent susceptibility to fraudulent and speculative ventures. In its opinion preceding the enactment of the decree, the Council of State cited the laws of several different

104 Id.

105 Decree 545 (Jan. 10, 1849). The authority of the Emperor to enact a corporations statute by decree was questionable – and was indeed explicitly questioned by Conselheiro Manoel Alves Branco in his dissenting vote in the Council of State, which argued that the matter required legislative action. See Resolution n. 172 (Jan. 3, 1849), in IMPERIAES RESOLUÇÕES DO CONSELHO DE ESTADO NA SECÇÃO DE FAZENDA [Imperial Resolutions of the Treasury Session of the Council of State], vol. II, 1845-1849 (1870) [hereinafter “Imperiais Resoluções da Seção de Fazenda do Conselho de Estado”], at 371.

106 Id. at 375.
jurisdictions, reasoning that the existence of limited liability and concerns about creditor protection, among other things,

“have induced the legislators of modern nations not to permit incorporations without previous governmental approval, and to respect freedom in the organization of other business associations.

England tolerates incorporations without governmental approval, but the members of such companies are jointly and severally liable in the absence of a chartering act by Parliament – an act which is usually so costly that there are companies who have spent more than 2 million cruzados to obtain one, as in the case of the railway company from Manchester to Liverpool.

The codes and statutes of commercial nations of the entire civilized world require prior authorization to incorporations: there can be no business corporations upon private agreement alone in France, Holland, Spain, Portugal, Sardinia, Napoli, Pontificate States, Russia and in the entire Germany.”

The Decree 545 of 1849 explicitly aimed at “establishing the rules for the incorporation of any sociedade anônima.” The decree imposed prior governmental authorization requirements to all incorporation, and required firms seeking special privileges to obtain special legislative charters. Under the decree, which was largely inspired by regulations issued by the French ministry of the interior in 1807 and 1817, the government had broad discretion in adjudicating charter petitions. The relevant factors for incorporation decisions under the decree included the likelihood that the firm will

---

107 Id. at 368.

succeed, “the qualities and morality of its subscribers,” and the “interests of industry in general.”

Corporate activity prior to obtaining the requisite governmental authorization resulted in joint and several liability of the firm’s directors and managers.

Banking corporations were subject to additional governmental supervision as well as to forced dissolution for failure to comply with legal requirements.

The backdrop of the 1849 decree was the recent upsurge in incorporations of state banks of emission, which the Imperial government sought to curtail by explicitly imposing governmental approval requirements. Brazil’s new incorporation statute, which on surface might have looked like a liberalizing and business-friendly move, was in reality less clearly so. To the dismay of some politicians, promoters had been organizing business corporations “spontaneously” – that is, with the approval of the executive alone and, in some cases, with no governmental approval at all. Few corporations existed in Brazil before 1849, but the instances of informal business

---

109 Decree 545 (Jan. 10, 1849), Art. 5.
110 Id., Art. 8.
111 Id., Art. 10.
112 The background behind this decree were consultations to the Council of State in 1847 and 1849 with respect to the legal status of state banks recently incorporated without governmental approval. See Consultation of May 28, 1847 (discussing the case of Banco da Bahia) and Resolution of Jan. 3, 1849 (discussing the case of Banco do Maranhão and proposing a decree establishing rules for the establishment of sociedades anônimas), both in Imperiais Resoluções da Seção de Fazenda do Conselho de Estado, supra note 105, at 218 and 366, respectively.
113 MARIA BÁRBARA LEVY, A INDÚSTRIA DO RIO DE JANEIRO ATRAVÉS DE SUAS SOCIEDADES ANÔNIMAS [The Industry of Rio de Janeiro through Its Business Corporations] (1994) (noting that, “while the Legislative did not act, corporations were formed in an arbitrary fashion and in a regime of almost complete irresponsibility”); J.X. CARVALHO DE MENDONÇA, TRATADO DE DIREITO COMERCIAL BRASILEIRO, vol. I 81 (4th ed., 1945) (arguing that Decree 545 was aimed at deterring abuses by the new banking enterprises that were beginning to appear).
formation and the surge in incorporations after the Code’s enactment suggests that their scarcity was due to legal hurdles, rather than a lack of demand alone.\textsuperscript{114}

As an attempt to deter the formation of local corporations and banks, this measure was likely detrimental to the country’s development. Bernardo de Souza Franco observed at the time that, despite the recent creation of Banco Commercial of Rio de Janeiro, Brazil’s economic center remained strikingly underserved by banking institutions. Before 1850, Rio de Janeiro had a population of 200,000, but only one bank with a capital of 2,500 contos de réis as restricted by its corporate charter. By contrast, New York City, with a population of approximately 312,000, had 24 banks with a capital of over 50,000 contos de réis.\textsuperscript{115} Commenting on Souza Franco’s findings, Carlos Manuel Pelaez and Wilson Suzigan have noted that “Brazil’s financial structure and economic activity were extremely backward both in relative and in absolute terms,” and that “one could hardly expect progress based on such limited financial and capital market.”\textsuperscript{116}

The Commercial Code, which came into effect in June 1850, maintained the State approval requirements for incorporations set forth by the 1849 decree. Mauá had pushed for free incorporation in his commission’s discussions, to no avail.\textsuperscript{117} That was a hard
sell at the time, since none of the other habitual foreign models, such as France, England, Spain, Portugal and Belgium, permitted full-fledged incorporations without prior governmental approval.\textsuperscript{118} England had since 1844 permitted the formation of joint-stock companies without specific authorization, but it still deprived them of limited liability.\textsuperscript{119} Only the United States had a large number of business corporations at the time,\textsuperscript{120} but even there general incorporation did not become the norm in most states until the late nineteenth century.\textsuperscript{121}

Brazil’s Commercial Code devoted only five articles to business corporations, which regulated their most basic features: (i) requisite governmental approvals, (ii) transferable shares, (iii) limited shareholder liability, (iv) publicity of constitutional documents, (v) causes for dissolution, and (v) unlimited management and director liability prior to the company’s registration.\textsuperscript{122} Scholars subsequently asserted that these provisions were an almost literal translation of the French Commercial Code.\textsuperscript{123} For

\begin{itemize}
  \item \textsuperscript{118} See supra note 107 and accompanying text for references to foreign jurisdictions prohibiting incorporation without governmental approval.
  \item \textsuperscript{119} England would not allow general incorporation with limited liability for most firms until the Companies Act of 1855-56.
  \item \textsuperscript{120} Richard Sylla & Robert E. Wright, Corporate Governance and Stockholder/Stakeholder Activism in the United States, 1790-1860: New Data and Perspectives, in THE ORIGINS OF SHAREHOLDER ACTIVISM (Jonathan G.S. Koppell ed., forthcoming 2011) (providing evidence that approximately 8,000 corporations had been chartered in the U.S. by 1830 and nearly 22,000 by 1860). France, by contrast, had incorporated only about 700 firms by 1860. Prussia had just about 300 by 1871, a figure that the U.S. surpassed around 1800. \textit{Id}.
  \item \textsuperscript{122} Law 556 (June 25, 1850) - Codigo Comercial Brasileiro [Brazilian Commercial Code], Arts. 295-299.
  \item \textsuperscript{123} Candido Luiz Maria de Oliveira, Curso de Legislação Comparada [Course on Comparative Legislation] 37 (1903).
\end{itemize}
example, Alfredo Lamy Filho and José Luiz Bulhões Pedreira, prominent Brazilian jurists and draftsmen of Brazil’s Corporations Law of 1976, stated that Brazil’s Commercial Code followed the French Code de commerce in dedicating five provisions to business corporations.\(^{124}\) Apart from the fact that the French Code in fact contained 11 articles on *sociétés anonymes* alone, the differences between the laws of business organizations of both countries would prove to run far deeper.

The apparent similarities in statutory language should not imply that Brazil’s newly adopted regime was a mirror image of legal developments in France or elsewhere in continental Europe. Brazil’s ruling elites were generally skeptical of incorporations, banks, and industrial ventures, and often found France’s relatively hostile approach to business organizations too permissive. As discussed in greater detail in Part IV below, to the extent that the French-inspired legal regime still left margins for financial development, Brazilian officials quickly acted to shut them down. Specifically, Brazil deliberately chose to withdraw the availability of tradable limited partnerships, an organizational substitute to incorporations provided and widely employed under French law.

By contrast, when it came to imposing rigorous governmental approval and oversight requirements over corporate affairs, Brazil followed France’s overly stringent legal practice rather strictly. The few and modest legal rules specified in the Commercial Code could misleadingly imply that Brazilian business corporations had significant leeway in tailoring their internal affairs and governance regime. Quite the opposite was

---

true, however, since Brazil’s Council of State, like its French counterpart, consistently conditioned its approval to chartering requests on the adoption of specific internal governance rules.

One area in which the Council of State consistently shaped corporate governance rules was that of shareholder voting rights. Even though Brazil’s Commercial Code was silent in this regard, entrepreneurs were not able to craft voting rules of their choosing. Instead, the Council of State typically conferred relatively greater voice to small over large shareholders by capping the number of votes any given shareholder could cast irrespective of his or her equity interest in the firm. The Council of State typically imposed voting ceilings of 30 or 15 (or fewer) votes per shareholder, even when the draft charter submitted for its consideration provided for proportional voting. For instance, in authorizing the incorporation of Banco Nacional, the government amended the draft charter to reduce the existing cap from 200 to 15 votes per shareholder. In denying a request from the Banco Commercial do Rio de Janeiro to loosen the existing voting

---

125 Voting caps were well-nigh universal among early nineteenth-century French corporations as a result of similar demands by the Conseil d’Etat. For a description of the role of Conseil d’Etat in shaping voting and other governance rules of French corporations in the nineteenth century, see Anne Lefebvre-Teillard, La société anonyme au XIXe siècle (du code de commerce à la loi de 1867 – histoire d’un instrument juridique du développement capitaliste [The business corporation in the 19th century (From the Commercial Code to the law of 1867: History of a legal instrument for the development of capitalism)] 370-1 (1985) (noting that sociétés anonymes formed under the Code de commerce in the first part of the 19th century contained stringent caps of four of five, or even less, votes per shareholder and that it was not until the 1850s that the Conseil began to regularly admit comparatively more flexible maximums of 10 or 20 votes per shareholder).

126 The charter of Banco do Brasil, for instance, granted one vote per each lot of 20 shares, and capped at 15 the number of votes per shareholder (for himself or by proxy). Decree 1,223 (1853). The Companhia de Seguros Marítimos Esperança, a maritime insurance company, provided one vote per lot of five shares, subject to a limit of four votes per shareholder. Decree 3,880 (1867).

127 See, e.g., Resolution of March 8, 1870, in Resoluções da Seção de Fazenda do Conselho de Estado, supra note 105, vol. IX, at 236.

128 Decree 4,819 (1871).
maximum from 20 to 40 votes per shareholder, the Council of State noted that “the proposed maximum is excessive and at odds with the regime adopted in the almost totality of charters of associations of the same nature, and of others of lesser scale.” It reasoned that such maximum-vote provisions are designed to avoid “the inconveniences that could result from the great preponderance in elections and other important decisions in favor of a small number of shareholders to the detriment of most interested parties only because the latter, if individually considered, hold a smaller quantity of shares.”

As a result of the Council of State’s policy towards shareholder voting rights, the vast majority of Brazilian corporations chartered between 1850 and 1882 were subject to regressive voting schemes. In a comparative study of nineteenth-century voting restrictions, Henry Hansmann and I have found that only 4 (or nearly 3%) of a sample of 147 corporations chartered in Brazil during this period granted voting rights in direct proportion to share ownership. Roughly 90% of corporations in the sample were subject to stringent voting caps and several more either specified a graduated voting scale or went as far as to limit the number of shares any shareholder could hold.

---

129 Resolution of Nov. 30, 1878 (on the reform of certain charter provisions of Banco Commercial do Rio de Janeiro, in Imperiais Resoluções da Seção de Fazenda do Conselho de Estado, supra note 105, at 236.


131 See, e.g., the charters of Companhia União e Indústria (railroad), granting one vote to shareholders holding between five and 10 shares, one vote for each 10 shares up to 50 shares, and one vote for each lot of 50 shares beyond that (Decree 1,355 of Feb. 18, 1854) and of Companhia Pernambucana (steam navigation), providing for one vote per lot of 10 shares for the first 50 shares and one vote per lot of 30 shares beyond that (Decree 1,1413 of July 15, 1854).

132 Most companies limiting the number of shares any shareholder could hold were mutuals. See, e.g., the charters of Companhia de Seguros Contra Incêndios – Interesse Público (fire insurance), granting one vote to holders of up to 6 shares and 2 votes to holders of 7 shares or more, but capping at 20 the number of shares any shareholder can hold. Decree 1,151 (Apr. 13, 1853); Companhia de Seguros “Paraense” (fire and maritime insurance), providing that no shareholder can hold more than 20 shares. Decree 6,837 (1878).
These restrictions to the voting rights of large shareholders may come as a surprise to an observer in the twentieth or twenty-first century, as proportional voting rules (one-share, one-vote) or even progressive voting rules conferring greater voting rights to major shareholders (through the issuance of non-voting or multi-voting stock) gradually became the norm. Nevertheless, restricted voting schemes were common, if not universal, in a number of jurisdictions in the twentieth century. As Colleen Dunlavy has prominently noted, regressive voting was commonplace in the early-nineteenth century U.S., as well as in the U.K., France and Germany – a practice which she attributed to an early “social conception of the corporation” that was more “democratic” than the “plutocratic” conception that would become dominant in the twentieth century.\textsuperscript{133} Other economic historians, such as Eric Hilt and Aldo Musacchio, have suggested that voting restrictions were effectively contractual mechanisms that operated to protect small shareholders from abuse by large shareholders in light of a rudimentary legal system that afforded insufficient investor protection.\textsuperscript{134} Aldo Musacchio, in particular, has shown that corporate charters of early twentieth-century corporations in Brazil often included regressive voting schemes – a phenomenon that he interpreted as evidence of how


“contracts” effectively served as a surrogate for low levels of legal investor protection to minority shareholders.\(^{135}\)

Nevertheless, Musacchio’s analysis – which is limited to the late nineteenth and early twentieth centuries – overlooks that a good part of such charter provisions were not the product of pure contract among shareholders and managers, but rather remnants of a prior period in which the Imperial government customarily imposed restricted voting clauses as a condition for incorporation. While Musacchio attributes the development of Brazil’s capital markets in the late nineteenth and early twentieth century to such regressive voting provisions, it seems that the opposite was true. As explained in greater detail elsewhere, the incidence of voting restrictions declined sharply just as companies were given a choice as to voting rules following the liberalization of the incorporation process in Brazil, which prompted the expansion of the country’s capital market.\(^{136}\)

Voting rights provides perhaps the best, but not the only, example of government intervention in internal governance rules between 1850 and 1882.\(^{137}\) Virtually all types of internal affairs rules were subject to governmental scrutiny and modification,

\(^{135}\) Musacchio, *Law Versus Contracts*, supra note 134, at 449 (“in many Brazilian corporations, voting-rights provisions, particularly maximum-vote provisions and graduated voting scales (whereby fewer votes are assigned to shareholders as their shareholdings increase), balanced the relative voting power of small and large investors. In contrast, investor protections embedded in national laws were weak and thus not very helpful in the development of Brazilian equity markets”).

\(^{136}\) Hansmann & Pargendler, supra note 130, at 41 (providing new data on Brazilian corporate charters and concluding that “similarly to other jurisdictions, the use of voting restrictions in Brazil declined sharply precisely at the same time as capital markets developed in the late nineteenth and early twentieth century, suggesting if anything an inverse correspondence between the use of voting caps and the ability of corporations to raise capital in financial markets”).

\(^{137}\) Governmental interference in internal governance rules were however limited to companies incorporated in Brazil. While foreign firms needed State approval to operate in the country, the government in that case faced a binary choice of either rejecting such applications or approving them without amending the terms of foreign charters. Decree 2,711 (1860), Art. 46, § 1. The result is that, while most Brazilian corporations were subject to voting restrictions, English companies operating in Brazil were free to adopt, and most often did adopt, proportional voting rules. Hansmann & Pargendler, supra note 130, at 33.
notwithstanding the absence of statutory guidance in the Commercial Code. The
government at times increased the minimum share denominations, so as to avoid
investments (and, arguably, losses) by the lower classes. 138 It often increased minimum
quorums for shareholder meetings and decreased minimum equity ownership
requirements for directors. 139 Still, these restrictions to contractual freedom in tailoring
governance provisions (even if sometimes misguided) paled in comparison to the
difficulty in obtaining a corporate charter.

IV. New Hurdles to Financial Development (1851-1881)

At least in relative terms, incorporations soared following the enactment of the
Commercial Code. Between 1850 and 1852, 13 new firms were incorporated in Brazil,
which was more than in the previous 40 years combined. 140 Established by the
government in 1845 to mainly trade in public bonds, the Rio de Janeiro Stock Exchange
saw a 460% increase in its trading volume in the two years following the enactment of
the Code. 141

138 See Consultation of Dec. 3, 1857 (regarding request for incorporation of Banco da Bahia), in Resoluções
da Seção de Fazenda do Conselho de Estado, supra note 105, vol. IV, at 238 (advising that the par value of
the stock be increased from 100 thousand réis to a a minimum of 200 thousand réis because “shares of too
low par value provide the inconvenient of attracting and absorbing the savings of the needier classes, and of
encouraging them to gamble”). Id. at 242.

139 See, e.g., Decree 6,865 (1878) (incorporation of Companhia Estrada de Ferro Barão de Araruama),
(amending the draft charter to reduce the ownership requirement to call shareholder meetings from one-
fifth to one-tenth of total capital; Decree 4,819 (1871) (incorporation of Banco Nacional) (amending the
draft charter to decrease the share ownership requirement for directors from 500 to 100 shares).

140 See Business Associations Authorized to Operate in Brazil, supra note 114.

141 Id. See also, MARIA BÁRBARA LEVY, HISTÓRIA DA BOLSA DE VALORES DO RIO DE JANEIRO 75 [The
History of the Rio de Janeiro Stock Exchange) (1977) (describing the rise in the number of traded
companies from three in 1850 to eight in 1852).
The first signs of financial development did not go unnoticed by conservative politicians. The backlash against incorporations and banks did not reflect populist resistance against big business, monopoly, or high interest rates, as was the case in the United States, but targeted instead competition and cheap financing. By 1853, politicians argued that high interest rates, a sign of “public prosperity,” stood for “industrial development, the country’s progress, and the people’s faith in the government.” Financial monopoly and high cost of capital were, in this view, not the problem, but the solution.

Brazil was of course not alone in displaying deep suspicions of corporations and banks in its earlier (and, to some extent, also later) history. Most countries faced significant anti-corporate sentiment in one form of another, although the precise nature of the objections raised against the corporate form varied widely.

Hostility against corporations was particularly pronounced in the U.S. prior to the Civil War. Anti-corporate sentiment in the U.S. was a product of the direct association between corporations and monopoly, since the grant of a corporate charter was construed during most of this early period to imply monopoly rights with respect to the underlying activity. This type of criticism however dissipated as states liberalized their chartering policies and eliminated monopoly rights. The upshot is that business corporations flourished in the U.S. like nowhere else during the nineteenth century.

---

142 Records of the Chamber of Deputies, speech of Sr. Viriati (session of June 11, 1853), at 158.


145 Sylla & Wright, supra note 120.
In other countries, notably France and England, suspicion of business corporations had deeper historical roots, tracing back to the eighteenth-century debacle of John Law’s Mississippi Company in France and of the South Sea Company in England. In this light, the main problem associated with business corporations was their propensity for crisis and the risk of fraudulent ventures. Monopoly was less of a concern, especially because under the French post-Revolutionary model (in which respect Brazil followed) the grant of a corporate charter did not automatically confer any monopoly rights. Nevertheless, while concerns with monopoly could be overcome by easing entry through a greater supply of corporate charters, concerns about crises required governmental restrictions to incorporations. It was precisely the latter approach – inspired by English and especially French anti-corporate rhetoric – that ultimately prevailed in Brazil for the most part of the nineteenth century, despite the opinions of corporate defenders to the contrary.

Moreover, the controversy surrounding business incorporations in Brazil was also intertwined with the lively and enduring political debate about monetary policy and the role of banks of emission. In the 1850s, in particular, Brazilian politicians once again


147 For prominent works defending the benefits of incorporations to economic development and condemning the government’s restrictive policies, see MAUÁ, supra note 94; JOSÉ ANTONIO PIMENTA BUENO, DIREITO PÚBLICO BRASILEIRO E ANÁLISE DA CONSTITUIÇÃO DO IMPÉRIO 408 (describing the existing procedures to obtain a corporate charter as “long and humiliating,” resulting in “the subordination of all national development” to the government). In this work, Pimenta Bueno defended the adoption of a regime of general incorporation, noting the benefits of business corporations to the U.S. economy, despite occasional crises. Id. at 409.
resurrected the traditional British nineteenth-century debates about the desirability of adopting the gold standard. In the tropics, the two sides of the debate were represented by metalistas, who sought to restrict the money supply through a strict adherence to the gold standard, and papelistas, who favored credit expansion.148 Both camps had read extensively about the English debate, and habitually quoted their English counterparts.149

The first assault on Brazil’s embryonic financial system by orthodox metalistas came in 1853 with the nationalization and merger of Brazil’s major banks – Banco Commercial and the second Banco do Brasil – to form yet another, state-controlled, Bank of Brazil. Commercial associations of Rio de Janeiro had formed Banco Comercial in 1838.150 Mauá enthusiastically established the Banco do Brasil in 1851. In a speech extolling the virtues of his new enterprise, Mauá cited the recent experience of the U.S. and Britain, and claimed that the “spirit of association” epitomized by the bank’s incorporation was “one of the strongest elements of prosperity in any country” and “the soul of progress.”151

The establishment of the second Banco do Brasil was meant to institute a monopoly of issue under a national bank following the model of the Bank of England.152 This new state-run but privately-owned monopoly attracted significant investor interest.


149 Villela, supra note 148, at 86 (noting that “some of the major tenets of the Currency school vs. Banking school controversy – such as the currency principle and the needs of trade doctrine – were repeated as undisputed truths”).

150 The bank’s incorporation, however, not officially approved until 1842. See Decree 187 (1842).

151 CALDEIRA, supra note 74, at 226.

152 PELAEZ & SUZIGAN, supra note 116, at 78.
Buyer orders exceeded by more than three times the number of shares offered, which were then placed according to political connectedness, not market forces.\(^{153}\) The new list of shareholders was a “who’s who” of Brazil’s political elite; members of the Brazilian and Portuguese royalty received the largest lots of 100 shares each. Attractive compensation made directorships in the new bank highly attractive, and an open battle for board appointments ensued.\(^{154}\) Following the merger, Banco do Brasil’s credit was primarily directed to rural oligarchs.\(^{155}\)

Mauá had been elected as a director of the new bank, but refused to serve. Dissatisfied with the new monopoly, he was determined to find ways around it. A new banking enterprise would require numerous investors, but he feared, quite naturally, that governmental approval to another bank charter would not be forthcoming after the recent State takeover. Indeed, a number of requests for incorporation of new banks following the establishment of the new Banco do Brasil were rapidly dismissed by the Council of State, which reasoned that, given the numerous administrative burdens imposed on the Banco do Brasil, “the creation of new competitors, which will limit its profits, shall not be authorized in the absence of widely recognized need.”\(^{156}\) In denying a petition for the chartering of a bank to be established in Porto Alegre, the Council argued that it would be

\(^{153}\) CALDEIRA, supra note 74, at 281.

\(^{154}\) Id. at 281. Indeed, compensation-driven fights over board appointments were common in Brazil during this period. Mauá was surprised by the opposition surrounding the creation of his Banco do Brasil in 1851, which he soon realized was due to disputes over board membership; his solution, then, was to amend the Bank’s charter to render directorships unpaid. See MAUÁ, supra note 94, at 127.


\(^{156}\) Resolution n. 353 of July 1, 1854 (denial of authorization to the chartering of Banco Urbano to be established in the city of Rio de Janeiro), in Resoluções da Seção de Fazenda do Conselho de Estado, supra note 105, vol. III, at 283.
more fruitful to “establish a branch of the Banco do Brasil in the city of Porto Alegre than an independent bank… not only because such a branch would provide greater resources and guarantees to the commerce of that location, but also because it is not in the State’s interest to limit the sphere of operations of the Banco do Brasil.”

Given the difficulty in obtaining a corporate charter, France provided an obvious model for inspiration, as its entrepreneurs had long resorted to tradable limited partnerships (sociétés en commandite par actions) to raise capital from the broader public while avoiding the burdensome governmental approval process required for incorporations. In 1854, Mauá attempted a similar strategy by forming the tradable limited partnership (sociedade em comandita por ações) of Mauá, MacGregor & Cia. In his words, he was “moved by the desire to place at the service of our progress a new instrument which, released from governmental guardianship, could develop independently of any government interference.” The potential for unlimited personal liability on his part as a general partner under this business organizational form did not seem to be a sufficient deterrent.

The creation of Mauá, MacGregor & Cia. however outraged the powers that be, which soon called into question the legality of limited partnerships divided in shares under Brazilian law. Unlike the French Commercial Code, which expressly authorized


158 See Naomi R. Lamoreaux & Jean-Laurent Rosenthal, Legal Regime and Contractual Flexibility: A Comparison of Business’s Organizational Choices in France and the United States during the Era of Industrialization, 7 AM. L. & ECON. REV. 28 (2005); Timothy Guinnane, Ron Harris, Naomi R. Lamoreaux & Jean-Laurent Rosenthal, Putting the Corporation in Its Place, 8 ENTERPRISE & SOC’Y 708 (2007) (arguing that, before 1857, the attractiveness of the share commandite in France was such that it in fact muted demand for free incorporation).

159 MAUÁ, supra note 94, at 236.
limited partnerships to divide their capital in shares, the Brazilian codification omitted such a provision. Following various filing requests by local merchants, Brazil’s commercial registries interpreted the Code’s silence as permitting limited partnership by shares and authorized their constitution. The issue, however, proved to be controversial and generated heated debates in Brazil’s Council of State.

The Council of State, many of whose members served as legislators years earlier when the Commercial Code was enacted, ruled that share limited partnerships were prohibited in Brazil. The Council’s decision noted that “it was still fresh in the memories of those who took part in the discussion of the Code the fact that the adoption of the provision of the French Commercial Code [permitting limited partnership by shares] was contemplated and deliberately rejected.” There was, to be sure, one forceful dissent to this decision, who questioned the soundness of the majority’s opinion by arguing that share limited partnerships were permissible under the Commercial Code and that a ban on such entities was unsound “in a new country, in which it is necessary to promote commercial and industrial associations.” This opinion culminated in the issuance of an “interpretive” decree declaring share limited partnerships illegal under Brazilian law and ordering the retroactive dissolution or conversion of all such companies then in existence.

---

160 Code de commerce (1807), art. 38 (providing that the capital of limited partnerships could be divided in shares, without prejudice to the legal rules applicable to this form of organization).


162 Id. at 524 (opinion of Conselheiro Visconde de Olinda).

163 Decree 1,487 of 1854.
From a legal standpoint, Brazilian lawmakers attributed the ban on tradable limited partnerships to the differences in statutory language between the commercial codes of France and Brazil,\textsuperscript{164} thus showing that seemingly minor deviations from foreign models could have teeth. It is doubtful, however, that the main reason for prohibiting tradable limited partnerships in Brazil was a highly formalistic, French-inspired, approach to statutory interpretation. France itself had interpreted its statutory provisions on limited partnerships broadly,\textsuperscript{165} and the very author of the Brazilian decree seemed eager to explain why this restrictive approach made good policy. Nabuco de Araújo, a prominent Brazilian senator, insisted that the decree was sound in light of France’s negative experience with share commandites, which he saw as replete with abuses to public confidence and creditors’ rights.\textsuperscript{166}

This incident showed that French legal solutions were well known, but by no means binding in Brazil. Brazilian politicians felt comfortable embracing French laws when they liked them, and then switching to selective import of French traumas when France’s legal solutions seemed too liberal for their taste. In 1857, a group legislators (including Mauá himself, who was then a member of the Chamber of Deputies) introduced a bill to revert the 1854 decree and permit the formation of tradable limited partnerships.


\textsuperscript{165} See Lamoureaux & Rosenthal, \textit{supra} note 158, at 34 (noting that, when disgruntled shareholders in 1830 challenged in court the issuance of bearer shares by commandites, on the ground that the practice was not specifically permitted by the French Commercial Code, French courts upheld their legality).

\textsuperscript{166} \textsc{Joaquim Nabuco}, \textit{Um Estadista do Império} [A Statesman of the Empire] (1936) (citing Nabuco’s speech of June 21, 1856).
partnerships in Brazil, but their attempt again met with resistance and was ultimately unsuccessful.167

The 1854 decree had forced Mauá to convert the bank into a regular limited partnership (sociedade em comandita simples). Unlike a share limited partnership, limited partners of a regular limited partnership could not be subject to later capital calls – a very useful and popular feature of corporations and tradable limited partnerships in the nineteenth century – and could easily exit by redeeming their partnership interests to the detriment of the firm’s capital.168 Still, few of the initial 182 limited partners defected upon the conversion, and the Bank initially enjoyed considerable success.169 At its peak, it boasted branches in various locations in Latin America, as well as in London, Manchester, Paris, and New York.170 A regular limited partnership, however, had its shortcomings from a legal and economic standpoint. When the bank ultimately collapsed years later, the 1854 decree forcing the bank’s conversion into a regular limited partnership headed Mauá’s blame list – in which three out of the top six causes listed for the bank’s debacle were perceived deficiencies of Brazilian law.171

167 For the lively legislative debates on this theme, see Annaes do Parlamento Brasileiro: Câmara dos Srs. Deputados [Records of the Chamber of Deputies], (sessions of July 28, 1857 and Aug. 5, 1857).

168 The ease of exit through redemptions, which is typical of partnerships, protects minority shareholders against expropriation, but it also prevents the firm from locking in the necessary capital for the development of large-scale projects. For a discussion of this tradeoff, see Guinnane et al., supra note 158, at 696; Margaret Blair, Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century, 51 UCLA L. REV. 387 (2003).

169 MAUÁ, supra note 94, at 237. Mauá, however, resented the fact that, through the conversion, the entity had lost its very foundation, the free transferability of its shares. Id. at 40.


171 See MAUÁ, supra note 94, at 287. Mauá argued that “the primary cause, if remote, of [the Bank’s] disaster was, without doubt, the unwarranted executive intervention in the organization of the banking
Brazil’s patchwork approach to the law of business organizations provides a clear example of selective transplants and local tailoring of foreign models, not necessarily for the better. Economists have recently debated the relative merits of the laws of civil and common law jurisdictions on business organizations in the nineteenth century. While a number of studies emphasize the pioneering role of common law countries (and the United States in particular) in the propagation of the corporate form, other scholars have argued that French and German law offered a greater array of business entities and more organizational flexibility than Anglo-Saxon jurisdictions. Tradable limited partnerships, in particular, allowed entrepreneurs to raise capital from the investing public, and effectively operated as functional substitutes, if imperfect, to incorporations.

On account of their comparative ease of formation, commandites par actions dwarfed the number of sociétés anonymes in France. Comparative lawyers of the time recognized that the functional equivalent to joint-stock companies in France were commandites par actions, not sociétés anonymes – the latter being “due to their very company, by issuing a decree, to which it granted retroactive effect, annulling the registration of the company, and compelling it to organize itself in a different form than I had contemplated, which prevented me from gathering the resources for its greater security in the future.”) Mauá also blamed the bank’s collapse on the financial restrictions under the Law of Impediments, discussed in Part IV infra, and on the unwillingness of Brazilian courts to enforce contracts. Id.

---

172 Sylla & Wright, supra note 120.

173 Guinnane et al., supra note 158, at 687 (arguing that the wider selection of business entity forms in French and German law since the nineteenth century discredited the notion that Anglo-Saxon legal institutions are inherently superior to civil law ones).

174 Obtaining a corporate a corporate charter from France’s Conseil d’Etat was a difficult, expensive, protracted and risky proposition. Corporations were subject to constant governmental supervision, and their authorization could be revoked at any time. See JEAN STREICHENBERGER, SOCIETES ANONYMES DE FRANCE ET D’ANGLETERRE [Business corporations in France and England] 41 (1933)
rarity, were only of secondary importance to the country.**\(^{175}\) Between 1823 and 1838 France saw the creation of 1,340 tradable limited partnerships but only 157 business corporations.\(^{176}\) To be sure, French contemporaries frequently resented the phenomenon known as the “limited partnership fever” (fièvre des commandites), which was associated with the proliferation of fraudulent ventures. In 1838 a draft bill aimed at regulating and restricting the use of tradable limited partnerships was introduced in the French parliament, but the strength of the liberal lobby prevented the proposal from obtaining the necessary political support. It was not until 1856 that France finally enacted a statute to regulate commandites par actions more closely.\(^{177}\) Even though contemporaries viewed France’s limited partnerships as inextricably linked to fraudulent ventures having deleterious effects on public savings, a more moderate revisionist view now suggests that many such firms had honest practices and played an important role in France’s industrialization.\(^{178}\) Brazil’s willingness to imitate parts of the French system, but not others, might have deterred the formation of local capital markets to support its development.

A second attack on financial activity came in 1860, after a brief experimental period with financial liberalization during the one-year tenure of Bernardo de Souza


\(^{177}\) Id. at 83-86.

Franco as Treasury Secretary. Franco was the author of a book on banking that was highly complimentary to New York’s Free Banking Act of 1837.179 During his brief tenure between 1858 and 1859, Souza Franco authorized the creation of six additional banks of emission in Brazil.180

Nevertheless, one year later, and exactly ten years after the enactment of the Commercial Code, conservative politicians pushed for the adoption of a new statute unambiguously aimed at deterring the formation of banks and business corporations. Banco do Brasil and its well-connected shareholders had a keen interest in regaining a monopoly of emission and restricting competition from other banking institutions. Moreover, the government itself feared the industrial and commercial expansion that the availability of financing was beginning to generate.181 The new statute had the support of Brazil’s emperor, who believed that the financial system should serve international trade transactions, not investments in Brazil’s domestic industrial production.182 Decades later, Brazilian congressmen would resent the enactment of the 1860 statute as an instance of the notion that in Brazil “vital questions were almost never decided by taking into consideration the practical standpoint from which they should be approached; politics

179 See FRANCO, supra note 68. In his words, he decided to publish a book on banking because “in a young and capital deprived like Brazil, it is a very important service to seek to... adopt credit institutions as the most powerful way to take advantage of existing capital, put it into the service of industry and duplicate its benefits.” Id. at 9.

180 Constitutional Congress Records [Congresso Constituinte], speech of Senator Amaro Cavalcanti 206 (Dec. 16, 1890).

181 Id. at 207.

182 Law 1,083 of 1860. In the words of a contemporary commentator, the new statute “would be a crime if it were not a law.” See TAVARES BASTOS, CARTAS DO SOLITÁRIO [Solitary letters] 19 (1863). This law was regulated by the Decree 2,711 of Dec. 19, 1860.
was involved in everything.”183

The new Brazilian statute was so hostile to financial activity that it came to be known in Europe as “loi d’entraves” (“Lei dos Entraves,” in Portuguese, or “Law of Impediments”).184 Even though the primary objective of the new law was to prevent the creation of new banks of emission, the statute’s wording and chilling effects were much broader in scope. Under the new regime, banks, railroads and navigation companies could no longer be formed without first obtaining special legislative charters.185 Executive authorization remained sufficient for the incorporation of firms in other industries, but the new statute strengthened the existing sanctions for failure to obtain the requisite approval. Business corporations formed without governmental authorization were subject not only to unlimited shareholder and director liability, but also to hefty fines and mandatory dissolution.186 Moreover, the statute also disenfranchised investors in banking firms by prohibiting proxy voting in director elections.187

The intense parliamentary debates preceding the enactment of the statute also contained numerous references to foreign law and practice. The disagreement had to do with the interpretation of the effects of the Anglo-American experience with financial liberalization. Detractors of the proposed statute argued that the availability of financing

183 Constitutional Congress Records [Congresso Constituinte], speech of Senator Amaro Cavalcanti 207 (Dec. 16, 1890).
184 French finance scholar Garnier seems to have been the first to coin this expression. See M. JOSEPH GARNIER, TRAITE DE FINANCES [Treatise on Finance] 403 (1862).
185 Law 1,083 of 1860, Art. 2, § 2.
186 Law 1,083 of 1860, Art. 2, § 1.
187 Id., Art. 2, § 12.
was an integral part of the U.S. recipe for economic success. Advocates of the new restrictions, in turn, stressed that both Britain and the U.S. required legislative approval of bank charters, and had in any case witnessed numerous financial crises and fraudulent ventures. The latter view prevailed and the statute came into effect in August of 1860.

Neither the laws of foreign jurisdictions, nor a local misunderstanding of their meaning and operation, are sufficient to explain Brazil’s early policies of financial deterrence. Looking at the political economy of financial development can be more illuminating. If plantation owners saw an interest in resisting any departure from Brazil’s role as an exporter of agricultural commodities, so did the incumbent merchant class, which was predominantly foreign. Portuguese merchants prevailed in numbers, while the English had by far the most capital. Foreign businessmen in the import-export business held an expressive majority of board seats in Brazil’s most influential commercial associations.

---

188 Senate records, speech of Senator Visconde de Maranguape, at 521 (July 21, 1860) (arguing that the “ample, almost unlimited freedom of credit” in the U.S. was a key ingredient in its recipe for industrial and economic development, an example which Brazil, as a new nation, should follow”).

189 Senate records, speech of Council’s President, at 43 (July 4, 1860).


191 See LEVY, supra note 113, at 78 (noting that exporters of agricultural commodities disfavored urban enterprises and the instability they were deemed to cause); Eugene W. Ridings, Business, Nationality and Dependency in Nineteenth Century Brazil, 14 J. LAT. AM. STUD. 55 (1982) (arguing that Brazil’s business elite was not Brazilian).

192 See RIDINGS, supra note 92, at 32.

193 Id. at 32. The most extreme cases were the commercial associations of Rio de Janeiro (Brazil’s largest) and Porto Alegre, in which, by statute, Brazilians were to occupy only 3 out of 17, and 3 out of 15 board seats, respectively.
Interestingly, the same commercial associations that so vehemently pushed for the adoption of a Commercial Code adopted a much more hesitant tone with respect to the creation of business corporations and banks. It is noteworthy that most commercial associations, also known for resisting industrialization policies, did not oppose the enactment of the Law of Impediments.194 Moreover, the few politically-connected banks and business corporations that succeeded in obtaining charters also had a vested interest in maintaining the existing legal hurdles and the barriers to entry that they erected.195

The small size of Brazil’s economic and political elite allowed its members to profit handsomely from their privileged access to State officials, a benefit that the development of impersonal market forces and economic growth could put in jeopardy. Brazil’s most powerful interests saw little to gain from financial development, and much to lose from the rise in competition, social mobility, and instability that capital markets were likely to generate. Financial development threatened their economic power and could lead, ultimately, to what Acemoglu and Johnson call a “political replacement effect” – a risk which is especially acute in places like Brazil, where upward and downward social mobility was not only possible, but common.196 All in all, incumbents erected institutions that would allow them to maintain their comfortable status quo, even if at the cost of general economic growth.

194 \textit{Id.} at 205 (asserting that “Brazil’s major business interest groups, the commercial associations of Rio de Janeiro, Bahia and Pernambuco, did not oppose the 1860 law”).


196 Daron Acemoglu & James A. Robinson, \textit{Economic Backwardness in Political Perspective} (NBER working paper, 2002). In their model, elites that are not highly entrenched are more likely to block institutional reform that poses risk to their incumbency advantage. \textit{See also}, \textit{Schulz}, supra note 155, at 3 (2008) (suggesting that “both upward and downward social mobility were extremely common in nineteenth-century Brazil”).
The restrictive policies of the 1860 statute had a noticeable effect on incorporations, at least initially. Figure 1 below shows a clear blip in the number of new corporate authorizations following the law’s enactment compared to previous periods. At the same time, the formation of regular limited partnerships rose significantly during this period, thus signaling some degree of substitution away from the corporate form.197

**Figure 1. Number of incorporations in Brazil (1850-1882)**

![Chart showing number of incorporations in Brazil (1850-1882)](chart)

**Total:** approximately 516 (based on author’s calculation)

**Source:** Author’s formulation based on data by Ministério do Trabalho, Indústria e Comércio (1946)

---

V. Boom, Bust and the Day After (1882 – 1900)

Brazil’s increasingly restrictive stance towards incorporations was on the wrong side of history – and it knew it. News about foreign legal developments traveled fast in the nineteenth century. And competitive and efficiency pressures towards legal convergence did not follow legal families lines.

In adopting the Companies Act of 1855 and 1856, England was the first country in Europe to permit the formation of business corporations with limited liability without the need for governmental approval. Its pioneering role was, at least in part, due to a lack of functional substitutes for the corporate form under English law. While France and Germany permitted the proliferation of tradable limited partnerships, England successfully resisted the introduction of *commandites* for many years despite strong demand for their admissibility. In 1862 England consolidated the previous statutes under a new Companies Act that further expanded the scope of general incorporation.

Only one year after the enactment of the Companies Act of 1862 French corporate law would rapidly converge towards the British model. Competitive pressures were behind this particular instance of legal diffusion. In 1862 England and France entered into a Free Trade Agreement that expressly authorized English corporations to operate in

---

198 *See* note 173 *supra* and accompanying text.

199 Despite creative attempts by English entrepreneurs to import continental European legal entity forms, English courts refused to accept limited partnerships under the common law. Limited partnerships were not permitted in England until the enactment of a 1907 statute. *See* Ron Harris, *Industrializing English Law: Entrepreneurship and Business Organization, 1720–1844* (2000). *See also* Rob McQueen, *A Social History of Company Law, Great Britain and Australian Colonies* 73 (2009) (describing attempts to introduce *commandites* into English law in the early 1850s).
French territory. Because England had already liberalized its incorporations process, French entrepreneurs judged that their national laws effectively put local firms at a disadvantage. The result was the enactment of a new French statute in 1863 authorizing the creation of sociétés limitées, a literal translation of the English term employed in the Companies Act, which served as a model for the French law. The French statute was more restrictive than the English Act, however, in that it limited the exemption from governmental authorization to corporations whose capitalization did not exceed 20 million francs. Unrestricted general incorporation in France would have to wait until 1867.

Brazilian politicians monitored these foreign developments closely. In 1865, legendary Brazilian statesman Nabuco de Araújo proposed a new corporations law based on the English and French statutes of 1862 and 1863. The primary goal of his proposed bill on sociedades limitadas, also a literal translation of the term employed in the English and French statutes, was to permit incorporations without governmental approval. In most instances, Nabuco favored the more liberal approach of the English statute over the more restrictive stance of its French counterpart.

The proposal, however, met with resistance in the Council of State, where ministers argued that Brazil’s lack of credit and “spirit of association” was not caused by legal restrictions, but by a lack of public confidence in view of prior abuses. The Council blocked the project, which it viewed as “in keeping with the conditions of the

---

200 Streichenberger, supra note 174, at 43.


English people, with its *self government*, with the sober character of the British citizen, the caution, pensive man who respects his own dignity and knows how to maintain untouched his political liberty and will therefore not abuse this commercial freedom."\(^{203}\)

The fact that France by then had already begun to allow firms to incorporate without obtaining governmental approval did not seem to move Brazilian lawmakers either. They Council contended “that there was no parallel between Brazil’s situation and France’s,” since France already permitted the organization of tradable limited partnerships (liberal incorporation being the logical next step), while Brazil did not.\(^{204}\) Refusing to follow its usual foreign models in liberalizing the incorporation process, the Council concluded, in a sober note, that “[i]t is our painful but necessary duty to note the condition of Brazil, which is truly deplorable.”\(^{205}\)

The conservative forces were highly successful in deterring business formation after the enactment of the 1860 statute, but less so in avoiding the looming shift in the balance of economic and political power. Even in the absence of legal change, incorporations picked up again in 1870, the year marking the end of the Paraguayan war (see Figure 1 *supra*). This means that, despite the existing bureaucratic and political hurdles to incorporation, a very large number of companies – more than 500, according to a conservative estimate – were chartered in the more than three decades following the enactment of the Commercial Code.\(^{206}\) There is good reason to believe that the number of business corporations – and, consequently, the vigor of economic activity – would

\(^{203}\) *Id.* at 1338.

\(^{204}\) *Id.* at 1339.

\(^{205}\) *Id.*

\(^{206}\) Author’s calculation based on Business Associations Authorized to Operate in Brazil, *supra* note 114.
have been even greater had Brazil adopted free incorporation laws earlier. Nevertheless, the conventional view among economists that incorporations were exceedingly rare in Brazil prior to 1882 is simply incorrect.207

In 1882 Congress finally overturned the Law of Impediments by enacting a new and more liberal corporate statute, which commentators celebrated as “releasing business corporations from State guardianship.”208 The legislative debates in the Chamber of Deputies stressed the importance of eliminating the pervasive “administrative lawyering” and rent-seeking behavior associated with governmental approval requirements, which Senator Andrade Figueira described as a form of “deplorable parasitism” that amounted to the “leprosy” or “cancer” of modern society.209

Legal scholars credited the structure of the 1882 Corporation Law to the French tripod freedom of association, publicity and liability.210 The statute’s main contribution was the elimination of the requirement of governmental approval for most business corporations. Companies in the foodstuff business, religious organizations, mutual insurance companies, and foreign firms remained subject to governmental approval. The incorporation of banks, in turn, continued to require special legislative authorization.211

207 For a recent exposition of this understanding, see Ran Ambramitzky, Zephyr Frank & Aprajit Mahajan, Risk, Incentives and Contracts: Partnerships in Rio De Janeiro, 1870-1891, 70 J. ECON. HIST. 686, 689 (2010) (noting that prior to the advent of free incorporation laws in Brazil, chartering “depended on imperial government authority, and very few joint-stock companies were formed before the 1880s”).

208 VAMPRE, supra note 97, at 40.


210 Senate Records, speech of Senator Lafayette (Apr. 24, 1882) (stating that “the mission fo the law is limited to the triology of liberty, publicity and responsibility; beyond that all there is are unjustifiable restrictions to individual rights”); DEDIMO AGAPITO DA VEIGA, AS SOCIEDADES ANONYMAS [Business Corporations] 9 (1888).

211 Law 3,150 (Nov. 4, 1882), Art. 1.
In exchange for the most liberal incorporation regime, the statute imposed stricter requirements in terms of disclosure and management responsibility. Liability-related provisions included shareholder rights to sue management directly for violations of law or charter provisions; the obligation of members of management to offer stock (as set forth in the charter) as security for their administration; and the imposition of criminal liability in cases of fraud, improper dividend payments, and irregular liquidation.\textsuperscript{212}

The new law had the support of commercial associations, including the powerful unit of Rio de Janeiro, which now attributed the repressive regime of 1860 to “abnormal circumstances.”\textsuperscript{213} Opponents of free incorporation appealed once again to various instances of corporate fraud and abuses in foreign experience as grounds for maintaining governmental intervention.\textsuperscript{214} Nonetheless, this time around the prevailing stance was that it was illogical to “destroy a powerful instrument of progress because it may originate abuses;” legislators argued that the statute should instead provide for “protective formulas whose objective is to alert the investing public and stimulate shareholder supervision.”\textsuperscript{215}

The 1882 statute provided for continuing seller liability for subscribed but not yet paid in capital for up to five years after the share transfer.\textsuperscript{216} In nineteenth-century

\textsuperscript{212}Id., Art. 10 (provision of shares as security); Art. 11 (civil liability of directors for damages caused by negligence or intentional wrongdoing); Art. 26 (fines for founders’ and managers’ failure to comply with various statutory provisions), Art. 27-30 (criminal penalties for managerial misconduct).

\textsuperscript{213}RIDINGS, supra note 92, at 287.

\textsuperscript{214}See Senate Records, speech of Senator Afonso Celso, at 65 (Aug. 22, 1882) (arguing that “the State is not indifferent to losses suffered by corporations, which frustrate and weaken the useful and fertile spirit of enterprise” and citing inconveniences in France and the Black Friday of England as a cautionary note).

\textsuperscript{215}VEIGA, supra note 210, at 28; Senate Records, speech of Senator Lafayette (April 25, 1882), at 1798.

\textsuperscript{216}Law 3,150, Art. 7, § 1º.
Brazil, as elsewhere, stock subscriptions were often paid in installments. As argued by Sylla and Wright, the installment mechanism was effectively an investor protection device, which allowed shareholders to observe the initial management and performance of the firm before committing the totality of their funds to their enterprise. Mid-way investor defection from businesses that turned out to be unattractive was common both in Brazil and in the U.S. Unlimited liability for unpaid subscriptions, which applied to any transferor of the shares for up to five years after the sale, provided additional protection for creditors at the expense of shareholders.

A shift towards fully liberal corporate and financial policies would not come until the final abolition of slavery in 1888. The end of slavery without compensation to slaveholders had a profound impact on Brazil’s economic and political environment. Almost instantly following abolition, Brazil’s rural oligarchs felt a deep need for additional credit and currency to enable a transition to a system of wage labor by immigrants and freemen. The incumbent economic and political forces were changing rapidly, and in November of 1889, the military deposed Brazil’s Emperor and declared the country a Republic with the support of the new financial bourgeoisie.

The effects of the liberal corporate and banking policies beginning in 1882 and culminating in the 1890 reforms were substantial. The main change to the Corporations Law of 1882 was the effective elimination of shareholder reserve liability for subscribed but not yet paid-in capital following a transfer. Combined with favorable changes in

217 Sylla & Wright, supra note 120, at 7.
218 Id. at 7; SCHULZ, supra note 155, at 82.
219 See, e.g., SCHULZ, supra note 155.
monetary policy, these legal reforms resulted in an exponential growth in the number of corporations operating in Brazil.\textsuperscript{220}

Only six months after the legal reforms of 1890, São Paulo saw the creation of at least 222 companies and banks, which stand in sharp contrast to the only 30 such firms in operation as late as 1897.\textsuperscript{221} Transactions in the Rio de Janeiro Stock Exchange, then Brazil’s primary listing venue, increased by 84\% in 1889, 98\% in 1890 and 45\% in 1891.\textsuperscript{222} By 1890, 114 firms traded on the Rio de Janeiro Exchange,\textsuperscript{223} and many more in the brand new São Paulo Stock Exchange.\textsuperscript{224} These events culminated in a speculative bubble which historians refer to as the Encilhamento (literally, “saddling up”).\textsuperscript{225}

The trading fever of Encilhamento attracted investors of the most varied segments of society, and proved that no inherent cultural repugnance existed among Brazilians to stock investment and speculation. In the critic words of a contemporary newspaper: “[E]veryone gambled – the merchant, the physician, the lawyer, the public servant, the broker, the [zangão]; with little of their own money, with much of other’ people’s money

\begin{footnotesize}
\textsuperscript{220} For a discussion of the effects of the 1890 reforms, see Stephen Haber, The Efficiency Consequences of Institutional Change: Financial Market Regulation and Industrial Productivity Growth in Brazil 1866-1934, NBER Historical Paper No. 94 (1996) (arguing that the reforms resulted in an increased rate of investment and productivity and a decline in industrial concentration).


\textsuperscript{222} Eulalia Maria Lahmeyer Lobo, O Encilhamento [The “Encilhamento”], 5 Revista Brasileira de Mercado de Capitais 261, 269 (1976).

\textsuperscript{223} Id.

\textsuperscript{224} See Hanley, supra note 221, at 88.

\textsuperscript{225} For an explanation of this metaphor, see Judith Martins-Costa, Machado, A Sociedade Anônima e A Modernidade Impossível [Machado, the Business Corporation and the Impossible Modernity], in Narração e Normatividade: Ensaios de Direito e Literatura (forthcoming 2011) (on file with the author). For a more general history and analysis of the factors leading to speculative bubbles generally, see Galbraith, supra note 146. Many of the causes of speculative bubbles listed by Galbraith, including “the thought that there is something new in the world,” were present in Brazil’s encilhamento. Id. at 18.
\end{footnotesize}
(...). Each citizen became an incorporator and a manager of banks and business firms; those who yesterday were not capable of running a small tavern had become managers of great finances; each citizen neglected his own profession to gamble, and Rio de Janeiro converted itself into a Monte Carlo casino...226

The legal reforms enabling the formation of a major stock market bubble in Brazil were not a reflection of foreign developments, but rather a response to special political and economic conditions following the abolition of slavery and changes in the political regime.227 John Schulz explains the trend toward financial liberalization by the end of the Empire and beginning of the Republic as an attempt to create “easy money” in order to appease disgruntled planters, who could no longer rely on slave labor and therefore had to pay wages in order to ensure production.228 The ultimate burst of Encilhamento in 1892 drove the national economy into a severe recession.

From a corporate governance perspective, the stock market collapse of the early 1890s exposed numerous fraudulent ventures involving fictitious firms, which earned the period a bad reputation that would shape corporate law policy for years to come.229 More recently, however, scholars have provided evidence that the initial bubble had longer-lasting positive effects on Brazil’s economic and industrial development. A significant number of the firms incorporated during the Encilhamento remained listed on the Rio de Janeiro Stock Exchange in the following years, and played a major role in the


227 SCHULZ, supra note 155, at xii.

228 Id. at 8.

229 See Part IV infra.
development of Brazilian industry until the State-run import-substitution industrialization process after World War II. For Albert Fishlow, Brazil’s first incursion into import-substitution industrialization took place during the inflationary finances of the Encilhamento period, which, in his view, represented “something much more substantial and enduring than a South Sea bubble.”

Stephen Haber finds that the 1890 legal reforms elicited an expansion of local capital markets, which in turn transformed the structure of Brazil’s textile industry vis-à-vis its counterpart in Mexico. While the rise of more competitive capital markets in Brazil allowed firms to access impersonal sources of financing and grow, the financial elite in Mexico successfully used its political clout to build legal barriers to entry in the banking industry, thus giving established and well-connected cotton mills an advantage over newcomers. As a result, Brazil’s cotton industry experienced a higher rate of growth, a lesser degree of concentration, and greater productivity levels than that of Mexico. Similarly, Aldo Musacchio and Ian Read studied the networks of interlocking boards of directors in Brazilian and Mexican companies in 1909 and found that kinship and network connections were significantly less important in Brazilian than in Mexican

---

230 Lobo, supra note 222, at 269.

231 Albert Fishlow, Origins and Consequences of Import Substitution in Brazil, in INTERNATIONAL ECONOMICS AND DEVELOPMENT: ESSAYS IN HONOR OF RAÚL PREBISCH 315 (1972) (disputing the conventional wisdom as to the detrimental effects of encilhamento as ignoring “the permanent consequences of this temporary stimulus to national entrepreneurial initiative”).

firms. \(^{233}\) Finally, Anne Hanley claims that meaningful access to impersonal sources of finance was instrumental to São Paulo’s major industrial jump in the early twentieth century. \(^{234}\) Indeed, before World War I, Brazil had active stock markets that were the second-largest markets in Latin America and second to none in the number of listed companies. Rajan and Zingales estimate that Brazil’s stock market capitalization at the time reached 25 percent of the GDP, \(^{235}\) a record level that would not be surpassed until the 1990s. \(^{236}\)

Although a significant number of **Encilhamento** firms withstood the crash reasonably well and contributed to the country’s economic modernization thereafter, the trauma from the bubble burst would later serve to justify the new system of increasingly concentrated corporate ownership and suspicion of outside financing. \(^{237}\) While Brazil spent a good part of the nineteenth century importing foreign disillusionment with finance, it had now experienced a big debacle of its own. Scholars have suggested that severe financial distress may be at the roots of repressive attitudes towards finance, but an adequate knowledge about the import of economic trauma to institutional development

---

\(^{233}\) Aldo Musacchio & Ian Read, *Bankers, Industrialists and Their Cliques: Elite Networks in Mexico and Brazil during Early Industrialization*, 8 ENTERPRISE & SOC’Y 842 (2007).

\(^{234}\) See Hanley, supra note 221, at 22 (stating that “[b]y the 1890s, São Paulo was home to a large banking sector and a formal stock and bond exchange. Relationships between bank and non-bank companies included personal ties, but these disappeared by the turn of the twentieth century. By the time São Paulo’s economy took off, in the period 1909-13, the transition from personal to formal intermediation was complete”).

\(^{235}\) Rajan & Zingales, supra note 15, at 15.


\(^{237}\) As Galbraith put it, “[t]he financial memory is brief, but subjective public attitudes can be more durable.” Galbraith, supra note 146, at 53.
There is little question that financial trauma can be real and consequential, but the Brazilian experience suggests that negative opinions can also be imported, or even fabricated, by those who can benefit from the absence of capital markets.

VI. Selective Transplants in the Twentieth Century

Legal transplants, as filtered by local politics, continued to play a major role in business law developments in Brazil throughout the twentieth century, but geopolitical factors changed the relative importance of different foreign models. The United States replaced England as the main exemplar from the common law world. Like other countries in Latin America, Brazil’s first Republican constitution of 1889 was modeled after that of the United States.

The new federalist republic was officially named Estados Unidos do Brazil (or “United States of Brazil”) and welcomed Marbury-style judicial review as the law of the land. An early decree of the new Republican era specifically directed federal courts in Brazil to apply “the statutes of cultivated nations, and especially those applicable in the United States of America, the cases of ‘common law’ and ‘equity’” as subsidiary sources of jurisprudence. Brazilian lawyers and policymakers apparently had access, and the ability to make use of, U.S. legal materials. During the most part of the nineteenth century, English as well as French knowledge were mandatory requirements in Brazilian

---

238 Morck & Steier, supra note 146, at 13.

239 Decree 848 (Oct. 11, 1890), Art. 386.
law schools. It was not until 1891 that Brazilian law students were given the option to choose between English and German, in addition to French, as foreign languages.

At the same time, France increasingly shared influence with Germany and Italy as the primary legal models from the continent. Brazil’s belated Civil Code of 1916 was based both on the French Code Civil and on the German BGB (Bürgerliches Gesetzbuch), as well as on Roman and colonial law sources. Brazil enacted its first law on limited liability companies (sociedades por quotas de responsabilidade limitada) law in 1919; the statute borrowed heavily from Portugal’s law of 1901, which in turn was modeled after Germany’s GmbH (Gesellschaft mit beschränkter Haftung) law of 1892. In the House of Representatives, a lawmaker justified the adoption of the statute introducing limited liability companies in Brazil by noting that such entities “had produced excellent results in England, Germany and Portugal.”

240 Decree of November 7, 1831 (regulating the curriculum of law schools in Brazil and mandating Latin, French and English classes as preparatory courses). For a detailed examination about the establishment of the first law schools in Brazil, see ALBERTO VENANCIO FILHO, DAS ARCADAS AO BACHARELISMO (150 ANOS DE ENSINO JURIDICO NO BRASIL) [From Arcadas to Bacharelismo: 150 Years of Legal Education in Brazil] 50 (1977).


242 Brazil’s Civil Code is usually said to follow the BGB in providing a “General Part” containing the general principles of civil law – although, to be fair, such a structure was present since Teixeira de Freitas’ nineteenth-century Rough Draft (Esboço) of the Civil Code. The Rough Draft preceded the German codification, although it was heavily influenced by Roman and Germanic sources. See Judith Martins-Costa, Antes de Clóvis, vem Tobias Barreto: Para entender um, temos de iniciar pelo outro [Before Clóvis comes Tobias: To understand one we must begin with the other], in CLÓVIS BEVILAQUA: UM SENHOR BRASILEIRO [Clóvis Beviláqua: A Brazilian Master] 215 (Cassio Schubsky ed., 2010) (noting the original and national character of Brazil’s Civil Code despite the strong influence of existing foreign models). See also Vera Maria Jacob de Fradera, A Circulação de Modelos Jurídicos Europeus na América Latina [The Circulation of European Legal Models in Latin America], 736 REVISTA DOS TRIBUNAIS 20, 27-8 (1997) (reflecting on the influence of European codes on Latin America’s codification movement); Vera Maria Jacob de Fradera, Brazil, in PARTY AUTONOMY: CONSTITUTIONAL AND INTERNATIONAL LIMITS IN COMPARATIVE PERSPECTIVE 107 (George A. Bermann ed., 2002) (describing the influence of early colonial laws and Roman law sources on Brazil’s Civil Code of 1916).

243 Decree 3,708 (Jan. 10, 1919).

liability company counterpart, the *société à responsabilité limitée* (SARL), itself modeled after German law, until 1925, following the recovery of Alsace-Loraine after World War I and the pressures from businesspeople in the region who had grown used to the GmbH.245 The combination of limited liability, fewer mandatory formalities, and stricter limitations on the transferability of shares would make limited liability companies the most popular form of business entity in Brazil, as elsewhere.246

The prototypical Brazilian corporation in the twentieth century came to display very concentrated control in the hands of families or the State, a separation between cash-flow and voting rights through the use of non-voting preferred shares or pyramidal structures, and very low valuation of minority interests. While non-voting preferred shares, in particular, would become pervasive in Brazil for the most part of the twentieth century, these securities were virtually unheard of in Brazil prior to 1932.247 Since the 1891 Corporations Law did not contain any provisions regarding the admissibility of different classes of stock, legal scholars continued to debate whether preferred shares

245 Loi du 7 mars 1925. See Guinnane et al., *supra* note 158, at 710-711. Guinnane et al. note that SARLs quickly came to account for the vast majority of firms established in France following the 1925 statute. *Id.* at 713. See also Allinne, *supra* note 176, at 91 (arguing that by resorting to Germany’s GmbH as its model, France was finally “turning the page on almost one century of domination by the Anglo-Saxon model”).

246 See Naomi Lamoreaux, *Scylla or Charybdis? Historical Reflections on Two Basic Problems of Corporate Governance*, 83 BUS. HIST. REV. 9, 27 (2009) (citing the examples of France, Germany and Britain, and arguing that “wherever and whenever [the limited liability company] became available, it quickly dwarfed the corporation in popularity”). In Brazil, as in other jurisdictions, the use of the corporate form declined sharply, but did not vanish, after the availability of limited liability companies. Given the decline of local capital markets, the corporate form continued to be used primarily due to the tax advantages associated with bearer shares. See *Lamy Filho & Bulhões Pedreira, supra* note 124, at 159-160.

247 While the permissibility of non-voting or multi-voting stock under the previous regime was unsettled, the debate was largely academic. The issuance of non-voting or multi-voting stock was extremely rare in Brazil before the 1932 decree. *Ernesto Leme, Das Ações Preferenciais nas Sociedades Anonymas* [Preferred Shares in Business Corporations] 39 (1933).
were permissible in Brazil. Brazil’s first draft legislation permitting the creation of preferred stock dates back to 1903, the same year of the French statute expressly authorizing their issuance. But legal change would not come until the 1930s, when the Rio de Janeiro Commercial Association, Brazil’s Federation of Business Associations and the Association of Banks of Rio de Janeiro submitted to the government a draft statute for the creation of preferred shares, a modified version of which was ultimately enacted into law.

The innovations of the Decree 21,536 of 1932 were two-fold and largely contradictory: it expressly prohibited the adoption of multi-voting stock, but authorized the issuance of non-voting preferred shares. The decree’s official statement of purpose linked multi-voting stock to evils ranging from entrenchment, conflicts of interest, and oligarchic management to indolence and speculation. It mentioned, to that effect, the recent ban on multi-voting stock in France and the ongoing legislative initiatives to abolish this prerogative in Germany and Switzerland, where it was allegedly falling into disrepute.

Yet the same statute blessed the issuance of non-voting preferred shares, to which its official justification denied the same vices and attributed the virtues of ensuring management stability and encouraging industrial concentration. Therefore, precisely

---

248 Id. (for a discussion of the debate).


250 Francisco Campos, Exposição de Motivos to Decree-Law 21,536 of 1932 (June 23, 1932).

251 Id. Both the perception of industrial concentration as an unambiguous virtue and the notion that concentrated ownership was necessary to achieve it are puzzling. In the same year, Berle and Means documented the simultaneous rise of dispersed corporate ownership and the increased concentration of corporate and industrial power in the U.S. ADOLPH BERLE & GARDINER MEANS, MODERN CORPORATION AND PRIVATE PROPERTY (1932).
in the same year that Adolph Berle and Gardiner Means famously documented the rise of widely-held firms in the United States, Brazil enacted a new law deliberately designed to encourage concentrated ownership and control. Ironically, doctrinal works of the time traced the adoption of the non-voting preferred shares in Brazil to Anglo-American law.\textsuperscript{252} The contemporary backlash against non-voting securities in the U.S. culminating in the outright NYSE ban of disparate voting rights in 1926 went however largely ignored.\textsuperscript{253}

As discussed in greater detail below, most economic accounts view departures from one-share-one-vote schemes as inefficient, as they decouple economic interest from power to influence firm decisions.\textsuperscript{254} Still, scholars have argued that the mere \textit{legality} of non-voting shares should be economically harmless. If non-voting shares facilitate minority expropriation, investors will pay little for these securities to begin with.\textsuperscript{255}

Local legal innovations, however, rendered preferred non-voting shares far more consequential in Brazil. As a result of special interest pressure, a 1940 federal decree allowed shareholders holding at least 40% of the shares of a corporation subject to federal authorization to petition the government to \textit{mandate} the conversion of the remaining

\textsuperscript{252} A. Cesarino Junior, \textit{Andou Bem o Legislar Proibindo o Voto Plural nas Sociedades Anôñimas?} [Did the Lawmakers Do the Right Thing by Prohibiting Multivoting Stock in Business Corporations?], 90 REVISTA DOS TRIBUNAIS 217 (1934).

\textsuperscript{253} \textit{Id. at} 217.


\textsuperscript{255} See, Ronald J. Gilson, \textit{Evaluating Dual Class Common Stock: The Relevance of Substitutes}, 73 VA. L. REV. 807 (1987) (arguing that the that the permissibility of a “stock’s limited voting rights are reflected in a reduced price, so that the company's owners at the time it goes public, and not the purchasers, bear the cost”).

81
common shares into preferred non-voting shares.\textsuperscript{256} If the admissibility of non-voting shares is generally inoffensive, coerced midway changes in a firm’s capital structure – of which this legal provision is an example – are not.\textsuperscript{257} This bizarre provision mandating the conversion of minority common stock into preferred stock was overruled a few years later,\textsuperscript{258} but generous tax cuts and fiscal subsidies to investments in public company stocks would distort market signals and encourage numerous firms issuing a majority of non-voting preferred shares to go public in the 1960s and early 1970s.\textsuperscript{259}

By 1940, the year of the enactment of a new Corporations Law, public subscriptions were rare and firms under tight family control had become the paradigmatic model of Brazilian enterprise – a state of affairs that the new law sought to reinforce, not overcome. Its draftsman, Miranda Valverde, refrained from incorporating provisions of an earlier draft statute modeled after the English Companies Act due to the liberalizing tone of its provisions. He resorted instead to French and Italian law, jurisdictions then having less developed capital markets, as its main foreign model.\textsuperscript{260} The official statement of purpose attributed the law’s conservative approach to the scars from Brazil’s

\textsuperscript{256} Decree-Law 2,055 (1940). The stated rationale for the decree was to curb minority shareholder abuses against the interests of the majority. The decree afforded the federal government ample discretion in evaluating the request for conversion. As noted by Trajano de Miranda Valverde, this confused statute was almost certainly enacted in response to special interests. \textsc{Trajano de Miranda Valverde, Sociedade por Ações} 33 (3rd ed., 1959).

\textsuperscript{257} See Gilson, \textit{supra} note 255 (arguing that while the issuance of non-voting stock should be uncontroversial, the same is not necessarily true for dual-class recapitalizations); Jeffrey N. Gordon, \textit{Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice}, 76 Cal. L. Rev. 1 (1988) (finding that dual-class recapitalizations have a negative effect on shareholder wealth).

\textsuperscript{258} Decree-Law 8,563 (1946) (allowing original holders of common shares that were compulsorily converted into preferred shares by the Decree-Law 2,055 of 1940 to request their reconversion into common shares).

\textsuperscript{259} For a brief description, see Gilson, Hansmann & Pargendler, \textit{supra} note 21.

\textsuperscript{260} \textsc{Lamy Filho & Bulhões Pedreira, supra} note 124, at 112.
past financial traumas. Valverde argued, in short, that the “the current generation has not completely forgotten the lessons of encilhamento.”

Moreover, generous tax incentives policies implemented in the 1960s induced a large number of family- and State-controlled companies to go public, and these newly-traded firms became a powerful and influential interest group with a vested interest in opposing improvements in minority investor rights. When Brazil sought to enact yet another Corporations Law in 1976, the issue was once again highly politicized. The proposed new Corporations Law even became the object of a Parliamentary Investigation Commission (Comissão Parlamentar de Inquérito – CPI), the process used to probe the most high profile political scandals in Brazil, as a result of accusations that multinationals had exercised undue influence on the legislative process. The legislative debates described the new Corporations Law as “one of the most important instruments to promote national development,” arguing that “the good or bad orientation of the country’s economic policy depended in large part on the achievements and mistakes reflected in the rules set forth in that statute.

Foreign law, at least in theory, played an important role in the corporate law reform process. Prior to the reform, a conference of prominent Brazilian lawyers and professors surveyed the corporate laws of the “most advanced legislations” – by which

---

261 Id. (quoting Valverde).
262 See Gilson, Hansmann & Pargendler, supra note 21.
263 LAMY FILHO & BULHÕES PEDREIRA, supra note 124, at 138.
they meant those of France, Germany, Italy, England and the U.S.265 (The fact that these jurisdictions had varying degrees of capital market development was apparently beside the point.) The choice of foreign legal transplants during the 1976 reform was once again highly selective given the goal of formally implementing progressive institutions while maintaining, if not reinforcing, the ample power and discretion (and, hence, wealth) of controlling shareholders.

U.S. corporate and securities law was arguably the most important source of inspiration for Brazil’s new Corporation Law, even as the Brazilian Bar Association resented what it saw as the inappropriate influence of U.S. law in the proposed bill.266 Many U.S.-inspired innovations were enabling in nature, such as the admission of stocks with no par value and a greater array of corporate securities. Other transplants suffered significant changes along the way. The new statute also imposed U.S.-style fiduciary duties on managers and controlling shareholders, but with a local twist.267 Managers and controlling shareholders were to serve the interests not only of shareholders as a whole, but also of employees, the community, and even “the national economy.”268 Probably the

265 Oscar Barreto Filho, Seminário sobre a Reforma das Sociedades Anônimas, Promovido pelo Instituto dos Advogados Brasileiros [Seminar on the Reform to the Corporations Law, promoted by the Brazilian Lawyers’ Institute], 77 REVISTA DE DIREITO MERCANTIL, ECONÔMICO E FINANCEIRO 119 (1972).

266 Senate Official Records [Anais do Senado], speech of Senator Franco Montoro, at 31 (session of Aug. 4, 1976) (quoting the objections to the bill raised by the Brazilian Bar Association).


268 Law 6,404/76, Arts. 116 and 117. As legal scholars have noted, broad fiduciary duties to different parties do not in fact make a fiduciary’s life more difficult due to the complex task of reconciling conflicting interests, but rather too easy, as “virtually any management decision, no matter how arbitrary, can be rationalized on the grounds that it benefits some constituency of the corporation.” See, e.g., Jonathan R. Macey, An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties, 21 STETSON L. REV. 23, 32 (1991).
most significant legal borrowing from the U.S. was the creation of a national securities oversight agency (Comissão de Valores Mobiliários – CVM), which was modeled after the U.S. Securities and Exchange Commission (SEC), even though it lacked the latter’s independence and enforcement capacity.269

Imports from French law had largely come to an end, although not necessarily for the better. France’s corporations statute of 1966 banned the issuance of non-voting shares, but the new Brazilian law in fact increased the existing ceiling from one half to two-thirds of the firm’s total equity capital. Alfredo Lamy Filho, one of the statute’s draftsmen, had previously suggested that Brazil follow the example of France’s recent legal reform to prohibit the issuance of partes beneficiárias – which he described as “securities, which do not serve to raise capital, but rather to distribute favors at the expense of the firm.”270 Nevertheless, partes beneficiárias made it into the 1976 law, and publicly-traded companies were not prohibited from employing them until 2001.271

One of the main changes introduced by the 1976 statute, however, did not come from the habitual foreign models. The statute imposed a mandatory dividend requirement – set at a default rate of 50% of the firm’s net income – with the goal of

---

269 But see Orlando Gomes, Fontes e Significado das Inovações da L. n. 6.404 [Sources and Meaning of the Innovations of L. n. 6.404], 275 REVISTA FORENSE 1 (1981) (attributing the creation of the Brazilian Securities and Exchange Commission (Comissão de Valores Mobiliários – CVM) to a transplant from Italian law). Although most scholars and policymakers likely had the U.S. model in mind, Brazil’s CVM – which established by the Capital Markets Law (Law 6,385) in 1976, the same year of the enactment of the then new Corporations Law – was initially timid in protecting investors and likely bore greater resemblance to its Italian (itself a transplant from U.S. law) than to its U.S. counterpart. Subsequent amendments to the Corporations Law and Capital Markets Law in 1997 and 2001 increased CVM’s autonomy vis-à-vis the executive and expanded the scope of its regulatory oversight and disciplinary authority.


protecting minority shareholders.\textsuperscript{272} Whereas many of the statutory innovations had an identifiable foreign source – at least in theory – the new mandatory dividend requirement was more of a local innovation. La Porta et al. have noted that only French civil law countries had minimum mandatory dividend requirements. Their data however reveals that all such countries are located in Latin America – and French law itself does not contain a similar provision.\textsuperscript{273}

As the literature documents, minimum dividend requirements are an imperfect substitute for more directly observable investor protections; they encourage tunneling to reduce the amounts that must be distributed to minority shareholders, with the effect not only of further discouraging minority investments, but also directly restricting the retained earnings available to fuel the company’s growth. In Brazil, the mandatory dividend requirement might have been in any case a sham as a contribution to minority protection. As the draftsmen of the 1976 statute acknowledged, Brazilian public companies already distributed, on average, a proportion of dividends to net income similar to the new statutory mandate.\textsuperscript{274}

Finally, when Brazil enacted its last major corporate law reform of the century in 1997, it again failed to mirror foreign legal developments. While other countries were

\textsuperscript{272} New companies, however, could lower the mandatory dividend rate in their corporate charters. For existing companies whose corporate charters were silent, the minimum dividend rate to be provided by charter amendments could not be lower than 25\% of the firm’s net income. \textit{See} Law 6,404 of 1976, Art. 202 (original formulation).

\textsuperscript{273} La Porta et al. have noted that only countries of civil law origin have mandatory dividends. La Porta et al., \textit{Law and Finance, supra} note 6. Nevertheless, the same authors also find that firms in common law countries generally make higher dividend payments than those in civil law countries. \textit{See} La Porta et al., \textit{Agency Problems and Dividend Policies around the World}, 55 J. FIN.1, 2 (2000).

\textsuperscript{274} Lamy Filho & Pedreira, \textit{supra} note 124, at 166 (noting that public companies distributed, on average, 40\% of their income in dividends, so that the new statutory regime did not represent a significant departure from the firms’ traditional dividend policies).
increasing the degree of legal protection afforded to shareholders, the amendments to Brazil’s Corporations Law aimed at eliminating various minority investor rights in control sales. As discussed in greater detail in Chapter IV, the goal of this government-sponsored reform was to maximize proceeds from control sales in privatizations by allocating to the State amounts that would otherwise have been paid to minority investors. Local politics, once again, hampered capital market development in Brazil. Capital market activity declined sharply in the late 1990s and would not recover until the success of the São Paulo Stock Exchange’s *Novo Mercado* experiment in the mid-2000s.

**VII. Evaluating Early Transplants**

As described above, Brazil has historically borrowed legal rules and institutions from a far more diverse array of jurisdictions than is usually assumed. The Portuguese did not forcefully impose French law in Brazil, nor were nineteenth-century Brazilians so immersed in French culture that any choice of legal system that they voluntarily made was severely constrained. Brazil’s nineteenth century lawyers – who were famous for

---


276 See Chapter IV *infra* for a detailed analysis of the driving forces and consequences of the 1997 legal reform to the Corporations Law.

277 For a description of the recent revival of Brazil’s capital markets, see Gilson, Hansmann & Pargendler, *supra* note 21.
being politicians rather than scholars\textsuperscript{278} – felt comfortable navigating and importing laws
and institutions from different civil and common law jurisdictions.

To be sure, the law-and-finance literature has increasingly shifted focus from
cross-country differences in specific commercial law rules to variations in more general
features of the legal system, such as the structure of the judiciary.\textsuperscript{279} But even when one
takes a broader perspective, the origins of Brazil’s legal system look equally diverse and
the resulting legal transplants just as selective. Brazilian lawmakers in the nineteenth
century were willing to consider England as a model not only for commercial laws, but
also for other more fundamental features of its legal system. Brazil’s first Constitution of
1824 simultaneously adopted a “Frencher-than-the-French” system of quadripartite
separation of powers\textsuperscript{280} and followed the English model in contemplating both civil and
criminal juries. Classic English remedies such as the \textit{habeas corpus} were adopted soon
thereafter.\textsuperscript{281}

\textsuperscript{278} See Miguel Reale, \textit{Prefácio} [Preface], in A. L. MACHADO NETO, \textit{HISTÓRIA DAS IDÉIAS JURÍDICAS NO BRASIL} (1969) (noting that Portuguese and Brazilian jurists were not traditionally inclined to general theorizing); VENÂNCIO FILHO, supra note 240, at 275 (stating that law school graduates comprised 67\% of ministries during the Empire and citing Senator Nabuco for the proposition that law schools were seen as the anteroom of Brazil’s House of Representatives).

\textsuperscript{279} See La Porta et al., \textit{Economic Consequences}, supra note 11.

\textsuperscript{280} Brazil’s Constitution of 1824 followed the work of French author Benjamin Constant in inaugurating a system which included the Moderating Power (\textit{Poder Moderador}), represented by the Emperor, in addition to the legislative, executive, and judicial branches. This quadripartite system was never adopted in France, and scholars have noted that the Brazilian conception of the Moderating Power made it even more powerful than originally envisioned by Constant. See, e.g., Nelson Saldanha, A Teoria do “Poder Moderador” e as Origens do Direito Político Brasileiro [The Theory of “Poder Moderador” and the Origins of Brazil’s Political Law] 6 (1988).

\textsuperscript{281} See Criminal Code of 1830 and Criminal Procedure Code of 1832. See also Senate Records, session of May 14, 1832, for a discussion of the adoption of the \textit{habeas corpus} remedy and its English origins. The propagation of English commercial instruments and legal institutions apparently puzzled some Brazilians. In a nineteenth-century chronicle by leading Brazilian writer Machado de Assis, one man, disappointed with the results of his investments in debentures, asks a friend about the wisdom of investing in \textit{habeas corpus} instead – to which the friend replies that “not everything that is foreign is a security” and that
Brazilian senators eulogized in several occasions the degree of judicial independence in England, referred to England as the “model country,” and described U.S. and English judges as “the first in the world.” They believed that a proposed project’s attempt to formalize a judicial career and create a judicial hierarchy would further erode the guarantee of an independent judiciary provided by the Brazilian constitution. The law-and-finance literature pays a great deal of attention to the lower status of judges in the French civil law tradition, but Brazilian judges in the nineteenth century “benefited from a degree of social and political prestige that was only comparable to those enjoyed by judges in England and North America.” Up to this day judges in Brazil are among the highest paid in the world.

There is little question that French law was highly influential in nineteenth-century Brazil, but its influence was by no means undisputed or inevitable. Overt criticism of France and its legal culture were commonplace, and Brazil repeatedly

\[ \textit{habeas corpus} \] “is a paper, but another kind of paper.” Machado de Assis, reprinted in \textsc{A Economia em Machado de Assis: O Olhar Oblíquo do Acionista} (Gustavo H.B. Franco ed., 2007).

282 Senate Records, speech of Sr. Saturnino (session of June 3, 1850), at 31; Senate Records, 1850, speech of Sr. Alves Branco (session of June 3, 1850) at 37. Indeed, greater judicial independence is said to be one of the distinguishing features of common law jurisdictions according to the law-and-finance literature. \textit{See}, e.g., Beck et al., \textsc{supra} note 16.

283 Senate Records, speech of Senator Alves Branco (session of May 25, 1850), at 97.

284 Beck et al., \textsc{supra} note 16, at 659 (noting that in the French civil law tradition, forms of recruiting, salary and prestige reflect the role of the judge as serving a mainly clerical function).


286 Eduardo Graeff, \textit{Luta de Classes no Brasil} [Class Struggle in Brazil], \textsc{Folha de São Paulo}, July 3, 2008.

287 Senate Records [Anais do Senado], speech of Senator Alves Branco (June 4, 1850), at 56 (“God save us from the French system!” – exclaimed Senator Alves Branco in discussing potential models for reform of Brazil’s judiciary).
chose to depart from French legal solutions both with respect to business organizations and the general structure of its legal system. Brazilian lawmakers expressly repudiated – not only once, but twice – proposals to adopt France’s system of a separate administrative jurisdiction, which it so successfully exported to other parts of the world. In both occasions, members of Brazil’s Council of State sought to avoid what they saw as an excessively “centralized nature of France’s administration,” by arguing that “Brazil’s constitution was more compatible with English principles of self-government.” After a careful study reviewing all available decisions by Brazil’s Council of State, legal historian José Reinaldo Lima Lopes concludes that

“our debt to foreign law was not limited to the continental, civilian, Romanist family. England was always remembered by Brazilian monarchists the ideal of a modern, liberal, conservative monarchy to be imitated. The United States also deserved attention and became the object of admiration.”

Brazil in fact lacked the quintessential element of a French civil law jurisdiction – a Civil Code – for the entire nineteenth century. Brazil’s Parliament did not commission a first draft a Civil Code until 1858 – eight years after the enactment of the Commercial Code and 34 years after the constitutional requirement for the Code’s enactment. This initial attempt however ultimately broke down when its draftsman, Augusto Teixeira

288 JOHN HENRY MERRYMAN, THE CIVIL LAW TRADITION: AN INTRODUCTION TO THE LEGAL SYSTEMS OF WESTERN EUROPE AND LATIN AMERICA 88 (2nd ed., 1985) (noting that various nations, including Belgium and Italy, attributed administrative jurisdictions to their own Councils of States, while other jurisdictions, such as Germany and Austria, created special administrative courts).

289 [Council of State Records, speech of Nabuco, at 262.]

290 LOPES, O ORÁCULO DE DELFOS, supra note 22, at 347.

291 See note 85 supra and accompanying text.
de Freitas, questioned the soundness of the separation adopted in French codifications between civil and commercial law, and refused to proceed with a civil codification that would be separate from a commercial one.\textsuperscript{292}

The codification scheme advanced by Freitas was markedly distinct from France’s \textit{Code} and its followers. His proposed framework would involve two distinct codifications: (i) a General Code (\textit{Código Geral}) that defined the legal terms and concepts common to all areas of law and (ii) a Civil Code (\textit{Código Civil}) that overcame the separation between Civil and Commercial Law, which Freitas regarded as “arbitrary” and unnecessary, and whose persistence elsewhere he attributed to the “inertia of legislations.”\textsuperscript{293} In his letter to the Imperial government defending his proposal, Freitas explained that his idea of producing a General Code was not novel, but rather had its seeds in sources as varied as (i) Pothier’s Pandectas, (ii) Bacon’s \textit{legum legis}, that is, laws that have as their object all other laws, and (iii) the Civil Code of Louisiana, which devoted its last section to general definitions of terms.\textsuperscript{294} In a different writing, Freitas

\textsuperscript{292} Teixeira de Freitas, the Code’s first draftsman, elaborated an entire Rough Draft of a Civil Code (\textit{Esboço}). The Rough Draft was never enacted into law in Brazil, but it served as a model for other Civil Codes in Latin America, notably the Argentinian one. Teixeira de Freitas’s overt repudiation of the division of private law in civil and commercial law, which would later become popular among Italian authors, was original at the time. For a thorough discussion of the process leading to the Civil Code’s enactment, see Moreira Alves, \textit{supra} note 64. In his letter to the imperial government, Teixeira de Freitas made a take-it-or-leave-it offer to the Imperial Government, in which he proposed either to draft a unified Code in its own terms or to rescind his contract. \textit{See} Augusto Teixeira de Freitas, \textit{Codificação do Direito Civil} [Codification of Civil Law] (letter of September 20, 1867 to the Minister of Justice) [hereinafter “Letter of Teixeira de Freitas”]. The contract was ultimately rescinded.

\textsuperscript{293} Letter of Teixeira de Freitas, \textit{supra} note 292.

\textsuperscript{294} \textit{Id.}
himself articulated the prevailing view of the time in stating that “[w]e do not have a law of a pure nationality.”

Lawmakers in the nineteenth century seemed utterly unaware that Brazil was a “French civil law jurisdiction,” and, as such, was bound to follow French legal solutions. In his lessons on “comparative legislation on private law,” Clóvis Bevilaqua, a prominent Brazilian scholar and later draftsman of Brazil’s Civil Code of 1916, relied heavily on the classificatory scheme advanced by French author Ernest Glasson. According to this categorization, the laws of European countries could be divided in three different groups: (i) legal systems that are largely exempt from the influence of Roman and canonic law, which included England, Scandinavian countries, the United States, and Russia; (ii) laws of strong Roman law heritage, which are exemplified by those of Spain, Portugal, Italy, and Romania; and (iii) legal systems combining Roman, Germanic, and national influence, which included France, Germany, Belgium, Holland, and Switzerland. To Glasson’s tripartite division Bevilaqua adds a fourth group to encompass the laws of Latin American countries, which, he claimed, “could not logically be included in any of the three aforementioned categories.” In his view, the laws of these groups were *sui generis* because they not only combined their Spanish and

---

295 F. P. Lacerda de Almeida, *O Direito Civil e sua Codificação* [Civil Law and its Codification], in *LIVRO DO CENTENÁRIO DOS CURSOS JURÍDICOS* (1827-1927) 169 (1928) (quoting Freitas).

296 For an excellent description of the culturalist *mentalité* of Clóvis Bevilaqua and of the Recife School of legal though (*Escola de Recife*) of which he is an offspring, see Martins-Costa, *supra* note 242, at 210 et seq.


298 *Id.* at 74.
Portuguese heritage with European (and notably French) legal influence but also displayed a “strong boldness” typical of young nations.\textsuperscript{299}

Most of the academic debate around the import of legal origins for financial development is framed in terms of how the effects of early legal transplants implemented during colonial times could persist for well over a century.\textsuperscript{300} This Chapter however suggests that the persistence puzzle is the wrong one. Indeed, the focus on legal families – and their consequences towards choice of legal imports – seems to be largely a twentieth-century phenomenon. While reference to English commercial law and U.S. public law seemed natural in the nineteenth century – to the point that a statute directed federal courts to employ cases of the U.S. common law and equity as subsidiary sources of procedure in Brazil.

The import of Anglo-American models, although common, began to be perceived as more “foreign” over the course of the twentieth century. France’s influence on Brazil’s commercial law has always been lesser than in other fields, but in the 1960s and 1970s the seeming Americanization of Brazilian commercial and corporate law then began to be seen as an “exception” to legal family lines.\textsuperscript{301}

If legal family considerations seemed immaterial to early Brazilian lawmakers, the opposite was true for legal transplants in general. Brazilian lawmakers reflected not only on the relative merits and implications of different foreign legal regimes, but also on

\textsuperscript{299} Id.

\textsuperscript{300} See, e.g., Aldo Musacchio, \textit{Law and Finance c. 1900}, NBER Working Paper No. 16216 (2010), available at http://papers.nber.org/papers/w16216 (seeking to ascertain “how persistent are the effects of legal institutions adopted or inherited in the distant past” are).

\textsuperscript{301} Arnoldo Wald, \textit{Brésil} [Brazil] 126 and 131, \textit{in LA CIRCULATION DU MODELE JURIDIQUE FRANCAIS} (Travaux de l’Association Henri Capitant des Amis de la Culture Juridique Français, 1993).
the very wisdom of borrowing other countries’ laws as a development strategy. References to the very term legal “transplants” (transplantes or, in its verb form, transplantar) were commonplace in legislative debates of the time, as were allusions to the underlying metaphor of a transferred plant that struggles to survive in unfamiliar soil.302 As one Senator put it, “we are not here to discuss if French legislation is good for that country, if Portuguese legislation produces such effects in Portugal etc.; our question is if the legislation of these countries can be adopted in Brazil without inconvenience, and if it will be here as fruitful as it perhaps might be in those countries.”303

In addition to considering the suitability of alien models to local conditions, parliamentary debates also addressed the institutional implications of copying the laws of other countries. One senator warned that the parliament of England, a “great country” having “much illustration and national pride,” does not spend all of its time “citing the laws of France, Bavaria or Spain.”304 Representatives warned that the endless references to foreign laws should be taken with caution as “our own country should be the principal object of our meditation.”305 In the words of one Brazilian senator, “[i]f our role is

302 Senate Records, speech of Senator D. Manoel (July 26, 1850), at 483 (arguing that the transplant of banking institutions to Brazil and the issuance of paper money should only be admissible once “the terrain is prepared to receive this still exotic plant in our country”); Senate Records, speech of Senator D. Manoel (July 26, 1850), at 483 (criticizing the import of the French national guard system as an “exotic plant which could not adapt [medrar] to Brazilian soil”). The etymological image of legal transplants as transplanted plants has since become a familiar one in the comparative law literature. See, e.g., Book Review, An Introduction to Comparative Law (K. Zweigert & H. Kötz) (by Christopher Osakwe), 62 TUL. L. REV. 1507, 1509 (1988) (equating the role of a comparatist with that of a plant geneticist that ensures that the transplanted plant will take roots in its new soil); Inga Markovits, Exporting Law Reform – But Will It Travel?, CORNELL INT’L L. J. 95, 98 (2004) (comparing the analysis about the viability of legal transplants to an “horticultural thought exercise”); Roderick A. Macdonald, Three Metaphors of Norm Migration in International Context, 34 BROOK. J. INT’L L. 603 (2009) (analogizing concerns about legal transplants to botanic and biodiversity considerations).

303 Senate Records, speech of Senator D. Manoel (June 1, 1860), at 13.

304 Senate Records, speech of Senator Senator D. Manoel, at 13 (June 1, 1860).

305 Id.
limited to translating some provisions of the French or the Bavaria code etc., then we do not need to think about the circumstances of this country; (...) if one illustrated nation can provide laws for the entire world, why then do we have this House, this deliberative body, why should we kill ourselves studying, thinking, debating for long days about any legislative matter?"306

Then, as now, efficiency pressures towards legal convergence also played an important role in legal reform. While Brazilian lawmakers felt comfortable picking, choosing and distorting foreign models, it was harder to explicitly avoid legal solutions that had reached universal acceptance among “cultivated” nations. When they did so, these departures often came in the form of inconspicuous decrees rather than in the more salient and prestigious provisions of codes and major statutes.

One must be cautious, however, about drawing generalizations from the Brazilian experience. The case of Brazil does not – indeed cannot – provide a precise roadmap of the evolution of corporate laws elsewhere in the developing world or even across Latin America. A previous study of commercial law history in Colombia revealed a radically different experience in nineteenth-century Latin America – one in which a lack of human and material resources led to thoughtless import of foreign laws without regard to local circumstances, or even social or economic demand.307

As described in Part IV above, Brazil endured a major political struggle before permitting business firms to incorporate without obtaining governmental approval.

---

306 Senate Records, speech of senator D. Manoel (responding to senator Nabuco).

307 See ROBERT CHARLES MEANS, UNDERDEVELOPMENT AND THE DEVELOPMENT OF LAW: CORPORATIONS AND CORPORATION LAW IN NINETEENTH-CENTURY COLOMBIA xiv (1980) (arguing that “[t]he codes’ corporate law provisions were only tenuously related to Colombian reality during most of the nineteenth century” and “[t]he very existence of the corporate law provisions of the codes owed little or nothing to any Colombian demand for a statutory law of business corporations”).
Conversely, Robert Means tells us that Colombia’s pioneering role as the first country in the region to adopt free incorporation did not reflect a conscious policy choice, but was rather the product of inadvertent changes by local draftsmen who were entirely unfamiliar with the corporate form.\textsuperscript{308} Previous inferences from Colombia’s experience to understand developments in Brazil were more misleading than informative; there is no reason why hasty generalizations from the Brazilian case to other countries would be immune from this risk.

Still, the role of politics in the origins of corporate laws might not have been unique to Brazil. Other Latin American countries have also been conspicuous latecomers in the free incorporation process.\textsuperscript{309} Given the speed in which legal ideas traveled in the nineteenth century, mere local ignorance of foreign legal developments is an improbable explanation. The case of Argentina seems particularly telling. Similarly to Brazil, private law institutions in Argentina generally had a Latin origin, but the strong commercial presence of Britain in the region made Argentinean commercial law very eclectic in nature and subject to a strong influence of English law.\textsuperscript{310} The draftsmen of the Argentinean Commercial Code of 1889 allegedly sought inspiration in the laws of

\textsuperscript{308} Id. at xv (arguing that Colombia’s “heterodoxy” in permitting free incorporations reflected “not an autonomous national legal development but an incapacity for such development. The changes permitting freedom of incorporation apparently were made by a draftsman with little understanding of the significance of the issues and approved by a legislature probably not even aware of their existence.”) These changes were later reversed when Colombia copied the Chilean Code years later.

\textsuperscript{309} M. C. MIROW, LATIN AMERICAN LAW: A HISTORY OF PRIVATE LAW AND INSTITUTIONS IN SPANISH AMERICA 162 (2004) (describing that “just as these European commercial codes were liberating corporations from the administrative control of the state, Gabriel Ocampo’s 1860 commercial code was being enacted in Chile in 1865. This influential code repeated the earlier ideas of state supervision”).

\textsuperscript{310} See, e.g., ANDRE FEASSE, LES SOCIÉTÉS ANONYMES DANS LA RÉPUBLIQUE ARGENTINE [Business Corporations in the Argentine Republique] (1928) 13 (emphasizing the eclectic character of Argentine commercial law, which mixed very different legal sources).
Portugal, Italy, England, Belgium, Spain and Germany.\textsuperscript{311} Nevertheless, Argentina deviated from every single one of these foreign models in retaining the requirement of governmental approval for incorporations well into the twentieth century.\textsuperscript{312}

VIII. Conclusion

The high degree of selectivity inherent to foreign legal transplants as adopted in Brazil did not go unnoticed by nineteenth-century Brazilian observers. Deviations from foreign models were habitually justified with references to different local circumstances, however arbitrary these differences may seem. Machado de Assis, who is widely acclaimed as the greatest writer of Brazilian literature, encapsulates this phenomenon in describing a dialogue between a meteorolite just fallen in the country and Mr. Carvalho, the public servant in charge of transporting the meteorolite to a national museum. When the meteorolite was surprised in hearing about the proposed adoption of the U.S. constitution under the emperor’s rule in Brazil, Carvalho replied by pointing to the different circumstances in both countries

“[C]onstitutional inventions, he noted, were not the business of a simple meteorolite, and that the supposition that the U.S. system is not consistent with a hereditary chief results from a lack of understanding of differences in weather and other conditions. It is

\textsuperscript{311} \textit{Id.} at 14.

\textsuperscript{312} \textit{Id.} at 39 (noting that by 1928, other than Argentina, only Chile, Paraguay, Uruguay, Holland, Russia and Turkey maintained the requirement of governmental approval for incorporations).
not striking to anyone that English is spoken there and Portuguese here. So it’s the same thing.”

Corporate lawmakers, in particular, entailed a conscious and thought through process which, following the examination of various foreign law models, often produced patchwork legal outcomes that did not mirror foreign legal solutions. The process leading to corporate law reforms was a highly political one – and self-consciously so. In the debates preceding the adoption of Brazil’s 1882 corporation statute, one senator warned that, despite efforts to frame the discussion in legal terms, the theme “has had for a long time a political connotation.”

Alan Watson’s view, echoed by La Porta et al., that legal systems evolve independently of political forces is predicated on the assumption that “for most of the time rulers and governments in the Western world as a whole were little interested in making private law.” Whatever wisdom this view may hold with respect to developments in contracts, torts, or property law, its utility in explaining the law of corporations is infinitely more fragile. For one, private law regimes have existed for over two millennia, while general business corporation statutes are only about two centuries’ old. More important, it is the effects that corporate laws can have on financial

313 Machado de Assis, Questão de federalismo... [Question of federalism...] (May 27, 1888), reprinted in A ECONOMIA EM MACHADO DE ASSIS: O OLHAR OBLÍQUO DO ACIONISTA 83-4 (Gustavo H.B. Franco ed., 2007).

314 Senate Records, speech of Senator Visconde de Jaguary (May 2, 1882), at 1. See also Lopes, A Formação do Direito Comercial Brasileiro, supra note 22, at 37 (noting that “commercial law was intimately linked to politics.”).


development and, consequently, on the degree of economic competition, growth, stability, and mobility that have made it almost impossible for governments to ignore them – in the present, as in the past.  

In conventional descriptions about the background of legal transplants, the story invariably goes that public-spirited reformers seek to modernize the law of a more backward society by importing “the best possible law” then governing a more developed nation. Just as the view of the law as politically neutral is misleading, so is the purported political neutrality of legal transplants. There is reason to think that legal outcomes have been intertwined with political power not only in the Middle Ages, as argued by Shleifer and Glaeser, or in contemporary Western social democracies, as suggested by most of the political economy literature, but across the board. 

In Brazil, the content of legal rules – and their perceived impact on ruling elites – was a far more relevant consideration in their adoption than whether the available legal menus were “made in France,” “made in the USA,” or made at home. Until the 1880s, Brazil not only mimicked, but independently magnified France’s restrictions towards business formation; in 1882, however, it also resorted to French law to liberalize the incorporation process, with positive consequences to financial development. In the

---

317 See, e.g., PETER ALEXIS GOUREVITCH & JAMES J. SHINN, POLITICAL POWER AND CORPORATE CONTROL XIV (2005) (noting that corporate governance “lies at the core of comparative and international political economy”).

318 WATSON, LEGAL TRANSPLANTS, at 92 (noting that law reform processes reflect “a conscious attempt to achieve the best possible rule”).

319 See PISTOR & MILHAUPT, supra note 14.

320 Shleifer & Glaeser, supra note 17.

321 See note 15 supra and accompanying text.
twentieth century, Anglo-American law served as inspiration for a statute authorizing the issuance of non-voting preferred shares, which came to be widely blamed for minority shareholder expropriation in Brazil.

Legal developments in Brazil were not mere copies, or inadvertent mutations, of foreign models. While many examples exist of foreign concepts that were simply lost in translation, intentional deviations from foreign legal solutions were commonplace throughout Brazilian history. One Brazilian Congressman in the nineteenth century sarcastically suggested that Brazil’s jury model – which differed markedly from its counterpart in England and France – deserved a patent for legal innovation. While many instances of local ingenuity were very fruitful (witness the recent _Novo Mercado_ experiment), others were less so. The selective transplantation of foreign models, and their transmutations into more friendly versions to local elites, was arguably one of the channels through which Brazilian oligarchies periodically recreated inefficient institutions to best fit their changing needs over time.

If legal families were not outcome determinative, and political considerations seemed to be driving the results, one could wonder whether legal transplants mattered at all. The Brazilian experience suggests that foreign models, as a whole, did carry significant weight. Brazilian lawmakers adopted a “cafeteria” approach to legal transplants. There was not a single country whose legal solution was binding in Brazil, but the legal outcomes of various “prestigious” jurisdictions served, in the aggregate, as a


323 Senate Records, speech of Senator Costa Ferreira, at 198 (1850).
menu based on which local lawmakers made their choices. Brazilian legislators felt more comfortable picking the bits they liked from different foreign models, and altering original combinations, than designing new rules and institutions from scratch.

In recent years, Rafael La Porta and his co-authors have expanded their concept of legal origins to encompass not only specific rules but also the “infrastructure” of the legal system, the “style of social control of economic life,” and the “human capital and beliefs of its participants.”³²⁴ This move towards a broader and more fluid definition of legal origins not only renders their claims increasingly unfalsifiable, but also dissociates it from the comparative law findings that form the basis for their models and categorizations. But notwithstanding the recent developments in the law-and-finance project, the assumption that legal origins are exogenous remains the cornerstone of the legal origins project.³²⁵ This case study of corporate law developments in Brazil cast serious doubts on the plausibility of this assumption.

Both the defenders of Legal Origins Theory and their followers at the World Bank have hopefully proclaimed that legal origins is not “destiny”³²⁶ – but the point of this Chapter is to demonstrate that, at least in Brazil’s case, it never was. Fighting undesirable legal outcomes alone, without regard to underlying political forces, deflects attention from the underlying causes of financial and economic underperformance. Because politics is such a key driver of corporate governance outcomes – now, as before

³²⁴ La Porta et al., Economic Consequences, supra note 11.

³²⁵ Id.

³²⁶ Simeon Djankov et al., Doing Business in 2004: Understanding Regulation (World Bank, 2004) (declaring that “heritage is not destiny”); La Porta et al., Economic Consequences, supra note 11, at 325 (denying that “origin is destiny”).
– policymakers could do well by turning their attention to the design of strategies to overcome the elites’ continuing resistance to financial and economic development.
I. Introduction

The effort to group jurisdictions around the world into a handful of legal families based on underlying common characteristics of their laws has traditionally occupied a central role in comparative law. While comparativists have over time become increasingly sophisticated about the limitations of legal family categories – which are now widely understood as ideal types rather than precise depictions of reality – many, if not most, comparative law books and treatises continue to be organized around this framework.1 And despite early suspicions that the seminal works of René David or Konrad Zweigert and Hein Kötz might have exhausted the theme as the object of legal scholarship,2 there have been a number of recent efforts to advance and refine, rather than abandon, legal family classifications.3

---


In the last fifteen years, two important but seemingly contradictory theoretical developments have brought the theme of legal families further into the spotlight. On the one hand, the continued utility of classifying jurisdictions as belonging to a handful of legal families has come under assault from a number of prominent comparativists. James Gordley has described the distinction between common and civil law as “obsolete,” while Hein Kötz, co-author of one of the most influential of such taxonomies, has urged comparative lawyers to bid farewell to legal family classifications. Some of the critiques were accompanied by proposals of alternative taxonomies, which aimed to supersede or complement existing categories. But the principal driving force behind this recent backlash is the widespread perception that the rise of the EU and pressures for legal convergence in a globalized world have rendered legal family distinctions increasingly outmoded.

4 James Gordley, Common law und civil law: eine überholte Unterscheidung [Common law and civil law: An obsolete distinction], 3 ZEITSCHRIFT FÜR EUROPÄISCHES PRIVATRECHT 498 (2003). See also JAMES GORDLEY, FOUNDATIONS OF PRIVATE LAW: PROPERTY, TORT, CONTRACT, UNJUST ENRICHMENT 43 (2006) (warning against the “danger of taking the difference in terminology too seriously and imagining that the common and civil law rest on fundamentally different concepts”).


6 For examples of recent proposals of alternative taxonomies, see James A. Whitman, Consumerism versus Producerism: A Study in Comparative Law, 117 YALE L. J. 340, 353 (2007) (arguing that “[g]ood comparative law should never claim to offer any single correct classification,” and proposing the distinction of consumeirism and producerism as categories that are “more revealing” than legal families in analyzing modern legal systems and informing social science inquiry); Ugo Mattei, Three Patterns of Law: Taxonomy and Change in the World’s Legal Systems, 45 AM. J. COMP. L. 5, 9 (1997) (arguing that “common taxonomies [of legal families] are outdated and should be replaced,” and advancing a new classification of legal systems as belonging to the rule of professional law, the rule of political law, or the rule of traditional law). Mattei classifies Latin America as belonging to the rule of political law, together with other non-Western jurisdictions. Id. at 28.

7 The literature is now too voluminous to be cited in full. For a few recent examples, see Arnold Wald, Doit-on repenser les « familles juridiques »? 188, in DE TOUS HORIZONS : MÉLANGES XAVIER BLANC-JOUVAN (2005) (arguing for the need to rethink legal family distinctions, which traditionally pay insufficient attention to developing countries); Bénédicte Fauvarque-Cosson, Anne-Julie Kerhuel, Is Law an Economic Contest? French Reactions to the Doing Business World Bank Reports and Economic Analysis of Law, 57 AM. J. COMP. L. 811, 829 (2009) (“the legal origins thesis bases its analysis on a
On the other hand, legal families have come to occupy a prominent role in the growing literature that seeks to ascertain the economic consequences of legal rules, institutions, and traditions. Since the late 1990s, a series of economic studies by Andrei Shleifer and his co-authors has broken new ground by using comparativists’ legal family classifications to test empirically whether a causal relationship exists between legal institutions and financial development. Their efforts have given rise to the so-called “law-and-finance” literature, whose sheer size and real-world influence are unprecedented in the field of comparative law.

classification of legal systems divided into legal families which is now by and large outdated. The globalization of law and its changing boundaries require a new approach to new analyses); Ralf Michaels, Comparative Law by Numbers? Legal Origins Thesis, Doing Business Reports, and the Silence of Traditional Comparative Law, 57 AM. J. COMP. L. 765 (“[i]n comparative law, we have come to think that the civil law/common law distinction is no longer very relevant for most important questions”: Holger Spamann, Contemporary Legal Transplants: Legal Families and the Diffusion of (Corporate) Law, 2009 B.Y.U. L. REV. 1813, 1815 (describing the growing consensus among sophisticated comparativists that there are “there are few if any relevant differences between common and civil law today”). For an earlier remark about convergence in judicial lawmaking in private law, see John P. Dawson, The General Clauses, Viewed from a Distance, 41 RABELS ZEITSCHRIFT FÜR AUSÄNDISCHES UND INTERNATIONALS PRIVATRECHT 441, 454 (1977) (highlighting the growing extent of judicial lawmaking by German judges in private law since the 1920s). But see for the opposite view, Pierre Legrand, European Legal Systems are Not Converging, 45 INT'L & COMP. L.Q. 52, 91 (1996) (refuting the “convergence thesis” between civil and common law systems, and arguing that there continue to exist in Europe “irreducibly distinctive modes of legal perception and thinking”).

See, for a few representative examples, Rafael La Porta et al., Law and Finance, 106 J. POL. ECON. 1113 (1998); Legal Determinants of External Finance, 52 J. FIN. 1131 (1997); Rafael La Porta et al., Law and Finance, 106 J. POL. ECON. 1113 (1998); Rafael La Porta et al., Corporate Ownership Around the World, 54 J. FIN. 471 (1999); Rafael La Porta et al., Investor Protection and Corporate Governance, 58 J. FIN. ECON. 3 (2000). To be sure, the “antidirector rights index” used in these initial works has been proved to be faulty. See Holger Spamann, The “Antidirector Rights Index” Revisited, 23 REV. FIN. STUD. 467 (2009) (finding numerous errors in the antidirector index that compromise the initial results obtained by the law-and-finance literature); Simeon Djankov et al., The Law and Economics of Self-Dealing, 88 J. FIN. ECON. 430 (2008) (for a more recent work that relies on an improved index and corroborates the initial results). For a review of this literature by its precursors, see Rafael La Porta et al., The Economic Consequences of Legal Origins, 46 J. ECON. LIT. 285 (2008) (hereinafter “Economic Consequences”). These studies have come to figure among the most cited and controversial studies in the social sciences in recent history. See Chapter II supra for a more detailed discussion of these works and their underlying assumptions. While legal families were initially used as an instrumental variable to provide an exogenous source of variation in the country’s legal systems, more recent studies have employed these classifications as explanatory variables. See La Porta et al., Economic Consequences, supra, for a discussion.

legal families just as comparative lawyers were abandoning the same classifications that until then had been one of the principal intellectual feats of their field.10

In assessing the current significance of legal families, comparative lawyers and economists have generally talked past each other and reached divergent conclusions. While comparativists have asserted the decline of legal families, a major strand of the economic literature has provided empirical evidence suggesting the persistence of legal family categories as a source of variation in legal and economic outcomes across jurisdictions.11 Nevertheless, despite their differences, the two camps share the assumption that legal family distinctions were stronger in the distant past than they are today. Indeed, it is telling that what comparative lawyers call “legal families” economists have come to term “legal origins,” a phrase that highlights the purported historicity of these categories that is key to their proponents’ purposes.12

To be sure, the comparative law literature is now replete with nuanced accounts about the meaning and significance of legal family distinctions. Even as comparative lawyers have become used to dividing the world in different legal families, they are
governance, inspired by the law-and-finance literature, as an “astonishing phenomenon” whose output “outdoes all of the publications in the rest of comparative law put together”).

10 Mathias Reimann, The Progress and Failure of Comparative Law in the Second Half of the Twentieth Century, 50 AM. J. COMP. L. 671, 673 (2002) (citing legal families, together with knowledge of foreign law and the process of comparison itself, as the three main areas of achievement for comparative law scholarship in the twentieth century). For a critique of the use of legal families in econometric studies, see Mathias M. Siems, Legal Origins: Reconciling Law & Finance and Comparative Law, 52 MCGILL L.J. 55 (2007).

11 Holger Spamann has attempted to reconcile these views by showing the persistence of strong diffusion patterns along legal families in the twentieth century. Spamann, supra note 7, at 1813 (stating that the continued importance of legal families as a source of legal materials in the periphery “raises the possibility that substantive differences between countries of different families around the world, such as those documented in the legal origins literature, continue to be the result of separate diffusion processes rather than of intrinsic differences between common and civil law”).

12 See note 8 supra and accompanying text.
acutely aware of the danger of gross generalizations inherent in such taxonomies. More recently, comparativists have come to emphasize the significant degree of mutual influence and cross-fertilization among different legal traditions throughout history.  

Nonetheless, when all is said and done, one is still left with the impression that the decline of legal family categories since the nineteenth century has followed a linear trend line – even though scholars continue to disagree about the slope of the decline, or the degree of current convergence.

This Chapter seeks to complicate the conventional understanding by surveying the evolution of legal family taxonomies from the first efforts at classification in the late-nineteenth century to the influential categorizations advanced by René David and Zweigert and Kötz in the 1960s. It will focus not on the perceived decline of legal family distinctions, but rather on the emergence of the concept in the comparative law literature. While much ink has been spilled on the former, the latter has been largely ignored – as if legal families were hard facts rather than theoretical constructs. In revisiting the intellectual history of comparative law as a discipline in general and of its taxonomic efforts in particular, I examine the timing and factors leading to the rise of legal families as a mainstream conceptual framework for making sense of commonality and variation across foreign legal regimes. In doing so, I demonstrate that early taxonomies looked significantly different from their modern counterparts.

13 See, e.g., Gino Gorla & Luigi Moccia, A ‘Revisiting’ of the Comparison between ‘Continental Law’ and ‘English Law’ (16th-19th Century), 2 J. LEGAL HIST. 143 (1981); The Reception of Continental Ideas in the Common Law World 1820-1920 (Mathias Reimann ed., 1993) (hereinafter “The Reception of Continental Ideas”) (“[t]he traditional view that the two great Western legal systems, the civil and the common law, developed in virtual isolation from each other is quickly being eroded”).
As this Chapter shows, the efforts at categorization that would eventually dominate research in comparative law remain embryonic throughout the nineteenth century. The first groupings of different countries’ laws under certain umbrella labels were beginning to appear by the end of the century, but the makeup of these early classificatory schemes was fundamentally dissimilar to their later replacements. The criteria used to sort different legal systems were still unsettled, ranging from historical characteristics and the geographical position of the jurisdiction in question to the racial makeup of its population.

These early classifications differed from current legal family categories in a number of ways. First and foremost, the core distinction between civil- and common-law regimes was conspicuously absent from most comparative taxonomies of legal systems until the twentieth century. While France and England were habitually classified as belonging to separate categories, Germany’s classification remained highly contested. Depending on the author, it was classified as belonging to the same group as England, to the same group as France, or to a separate category altogether. Moreover, early Latin American comparativists classified the countries in the region not as the offspring of European traditions, as they are commonly understood today, but rather as belonging to a *sui generis* category of original legal systems.

This degree of transformation in the conceptions and characterizations of legal families over time is surprising. Legal families imply ancestry, while legal traditions
entail “pastness.”14 And yet, just a few generations ago, the prevailing conceptions about legal families looked significantly different from their modern-day counterparts.

The relatively recent vintage of legal family classifications raises questions about why prevailing conceptions about the origins and affiliations of legal systems underwent such a major transformation over time, and the extent to which shifting taxonomies tracked changes in legal developments on the ground. Were early comparativists simply less sophisticated and knowledgeable about foreign legal systems, and did they thus fail to grasp the true nature of their object of study? Or could it be that the variation in taxonomies over time was attributable to corresponding differences in underlying legal phenomena? While this study does not and cannot provide definitive answers to these questions, it offers some preliminary and necessarily tentative thoughts that underscore the importance of pursuing this line of inquiry.

Clearly, one cannot take legal family classifications – present or historical – as precise assessments of an underlying reality. At the other extreme, however, it would be premature to dismiss early authors’ groupings of legal systems as hopelessly flawed and lacking any instructive value about the then-contemporary legal systems that they sought to describe. While the first comparativists of the nineteenth century did not enjoy the benefit of subsequent theoretical advances, they had the comparative advantage of an unmatched proximity to the legal systems and worldviews that their classifications sought to capture.

14 The expression, in the context of legal traditions, comes from H. PATRICK GLENN, LEGAL TRADITIONS OF THE WORLD: SUSTAINABLE DIVERSITY IN LAW 5 (4th ed., 2010) (“[t]he most obvious and generally accepted element of tradition is what T.S. Eliot has called its ‘pastness’”).
I conjecture that there is a mutually reinforcing relationship between legal family classifications and surrounding legal developments. On the one hand, one can expect classificatory schemes to reflect, even if only partially and imperfectly, the character of legal systems around the world as contemporary observers perceived them. On the other hand, because law is a social and cultural phenomenon, existing understandings about legal systems and traditions may in turn impinge on subsequent legal developments. This Chapter thus suggests that nineteenth-century comparativists’ lesser degree of attention to the civil-common law dichotomy was in part a product of the more cosmopolitan orientation of law and culture in that period. In turn, by de-emphasizing the importance of deep-rooted legal traditions, the existing theoretical framework has likely facilitated more diverse sources of legal borrowings, thus reinforcing the reigning belief in the desirability and feasibility of legal convergence.

In delineating the intellectual history of comparative law as a discipline, this Chapter argues that the oversight of existing diversity across legal traditions both reflected and reinforced the cosmopolitan stance of early comparative efforts. At its inception in the nineteenth century, the field now known as comparative law – then called “comparative legislation” (legislation comparée) – had a mission that differed in important ways from its later goals. The primary goal of comparative legislation was to produce knowledge by juxtaposing foreign legal rules – not to draw meaningful comparisons or scientific theories about different legal systems. The resulting studies aimed not so much to stress differences among legal systems, but to overcome an excessively formalist focus on national law and discuss avenues for legal convergence.
and unification. Just like the globalization movement of the late-twentieth century, the late nineteenth century’s own (arguably just as profound) period of globalization generated significant pressures for cross-border legal convergence and integration.

The notion that the development of legal traditions has not been as linear and isolated as conventionally assumed is gradually gaining acceptance in the comparative law literature. An excellent collection of works by prominent comparative law scholars on the diffusion of continental legal ideas between 1820 and 1920 has shown that, “astonishing as it may be to many legal historians and comparatists, the exchange of ideas between the civil- and common-law culture was lively and fruitful even during the heyday of caselaw and codification.” This study adds to these earlier findings by challenging the very idea that the nineteenth century was unambiguously the apex of the civil-common law dichotomy. The central purpose of this Chapter is to highlight the previously overlooked extent to which the reification of legal family distinctions is a twentieth-century phenomenon.

Throughout the twentieth century, research in comparative law made considerable progress in accumulating knowledge about foreign legal systems and conceptualizing

---

15 Id. at 9 (noting that the developments of comparative lawyers in the end of the nineteenth century were marked by a contestation of “legal nationalism” and by a desire for legal unification). See also, David Kennedy, The Methods and Politics of Comparative Law, The Methods and Politics of Comparative Law, in COMPARATIVE LEGAL STUDIES: TRADITIONS AND TRANSITIONS (Pierre Legrand & Roderick Mundary, 2003) (for an intellectual history of the evolution of comparative law as a discipline from 1900 onward).

16 See HAROLD JAMES, THE END OF GLOBALIZATION: LESSONS FROM THE GREAT DEPRESSION 10-12 (2001) (noting that “[a]t the end of the nineteenth century, the world was highly integrated economically, through mobility, of capital, information, goods, and people,” and that “[f]or most countries, despite all the intervening improvements in the means of transportation, the levels of trade of the prewar world were not reached again until the 1980s”). James also stresses that “the optimism of the age [late nineteenth century] can be used as a testimony to its internationalization of cosmo-politanism. Id. at 13.

important differences in the operation of the law across legal traditions. But while important, theoretical progress was merely one element contributing to the solidification of legal family categories in the twentieth century. At least two other factors external to the practice and study of the law – anti-colonialist sentiment and economic liberalism – likely played a role in minimizing the salience of legal traditions in nineteenth-century legal thought.

In that period, many recently-independent countries viewed tradition – including legal tradition – as closely intertwined with colonial domination and therefore suspect. Young nations sought to ascertain their independence and identity by underplaying the importance of tradition and resorting to diverse legal borrowings in an attempt to construe an original system of their own. This phenomenon was, in turn, significantly reinforced by the model of economic liberalism prevailing at the time, which encouraged economic integration and the free flow of goods, people, and ideas to an extent that was not replicated until the last decades of the twentieth century. As states gradually became more nationalistic and autarkic after World War I, a stronger attachment to legal traditions began to take hold; incidentally, these same conceptions had the benefit of buttressing national identity in a period in the face of a different set of world superpowers, the United States and the Soviet Union, which were thought to lack longstanding legal traditions of their own.

This Chapter is structured as follows. Part II describes how comparative lawyers’ taxonomies of legal systems evolved over time, from nineteenth-century scholars’ first efforts to the legal family classifications that are standard, though increasingly contested, today. Part III examines the shift in the content, method, and purposes of comparative
legal studies in the nineteenth and twentieth centuries, showing how the lesser role of legal family categories in the nineteenth-century legal imagination paralleled the more cosmopolitan orientation of early comparative efforts. Part IV explores how this lesser degree of awareness of legal families and traditions may have influenced patterns of legal borrowing during the “first globalization” of the nineteenth century. It also offers some tentative explanations for the solidification of conceptions of legal families and traditions in the twentieth century. Part V concludes.

II. Legal Family Taxonomies in Historical Perspective

Notwithstanding all the criticism directed against legal family classifications and ongoing charges of obsolescence, there is little question that such taxonomies figure among the main contributions of twentieth-century comparative legal scholarship. Most comparative law books and treatises devote entire chapters to the concept of legal families, even as they warn that such classifications are at best approximations rather than exact descriptions of reality. More recently, legal family distinctions have come to occupy a prominent role in the economic literature as well, as distinguished economists have drawn from comparative law categories to produce some of the most cited and controversial social science articles in recent memory.\(^\text{18}\)

Contemporary scholars typically associate legal family taxonomies with their most famous proponents – French comparativist René David and German legal scholars

\(^{18}\) See supra note 8 and accompanying text.
Konrad Zweigert and Hein Kötz. Although the publication dates of their seminal works are well known – 1964 for David’s “Les grands systèmes de droit contemporains” and 1969 for Zweigert and Kötz’s “Einführung in die Rechtsvergleichung” (1969) – the resulting groupings have come to be viewed as historically-rooted categories. Indeed, while there is now a voluminous literature attesting to the declining significance of legal families, scholars have thus far paid insufficient attention to the timing and driving forces behind the rise of these conceptual categories.

This Chapter examines how comparative lawyers viewed the relationship between different legal systems before the taxonomies popularized by René David, or Zweigert and Kötz, gained ascendancy. The thrust of this section is to underscore how recent now-conventional legal family classifications really are. I show that the first nineteenth-century taxonomies differed significantly from those advocated by David and Zweigert and Kötz. Early categorizations did not even distinguish between “common law” and “civil law” jurisdictions – the most basic unit of the legal family project. Moreover, the first classificatory schemes advanced by Latin American scholars treated the jurisdictions in the region as belonging to a category distinct from European families because of what they deemed to be the “original” character of Latin American countries’ laws.

I begin by examining the pioneering classification proposed by French scholar Ernest Glasson in 1880. Before Glasson, Gumersindo de Azcárate, a Spanish scholar, proposed one of the first groupings of various jurisdictions in his treatise on comparative legislation of 1874. He sorted jurisdictions according to the ethnicity of their people, hence resulting in five different groups: (i) Neo-Latin peoples, (ii) Germanic

\[\text{19} \text{ Reimann, }	extit{supra} \text{ note 10 ("today, everybody in the field is familiar at least with the modern classics: René David’s scheme and Zweigert & Kötz’ widely accepted definition of families according to “style,” both first published in the 1960s").}
\[\text{20} \text{ See notes 23-29 infra and accompanying text.}
\[\text{21} \text{ Before Glasson, Gumersindo de Azcárate, a Spanish scholar, proposed one of the first groupings of various jurisdictions in his treatise on comparative legislation of 1874. He sorted jurisdictions according to the ethnicity of their people, hence resulting in five different groups: (i) Neo-Latin peoples, (ii) Germanic}

comparative legislation, Glasson devoted an entire section to a survey of the sources of
civil law in Europe. It is in that section that he advances a classification of different
jurisdictions based on common characteristics of their laws. Glasson’s tripartite
classification divides countries into the following categories: (i) jurisdictions that are
strongly influenced by Roman law, such as Spain, Portugal, Italy, and Romania; (ii)
jurisdictions that are largely immune from Roman-law influence, such as England,
Russia, and Scandinavian countries; and (iii) jurisdictions that combine Roman and
Germanic (i.e., barbaric) influence, such as France and Germany. There is very little, if
anything of David or Zweigert and Kötz, in this effort. Glasson does not articulate an
overarching distinction between civil-law and common-law jurisdictions. Moreover,
England, Russia, and Scandinavia, each of which would have belonged to a separate
family under contemporary schemes, were grouped as belonging to the same category.
France and Germany were assigned to the same group but one distinct from that of Spain,
Portugal, and Italy – jurisdictions that are today deemed to be part of the French tradition.

Glasson’s taxonomy, though covering only European countries, travelled rapidly
across the Atlantic. When Clóvis Bevilaqua – professor of Comparative Legislation at
the Faculty of Law of Recife (Faculdade de Direito de Recife) in Brazil and later
draftsman of the 1916 Brazilian Civil Code – wrote his own treatise on the subject in

peoples (which included not only Germany and some of its neighbors, but also England and the United
States), (iii) Scandinavian peoples, (iv) Slavic peoples, and (v) a residual categories for “other peoples of
Christian-European civilizations,” including Greece, Malta and the Jonic Islands. It is clear, however, that
sole purpose of his classification was to organize countries’ descriptions in chapters. [The author does not
elaborate on the criteria he used for the classification, nor does he claim that the laws of the countries so
ordered have much in common. See GUMERSINDO DE AZCÁRATE, ENSAYO DE UNA INTRODUCCIÓN AL
ESTUDIO DE LA LEGISLACIÓN COMPARADA (1874).

22 ERNEST GLASSON, LE MARIAGE CIVIL ET LE DIVORCE DANS L’ANTIQUITÉ ET DANS LES PRINCIPALES
LÉGISLATIONS MODERNES DE L’EUROPE: ÉTUDES DE LÉGISLATION COMPARÉ PRÉCÉDÉE D’UN APERÇU SUR
LES ORIGINES DU DROIT CIVIL MODERNE (1880).
1893, he relied heavily on Glasson’s classificatory scheme. But since the French scholar’s categorization was limited to European countries, Bevilaqua undertook to complement it.

In this regard, it is highly revealing that Bevilaqua did not simply revise Glasson’s scheme by pigeonholing Latin American countries into one of the pre-conceived European categories, as would become the norm in modern-day classifications. Rather, he created a fourth and separate category to describe the laws of Latin American countries, which, in his view, “could not logically be included in any of the three aforementioned categories” — a move that is illustrative of how lawyers in peripheral legal systems viewed their countries’ legal allegiances in the nineteenth century. For Bevilaqua, the laws of Latin American jurisdictions were *sui generis* because they combined a Spanish and Portuguese heritage with European (and notably French) legal influence while displaying a “strong boldness” typical of young nations. The distinctiveness of these early categorizations raises the question whether, at least in the New World, legal traditions were to a surprising degree invented well into the twentieth century.

---


24 *Id.* at 74.

25 *Id.*

26 Legal traditions are, in this sense, similar akin to “invented traditions,” — that is the notion that “‘traditions’ that appear or claim to be old are often quite recent in origin and sometimes invented. See Eric Hobsbawm, *Introduction: Inventing Traditions*, *in The Invention of Tradition* 1 (Eric Hobsbawm & Terence Ranger eds., 1983) (noting that “[i]nsofar as there is such reference to a historic past, the peculiarity of “invented traditions is that the continuity with it is largely factitious”).
Subsequent Latin American comparativists continued to employ Glasson’s classification as amended by Bevilaqua. Candido Luiz Maria de Oliveira – a Brazilian jurist whom René David would later acknowledge as a true precursor in the field of comparative law27 – employed a virtually unchanged version of Bevilaqua’s taxonomy in his comparative legislation treatise of 1903.28 Similarly, Argentinean scholar Enrique Martinez Paz relied on and expanded Glasson’s categories as amended by Bevilaqua well into the 1930s.29

These studies show that the first attempts to group different countries based on the perceived common characteristics of their legal systems date back at least to the late-nineteenth century. Still, the main purpose of these emerging efforts seems to have been expositional clarity rather than the formulation of scientific hypotheses about different legal systems. Categories became headers of book chapters. It was not until the 1900 International Congress on Comparative Law (Congrès international de droit comparé) in Paris that taxonomies of legal systems would be elevated to a central feature of comparative law as the science that it aspired to become.

At the 1900 Congress, Gabriel Tarde, professor at the Collège de France, articulated a clear defense of legal family classifications as a central goal of comparative law. In his words, “under this new viewpoint, the task of comparative law is less to indefinitely collect exhumed laws than to formulate a natural – that is, rational –


28 Candido Luiz Maria de Oliveira, Curso de Legislação Comparada (1903).

29 See note 43 infra and accompanying text.
classification of juridical types, of branches and families of law.”  

For Tarde, this framework, once discovered, would easily encompass all possible legal institutions “known or to be known.”

Tarde’s paradigm for comparative law taxonomies borrowed heavily from linguistics and biology. He stressed that, despite the existing heterogeneity of language families, linguists had no trouble sorting newly-discovered languages into existing categories. The same was true, he argued, for botanical and zoological classifications, which remain unaltered by the discovery of new animals and plant species or the extinction of existing ones. Tarde argued that, so long as the classification is the right one, “the interest in completing the collection becomes secondary.”

It does not take a major stretch of imagination to think that the very concept of a “family,” for Tarde, was borrowed from biology’s phylogenetic categories of kingdom, class, order, family, genus, and species. In this light, René David’s oft-cited admonition that legal families are a “didactic device, rather than a biological reality” looks less like a mere acknowledgment of the limitations of classificatory schemes, as the phrase has been usually construed, and more like a clear departure from his intellectual tradition.

Tarde’s contribution was an early articulation of an approach that would become entrenched in twentieth-century comparative law. Classifications were no longer meant

---


31 *Id.*

32 *Id.*

33 Tarde speaks of *embranchements* (“branches”), a word used in French to describe, among other things, biological taxonomies.

simply to organize the exposition of different countries’ legal systems. Instead, the formulation of a proper taxonomy became the primary task of comparative law as a discipline; the knowledge of the actual laws of a number of foreign countries, meanwhile, was written off as a matter of secondary importance. The goal of taxonomies was not to complement but to replace mere descriptions or juxtapositions of foreign laws.

While Tarde himself did not propose a criterion to classify different systems, Adhémar Esmein, a law professor at the University of Paris, filled in the gap in his own contribution to the Paris Congress. For Esmein, sensible classifications were crucial for advancing sensible comparisons. He argued that comparativists should refrain from taking their national legislation as the center of the legal universe and treating other legal systems as mere satellites.\(^{35}\) At the same time, he claimed that a random choice of legislations to be studied would be equally inappropriate. Instead, he proposed to “classify the legislations (or customs) of different peoples, by reducing them to a small number of families or groups, of which each represents an original system; creating awareness about the historical formation, the general structure, and the distinctive traits of each of these systems seems to be a first, general, and essential part of the scientific comparative law education.”\(^{36}\)

Esmein proposed a division of Western legal systems into four groups: (i) the Latin group, comprising France, Belgium, Italy, Spain, Portugal, Romania, and Latin American countries; (ii) the Germanic group, including Germany, Scandinavian

\(^{35}\) This approach was indeed dominant in the nineteenth century. See notes 78-80 and 84 infra and accompanying text for examples of earlier studies adopting precisely this approach.

countries, Austria, and Hungary; (iii) the Anglo-Saxon group, comprising England, the United States, and the British colonies and dominions; and (iv) the Slavic group. In addition to these, Esmein proposed the inclusion of a fifth group for Muslim law as yet another original system and of interest to European nations because of their colonies’ Muslim populations. Unlike the taxonomies proposed throughout the nineteenth century, Esmein’s classification looks similar to those that would become dominant later in the twentieth century. Combine the Latin and the Germanic group, and read “socialist” instead of Slavic, and you get René David’s taxonomy. A spin-off of Scandinavian countries from the Germanic group, in turn, produces Zweigert and Kötz’s framework.

Yet it would be premature to conclude that the framework of David and Zweigert and Kötz has been dominant since the publication of Esmein’s piece in 1900. On the contrary, Esmein’s piece was soon criticized and rapidly forgotten. Perceptions of legal families remained very much in flux among comparativists, and conflicting taxonomies continued to proliferate. Moreover, upon closer inspection, Esmein’s classificatory scheme is remarkable not only for the distinctions it anticipated, but also for those it missed. The core distinction between civil-law and common-law systems is entirely absent from his framework. While the Anglo-Saxon group is now separated from others, there is yet no sign of the underlying commonality between the Latin and Germanic groups as members of a single tradition.

In 1913, French comparativist Georges Sauser-Hall published his *Fonction et méthode du droit comparé*. His book criticized existing taxonomies and proposed a new,

37 *Id.*

38 Zweigert & Kōtz, note 55 infra, at 64, in fact came to the defense of Esmein’s classification from later criticism, arguing that “Esmein’s grouping was particularly good for his time.”
ethnological classification of legal families based on race – including such legal families as the Hindu, Celtic, Anglo-Saxon, Hebraic, Egyptian, Germanic, and Graeco-Latin, among many others. In sorting out legal families according to the apparently immutable criterion of race, Sauser-Hall was unsurprisingly quite critical of early comparativists’ universalist vision, which in his view ignored entrenched legal differences across countries.39

In 1923, it was Henry Levy-Ullman, another French legal scholar, who advocated the formulation of legal family classifications as a central feature of the comparative method in his contribution to volume celebrating the fiftieth anniversary of the Société de législation comparée. In his view,

« les principes fondamentaux de la méthode comparative ordonnent, en effet, aux juristes (...) de commencer par procéder à un groupement rationnel des législations, c’est-à-dire de les classer, non pas superficiellement, par l’alphabet ou la géographie, mais par « familles », au moyen d’un véritable apparentement reposant sur des affinités scientifiquement déterminées : et cette opération préalable, à laquelle je vais consacrer quelques moments, dominera, par la suite, mon exposé, jusqu’à ses conclusions finales. »40

While heaping praise on the scientific character of legal family taxonomies, Levy-Ullman was nevertheless critical of Esmein’s proposed classification, which he saw as too dependent on ethnic considerations and “terribly obsolete.”41 In what was an obvious

39 GEORGES SAUSER-HALL, FONCTION ET METHODE DU DROIT COMPARE 59-63 (1913).
40 Henry Levy-Ullman, Observation générales sur les communications relatives au droit privé dans les pays étrangers 85, in LES TRANSFORMATIONS DU DROIT DANS LES PRINCIPAUX PAYS DEPUIS CINQUANTE ANS (1869-1919) (Livre du cinquantenaire de la Société de Législation comparée) (1923).
41 Id. at 87.
antecedent of René David’s work, Levy-Ullman proposed a division into three “great systems” (grands systèmes) according to “sources of law”: (i) legal systems of continental countries, which are based on written sources of law (pays de droit écrit); (ii) legal systems of English-language countries, which follow the common law; and (iii) legal systems of Islamic countries. It is remarkable that the first clear articulation by a prominent comparativist of the great common-civil law dichotomy based on the criterion of “sources of law” apparently did not take place until the 1920s – perhaps not coincidentally after World War I destroyed the strong faith in world integration and progress that had characterized the previous generation.

Nevertheless, even these seemingly straightforward and all too familiar distinctions were not immediately influential. In 1934, Argentinean comparativist Enrique Martinez Paz advanced a modified version of Glasson and Bevilaqua’s taxonomy. The approach embraced in Martinez Paz’s treatise shows that, as late as the 1930s, comparativists not only continued to neglect the civil-common law dichotomy but were also willing to group under the same label legal systems as diverse as those of Latin America, Switzerland, and Russia. The Martinez Paz’s taxonomy would certainly cause surprise today, and one may be inclined to dismiss it as an aberration or outlier. But in continuing to play down the distinction between civil- and common-law systems, Martinez Paz was in distinguished company – namely, that of the early René David, who

42 Id. at 87 (“[t]els sont les trois grands systèmes entre lesquels se repartit aujourd’hui le droit des principaux pays, quelles que soient les nuances qui séparent dans l’intérieur de chaque groupe, les familles distinguées par la classification d’Esmein, et entre lesquelles les différences – comparées à celles sur lesquelles repose la nouvelle classification – apparaissent comme vraiment secondaires”).

43 ENRIQUE MARTINEZ PAZ, INTRODUCCIÓN AL ESTUDIO DEL DERECHO CIVIL COMPARADO (1934).
came to be “one of the most influential theorists of the ideal of ‘legal families’ in both the continent and the U.S.”

As is well known, René David’s celebrated book “Les grands systèmes de droit contemporain,” published in 1962, later came to divide the world map into four large groups: (i) Romano-Germanic laws, (ii) Common Law, (iii) Islamic Law, and (iv) Socialist Law. It is therefore striking that David himself held a very different view of the significance of the common-civil law distinction just one decade earlier, when he published his “Traité élémentaire de droit civil comparé.” His 1950 treatise divides the world in five different legal systems: (i) Western Law, (ii) Socialist Law, (iii) Islamic Law, (iv) Hindu Law, and (v) Chinese Law. The distinction between continental and common-law traditions is conspicuously absent as a high-level category.

In his treatise, David emphasizes the “inevitably arbitrary” character of legal taxonomies, and illustrates his claim by citing most of his predecessors’ attempts to devise adequate classifications. David, however, deliberately chooses to distance himself from what he described as the “traditional opposition, affirmed by all authors, between the Roman-law system and the common-law system.” In fact, his treatise goes to great lengths to downplay the significance of the distinction between Romano-Germanic and common-law systems.

---


45 DAVID, note 73 infra, at 225.

46 Id. at 222 (stressing that “[t]oute classification est nécessairement arbitraire”).

47 Id. at 225 (“l’on s’étonnera principalement, sans doute, de ne pas retrouver, dans la classification ici proposée, l’opposition traditionnelle, affirmée par tous les auteurs, entre le système du droit romain et le système de la common law”).
While David acknowledges the existence of important differences between common- and civil-law systems (and includes the dichotomy between the “French group” and the “Anglo-American” group as main subdivisions of the Western group), he insists that such distinctions are not of the same order as those that exist among the other groups. The observable differences between French and English law, he argues, exist at what is “essentially a technical, not an ideological, level.” David contends that both systems, through different technical methods, reach essentially similar legal solutions. Therefore, he concludes that

“[t]he “opposition between continental and common law cannot be scientifically placed at the same level as that between French and Chinese law; it permits no more than to establish a division, albeit fundamental, within a legal system whose unity is recognized and affirmed: the Western legal system. It is only by an error of perspective that Anglo-American law, and with even greater reason German law, was until now considered as constituting separate categories enjoying perfect autonomy relative to French law.”

In the same year that René David’s volume came out, a trio of Egyptian, Russian, and German scholars – Pierre Arminjon, Boris Nolde, and Martin Wolff, respectively – teamed up to publish a competing comparative law treatise. Arminjon et al.’s treatise valued the formulation of legal family taxonomies to an even greater extent than David himself. In their view, “the task of comparative law as an autonomous science should

48 The author’s national bias is once again apparent.
49 *Id.* at 225.
50 *Id.* at 225.
51 PIERRE ARMINJON ET AL., TRAITÉ DE DROIT COMPARÉ (1950).
have as its starting point the classification of the large number of the world’s legal systems."\textsuperscript{52} They divided the world map explicitly into “parent tree systems” and “derived systems,” which together constituted seven different legal families: (i) French, (ii) German, (iii) Scandinavian, (iv) English, (v) Russian, (vi) Islamic, and (vii) Hindu.\textsuperscript{53} Interestingly, like David’s book published in the same year, Arminjon et al. failed to make any overarching distinction between civil-law and common-law systems.

It was not until the 1960s that the legal family classifications that are standard today came into being in the later and more well-known work of David and the comparative law treatise of Zweigert and Kötz. David’s new taxonomy – which divided the world into Romano-Germanic, Common Law, Socialist, Muslim-Hindu-Jewish, and Far East legal traditions – replaced a monolithic view of the Western legal tradition with a conception of the continental legal family as distinct from the common-law family.\textsuperscript{54} The shift in David’s classifications is particularly revealing, for it shows that conceptions of legal families – and, in particular, the importance of the distinction between common and civil law – were gaining importance over time not only generally across authors but even within the same author.

In 1969 Zweigert and Kötz brought the subdivisions within the civil-law tradition into the mainstream by spinning off the French, German, and Scandinavian civil-law families. The resulting classifications have found frequent use among the economists

\textsuperscript{52} Id. at 42.

\textsuperscript{53} Id. at 49.

\textsuperscript{54} RENÉ DAVID, LES GRANDS SYSTÈMES DE DROIT CONTEMPORAIN (2nd ed., 1966; first published in 1964).
associated with the law-and-finance literature.\textsuperscript{55} As German legal scholars, Zweigert and Kötz were arguably interested, if unconsciously, in conferring the status of an independent group on their home country’s legal system, as were so many of their predecessors, from Clóvis Bevilaqua, to René David, and Arminjon, Nolde, and Wolff. While the pioneers in the efforts to sort legal systems into different legal families have admitted the pliable and arbitrary nature of such endeavors, Ives-Marie Lathier has rightly noted that these typologies also have an ideological character and nationalist bias.\textsuperscript{56}

The coverage of the evolution of legal family taxonomies in this study (see Table 1 \textit{infra}) ends with a description of the classic categorizations advanced by René David and Zweigert and Kötz in the 1960s, for they are widely recognized as the most well known and influential in this enterprise. As John Langbein once put it, “once René David has written, once you have Zweigert & Kötz on the shelf, there seems to be less reason to keep doing it”.\textsuperscript{57} But despite predictions to the contrary, the categorizations proposed by these authors did not mark the end of legal family taxonomies. Comparative lawyers have since continued to refine existing classifications.\textsuperscript{58} Moreover, classic works


\textsuperscript{56} Yves-Marie Lathier, \textit{Droit comparé [Comparative Law]} 31 (2009) (arguing that David’s tripartite classification, crafted during World War II, placed France, as the leader of the Roman-Germanistic family, at the same level of the United States and the Soviet Union; Zweigert and Kötz’s typology, on the other hand, effectively gave a special role for German law as the parent jurisdiction of its own legal family).

\textsuperscript{57} Langbein, \textit{supra} note 2, at 9.

\textsuperscript{58} See, \textit{e.g.}, Palmer, \textit{supra} note 3 (arguing that mixed jurisdictions are part of a separate legal family); Åke Malmström, \textit{The System of Legal Systems: Notes on a Problem of Classification in Comparative Law}, 13 \textit{Scandinavian Stud. L.} 127, 147 (1969) (proposing a division of four main groups: (i) the Occidental group, comprising the laws of Europe, Latin America, common-law countries and Scandinavia, (ii) the

More recently, prominent scholars have gone further and advanced entirely different criteria to group legal systems. Ugo Mattei has offered a classification of legal systems into three distinct categories depending on whether they follow what he calls (i) the rule of professional law, (ii) the rule of political law, or (iii) the rule of traditional law, with Latin American countries grouped under the second category together with non-Western jurisdictions. James Whitman has suggested that distinguishing between consumerism and producerism may throw more light on the operation and preferences of different legal systems than conventional legal family classifications. Meanwhile, distinguished Italian comparativists, such as Rodolfo Sacco and Mario Losano have continued to organize their treatises around categories of legal systems for expositional purposes but have otherwise largely avoided using legal families.


60 Mattei, supra note 6, at 9.

61 Whitman, supra note 6, at 353.

62 Indeed, Losano and Sacco’s divisions are similar to those from the nineteenth century in which expositional purposes dominate scientific ambitions in the grouping of jurisdictions. See generally Antonio Gambaro & Rodolfo Sacco, Sistemi Giuridici Comparati [Legal Systems Compared] 15-16 (2008) (noting the decline of the common-civil law distinction emphasized by David and suggesting the use of classifications for expositional purposes). Gambaro and Sacco’s treatise includes chapters on the common law and equity in England, the legal experience in the United States, the French model, the German model, Eastern Europe, Islamic countries, Indian law, East Asian law, and Sub-Saharan Africa). See also Mario G. Losano, I Grandi Sistemi Giuridici: Introduzione ai Diritti Europei ed Extraeuropei [The major legal systems: Introduction to European and Extraeuropean Law] (2000)
It is also important to note that neither René David nor Zweigert and Kötz have claimed that the legal family classifications they identified had deep historical roots. On the contrary, David’s well-known treatise was translated into English as “Major Legal Systems in the World Today,”63 thus expressly conceding that the ensuing categorizations were temporally grounded. Likewise, Zweigert and Kötz specifically addressed their work’s historical contingency, warning that any taxonomy “depends on the period of which one is speaking,” so that “the division of the world’s legal systems into families, especially the attribution of a system to a particular family, is susceptible to alteration as a result of legislation or other events, and can therefore be only temporary.”64 And yet once legal family classifications took hold in the twentieth century, they increasingly came to be seen, even if unconsciously, as deep-rooted historical categories.

The crux of this section is that now-entrenched conceptions about legal families are relatively recent. The relevance and significance of legal families were undertheorized – and to a large extent underappreciated – before the twentieth century. But while scholars continue to debate over the decline of legal family distinctions, the rise of legal family categories as a fixture of legal thought in general and of comparative law scholarship in particular has been largely neglected.

(containing chapters on private and public European law, Russian and Soviet law, South American law, Muslim law, Indian law, and East Asian law).

63 Emphasis added. See DAVID & BRIERLEY, supra note 34.

64 ZWEIGERT & KÖTZ, supra note 55, at 66.
Table 1. *Evolution of legal system taxonomies*

<table>
<thead>
<tr>
<th>Author / Work</th>
<th>Criteria</th>
<th>Classification of Legal Families</th>
</tr>
</thead>
</table>
| Gumersindo de Azcárate, *Ensayo de una Introduccion al Estudio de la Legislacion Comparada* (1874)  
*Spain* | *For purposes of exposition only* | 1. Neo-Latin Peoples  
a) France  
b) Spain  
c) Portugal  
d) Italy  
e) Belgium  
f) Latin America  
2. Germanic Peoples  
a) Germany  
b) Netherlands  
c) Switzerland  
d) England and Ireland  
e) Scotland  
f) United States  
3. Scandinavian Peoples  
4. Slavic Peoples  
a) Russia  
b) Other Slavic Peoples  
5. Other Peoples of Christian-European Civilizations  
a) Greece  
b) Malta  
c) Jonian Islands  
6. Other Peoples from Different Civilizations  
a) Turkey, Egypt, and Tunisia  
b) India and China  
c) Liberia  

| Ernest Glasson, *Le Mariage civil et le divorce* (2nd ed., 1880)  
*France* | Legal heritage and influence  
*Classification limited to European countries* | 1. Legal systems strongly influenced by Roman law  
a) Italy  
b) Spain  
c) Portugal  
d) Romania  
e) Greece  
2. Legal systems that are immune from Roman-law influence  
a) England  
b) Scandinavia  
c) Russia  

*For purposes of exposition only*
<table>
<thead>
<tr>
<th>Author / Work</th>
<th>Criteria</th>
<th>Classification of Legal Families</th>
</tr>
</thead>
</table>
| Clóvis Bevilaqua, Resumo das Licções de Legislação Comparada sobre o Direito Privado (1893) Brazil | Legal influence Bevilacqua follows Glasson’s classifications, but adds a fourth category: | 3. Legal systems that combine Roman and Germanic influence  
   a) France  
   b) Germany  
   c) Switzerland |
| Adhémar Esmein, Le droit comparé et l’enseignement du droit (1900) France | History, general structure, and distinctive traits | 1. Latin group  
   a) France  
   b) Belgium  
   c) Italy  
   d) Spain  
   e) Portugal  
   f) Romania  
   g) Latin America  

2. Germanic group  
   a) Germany  
   b) Scandinavia  
   c) Austria  
   d) Hungary  

3. Anglo-Saxon group |
<table>
<thead>
<tr>
<th>Author / Work</th>
<th>Criteria</th>
<th>Classification of Legal Families</th>
</tr>
</thead>
</table>
| **Candido Luiz Maria de Oliveira**, Curso de Legislação Comparada (1903) *Brazil* | Relies heavily on Glasson’s classification as modified by Bevilaqua | 1. Legal systems strongly influenced by Roman law  
   a) Italy  
   b) Spain  
   c) Portugal  
   d) Romania  
   e) Greece  
2. Legal systems that combine Roman and Germanic influence  
   a) France (including French colonies)  
   b) Germany  
   c) Austria  
   d) Hungary  
   e) Belgium  
   f) Holland  
   g) Serbia  
   h) Montenegro  
   i) Bulgaria  
   j) Turkey  
3. Legal systems that are immune from Roman law influence  
   a) England  
   b) United States  
   c) Sweden  
   d) Norway  
   e) Denmark  
   f) Finland  
   g) Russia  
4. Republics of Hispanic America |
| **Georges Sauser-Hall**, Fonction et méthode du droit comparé (1913) *Switzerland* | Racial or ethnographic | 1. Laws of peoples of Arian or Indo-European Race  
   a) Hindu  
   b) Iranian (Persian, Armenian, etc.)  
   c) Celtic (Celtic, Welsh, Irish, and Gaelic) |
<table>
<thead>
<tr>
<th>Author / Work</th>
<th>Criteria</th>
<th>Classification of Legal Families</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Henry Levy-Ullman,</strong></td>
<td>Sources of law and legal evolution</td>
<td>1. Continental legal systems (&quot;written law&quot;)</td>
</tr>
<tr>
<td><strong>Introduccion al Estudio del Derecho Civil Comparado</strong></td>
<td>(1934)</td>
<td>2. Legal systems of English language-countries (&quot;common law&quot;)</td>
</tr>
<tr>
<td><strong>Argentina</strong></td>
<td></td>
<td>3. Islamic law</td>
</tr>
<tr>
<td><strong>Enrique Martinez Paz,</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Uses and modifies Glasson’s classification, as modified by Bevilaqua</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Pierre Arminjon, Boris Nolde,</strong></td>
<td>Centres of</td>
<td>1. French Law</td>
</tr>
</tbody>
</table>

### Legal Families

- **d)** Graeco-Latin (Greek, Roman, Canon, and Neo-Latin)
- **e)** Germanic or Teutonic (Scandinavian, Germanic, Dutch, and Swiss)
- **f)** Anglo-Saxon (English, Anglo-American, and New-Saxon)
- **g)** Slav (Russian, Slovenian, Czech, Polish, Bulgarian, etc.)

2. **Laws of peoples of Semitic races**
   - a) Assyrian
   - b) Egyptian
   - c) Hebrew
   - d) Arab-Islamic

3. **Laws of Mongol races**
   - a) Chinese
   - b) Japanese

4. **Barbarian peoples**
## III. From Comparative Legislation to Comparative Law

Since conceptions of legal families did not develop in a vacuum, Part II aims to situate the solidification of legal families within the evolution of comparative legal scholarship. Compared to thousands of years of legal history and writing, comparative
law is a fairly new discipline.\textsuperscript{65} For most scholars, the landmark International Congress on Comparative Law (\textit{Congrès international de droit comparé}), which took place in Paris in 1900, marked the beginning of comparative law as we know it.\textsuperscript{66} Moreover, it was arguably not until the second half of the twentieth century that comparative law developed into “a respectable body of actual knowledge.”\textsuperscript{67} As described by Mathias Reimann, “before 1950, there were no full-fledged comparative law treatises or casebooks, few monographs and certainly no standard reference works, no specialized journals, and only a limited number of articles.”\textsuperscript{68}

Up until the 1900 Paris Congress, the emerging comparative efforts of the nineteenth century were generally less theoretical and more pragmatic.\textsuperscript{69} The very designation of the field in the nineteenth century is suggestive of this more practical approach: its usual title then was “comparative legislation” (\textit{législation comparée}), not

\begin{itemize}
\item \textsuperscript{65} See, e.g., Walther Hug, \textit{The History of Comparative Law}, 45 HARV. L. REV. 1027, 1028 (1932) (“[u]ndoubtedly, comparative law as a distinct branch of legal science is of recent origin, and no common opinion yet prevails as to the tasks it should fulfill, the objects of its studies, and the methods it should pursue”); Frederick Pollock, \textit{The History of Comparative Jurisprudence}, 5 J. SOC’Y COMP. LEGISLATION 74, 74 (1903) (“the name of comparative jurisprudence is modern; our current use of the term, with the full meaning which it now bears, is barely a generation old”). Both authors of course acknowledge that legal scholars have looked into foreign legal systems before the nineteenth century, but argue that the process was not one of comparative law as it came to be conceived.
\item \textsuperscript{66} See, e.g., H.C. GUTTERIDGE, \textit{COMPARATIVE LAW} 18 (1946) (noting that the Paris Congress “came to be regarded by many as the occasion in which modern comparative law first came into being”); ZWEIGERT & KÖTZ, \textit{supra} note 55, at 2 (“[c]omparative law as we know it started in Paris in 1900, the year of the World exhibition”); Judith Martins-Costa, \textit{Clôvis Beviláqua} 13 (working paper, 2010), on file with the author (tracing the birth of the comparative method to 1900 in France).
\item \textsuperscript{67} MARY ANN GLENDON, PAOLO G. CAROZZA & COLIN B. PICKER, \textit{COMPARATIVE LEGAL TRADITIONS: TEXT, MATERIALS AND CASES ON WESTERN LAW} 8 (3rd ed., 2007).
\item \textsuperscript{68} Reimann, \textit{supra} note 10, at 673.
\item \textsuperscript{69} ZWEIGERT & KÖTZ, \textit{supra} note 55, at 53 (“[t]here is an astonishing similarity in the way different countries in the early nineteenth century embarked on the purposive and systematic comparison of different legal systems, that is, modern comparative law. Its intellectual origins are also similar. The purposes are practical, namely reform and improvement of the law at home, rather than theoretical, philosophical and speculative”).
\end{itemize}
comparative law proper. The pioneering Société française de législation comparée was established in 1869, having as its object “the study of statutes of different countries and the research of practical means to improve the various branches of legislation.” Its English counterpart, the English Society of Comparative Legislation, dates back to 1895. Comparative legislation became a law-school subject in European and Latin American law schools as early as the nineteenth century: a university chair on the subject was inaugurated in 1839 in France and in 1891 in Brazil. Sir Henry Maine inaugurated Oxford’s newly founded chair on Comparative and Historical Jurisprudence in 1869.

The phrase “comparative legislation” hinted at both the practical nature of nineteenth-century comparative legal studies and their cosmopolitan orientation. For while judicial decisions were not formally recognized as a source of law in many jurisdictions, all countries had legislation in one form or another. In fact, the dominant focus on legislation arguably shaped, and was shaped by, nineteenth-century comparativists’ universalist vision by concentrating on a source of law that was both

70 H. J. Randall, Sir John Macdonell and the Study of Comparative Law, 12 J. COMP. LEG. & INT’L L. 188, 189-190 (1930) (arguing that, in England, the “rather strange name [comparative legislation was undoubtedly a diplomatic subterfuge. It would have been a hopeless task to have aroused interest in a society formed to study anything so unpractical and academic as comparative law; but comparative legislation had a useful and practical sound about it”).

71 Société de législation comparée, Statuts, in BULLETIN DE LA SOCIETE DE LEGISLATION COMPAREE (1932) (“[U]ne Société est intitulée sous le nom de Société de législation comparée; II. Elle a pour objet l’étude des lois des différents pays et la recherche des moyens pratiques d’améliorer les diverses branches de la législation”).


73 RENÉ DAVID, TRAITÉ ÉLÉMENTAIRE DE DROIT CIVIL COMPARÉ IV (1950) (on the establishment of the first comparative legislation course in France in Collège de France in 1839); CANDIDO LUÍZ MARIA DE OLIVEIRA, CURSO DE LEGISLAÇÃO COMPARADA (1903) (describing a 1891 Brazilian statute amending law-school curricula, which for the first time made comparative legislation a separate subject in the curriculum).
shared and more easily reproducible. Later comparativists such as René David criticized early works on comparative legislation for holding too narrow a view of sources of law and, therefore, failing to capture the importance of judicial lawmaking in common-law countries. It is noteworthy that his nineteenth-century predecessors from the Anglo-Saxon world, perhaps too immersed in a cosmopolitan culture, had largely failed to voice similar concerns.

Classificatory schemes did not play a major role in early studies on comparative legislation, although the first groupings of jurisdictions into a handful of categories were beginning to appear. These early groupings of different countries however were not, nor did they aspire to be, “scientific.” The primary driver behind early categorizations seems to have been ease of exposition rather than an overarching theory about the relationship among different legal systems. As explained in greater detail in Part II above, early taxonomies of legal systems were rudimentary, fluid, and conflicting. They were, at any rate, quite different from the mainstream categorizations of the twentieth century.

In the rapidly globalizing world of the nineteenth century, early comparativists seemed less concerned with measuring differences across legal systems than with paving the way for legal convergence. The purpose of most comparative works was not to highlight differences but rather to search for common ground amidst apparent diversity. An 1850 commercial law treatise by Leone Levi, one of the first comparative lawyers in

---

74 Conversely, as noted by ZWEIGERT & KÖTZ, supra note 55, at 60, “[t]here is a clear connection between the shift of focus from purely statutory law and the ‘discovery’ of the Common Law.”

75 DAVID, supra note 73, at 10.

76 This trend reappeared more recently. ZWEIGERT & KÖTZ, supra note 55, speak of a præsumptio similitudinis, that is, a presumption that different advanced legal systems achieve similar practical outcomes to similar questions. Id. at 36.
the English-speaking world,\textsuperscript{77} is illustrative of the prevailing beliefs that legal convergence was both the inevitable and desirable result of economic globalization. In his words, 

“To bring these separate rules into contact with each other, and to study these great monuments of legislative and philosophical research, will furnish materials for arriving at those universal principles which form the common law for all nations. In an epoch when commercial relations embrace the greatest public and private interests, when nationalities are all but blended into each other, when work, improvement, and welfare are all-prevailing ideas; and when the rapidity of communication demands in a corresponding degree security and protection; the revision of the laws, statutes, usages, and customs of all countries becomes imperative. As nations approach one another, each is enabled to profit by the common experience; and it is of the utmost importance to watch carefully all innovations, and to mark the reason and the starting point of all essential and permanent progress.”\textsuperscript{78}

Leone Levi’s work provides a paradigmatic example of the style, ambitions, and pitfalls of comparative work in the nineteenth century.\textsuperscript{79} The very cover and subtitle of his volume illustrates its impressive coverage: in addition to Great Britain, it lists 59 other “countries,” plus the Institutes of Justinian.\textsuperscript{80} The book’s primary purpose was

\textsuperscript{77} Walther Hug, \textit{The History of Comparative Law}, 45 HARY. L. REV. 1027, 1066 (1932) (remarking, based on Levi’s work, that “an Englishman was the first to give expression to the idea that in the field of commercial law comparison should be followed by unification”); ZWEIGERT & KÖTZ, \textit{supra} note 55, at 44 (citing Levi’s work as the “first-fruit of English comparative law,” which was inspired by a “practical aim, namely to satisfy the need of English tradesmen for information about the commercial law of other peoples”). Another early comparative work from nineteenth-century England is WILLIAM BURGE, \textit{Commentaries on Colonial and Foreign Laws: Generally, and in Their Conflict with Each Other, and with the Law of England} (1838).

\textsuperscript{78} LEONE LEVI, \textit{Commercial Law: Its Principles and Administration} vii (1850).

\textsuperscript{79} \textit{Id}.

\textsuperscript{80} The subtitle of the book is “The Mercantile Law of Great Britain Compared with the Codes and Laws of Commerce of the Following Mercantile Countries: Anhalt, Austria, Baden, Bavaria, Belgium, Brazil, Bremen, British Colonies, British Guiana, Brunswick, Canada, China, Denmark, East Indies, France, Frankfurt, Greece, Guernsey, Hamburg, Hannover, Haiti, Hesse Electorate, Hindustan, Holland, Hungary,
practical, and its target audience – British merchants involved in cross-border trade – was well defined. As described by Levi, “the object of this work being the compilation of a Manual for constant use and reference to the Mercantile Classes, nothing has been spared to give it clearness, order, and easiness of information.”

Consistent with his strong faith in commercial progress and legal convergence, Levi’s treatise culminates in a bold proposal for a “National and International Code of Commerce among All Civilized Countries.” In his letter to Prince Albert of Great Britain, Levi justified his proposal as follows:

“Jurisprudence has made rapid advancement in every country – an advancement directed everywhere in conformity with the established laws of other nations. Commercial legislation, in its onward course, has manifested in special degree a tendency to an equalization of general principles. To foster such a development, and to lay the basis for the universal adoption of those great fundamental laws which regulate commercial intercourse, deserve the most strenuous efforts. To your Royal Highness (...) I venture to propose what, it is generally acknowledged, would be an invaluable benefit to this and to all nations – A NATIONAL AND INTERNATIONAL CODE OF COMMERCE AMONG ALL CIVILIZED COUNTRIES.”

Such an International Commercial Code never came into being – and the first international conventions on narrower areas of commercial law, such as negotiable

---

81 Id. (Plan of Work).
82 Id. at xv.
83 Id.
instruments, had to wait until the twentieth century. Meanwhile, most works on comparative legislation continued to provide more or less organized collections of foreign laws. The practical nature of these endeavors was also evident in works that focused on the laws of a small number of jurisdictions. For instance, M.J.C. Colfavru’s book on “Le droit commercial comparé de la France et de l’Angleterre” had as its subtitle “a necessary and practical book for the application of the new treaty of commerce of January 23, 1860, following the ordering of the French Commercial Code.” Published in response to the recent commercial treaty between Great Britain and France, the volume sought to facilitate business practice and to strengthen the relationship between both nations.84

While comparisons of commercial law in the nineteenth century were often directed at merchants (as were, in fact, many of the works on domestic commercial law at the time85) and sought to facilitate business practice, other comparative studies were meant to inform national legislative reform – presumably to foster greater legal convergence. As summarized by H.C. Gutteridge, comparative legislation essentially aimed at the “collection and distribution of information as to foreign law,” and the “utilization of the experience gained in other systems of law for the purpose of law reform.”86 Nineteenth-century faith in legal harmonization was such that one German jurist went as far as to publish a booklet in 1888 entitled “Die Möglichkeit eines

84 M. J. C. COLFAVRU, LE DROIT COMMERCIAL COMPARÉ DE LA FRANCE ET DE L’ANGLETERRE i (1861).

85 See, e.g., for an exemplar of a Brazilian commercial law book directed to merchants, DÍDIMO AGAPITO DA VEIGA, O AMIGO E CONSELHEIRO DOS COMMERCIANTES (1873).

86 GUTTERIDGE, supra note 66, at 2.
“Weltrechts” (“The Possibility of a Global Legal System”), which came to represent the high-water mark of belief in the possibility of global legal convergence.\(^8^7\)

Nonetheless, by the turn of the century, both the form and substance of existing comparative studies came under assault during the 1900 Paris Congress, which gathered prominent comparativists (mostly from France but also from other countries) to discuss methods, purposes, and vision for the discipline of comparative law. One perceived problem was that, by relying primarily on superficial and uncritical descriptions of foreign laws, comparative legislation was not up to the task it set for itself – namely, contributing to the improvement of national law. Specifically, its deficiencies were twofold. First, comparative works rarely compared, instead merely describing foreign legal regimes.\(^8^8\) And the resulting descriptions, which encompassed an arbitrarily large number of countries, were often sketchy and unsatisfying. This paradigm of “juxtaposition without comparison” – that is, the indiscriminate collection of foreign legal rules – was precisely the one that the leading comparativists present at the 1900 Congress sought to overcome.\(^8^9\) Second, and relatedly, these uncritical inventories of

\(^8^7\) ERNST ZITELMANN, DIE MÖGLICHKEIT EINES WELTRECHTS (1888; 2nd ed. 1916).

\(^8^8\) This feature arguably did not change much in the following century, although this dearth of actual comparison came to be regarded as a positive feature. See William Twining, Reviving General Jurisprudence 19, in TRANSNATIONAL LEGAL PROCESSES: GLOBALISATION AND POWER DISPARITIES (Michael Likoksi ed., 2002) (arguing that “few experienced comparativists compare,” by which he means that “even within mainstream comparative law sustained explicit molecular comparison is wholly exceptional,” although “juxtaposition, parallel studies, outsider perspectives, and ad hoc contrasts all abound”).

\(^8^9\) CONGRÈS INTERNATIONAL DE DROIT COMPARÉ TENU À PARIS DU 31 JUILLET AU 4 AOÛT 1900, PROCÈS-VERBAUX DES SÉANCES ET DOCUMENTS (1905) [hereinafter “Transcripts of Paris Congress”]. In the words of Edouard Lambert “il n’y a là qu’une juxtaposition de législations, et non pas une comparaison entre législations.” Id. at 31.
foreign rules lacked scientific character.\textsuperscript{90} It was this absence of scientific method and aspirations that Raymond Saleilles, a prominent French scholar and chief organizer of the Congress, found particularly problematic:

« Souvent même cette fonction critique est totalement absente de l’exposé parallèle que l’on présente des législations étrangères. On se contente d’une juxtaposition de textes empruntés à des législations de pays différents, sans qu’aucune méthode, ni critique, ni rationnelle, préside à cette sorte de nomenclature. Il va de soi que cette façon de faire du droit comparé ne saurait en aucune manière correspondre à l’idée d’une science indépendante, ayant son objet propre, ses lois et sa méthode. C’est l’absence même de toute discipline scientifique. »\textsuperscript{91}

By 1900, two distinctive features of comparative legislation as practiced in the nineteenth century – its cosmopolitan vision and its practical orientation – were beginning to break down, although this was not at all apparent from the surrounding discourse. On the contrary, as described by Christophe Jamin, the “old dream” shared by Raymond Saleilles and Édouard Lambert – the French comparativists who served as organizer and rapporteur of the Paris Congress, respectively – encompassed both a universalist and a practical dimension.\textsuperscript{92}

\textsuperscript{90} The conception of “law as science” was a particularly dominant in the nineteenth century – and is one that remains prevalent, although arguably with lesser force, in many countries outside the U.S. today.


\textsuperscript{92} Christophe Jamin, \textit{Le vieux rêve de Saleilles et Lambert Revisité : à propos du centenaire du Congrès international de droit comparé de Paris}, 4 \textit{REVUE INTERNATIONAL DE DROIT COMPARE} 733 (2000) (interpreting the rise of comparative law in France as a reaction against the prevailing formalism and the exegetical approach of nineteenth-century legal scholars). The same article was reprinted in English as \textit{Saleilles’ and Lambert’s Old Dream Revisited}, 50 \textit{AM. J. COMP. L.} 701 (2002). Unless otherwise noted, citations are to the original [French] version.
Both Saleilles, a prominent legal scholar, and Lambert, then a young law professor, proclaimed the existence of substantial unity amidst apparent diversity across national laws. Lambert, in particular, argued that it is the task of comparative law to search for what he calls “droit commun législatif” (common legislative law) that reflects the underlying unity of purpose among the laws of different jurisdictions. For both authors, comparative legal studies ought to have direct influence on national laws. Lambert defended the use of droit commun législatif as discovered and articulated by legal scholars as an instrument to perfect national laws. Similarly, Saleilles argued that comparative law should become “one of the factors, no longer unconscious, but rather reasoned and truly scientific, for the development of the civil law.”

Nonetheless, the new scientific approach advocated by comparativists would progressively undermine both its universalist and its practical vocation. A number of comparativists present at the 1900 Paris Congress advocated the formulation of scientific taxonomies – along the lines of those used in linguistics and biology – as one of the field’s principal tasks. One immediate, if unintended, effect of taxonomic efforts is to spotlight differences among various categories of legal systems.

Moreover, the conception of a “droit commun législatif” embraced by the young Lambert was far less universalist than the notion of a “droit commun” embraced by Saleilles and his predecessors. In a different venue, Lambert proclaimed in the same year that “[f]rom now on, we should direct our energies towards a rapprochement between our

---

93 Id. at 741.

94 Id.

95 Id. at 739.
legislation and germane legislations, that is, those legislations that have reached approximately the same level of scientific elaboration as ours, and which govern peoples that have achieved the same stage of social and economic development as we have.\(^96\)

As noted by Christophe Jamin, this restriction to comparisons among “germane legislations” was a novel development, and one not shared by Saleilles.\(^97\)

Another departure from prior practice was Lambert’s hostility towards English law and his conclusion that it must be excluded from the group of “germane legislation” – a groundbreaking approach that would soon become popular among comparativists.\(^98\)

Perhaps influenced by his negative personal experience with the British, Lambert came to despise English law as “archaic and conservative,” which, in his view, precluded “any convergence between this system and those of other European countries in all but a few rare instances.”\(^99\) Indeed, Lambert came to emphasize the existence of a “group-based droit commun specific to each group.”\(^100\) He would argue that common-law countries belonged to a separate group and thus in most instances did not deserve the attention of continental jurists.\(^101\) Notions of different legal traditions were beginning to take hold.

\(^96\) Id. at 716.

\(^97\) Id.

\(^98\) Id.

\(^99\) Id. (“Lambert does not much appreciate the English and he dislikes the disorderliness of their law”). Jamin attributes Lambert’s hostility to English law, among other things, to an incident at the École khédiviale in Cairo, from which Lambert resigned “after months of quarrels with the English authorities who in Lambert eyes conspire to deprive the French of one of the last remaining fields where they might exert their influence in Egypt.” Id.

\(^100\) Id.

\(^101\) Id. at 717.
Roughly at the same time as French jurist Edouard Lambert was emphasizing the common elements shared by continental legal systems and excluding English law from the set of “comparables worth comparing,” English scholars were asserting the rising prominence of English law as a competitor to Roman law, which they saw as dominating most of the world map. In 1907, James Bryce declared, referring to Roman law and English law, that “[t]he world is, or will shortly be, practically divided between two sets of legal conceptions or rules, and only two.” Still, Bryce continued to believe in the likelihood of convergence, especially in private law. Even as he argued that “[n]either is likely to overpower or absorb the other,” he conceded that “it is possible that they may draw nearer” and that “[a]lready the commercial law of all civilized countries is in substance the same everywhere, that is to say, it guarantees rights and provides remedies which afford equivalent securities to men in their dealings with one another and bring them to the same goal by slightly different paths.”

But if by 1900 Anglo-Saxon scholars stressed differences but continued to believe in convergence, by 1950 the common-civil law dichotomy was beginning to be viewed as sufficiently entrenched and historically rooted to prevent harmonization. As Roscoe Pound put it in 1950,

“History has played a decisive part in the development of systems of law more than once. A taught tradition is a decisive element in a system. Two distinct long traditions, the one going back to the Roman jurisconsults of the classical era, the other to the teaching of the law of the King’s Courts by medieval English lawyers, have kept their identity since the Middle Ages. They have put their mark

---

102 James Bryce, The Extension of Roman and English Law throughout the World, in SELECT ESSAYS IN ANGLO AMERICAN LEGAL HISTORY 619 (1907).

103 Id. at 619-620.
upon the significant features of the respective systems and have set
the two systems off as independent however much either may have
borrowed something from the other at one time or another. Whatever the Continental law borrows it Romanizes. (…) Whatever the Anglo-American law borrows it Anglicizes. (…) From the Middle Ages the Continental lawyer and the English lawyer have had a different bringing up.”

By 1950, the civil-common law dichotomy was being exalted to such heights
precisely as René David was seeking to abandon it at he emphasized the unity of the
Western legal tradition. The dichotomy was reaching its apex in the eyes of
comparativists precisely as the first seeds of its destruction were being sowed.

In sum, the rise of legal family categories helped transform the methods and
practice of comparative law. The new taxonomies of legal systems were crucial both for
the purported scientificization of comparative law and for solidifying a hierarchy of
foreign laws. The concept of legal families – and the hierarchical structure they
inevitably expressed – provided comparativists with clear guidance on which
jurisdictions to focus on: the parent jurisdictions were clearly more important than their
offspring and only they were, for the most part, worthy of attention. This point is made
particularly clear in Zweigert and Kötz’s treatise, which urges comparativists to “ignore

---


105 David, supra note 73, at 227.

106 In addition to drawing attention to seemingly natural and insurmountable differences among groups of
legal systems, another consequence of the greater prominence of classificatory schemes was a sharp
decrease in the number of countries of interest to comparativists. The comparative studies of the nineteenth
century typically encompassed a very large number of jurisdictions. One reason for such extensive
coverage is the practical and informative goals of these early works: country-specific information is
certainly more useful to merchants doing business in any given jurisdiction than overly rough
approximations based on theoretical models. Another, perhaps more important, reason is that, in the
absence of both a theory and a method, early comparativists also lacked consistent criteria for choosing
target jurisdictions – and apparently concluded that the more, the merrier.
the affiliate [legal system] and concentrate on the parent system”\textsuperscript{107} As a result, classificatory schemes not only complemented descriptions of legal rules of different jurisdictions; to a large extent they simply replaced them.

Table 2. \textit{Comparative Legislation vs. Comparative Law}

<table>
<thead>
<tr>
<th></th>
<th>Comparative Legislation</th>
<th>Comparative Law</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Period</strong></td>
<td>19\textsuperscript{th} century</td>
<td>20\textsuperscript{th} century</td>
</tr>
<tr>
<td><strong>Orientation</strong></td>
<td>Practical</td>
<td>Scientific</td>
</tr>
<tr>
<td><strong>Target audience</strong></td>
<td>Domestic lawmakers</td>
<td>Scholars</td>
</tr>
<tr>
<td></td>
<td>International merchants</td>
<td>Students</td>
</tr>
<tr>
<td><strong>Primary content</strong></td>
<td>Description of (mainly statutory) laws of foreign jurisdictions</td>
<td>Classification of legal families and theorization about similarities and differences</td>
</tr>
<tr>
<td><strong>Role of classifications</strong></td>
<td>Incidental; goal is expositional clarity</td>
<td>Central; goal is scientific or didactic</td>
</tr>
<tr>
<td><strong>Number of foreign jurisdictions analyzed</strong></td>
<td>Large</td>
<td>Small</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(focus on a few “parent” or original jurisdictions as representative of a legal family or tradition)</td>
</tr>
<tr>
<td><strong>View of legal differences</strong></td>
<td>Contingent</td>
<td>Persistent</td>
</tr>
<tr>
<td><strong>View of legal evolution</strong></td>
<td>Universalist; emphasizes convergence</td>
<td>Acknowledges continuing differences across legal families or traditions, even if different institutions might serve similar functions</td>
</tr>
</tbody>
</table>

\textsuperscript{107} Id. at 64. In this vein, they suggest that scholars interested in the Romanistic tradition focus exclusively on France and Italy, as “[t]he legal systems of Spain and Portugal (…) do not often call for or justify very intensive investigation.” Id. Although clearly enunciated by Zweigert and Kötz, the notion that comparativists should concentrate their efforts by focusing on “parent” jurisdictions is almost as old as legal families themselves.
IV. Self-Image and Legal Transplants in the Nineteenth Century

The previous sections showed that legal family classifications were still incipient and unsettled in the nineteenth century, and that early comparativists held a more cosmopolitan view of the law than their twentieth-century counterparts. Part IV explores the reasons for why nineteenth-century scholars rated legal traditions of lesser importance than their twentieth-century counterparts; it also examines the implications of this shift for patterns of legal borrowing. I suggest that the concepts of legal families and traditions were comparatively less salient – and ensuing legal transplants more diverse – for several reasons both internal and external to legal theory and practice. The analysis here is necessarily tentative; its goal is to raise questions and formulate hypotheses rather than to provide definitive answers.

This section posits that numerous factors may have contributed to a lesser degree of deference to, or consciousness of, legal traditions in the nineteenth century compared to the twentieth century. First, and most obviously, there was significant theoretical confusion about the meaning and origins of different legal systems – as exemplified by the existing diversity of classificatory schemes, as well as the frequent statements by prominent English and U.S. authors that English law stemmed from Roman law.108 Second, conceptions about legal tradition and the appropriate sources for one country’s law were intimately intertwined with the search for identity – including legal identity – by the various nations that had then recently acquired independence. New countries were

108 See Part IV(A) infra.
reluctant copycats, and wholesale legal transplants from one legal system seemed more
dangerous to one’s identity and autonomy than a combination of numerous foreign
sources. Third, and relatedly, anti-colonialist sentiment was very much alive in many
newly independent nations, which made them despise the notion of legal continuity from
colonial times and thus view the idea of legal tradition rather unfavorably. Lastly, the
nineteenth century was the heyday of economic liberalism and the free trade of goods,
persons, and ideas. Such an intense degree of international trade and economic
integration, in turn, created demand for legal harmonization and lessened the importance
of local peculiarities.

Each of these factors lost significance in the twentieth century. The rise of
comparative law as a discipline and the greater sophistication of comparative and
historical studies cleaned up some of the existing confusion about the origins of legal
systems in the Middle Ages. Roman and common law were then increasingly understood
as not only lacking a common root but also as largely impervious to mutual influence,
despite what were seen as sparse and isolated instances of legal borrowings. In addition,
as memory of colonial times receded, legal traditions came increasingly to be viewed in a
more favorable light.

Moreover, changes in world’s balance of power facilitated the solidification of
legal traditions. Following decolonization, declining powers such as France and Great
Britain (and eventually the U.S.) viewed legal imperialism and the export of legal culture
as a substitute for de facto occupation.\footnote{To be sure, French legal imperialism was alive and well in the nineteenth century through the diffusion of the \textit{Code Napoléon}. Nevertheless, the Code’s export was not framed in terms of the diffusion of France’s legal \textit{tradition}. On the contrary, Napoleon envisioned the Code as an effective tool to break away from the law and institutions of France’s past.} From the perspective of the periphery, the
return to legal traditions in the twentieth century often had the effect of strengthening a country’s sense of independence and identity in the face of American and Soviet economic and political hegemony. Finally, the turn towards autarkic policies and economic nationalism after World War I put an end to the earlier age of globalization and, in decreasing international trade, created an environment more favorable to legal nationalism (and to the ingrained and persistent differences across legal systems that legal families implied) and less conducive to legal convergence.

This section illustrates how these factors may have influenced nineteenth-century legal borrowings in three different contexts: (i) the influence of civil law ideas in England and the U.S., (ii) the combination of diverse legal borrowings in Latin America, and (iii) the degree of cross-fertilization between England and France in company law.

### A. Continental Influence in Early-nineteenth-century English and U.S. Law

#### i. England

The influence of civil-law ideas on nineteenth-century English law is now well established. As James Gordley describes, common-law causes of action were progressively abolished and replaced by civil-law categories to such an extent that what F.W. Maitland would later call the great legal categories of common law were in fact borrowed directly from continental jurists.\(^\text{110}\) For instance, the common-law rule setting forth the limits for recovery of consequential damages enunciated in the classic contracts case of *Hadley v. Baxendale*\(^\text{111}\) came directly from the work of French legal scholar

\(^{110}\) Gordley, *supra* note 4.

\(^{111}\) 9. Ex. 341 (1854).
Pothier. The examples of covert and overt borrowings of continental legal concepts by the common law are indeed too numerous to be detailed in full.

The pressing need to modernize and rationalize the common law to best suit a rapidly developing economy, combined with a significant degree of theoretical confusion about the historical origins of the law of England, were important factors prompting continental law borrowings. In nineteenth-century Britain, references to Roman law did not seem problematic in light of the reigning (though not universal) beliefs that English law in some way derived from Roman law. An excellent study by Michele Graziadei examines the “change in the image” of English law in the nineteenth century from the early understanding of English law as originating from Roman law to a later conception of the common law as the source of a distinct legal tradition.

Graziadei shows that, as late as 1869, Finlason’s new edition of John Reeve’s book on “The History of English Law” purported to identify Roman-law roots for every possible rule of English law, including trial by jury. As the author argues, however, “the cosmopolitan attitude displayed by some members of the legal community up to the middle of the nineteenth century seems to be diametrically opposed to the outlook on the relationship between the civil law and the common law which was predominant in the last thirty years of it.” Graziadei’s conclusion – that consciousness of an independent

112 Gordley, supra note 4, at 566.
113 See id. for additional examples.
115 Id. at 116.
116 Id. at 121.
English tradition of the common law developed only toward the end of the nineteenth century – is consistent with this chapter’s central claim that conceptions of legal traditions solidified only in the relatively recent past. In Graziadei’s words, theoretical developments in nineteenth-century England (which were, paradoxically, inspired by contemporary doctrinal developments in Germany) “transformed the perception of the historical background of the law and eventually produced a new awareness of the distinctive character of the common law tradition.”

After borrowing heavily from civil law to reformulate old common-law categories in the early nineteenth century, English law became increasingly impervious to continental sources. An important reason for this greater resistance to foreign influence seems to have been the mounting imperialist ambitions of English law, coupled with the new-found awareness that English law was the source of a major tradition to uphold. As explained by M. Schmitthoff:

“Though the judges of the nineteenth century did not exalt the Roman law to such heights as some of their predecessors, they still adhered to the view that the Roman system served as a general guide whenever the Court required such means of judicial interpretation. The position of Roman Law as a testing device for the rules of the Common Law has substantially changed during the last four decades.

The reason is not so much that the systematization of English Law has been greatly advanced. The decisive cause is that the Anglo-Saxon legal system has acquired a world-wide character that competes internationally with the law of Rome.”

---

117 Id. at 115.

Similarly, Roman and continental law texts were part of forensic practice, case law, and academic readings in the nineteenth-century U.S. John Langbein has noted that Chancellor Kent – a prominent U.S. judge, legal scholar and author of the famous “Commentaries on American Law” (1826-1830) – relied on continental legal materials to such an extent that he went as far as to rewrite history through his repeated assertions that English law derived from Roman law. Moreover, while citations to foreign law by U.S. courts have generated considerable controversy in recent years, such a practice was generally accepted in the late eighteenth and early nineteenth centuries. At that time, the U.S. Supreme Court not only felt comfortable relying on foreign legal sources, but also went as far as to quote extensively from foreign scholars in Latin without even providing an English translation. The U.S. was then a new nation in search for guidance, and it welcomed different guides.

While historical confusions and the needs of modernization may explain the use of continental sources in England, in America receptiveness to civilian concepts was also the product of anti-English sentiment in the first decades after independence. Perhaps

119 See, e.g., Roscoe Pound, *The Influence of French Law in America*, 3 Ill. L. Rev. 354, 354 (1908-1909) (noting that “[o]ne who reads the older American reports, particularly those of the State of New York, cannot fail to notice the unusual number of references to the writers and authorities of the civil law which they contain and the great deference which appears to be paid to such authorities” and that “[n]o less remarkable is the rapid falling off in this practice and practically complete cessation of it by the middle of the nineteenth century”). R.H. Helmholz, *Use of the Civil Law in Post-Revolutionary American Jurisprudence*, 66 Tul. L. Rev. 1649, 1653 (1992) (“Roman law texts and Continental treatises were clearly used in forensic practice by American lawyers and cited by judges in American opinions”).


paradoxically, Chancellor Kent resorted to continental sources precisely to legitimize certain common-law concepts, even when the civilian citations were not dispositive of the case’s outcome.\(^\text{122}\) That is, the argument that rendered English law an acceptable source was not that it was part of the U.S. particular legal tradition, but quite the opposite: English law was more legitimate to the extent that its precepts were the same as those of French and Roman law. As described by Alan Watson, “[h]ere the foreign references may have been useful, given the then unpopularity of things English, in persuading the other judges not to follow the practice of other U.S. states.”\(^\text{123}\) The anti-colonialist motivation behind the use of foreign sources was made explicit in Chancellor Kent’s famous letter:

“Between that time and 1804 I rode my share of circuits, attended all the terms, and was never absent, and was always ready in every case by the day. I read in that time Valin and Emerigon, and completely abridged the latter, and made copious digests of all the English law reports and treatises as they came out. I made much use of the Corpus Juris, and as the judges (Livingston excepted) knew nothing of French or civil law, I had immense advantage over them. I could generally put my brethren to rout and carry my point by my mysterious wand of French and civil law.

*The judges were Republicans and very kindly disposed to everything that was French,* and this enabled me, without exciting any alarm or jealousy, to make free use of such authorities and thereby enrich our commercial law.”\(^\text{124}\) (emphasis added)

\(^\text{122}\) Alan Watson, *Chancellor Kent’s Use of Foreign Law,* in *The Reception of Continental Ideas in the Common Law World 1820–1920* (Mathias Reimann ed., 1993) (arguing that many of Kent’s references to foreign law were unnecessary or inaccurate, and that virtually all such references were not dispositive of the outcome of the case).

\(^\text{123}\) Id. at 50.

B. Cross-fertilization in Company Law

Chapter II highlighted the extent to which the crafting of early business-organization laws in Brazil was a complex and carefully considered, if controversial, process that relied on various foreign legal models, including Anglo-Saxon and continental sources. Yet Brazil was by no means unique in turning to a diverse array of foreign jurisdictions for commercial- and corporate-law models in the nineteenth century. Other “French civil law” jurisdictions followed a very similar pattern. Portugal’s Commercial Code of 1833 was drafted in London and drew heavily on English law in addition to continental legal sources.125 According to Guido Ferrarini, Italy’s Commercial Code of 1882 “was the result of drafting efforts which extended over more than a decade with the participation of some of Italy’s finest scholars.”126 The foreign models on company law consulted during the legislative process included the English Law of 1861, the French Law of 1867, the German Commercial Code of 1861 and the Law of 1870, and the Belgian Law of 1873.127 The influence of English law was evident, for instance, in the Italian statutory default rule for shareholder voting rights, which provided a regime very similar to the distinctive graduated voting scale specified in Table A of the Companies Act.128 Likewise, the draftsmen of the Argentinean Commercial

125 See Chapter II supra.

126 Guido Ferrarini, Corporate Governance Changes in the 20th Century: A View from Italy, in CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES, AND MARKETS IN EUROPE, JAPAN, AND THE US 34 (Klaus Hopt et al. eds., 2005).

127 Id.

128 CESARE VIVANTE, TRATTATO DI DIRITTO COMMERCIALE, v. 2, at 223 (1903) (describing art. 157 of the Italian Code, which provided as a default rule a graduated voting scale granting one vote per share up to five shares, one vote per five shares up to 100 shares, and one vote per 25 shares beyond that).
Code of 1889 allegedly sought inspiration in the laws of Portugal, Italy, England, Belgium, Spain, and Germany.\(^\text{129}\)

A significant degree of cross-fertilization in business law also took place among “parent” jurisdictions such as England and France. Increasingly integrated markets meant that news about foreign legal developments spread swiftly. And increasing international competition demanded rapid diffusion of useful legal innovations, lest merchants in laggard countries find themselves at a competitive disadvantage. For years, English businessmen pressed for the adoption of limited partnerships (société en commandite) along French lines, since general incorporation was still unavailable in England.\(^\text{130}\) This attempt at legal transplantation ultimately failed.\(^\text{131}\) Greater access to limited liability entities in England would come through the Companies Act of 1862, which effectively permitted the incorporation of limited liability joint-stock companies without the need for governmental approval. Bypassing England, the U.S. was far more expeditious in borrowing France’s model of limited partnerships in the early nineteenth century. New York’s limited partnership statute of 1822, which was an almost literal copy of the French code and of other U.S. states that had previously adopted the French

\(^{129}\) See, e.g., ANDRE FEASSE, LES SOCIÉTÉS ANONYMES DANS LA REPUBLIQUE ARGENTINE (1928) 13-14 (emphasizing the eclectic character of Argentine commercial law, which mixed very different legal sources). Nevertheless, as described in Chapter II, the Argentinean civil code still departed from all available foreign models in maintaining the requirement of governmental authorization for incorporations.

\(^{130}\) See, e.g., RON HARRIS, INDUSTRIALIZING ENGLISH LAW: ENTREPRENEURSHIP & BUSINESS ORGANIZATION, 1720-1844 273-4 (for a description of the unsuccessful attempts to adopt commandites in England).

\(^{131}\) England did not enact a limited partnership statute until 1907.
model, represented the first time New York had directly imitated foreign legislation from a country other than England.\textsuperscript{132}

While English businessmen tried to import French-style limited partnerships to England, conservative forces in France resorted to English law in their unsuccessful attempt to outlaw tradable limited partnerships in the late 1830s.\textsuperscript{133} However, French legislators would come to borrow heavily from English law soon thereafter, not least because of the competitive pressures in an integrated market. Only one year after the enactment of the Companies Act of 1862, French corporate law would rapidly converge towards the British model. The driving force behind this transplant was the 1862 free trade agreement between France and Great Britain, which expressly authorized English corporations to operate in French territory. Because England had already liberalized its incorporation process, French entrepreneurs judged that their national laws effectively put local firms at a disadvantage.\textsuperscript{134} The result was the enactment of a new French statute in 1863 authorizing the creation of sociétés limitées, a literal translation of the English term employed in the Companies Act, which served as a model for the French law. The French statute was more restrictive than the English one, however, in that it limited the exemption from governmental authorization to corporations whose capitalization did not


\textsuperscript{133} Ch. Coquelin, \textit{Des sociétés commerciales en France et en Angleterre} 422, in \textit{REVUE DES DEUX MONDES} (1843). Coquelin denounced this argument as a “misleading analogy.” He noted that tradable limited partnerships served as a surrogate for incorporations (which were highly restricted in France, though not in England), so that formal convergence in the legal texts would lead to greater divergence in practice. \textit{Id.} at 422

\textsuperscript{134} JEAN STREICHENBERGER, SOCIÉTÉS ANONYMES DE FRANCE ET D’ANGLETERRE 43 (1933).
exceed 20 million francs. In 1867 France finally adopted general incorporation, at least partially due to competitive pressures.

C. Legal Bricolage in Latin America

As explored in greater detail in Chapter II, Brazilian lawmakers resorted to a vast array of foreign legal models – including both civil- and common-law jurisdictions – in designing and reforming its legal system in the nineteenth century. Such diversity in foreign legal sources was particularly clear in Brazilian commercial law but was present in other areas of the law as well. Indeed, given the degree of fusion, adaptation, and rejection of foreign legal solutions, legal “bricolage” is arguably a more fitting metaphor than legal “transplantation” for describing the early corporate lawmaking process in Brazil.135 There was arguably as great, perhaps even greater, reliance on Anglo-Saxon legal institutions in the nineteenth century than in the twentieth century, despite the ascendancy of the U.S. as a global power and the imperialistic strength of U.S. law during the latter period.136 Indeed, knowledge of English was, together with French proficiency, an entry requirement for Brazilian law schools during most of the nineteenth century, though the practice died out in the twentieth century.137

135 For a conceptualization of “bricolage” as a mode of institutional change, see JOHN L. CAMPBELL, INSTITUTIONAL CHANGE AND GLOBALIZATION 65 (2004) (describing bricolage as “the process whereby actors recombine locally available institutional principles and practices in ways that yield change”).


137 See Chapter II supra for a more detailed description.
In searching for models among a vast array of foreign legal sources – including English company law – Brazilian lawmakers did not feel constrained by a sense of belonging to any given legal tradition. Although lawmakers reflected carefully on the desirability and potential consequences of “transplanting” foreign laws to a different territory, references to legal families or traditions were markedly absent from the legislative debate. In particular, nineteenth-century lawmakers seemed utterly unaware that Brazil was a “French civil law jurisdiction” and, as such, was bound to imitate French legal institutions. Indeed, by 1891 Brazil had adopted not only a U.S.-inspired constitution but also a statute directing federal courts to apply “the statutes of cultivated nations, and especially those applicable in the United States of America, the cases of ‘common law’ and ‘equity’ ” as subsidiary sources of jurisprudence.\(^{138}\)

While reference to foreign sources were pervasive in processes of corporate-law reforms throughout its history, the role of legal “tradition” in the discussion about appropriate foreign models is largely a twentieth-century phenomenon. While nineteenth-century lawmakers examined in detail the company law rules of England, France and other jurisdictions, references to legal families or traditions as guides for decisions about legal transplants were conspicuously absent from the debate. In the latter part of the twentieth century, by contrast, legal traditions were at the center of the debate. The draft bill that would result in Brazil’s new Corporations Law of 1976 specifically listed as one of the goals of the statute “to observe the Brazilian tradition on the matter, which comes from European continental law, but to accept the useful solutions from the Anglo-American system, which by reason of accelerating international trade are

\(^{138}\) Decree 848 (Oct. 11, 1890), Art. 386.
becoming increasingly prevalent in Europe and diffused among us.”139 In the process leading to the adoption of Brazil’s Corporations Law of 1976, the Brazilian Bar Association (Ordem dos Advogados do Brasil – OAB) criticized certain provisions of the U.S.-inspired bill as “alien” to Brazil’s Romanist tradition of corporate law.140

The diversity of foreign sources in nineteenth-century Latin America is a striking and well-known phenomenon. Continental sources arguably dominated private-law borrowings, whereas public law (including constitutional law) largely followed the U.S. model. Here, again, a lack of self-understanding about legal traditions, combined with a desire to craft an original legal system, played an important role in determining this mixture of foreign legal transplants. The adoption of U.S.-style republican (and, in some cases, federalist) constitutions represented a clear rupture with the past. Contemporary scholars are often mystified by this unlikely – and arguably unfitting – combination of a continental civil-law model and a U.S.-inspired constitution (in many cases interpreted as requiring decentralized judicial review). In the nineteenth century, however, this combination seemed like a less radical choice. Because nineteenth-century lawyers in Latin America, as elsewhere, lacked an articulate conception of legal families – and, therefore, a source of guidance on transplant compatibility141 – such a combination of legal traditions did not seem strange, much less problematic.


140 Most such provisions were nonetheless enacted. For a description of the opposition to foreign borrowings and of the need to reconcile U.S. institutions with Brazil’s Romanist tradition of corporate law, see the description of the Law’s co-draftsman, Alfredo Lamy, A Lei das S.A. – Razões do Anteprojeto [Corporations Law – Reasons for the Proposed Draft], 15 REVISTA DE DIREITO RENOVAR 63, 65-66 (1999).

141 The assumption is that intra-family transplants are more compatible and thus more likely to succeed.
V. Conclusion

Comparativists have insistently debated the extent of the decline of legal family distinctions, but little attention has been paid to the rise of now-conventional understandings about legal families and traditions. By offering a brief intellectual history of the taxonomic efforts in the comparative law literature, this Chapter suggests that legal family categories followed a parabolic, rather than linear, trajectory. Contrary to conventional understandings, the reification of legal families may have peaked in the twentieth century – after the end of the first globalization in 1914 but before the second globalization of the latter half of that century.

I suggest here that the view of the nineteenth century as a period dominated by a strong and conscious dichotomy between civil law and common law is largely anachronistic. Reality was more complicated. In the nineteenth century, a variety of factors – ranging from theoretical underdevelopment to anti-colonialism and free trade – circumscribed the role of legal tradition. Perhaps more important, many critical choices that would eventually shape legal family affiliations had not yet been made. Both Germany and Brazil are considered to be typical members of the civil law tradition even though they lacked civil codes – the mark par excellence of the civilian tradition – for the entire nineteenth century. Germany’s Bürgerliches Gesetzbuch came into force in 1900, while Brazil’s first Código Civil was not enacted until 1916. In both cases, the delay was not accidental, but rather the result of genuine disagreement about the desirability of a code and the suitability of existing models.142

---

142 The famous opposition to codification on the part of Savigny’s Historical School here comes to mind. See, e.g., Mathias Reimann, The Historical School against Codification: Savigny, Carter, and the Defeat of the New York Civil Code, 37 AM. J. COMP. L. 95 (1989), for a brief overview of Savigny’s anti-codification
To conclude, the development of legal family categories cannot, as is usually assumed, be explained by long-standing historical traditions alone; it has also been profoundly shaped by more recent trends in politics and economics. As the bulk of the comparative law literature has focused on the extent to which legal families are still relevant, the inquiry into the causes and consequences of strong conceptions of legal traditions provides interesting avenues for future research.

arguments in English and its influence on the opposition to codification efforts in New York. For a description of the convoluted process leading to the adoption of Brazil’s civil code, see Chapter II supra.
I. Introduction: State Intervention in Nineteenth-Century Brazil

As most jurisdictions around the world, state-owned corporations in Brazil became more, not less, common in the twentieth century, and especially in the second half of that century.\(^1\) This is not to say, of course, that State intervention was lacking in the nineteenth-century Brazilian economy. On the contrary, the government exerted significant control over economic activity. In his seminal book on the history of the Brazilian State, Raymundo Faoro describes the government’s sway over economic activity in the nineteenth century as “extensive to all commercial, industrial, and public service activities. The state authorized the functioning of business corporations and banks, granted privileges, made special concessions for railroads and ports, assured supplies, and guaranteed interest payments. The sum of these favors and privileges comprises the lion’s share of economic activity (…) which is only made possible through the life transmitted by government’s umbilical cord.”\(^2\)

As in other countries, the rise of the corporate form in Brazil was tightly intertwined with the state’s financing needs. In response to Napoleon’s impending

---

\(^1\) See Chapter V *infra* for a description of mixed enterprises in the U.S., China, and Continental Europe.

invasion of Portugal, the Portuguese royal family fled from Lisbon to seek refuge in Rio de Janeiro in 1808. In that same year, the regent prince of Portugal authorized the creation of Brazil’s first native business corporation, the first Bank of Brazil (Banco do Brasil), with the goal of issuing the requisite currency to finance the monarchy’s expenses and develop indigenous trade and industry.³

Having exhausted its reserves in the relocation to Brazil, the Portuguese government sought to capitalize the Bank entirely with private funds by marketing its stock to wealthy merchants and landowners, who were formally meant to exercise control over the institution. According to the Bank’s royal charter, Portugal’s regent prince appointed the Bank’s first management team, but subsequent elections would take place at the general shareholder meeting. Only the 40 largest investors were entitled to attend shareholder meetings, and no shareholder could cast more than four votes each.⁴

The subscription of the first 100 shares necessary for the inauguration of the Bank’s activities as required by its charter took 14 months. The Portuguese government had initially tried to compensate the lack of spontaneous interest in the Bank’s shares by expending political favors – which ranged from royal titles to public offices – to lure additional stockholders, but that, too, proved to be insufficient. By 1812, only 26 shares additional had been subscribed. It was not until that year that the government became a shareholder in the Banco do Brasil when, owing to the continuing difficulty in attracting private investment, it made a capital contribution originating from newly created taxes

³ There were, to be sure, various colonial corporations chartered in Portugal and operating in Brazil in the eighteenth century. For a thorough description of such companies, see RUI MANUEL DE FIGUEIREDO MARCOS, AS COMPANHIAS POMBALINAS [Pombal’s Companies] (1997).

⁴ See Alvará (Oct. 12, 1808), providing for the corporate charter (estatutos) of Banco do Brasil, Arts. IX, X and XI.
whose proceeds were to be channeled to the Bank.\textsuperscript{5} The Portuguese government waived its right to dividends for the first five years, therefore helping assure the payment of generous dividends to private investors, a strategy that finally succeeded in drawing enough subscribers. By 1817 investors had subscribed the totality of the Bank’s minimum capital of 1,200 réis, ending what was the first and most protracted share offering in Brazilian history.\textsuperscript{6}

Unlike the Bank of North America of 1781 and the First Bank of the United States, in which the government held a significant stake (60% and 20%, respectively), the Banco do Brasil was overwhelmingly funded by private capital, even though the government was its principal customer.\textsuperscript{7} As of 1821, the Treasury, the Bank’s single largest shareholder, held only 76 (or 3.4%) out of a total of 2,235 shares outstanding.\textsuperscript{8} Like other Brazilian corporations in the nineteenth century, the Bank of Brazil formally bore closer resemblance to a government-sponsored company that was a beneficiary and a source of public favors than to a state-owned enterprise whose majority equity is held by the government.\textsuperscript{9} Nonetheless, historians have noted that, despite the government’s

\textsuperscript{5} Alvará (Oct. 20, 1812).

\textsuperscript{6} For a thorough description of the experience of the first Banco do Brasil, see AFONSO ARINOS DE MELO FRANCO, HISTÓRIA DO BANCO DO BRASIL (Primeira Fase – 1808-1835) [The History of the Banco do Brasil (First Phase – 1808-1835)] (1973).

\textsuperscript{7} For descriptions of the Bank of the North America and the Bank of the United States, see Chapter V, Part II(A) \textit{infra}. Although the Banco do Brasil also discounted short-term bills of exchange, most of the Bank’s notes were used to finance public deficits. Carlos Manuel Peláez, \textit{The Establishment of Banking Institutions in a Backward Economy: Brazil, 1800-1851}, 49 BUS. HIST. REV. 446, 464 (1975).

\textsuperscript{8} MELO FRANCO, \textit{supra} note 6, at 82. \textit{But see} HISTÓRIA GERAL DA CIVILIZAÇÃO BRASILEIRA [The General History of Brazilian Civilization], vol I 113 (Sérgio Buarque de Holanda ed., 1962) (stating that the government owned approximately 23% of the Bank’s equity in 1821).

\textsuperscript{9} The lack of significant government ownership in the Banco do Brasil has however escaped notice by corporate law scholars. \textit{See}, e.g., WALDEMAR FERREIRA, A SOCIEDADE DE ECONOMIA MISTA EM SEU ASPECTO CONTEMPORÂNEO [Mixed Enterprise in Its Contemporary Aspect] 90-1 (1956) (describing the
small equity holdings and charter provisions to the contrary, the Banco do Brasil was under *de facto*, if not *de jure*, government control.\(^{10}\)

In financial distress since the Portuguese royal family returned to Lisbon in 1821, bringing with it the Bank’s metal reserves, the First Bank of Brazil was dissolved following the expiration of its 20-year term in 1829.\(^{11}\) A second state-sponsored bank would not appear until 1853,\(^{12}\) when the Imperial government forced the merger of Brazil’s two major banks at the time – the Banco Commercial of 1842 and new the privately-controlled Banco do Brasil of 1852 – to form yet another, semi-official Banco do Brasil holding a monopoly of currency issue. Even though the new Bank of Brazil

---

\(^{10}\) MELO FRANCO, *supra* note 6, at 22. The Banco do Brasil was not unique as an early instance of a semi-public corporation over which the government exercised significant control despite a modest equity interest. At least since the Dutch East India Company, cash-strapped States had chartered business corporations to fulfill public functions. The State’s contribution to many of these early corporations came in the form of legal privileges, including monopoly rights, rather than through a financial investment in the firm. For a description of the governance structure of the Dutch East India Company, see Oscar Gelderblom, Abe de Jong & Joost Jonker, *Putting Le Maire into Perspective: Business Organization and the Evolution of Corporate Governance in the Dutch Republic, 1590-1610*, in *The Origins of Shareholder Activism* (Jonathan G.S. Koppell ed., forthcoming 2011) (describing that the Estates-General had significant governance rights, while outside investors lacked voting rights). *See also* NUNO CUNHA RODRIGUES, *“Golden-Shares”: As Empresas Participadas e Os Privilégios Do Estado Enquanto Accionista Minoritário* [“Golden-Shares”: State-owned companies and the privileges of the state as minority shareholder] 110 (2004) (noting that Portugal’s colonial companies (*companhias pombalinas*) were funded exclusively by private capital, even though their charters conferred on them significant sovereign powers).


\(^{12}\) A previous proposal for the creation of a second Banco do Brasil in 1833 did not move forward. According to the proposed charter for the new banking institution, the government would hold at least one-fifth (or 4,000) of the Bank’s 20,000 shares. *See* Annaes do Parlamento Brasileiro: Câmara dos Srs. Deputados [Records of the Chamber of Deputies] at 65 (Apr. 29, 1833).
was entirely owned by private shareholders, its charter specifically conferred on Brazil’s Emperor the right to appoint the Bank’s president. The Bank was to be 53%-owned by the shareholders of the merging institutions, with the remainder of its capital being offered for subscription by the general public.

Business corporations played a major role in railroad development in Brazil, but here again State ownership was negligible. One notable exception was the Estrada de Ferro D. Pedro II, one of the largest corporations of nineteenth-century Brazil, whose charter granted to Brazil’s Emperor, after whom the railroad was named, the right to appoint the company’s president. The Imperial government came to be a majority shareholder of the D. Pedro II railroad, which was ultimately taken over by the State in its entirety in 1863 in exchange for government bonds. Similarly, the Imperial

---

13 MELO FRANCO, supra note 6, at 395.

14 Decree 1,223 (Aug. 31, 1853). Shareholders were in charge of electing the Bank’s directors, but could cast no more than 15 votes each. Id. A subsequent interpretive decree by the government also made clear that, while shareholder assemblies were responsible for interpreting the meaning of ambiguous charter provisions, the Banco do Brasil’s charter was to be interpreted by the Imperial government. See Decree 588 (Dec. 16, 1961).

15 For a description of favoritism in the allocation of shares in the oversubscribed offering by the second Banco do Brasil, see Chapter II supra. An example of an early corporation having governmental participation was the Imperial Companhia Seropédica Fluminense, chartered by the Decree 1,341 of March 2, 1854. This silk manufacturer was initially privately owned but was bailed out by Emperor D. Pedro II, who was its majority shareholder at the time of incorporation.

16 The government for some time owned a majority of the D. Pedro II railroad’s stock, but did not have legal control rights over the corporation, whose charter, like most of its contemporary counterparts, limited the voting rights of large shareholders by providing a cap of 20 votes per shareholder. For a discussion of the conflicts between the State’s financial interest and its limited control rights under the company’s charter, Annaes do Parlamento Brazileiro: Câmara dos Srs. Deputados, speech of Sr. Ottoni (sessions of Aug. 26, 1861 and Aug. 30, 1861). For a discussion of shareholder voting rights in nineteenth-century corporations in Brazil, see Chapter II, Part III, supra.

government had become a shareholder in the Estrada de Ferro de Pernambuco in 1861 after an exchanging stock for government bonds. Nevertheless, as a general rule, government support to railroad building in Brazil, while quite generous, typically took the form of dividend guarantees of 5 or 7% to private railroad corporations, instead of outright ownership.

II. The Rise of Mixed Enterprise

State shareholdings, initially modest, acquired far greater significance in the twentieth century. The disruptions in international trade during World War I led to major economic and political changes in Brazil. The federal government adopted a policy of currency devaluation to minimize the losses of coffee producers (then Brazil’s most powerful oligarchy), which had the unanticipated side effect of increasing the cost of foreign products and boosting local industrialization. During that time, the level of capital market activity – until then the second highest in Latin America – declined rapidly, and corporate ownership became increasingly concentrated in the hands of wealthy families.

---

18 See Imperiais Resoluções da Seção de Fazenda do Conselho de Estado, supra note 105, vol. V, at 35 et seq. (Consultation n. 619 of March 27, 1861).

19 For a description of railroad development in Brazil, see, e.g., WILLIAM R. SUMMERHILL, ORDER AGAINST PROGRESS: GOVERNMENT, FOREIGN INVESTMENT, AND RAILROADS IN BRAZIL (2003).


21 See Raghuram Rajan & Luigi Zingales, The Great Reversals: The Politics of Financial Development in the Twentieth Century, 69 J. FIN. ECON. 5 (2003) (estimating that Brazil’s market capitalization in the eve of World War I reached 25% of its GDP, a level that was not surpassed until the 1990s); Aldo Musacchio, Law Versus Contracts: Shareholder Protections and Ownership Concentration in Brazil, 1890-1950, 82 BUS. HIST. REV. 445 (2008).
The trend toward concentrated corporate ownership was also apparent in firms where the government held a minority stake. While the first Bank of Brazil of 1808 was born with an oligarchic, but relatively dispersed control structure, when the third Bank of Brazil was created in 1905 the federal government acquired one-third of its total capital, which represented the bank’s largest voting block. In 1923, the Treasury acquired sufficient shares to become the Bank’s majority shareholder. When the state government acquired a large equity stake in the Bank of the State of São Paulo (Banco do Estado de São Paulo – Banespa) in 1926, graduated voting scales were eliminated from the firm’s charter to secure uncontested state control, a practice that would become pervasive in government bail-outs and nationalizations of private companies in the following decades.

In 1932, Brazil enacted its first statute permitting the issuance of preferred non-voting shares, which would become the main mechanism for the exercise of uncontested concentrated control in subsequent decades. The Decree 21,536 of 1932 allowed corporations to issue non-voting stock so long as these securities granted either a

---

22 See note 4 supra and accompanying text.

23 Topik, supra note 11, at 71.

24 Id.

25 Musacchio, supra note 21, at 468.

26 Decree 21,536 of 1932. The same statute also expressly banned the issuance of multi-voting stock, which have since been illegal in Brazil. The issuance of non-voting preferred shares alone would eventually make Brazil the jurisdiction displaying the highest number of dual-class shares and the largest average wedge between voting and cash-flow rights in the world. See Andre Carvalhal da Silva & Avanidhar Subrahmanyan, Dual-Class Premium, Corporate Governance and the Mandatory Bid Rule: Evidence from the Brazilian Stock Market, 13 J. CORP. FIN. 1, 4 (2007) (dual-class shares); Tatiana Nenova, Control Values and Changes in Corporate Law in Brazil (2001), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=294064 (gap between cash-flow and voting rights).
Many firms came to issue non-voting preferred stock providing only for a liquidation preference, thus rendering such securities akin to non-voting common stock. Like family-controlled corporations, State-owned enterprises would subsequently make ample use of preferred non-voting shares to obtain outside equity financing while allowing the government to retain uncontested control over corporate affairs.

In Brazil, as elsewhere, the interests of the State qua shareholder have played an important role in supporting the enactment of corporate laws that permit departures from the one-share-one-vote standard. Deviations from proportional voting in Brazil typically take the form of non-voting preferred stock, while in other countries alternative voting schemes that separate voting from cash-flow rights also include multi-voting stock and voting caps. The desirability of a broad ban on deviations from the one-share-one-vote rule is one of the main themes of contemporary corporate governance, and remains subject to debate.

For one, critics of the mandatory imposition of proportional voting point out that dispersed minority shareholders are widely recognized as being “rationally apathetic,” having little interest and incentive to exercise their voting rights in shareholder meetings.

---

27 It was not until the legal reforms of 1997 and 2001 that the Corporations Law required corporations to grant more substantial preferences (such as favorable dividend treatment, or tag-along rights) in exchange for the withdrawal of the right to vote. According to the 1932 decree, using language that was incorporated to subsequent corporate statutes, non-voting preferred shares would temporarily acquire voting rights if dividends were not paid for three consecutive fiscal years. A nominal dividend payment was however sufficient to avoid the application of this rule.

28 See Chapter V infra for the cases of France and Germany.

29 Under Brazil’s Corporations laws, voting caps are legally permissible, but multi-voting rights are not. Law 6,404/76, Art. 110, §2.
or even by proxy.\textsuperscript{30} Moreover, the laws of jurisdictions where mixed ownership has been less frequent and capital markets most developed afford corporations and shareholders considerable flexibility in tailoring voting rights provisions. Both U.S. and U.K. law have traditionally permitted deviations from the one-share-one-vote rule, even if the vast majority of publicly-traded firms in these countries have adopted precisely this scheme in practice.\textsuperscript{31}

Nevertheless, although the empirical and theoretical scholarship on the subject recognizes that a one-share-one-vote scheme entails costs and benefits, the “dominant view” in the literature emphasizes the economic virtues of proportional voting as a general rule.\textsuperscript{32} Granting voting rights in proportion to an investor’s equity interest

\textsuperscript{30} For a classical enunciation of this problem, see \textsc{Joaquín Garrigues, Nuevos Hechos, Nuevo Derecho de Sociedades Anónimas} 84 et seq. (1933) (describing small shareholders’ lack of interest in influencing corporate affairs and challenging the soundness of the practice of granting equal voting rights to all shareholders).


\textsuperscript{32} Renée Adams & Daniel Ferreira, \textit{One Share-One Vote: The Empirical Evidence}, 12 \textsc{Rev. Fin.} 51, 52 (2008) (“[t]he idea that the “one share-one vote” principle is desirable is what might be considered the dominant view in the literature”). Adams and Ferreira survey the empirical literature on the economic consequences of the one-share-one-vote rule, and posit that, while “the findings from the empirical literature on ownership disproportionality often disagree,” “there is some support in the literature for the hypothesis that deviations from one share-one vote affect the value of outside equity negatively.” \textit{Id.} at 85-5. See also Mike Burkart & Samuel Lee, \textit{One Share-One Vote: The Theory}, 12 \textsc{Rev. Fin.} 1, 1 (2008) (reviewing the theoretical economic literature and concluding that it remains “an open question whether mandating one share-one vote would improve the quality of corporate governance”).
produces beneficial incentives that subsist even if minority shareholders are passive and feel disinclined to vote most of the time.  

First, proportional voting both encourages and facilitates the efficient operation of the market for corporate control. By contrast, disproportional voting rules such as non-voting stock, multi-voting stock or voting caps usually serve as hostile takeover shields, hence removing or impairing the market for corporate control as an available check on mismanagement. However, even if minority shareholders are generally apathetic and the market for corporate control is unavailable because of concentrated ownership, a one-share-one-vote rule may still help improve the incentives of controlling shareholders.

By decoupling voting rights from the underlying economic interest in the firm, departures from the one-share-one-vote rule create incentives for inefficient decision-making. Specifically, disproportional voting rules are often used to permit a shareholder holding less than a majority of the firm’s equity interest to exercise uncontested control over the firm. This type of “controlling-minority structure” (CMS), as Bebchuk, Kraakman, and Triantis dub it, creates particular grave distortions of controlling shareholders’ incentives compared to controlling shareholders that also hold a majority of the firm’s stock.

---

33 See Henry Hansmann, Ownership of Enterprise 11 et seq. (describing the role of “formal” voting rights in different enterprise structures even if the firm’s owners may choose not to exercise them).


35 For a model showing the exponential increase in agency costs in controlling-minority structures, see Lucian A. Bebchuk, Reinier H. Kraakman & George G. Triantis, Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights, in Concentrated Corporate Ownership (Randall Morck ed., 2000)
Intuitively, one can only “steal” something that belongs to others. By this logic, the opportunity and incentives of controlling shareholders to engage in minority expropriation through theft and tunneling increase as their ownership interest in the firm decreases. And, as Bebchuk, Kraakman, and Triantis’s model show, “as the size of cash-flow rights held decreases, the size of agency costs increases, not linearly, but rather at a sharply increasing rate.” Consequently, a one-share-one-vote rule can also increase investor protection and managerial efficiency by tying uncontested control to the ownership of a majority (or quasi-majority) of the equity interests in the firm.

Still, the economic rationale for imposing an outright ban on voting schemes other than one vote per share may seem dubious at first. While mid-way changes in minority shareholder rights through dual-class recapitalizations are more obviously problematic (and are therefore outlawed in the U.S.), the mere legality of alternative voting schemes is arguably harmless from an economic standpoint. Ex ante, investors are expected to be either unwilling to invest in such securities or to duly discount their share price in order to account for the probability of future expropriation.

---

36 *Id.* at 296.

37 Indeed, many of the firms listed on the São Paulo Stock Exchange’s Novo Mercado segment, which prohibits the issuance of non-voting shares, still have a controlling shareholder holding a majority of the firm’s shares. *See* Érica Gorga, *Changing the Paradigm of Stock Ownership from Concentrated Towards Dispersed Ownership? Evidence from Brazil and Consequences for Emerging Countries*, 29 NW. J. INT’L L. & BUS. 439, 523 (2008) (finding that nearly 30% of Novo Mercado firms in her sample had a majority shareholder). Although the presence of a controlling shareholder certainly impairs the market for corporate control, it is arguably still an improvement compared to the historical prevalence of control-minority structures in Brazil’s capital markets.

38 *See*, e.g., Ronald J. Gilson, *Evaluating Dual-Class Common Stock: The Relevance of Substitutes*, 73 VA. L. REV. 807 (1987) (arguing that the that the permissibility of a “stock’s limited voting rights are reflected in a reduced price, so that the company’s owners at the time it goes public, and not the purchasers, bear the cost”); Jeffrey N. Gordon, *Ties that Bond: Dual-Class Common Stock and the Problem of Shareholder Choice*, 76 CAL. L. REV. 1 (1988) (finding that dual-class recapitalizations have a negative effect on shareholder wealth). But see Randall Morck, Daniel Wolfenzon & Bernard Yeung, *Corporate Governance, Economic Entrenchment, and Growth*, 43 J. ECON. LIT. 655, 655 (2005) (arguing that entrenched corporate control “permit a range of agency problems and hence resource misallocation” and that “[i]f a few families
A more nuanced approach however suggests that the efficiency of a broad one-share-one-vote rule cannot be assessed independently of the degree of investor protection afforded by a given legal system. In a system that adequately deters self-dealing transactions, the structural incentives for good behavior afforded by a one-share-one-vote scheme may be unnecessary, thus possibly justifying greater flexibility for corporations and shareholders to tailor their capital and voting structures. It is noteworthy that both in the U.S. and the U.K. – jurisdictions that simultaneously provide relatively high levels of investor protection but otherwise permit disparate voting rights – the one-share-one-vote rule is still the norm in corporate practice.³⁹ This perhaps suggests that, where investor protection is stronger and opportunities for expropriation are weaker, there will be little incentive to depart from the efficient scheme of tying voting to cash-flow rights.

Nonetheless, in jurisdictions providing lower levels of legal investor protection – as was historically the case in Brazil, as well as in most of those discussed in Chapter V – a one-share-one-vote rule may serve as a structural substitute for more complex legal standards and sophisticated techniques of judicial enforcement to protect the investing public. This may explain why the New York Stock Exchange included a one-share-one-vote requirement as part of its listing standards in 1926, a time in which most legal investor protections that are customary today were still embryonic. Indeed, it was not until 1986 – more than half a century of corporate legal development – that the NYSE finally abandoned such a listing requirement.⁴⁰ It is curious that, precisely as U.S. control large swaths of an economy, such corporate governance problems can attain macroeconomic importance”.

³⁹ See supra note 31 and accompanying text.

⁴⁰ For an overview and analysis of the history of the NYSE listing rule mandating one vote per share, see Joel Seligman, Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote
corporate practice had begun to shun non-voting shares in the 1920s and 1930s, Brazil was amending its laws to follow the U.S. model in permitting the issuance of non-voting preferred stock, a type of securities that would become particularly common among its emerging state-owned enterprises.41

The depression years of the 1930s prompted greater State intervention in the economy through price controls and import restrictions. Although the State did not start new enterprises in this period, it increased its participation in those industries in which it was previously involved. While most nineteenth-century railroad corporations enjoyed publicly-guaranteed dividends but were owned by private shareholders, by 1929 the government had taken over two-thirds of the country’s railways, a percentage that would increase even further in the following years.42

It was not until the early 1940s, with the incorporation of the Companhia Siderúrgica Nacional (CSN) in 1941 (steel) and the Companhia Vale do Rio Doce (CVRD) in 1942 (mining), that Brazil witnessed the emergence of the first large-scale enterprises having the government as a controlling shareholder from the outset.43 CSN, which was responsible for building Brazil’s Volta Redonda steel works during World

---

*Controversy*, 54 GEO. WASH. L. REV. 687 (1986) (concluding that “nonvoting or disproportionate voting common stock is the corporate law equivalent to price-fixing. It is one of a very few devices that must be proscribed for a market system to operate effectively”). *Id.* at 88.

41 See Chapter II *supra* for a more detailed discussion of Brazil’s 1932 statute.


43 See Decree-Law 3,002 (Jan. 30, 1941) (incorporating CSN) and Decree-Law 4,352 (June 1, 1942) (incorporating CVRD). *See PINTO JUNIOR, supra* note 9, at 23 (noting that the Brazilian State made incursions into entrepreneurial activities in the 1940s primarily by launching new enterprises, rather than nationalizing existing ones, as was the case in England, France and Italy).
War II, was the first such company. The U.S. Eximbank extended a generous loan to partially finance its creation in exchange for Brazilian support in the war. 44 As a mixed enterprise, Brazil’s federal government held uncontested control over CSN, which was to be partially funded by private shareholders. 45 In a large-scale media campaign that would be later described as a “true national crusade,” 46 the government appealed to patriotic motives in encouraging subscriptions in CSN. It also authorized the Treasury to transfer to Brazilian firms and citizens part of the shares it had previously subscribed, with subsequent installments paid directly to CSN. Yet, despite these efforts, the government was unable to obtain more than one-third of the amounts offered for private subscription. 47

The impetus for the creation of these national giants came from a combination of national security considerations in view of the ongoing world war and a Gerschenkronian lack of private capital for financing industrialization. 48 Brazil’s National Development Bank (Banco Nacional de Desenvolvimento Econômico – BNDE, later renamed Banco

44 For a description of early U.S. support and the subsequent successful record of CSN, see Alice H. Amsden, The Rise of “The Rest”: Challenges to the West from Late-Industrializing Economies 96-98 (2001). As the firm’s largest lender, the Eximbank required that “management would include administrators and engineers trained in the United States.” Id. at 97.

45 CSN was created by Decree-Law 3,002 of 1941. According to its federal charter, the President of Brazil had the right to appoint the company’s President, while shareholders were to elect the other directors. Id., Art. 15.


47 Id. at 271.

48 See generally Alexander Gerschenkron, Economic Backwardness in Historical Perspective (1962). See also Pinto Junior, supra note 9, at 25 (attributing the rise of State ownership in Brazil, among other things, to the lack of a vibrant capital markets capable of financing large-scale industrial ventures).
Nacional de Desenvolvimento Econômico e Social – BNDES), established in 1952, became an important financing source of public enterprises before switching roles to operate as a main financier of the private sector in subsequent decades. In 1953, the federal government incorporated another mixed enterprise – which would become the global oil giant Petrobras – following a popular marketing campaign based on the nationalistic slogan “the oil is ours.” While the CSN and the BNDE initially benefited from U.S. government loans in connection with war-cooperation efforts, most state-owned firms were primarily financed via forced savings through taxation.

Throughout this work, mixed enterprises are defined in broadly functional terms as firms in which the State shares ownership with private investors. As argued by prominent Brazilian jurist Pontes de Miranda, “the concept of ‘sociedade de economia mista’ is one of economics and finance, not properly a legal concept.” Following

---

49 The BNDE was created by Law 1,628 of 1952 as an agency of the federal government, but it was transformed into a wholly-owned government corporation by Law 5,562 of 1971. Initial proposals to establish the bank as a mixed corporation were ultimately rejected both because of a lack of private interest in long-term financing projects and because of the World Bank’s requirement of a government guarantee in return for its loans to the Bank. See Roberto Campos, A Lanterna na Popa 191 (1994) (for a description of the process leading to the creation of BNDE).

50 Werner Baer & Annibal V. Villela, The Changing Nature of Development Banking in Brazil, 22 J. INT. STUD. & WORLD AFFAIRS 423, 425-34 (1980) (describing that the share of the Bank’s funds allocated to the private sector vis-à-vis public enterprises grew from less than 10% in its early years to more than 80% by the mid 1970s).

51 Law 2,004 (Oct. 3, 1953).

52 Luciano Martins, Estado Capitalista e Burocracia no Brasil Pós-64 [Capitalist State and Bureaucracy in Brazil Post-64] 60 (1985).

53 As warned by Toshio Mukai, such is an economic, rather than legal, definition of mixed enterprises. See Toshio Mukai, A Sociedade de Economia Mista na Lei das S.A., 136 REVISTA DE DIREITO ADMINISTRATIVO 297, 297 (1979).

subsequent legislative developments, however, legal scholars have extensively debated the legal concept of mixed enterprises, and have habitually embraced narrower definitions that require majority State control, joint public and private management, specific legislative authorization, and the pursuit of public objectives in addition to shared private and public ownership. 55

Initially by practice, and later by law, mixed enterprises in Brazil (sociedades de economia mista) had necessarily to be organized as a sociedade anônima (business corporation). 56 As such, mixed enterprises were by and large subject to general corporate laws, except to the extent in which their statutory corporate charters abrogated the standard private law regime. For instance, most statutory charters authorizing the creation of state-owned enterprises depart from general corporate laws in that they provide for presidential appointment of the company’s chief executive. Director elections, by contrast, were often subject to general corporate law rules, which in any case ensured that the State, as any other majority shareholder, is able to appoint at least a majority of the company’s board.

In 1940 Brazil enacted a new Corporations Law (Decree-Law 2,627), a statute that was primarily designed to address the then existing reality in which the vast majority

55 Neither Brazil’s 1988 Constitution nor its current Corporations Law contains a definition of sociedade de economia mista. The Decree-Law 200 of 1967, Art. 5, III, defines sociedade de economia mista as “the entity endowed with legal personality of private law, created by statute for the exploitation of economic activity, under the form of a business corporations, whose voting shares belong in their majority to the Union or to an entity of the Indirect Administration”). See Mario Engler Pinto Jr., A Atuação Empresarial do Estado e o Papel da Empresa Estatal [The State as Entrepreneur and the Role of State Enterprise]. 151-152 REVISTA DE DIREITO MERCANTIL, INDUSTRIAL, ECONÔMICO E FINANCEIRO 256, 258-60 (2009), for an excellent discussion of the technical legal concept of sociedade de economia mista under Brazilian law.

56 Decree-Law 200 of 1967, Art. 5, III. In the vast majority of countries mixed enterprises are organized as business corporations. One exception is Germany, where mixed enterprises historically took the form of limited liability companies (Gesellschaft mit beschränkter Haftung – GmbH) as well as business corporations (Aktiengesellschaft – AG). See THEOPHILDE AZEREDO SANTOS, AS SOCIEDADES DE ECONOMIA MISTA NO DIREITO BRASILEIRO [Mixed Enterprise in Brazilian Law] 13 (1964).
of business corporations were family controlled. The new statute did not include any special provisions on mixed enterprises, even though its draftsman, Miranda Valverde, kept the expected rise of state-owned enterprises in mind in elaborating the new body of rules. In his Exposition of Motives to the new law, Valverde regarded the probable emergence of mixed enterprises as the only hope to revert the existing status quo of capital markets stagnation.\textsuperscript{57} In his view, the success of mixed enterprises would depend on “the manner in which the company will be managed, the competency and responsibility of its managers, parsimony in expenses, and no bureaucracy – all as if it were a private firm.”\textsuperscript{58}

Nevertheless, even Brazil’s lax corporate law rules turned out to be too inconvenient for the government as the controlling shareholder of a growing number of mixed enterprises. At the time, the government’s solution was to enact \textit{ad hoc} special decrees exempting the companies it controlled from the legal requirements it found most cumbersome. In the same year of the enactment of the new Corporations Law of 1940, the President issued a decree that exempted business corporations owned by the federal government from the provisions of the corporate statute that authorized members of the supervisory board to examine the corporation’s books and records as well as from the

\textsuperscript{57} Trajano de Miranda Valverde, \textit{Exposição de Motivos ao Anteprojeto convertido em Decreto-Lei n. 2.627 de 1940} [Exposition of Purpose to the Draft Bill converted in the Decree-Law n. 2.627 of 1940] (1940) (“it is possible that the government, with time, may be able to change this situation [of underdeveloped capital markets], establishing mixed enterprise corporations, for the accomplishment of undertakings of general interest”).

\textsuperscript{58} \textit{Id.} (noting that “[t]he great national companies, which are organized as business corporations, began as family firms. And many of those that exist to day are impregnated of a family character. We do not have a financial market, and it is manifest that our stock exchanges are profoundly anemic. There is an entire absence of this creative economy, which seeks to undertake risks inherent in industrial and commercial activities, because there is the probability of corresponding profits.” (free translation)
rule mandating the allocation of 5% of net profits to minimum reserve funds.\textsuperscript{59} The federal government defended the soundness of special legal treatment to state-owned enterprises on the grounds that it was necessary to protect public institutions from “shareholder curiosity” leading to pressures for dividend payments.\textsuperscript{60} Valverde subsequently noted that this statute aimed to avoid public disclosure and investor pressure in light of the Banco do Brasil’s “astronomical reserves.”\textsuperscript{61}

A few years later, the federal government enacted still another decree exempting government-controlled corporations from the provision of the Corporations Law that capped the issuance of non-voting preferred shares at one-half of the firm’s total equity capital.\textsuperscript{62} The Exposition of Motives to the Decree 6,464 of 1944 contended that, while the statutory cap on the issuance of preferred non-voting shares was a reasonable one when applied to private sector corporations, this rule was unnecessary when the State was in control. Government-controlled corporations, it was argued, enjoyed greater favors and guarantees than private firms, hence justifying an exception to the general rule. Such an exception, in turn, would permit mixed enterprises “to expand their business without the obligation to use budgetary resources to subscribe for new shares to maintain government control over these firms, especially in the current moment in which there are

\textsuperscript{59} Decreto 2,928 of 1940.

\textsuperscript{60} LEVY, supra note 46, at 257.

\textsuperscript{61} TRAJANO DE MIRANDA VALVERDE, SOCIEDADE POR AÇÕES 37 (3rd ed., 1959).

\textsuperscript{62} Decree-Law 6,464 of 1944.
great sums of inactive private capital and a growing interest in the industrial and commercial initiatives of the State.”

Starting in 1964, the ruling military government inaugurated a series of ambitious policies to develop Brazil’s capital markets. In that year, the newly empowered Castello Branco administration put in place its first “incentives policy for the evolution of capital markets” by creating fiscal incentives in the form of favorable tax treatment for both investors and publicly-traded companies. This approach, however, failed to induce a meaningful number of companies to go public on local stock markets, even after changes that successively weakened its requirements.

Disappointed, but not discouraged, by the failure of its initial policies, the government decided to strengthen its non-confrontational “incentives strategy” by adding further subsidies on the demand side. In particular, in 1967 the government enacted the Decree-Law 157, which allowed taxpayers to allocate part of their federal income tax dues to make personal investments in publicly-traded firms through certain mutual funds (the “fundos 157”) – thus making the purchase of shares in listed companies essentially

---


64 The program was part of a group of then recent anti-inflationary policies which, by restricting governmental loans to the private sector, triggered a severe working capital shortage in many firms. For a detailed description of these policies, see DAVID M. TRUBEK, JORGE HILÁRIO GOUEVA VEIRA & PAULO FERNANDES DE SÁ, O MERCADO DE CAPITAIS E OS INCENTIVOS FISCAIS [Capital Market and Fiscal Incentives] 113 (1971); David M. Trubek, Law, Planning and the Development of the Brazilian Capital Market, N.Y.U. Graduate School of Business Administration, Institute of Finance Bulletin Nos. 72-73 (1971).

65 TRUBEK ET AL., supra note 64.

66 The criteria for a firm to qualify as a publicly traded company qualifying for tax subsidies suffered multiple changes over a small period of time, ranging from a requirement of a progressive diffusion of voting shares up to 50% of total capital to the sufficiency of trading volume standards alone. Id.
free from a shareholder’s perspective, since the price was paid by the federal government. Unsurprisingly, this measure triggered a massive flow of funds into public companies and led to a capital markets boom.67

The importance of these funds to the surge in local stock markets in the late 1960s was such that rumors about the impending interruption of these subsidies led the Rio de Janeiro Stock Exchange to close in protest.68 Moreover, the government further reinforced the creation of compulsory demand for domestic equities by imposing a legal requirement that pension funds and insurance companies invest a minimum percentage of their portfolio in local stock markets.69 As Ary Oswaldo Mattos Filho put it, the government’s public policies to develop capital markets in the 1960s gave rise to the “unusual figure of a compulsory shareholder.”70

Ironically, however, it was precisely during the military government’s attempt to foster private securities markets that the real explosion in the number of state-owned enterprises took place.71 Intentionally or not, mixed enterprises turned out to be the foremost beneficiaries of the captive demand created by the government’s program to foster capital market development through forced savings.72 As contemporary

---

67 By the end of 1967, the trading volume on the Brazilian stock exchanges had risen by 91%. Id. at 150.

68 See TRUBEK et al., supra note 65 at 151.


71 SUZIGAN, supra note 42, at 90.

72 José Roberto Mendonça de Barros & Douglas H. Graham, Brazilian Economic Miracle Revisited: Private and Public Sector Initiative in a Market Economy, 13 LATIN AM. RES. REV. 5, 20 (1978) (finding that “State enterprises rather than private firms were the major beneficiaries [of tax incentives].” These
economists put it, “what began as an institutional reform to promote the low cost
capitalization of private sector growth has in effect become a vehicle for public enterprise
capital expansion.”

Mixed enterprises were perceived to be less risky, holding monopolistic positions
and boasting a more generous dividend policy. A number of government-controlled
firms were mixed enterprises that figured among the “blue chips” traded on Brazil’s stock
exchanges. According to some estimates, stocks of mixed enterprises in Brazil were so
lucrative as to make them one of the best investments worldwide in the 1950s and
1960s. Responsible for 75% of the market’s trading volume, the securities issued by
state-owned corporations were the darlings of Brazil’s capital markets and a main target
of Brazil’s speculative fever in the early 1970s.

Demand for new share offerings of state-owned enterprises rose 84% between
1974 and 1975, compared to growth of only 32% in private sector offerings. In 1975
the government went as far as to temporarily prohibit high-profile SOEs from making
new public offerings so as not to divert scarce funds from private issuers. All in all, the

firms accounted for the vast majority of the new issues and their weight predominates in the daily trading
of the exchange”.

73 Id. at 11.

74 Walter L. Ness, Jr., A Empresa Estatal no Mercado de Capitais [State Enterprise in the Capital Market],
12 Revista Brasileira de Mercado de Capitais 359, 369 (1978). Nevertheless, state-owned firms
generally had a price-equity ratio below the market average, perhaps evidencing continuing investor
reservations about government control. Id. at 369.

75 Martins, supra note 52, at 71. For a description of the speculative boom and crash of 1971, see

76 Id.

77 Mario Henrique Simonsen, O Brasil e as Multinacionais [Brazil and the Multinationals] (conference
presented by the Treasury Minister Mario Henrique Simonsen to the Economy Commission of Brazil’s
Chamber of Deputies) (Oct. 8, 1975).
result is that, even if highly regressive,\textsuperscript{78} the government’s fiscal subsidies returned in large part (but by no means entirely) to the State itself.\textsuperscript{79}

The magnitude of the expansion of state-owned enterprises is striking, with 231 public enterprises created between 1966 and 1976 alone.\textsuperscript{80} By 1974, 22 out of the top 25 firms in the Brazilian economy were controlled by the government; in fact, SOEs were responsible for 49.7\% of the total net book value of the top 1,000 Brazilian firms.\textsuperscript{81}

In the 1970s, academics and policymakers recognized that tax incentives alone were insufficient to foster capital market development in Brazil; legal reforms to strengthen minority shareholder protection were also deemed crucial to increase investor

\textsuperscript{78} Walter Lee Ness Jr., Financial Markets Innovation as a Development Strategy: Initial Results from the Brazilian Experience, 22 ECON. DEV. & CULT. CHANGE 453, 454 (1974) (attributing to the non-democratic nature of Brazil’s military government the political feasibility of a reform program which so directly benefits the upper classes). In Brazil at the time, as now, a significant majority of the population did not earn enough income so as to pay income taxes, and, as such, could not directly benefit from the program. However, the government’s incentives policy, even if regressive, was not entirely illogical. First, a firm’s decision to go public produces positive externalities to the extent that it contributes to increase liquidity and, hence, the attractiveness of local markets; in this sense tax subsidies could help increase the number of listed companies by leading firms to internalize the net benefits of their actions. Second, and most importantly, corporate tax laws at the time effectively subsidized family and closely-held firms by taxing any formal increases in shareholders’ equity, even if due to inflation or retained earnings. Family firms relying more on blood ties and trust than on contract terms to govern their corporate affairs often opted not to book such capital increases and paid less taxes accordingly. \textit{See ALFREDO LAMY FILHO & JOSÉ LUIZ BULHÕES PEDREIRA, A LEI DAS S.A.} 128 (1992) (for a description of tax considerations). Indeed, sociologist (and future president of Brazil) Fernando Henrique Cardoso viewed the economic distortions attributable to inadequate tax laws as a more important hurdle to IPOs by closely-held family firms in Brazil than local “mentality” favoring family businesses. \textit{FERNANDO HENRIQUE CARDOSO, EMPRESÁRIO INDUSTRIAL E DESENVOLVIMENTO ECONÔMICO NO BRASIL [Industrial Entrepreneur and Economic Development in Brazil]}120 (1964). Viewed in this light, tax subsidies for publicly-traded firms could in fact help level the playing field compared to the actual dues paid by their private counterparts.

\textsuperscript{79} Barros & Graham, \textit{supra} note 72, at 21 (“one could later argue that what the public treasury lost in foregone revenues growing out of fiscal incentives for capital market reforms, they gained back through the increased subscription of stock to state owned enterprises through the stock market”).

\textsuperscript{80} MARTINS, \textit{supra} note 52, at 67. \textit{See also} THOMAS J. TREBAT, \textsc{Brazil’s State-Owned Enterprises: A Case Study of the State as Entrepreneur} 36 (1983) (noting that there was “not only the growth of public enterprises in the postwar period, but also the proliferation of such entities under conservative military governments in the 1960s and 1970s”).

\textsuperscript{81} Brazil Report – A Who’s Who of the Brazilian economy prepared by Visão 45 (1974) [hereinafter “Visão”]; Barros & Graham, \textit{supra} note 72, at 8.
confidence and interest in corporate securities. Economist Mário Henrique Simonsen, then Treasury Secretary (Ministro da Fazenda), resented Brazil’s dearth of large private enterprises: out of the 20 largest Brazilian companies as of 1972, 11 were SOEs, 7 were controlled by foreign investors and only two were controlled by Brazilian private capital. Simonsen attributed the absence of large private firms in Brazil not to a lack of private savings (which in fact abounded), but to the absence of legal mechanisms to protect minority shareholders from expropriation and thus encourage capital aggregation.

Simonsen posited that there were no business organizational forms in Brazil that simultaneously protected the firm and its investors. Partnerships and limited liability companies (sociedades de responsabilidade limitada) protected investors, who could at any time withdraw their capital contributions, but failed to protect the firm. Conversely, the corporate form permitted entrepreneurs to lock in capital, since disgruntled shareholders could not generally force a partial dissolution, but failed to afford sufficient protection to minority investors. This view was reflected in the recommendations of a prominent trade publication of the time, which advised foreign investors that “Brazilian corporation law spells out several protective rights for minority shareholders, but they are generally meaningless.” It argued that “[a]s a result, the Limitada becomes a very

82 MÁRIO HENRIQUE SIMONSEN, A NOVA ECONOMIA BRASILEIRA (1974).

83 MÁRIO HENRIQUE SIMONSEN, BRASIL 2002 124 (1972). See also EPEA, O MERCADO BRASILEIRO DE CAPITAIS [Brazilian Capital Market] (Mario Henrique Simonsen ed., 1965) (arguing that the then current Corporations Law did not provide the requisite shareholder protections for developed capital markets). Between 1966 and 1969 that 75% of capital formation in Brazil was financed by private savings against 17% of public savings and 8% of foreign savings. Id. at 118.

84 SIMONSEN, BRASIL 2002, at 124. See Timothy Guinnane, Ron Harris, Naomi R. Lamoreaux & Jean-Laurent Rosenthal, Putting the Corporation in Its Place, 8 ENTERP. & SOC’Y 687, 696 (discussing the trade-off between exit rights as a mechanism for minority protection in partnerships and limited liability companies and the need to lock-in capital for long-term investments).
convenient type of company whenever the parties desire to include certain protective measures for the minority partners.”\(^{85}\)

Proponents of a new legal framework viewed the development of capital markets as the only means to slow down the State’s growing incursion into economic activity, which was widely attributed to the existing capital market failure to finance necessary investments. In a 1975 op-ed, José Luiz Bulhões Pedreira, one of the draftsmen of the new Corporations Law, declared that “the alternatives are simple, clear, obvious: either we manage to create in the country a primary market for securities, or the process of statization of the economy will continue to accelerate exponentially.”\(^{86}\) The proposed Capital Markets Law, which would be enacted in the same year as a companion to the new Corporations Law, had the explicit goal of supporting capital markets development in order to “strengthen the position of large private national capital.”\(^{87}\)

Nevertheless, having just used generous tax incentives and captive demand policies to induce a large number of companies to go public – virtually all of which had wealthy families or the State as controlling shareholder – Brazil’s legal reform process faced an uphill political battle. In 1971, controlling shareholders of publicly-traded firms established the Brazilian Association of Public Companies (Associação Brasileira de Companhias Abertas – ABRASCA), which would prove to be highly influential in

\(^{85}\) Visão, supra note 81, at 134.


\(^{87}\) Exposição de Motivos n. 197 pelo Ministro da Fazenda [Treasury Secretary] (June 24, 1976).
opposing investor protection reforms in subsequent years and decades. Not only controlling families but also the State had a vested interest in preventing the adoption of sweeping legal reforms that could redistribute corporate wealth and power away to minority shareholders. More government-controlled corporations had been created in the decade preceding the adoption of Brazil’s 1976 Corporation Law than in the previous 100 years, and many such firms figured among the largest listed companies in the country.

Consequently, the interests of mixed enterprises were among the factors drawing considerable political attention to the proposed reform to the Corporations Law. As legendary Senator Franco Montoro put it, “the legal regime of business corporations and especially its reform constitute an element of economic policy and more generally a political fact. This assertion is true to the point that, today, almost all sectors of public life and parties interested in the country’s economic policy are mobilized to study that document [the bill], seeking to verify to what extent it is consistent with the national interests, with the strengthening of private Brazilian enterprise, with the prerogatives and the fundamental role of State and mixed enterprises, and with the legitimate rights and interests of shareholders.”

Given the prominence of SOEs in Brazil’s corporate landscape, some scholars had defended the adoption of a separate statute to suit the peculiar needs and characteristics of

---

88 See Luciano Coutinho & Flavio Marcilio Rabelo, Brazil: Keeping It in the Family 45, in CORPORATE GOVERNANCE IN DEVELOPMENT: THE EXPERIENCES OF BRAZIL, CHILE, INDIA AND SOUTH AFRICA (Charles P. Oman ed., 2004) (describing the Brazilian Association of Public Companies as a “traditional representative of the business elite” that has successfully opposed corporate governance reforms). For a more thorough description, see also Ronald J. Gilson, Henry Hansmann & Mariana Pargendler, Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the U.S. and the EU, 63 STAN. L. REV. (forthcoming 2011).

89 MARTINS, supra note 52, at 61.

90 Anais do Senado [Senate Records], speech of Senator Franco Montoro, at 489 (1975).
government-controlled firms, a proposal that was nevertheless defeated. In the absence of special legislation, the prevailing approach was to have a single Corporations Law apply to private and state-owned companies alike. As explained in the Exposition of Motives to the new statute, “in addition to regulating this form of organization when used by the private sector, the Corporations Law is the general law of mixed enterprises, which are subject to its provisions, subject to the derogations set forth in the special statutes that authorize their creation.” The Exposition further notes that “in resorting to the corporate form for the enterprises it promotes, the State seeks to assure private parties, to whom it offers association, the same rights and guarantees enjoyed by shareholders of other companies, without prejudice to the special provisions of federal law.”

The new Corporations Law of 1976 also included a new, though remarkably lean, chapter devoted to sociedades de economia mista (mixed enterprises). According to the justification to the bill advanced by its draftsmen, the goal of the chapter was to limit itself to the “minimum necessary” to “protect minority shareholders” of mixed corporations. The chapter made clear that, except as otherwise specified therein or in federal law, publicly-traded mixed enterprises were subject to the same corporate law

---

91 See, e.g., José Cretella Junior, Sociedades de Economia Mista no Brasil, 80 REVISTA DE DIREITO ADMINISTRATIVO 37 (1965) (defending the adoption of a separate statute to govern state-owned firms).

92 Exposição de Motivos n. 196 pelo Ministro da Fazenda [Treasury Secretary] (June 24, 1976).

93 The new Chapter IX on mixed enterprises contained only 8 out of the statute’s 300 articles. A 2001 law reform further eliminated two of them, with only 6 remaining in force.

rules and regulations of the newly-created Securities and Exchange Commission (Comissão de Valores Mobiliários – CVM) as private issuers.\(^95\)

The most controversial provision of the new chapter – which, in fairness, is a customary one by international standards – exempted mixed enterprises from bankruptcy proceedings, rendering the government liable for the firm’s obligations.\(^96\) Interestingly, this Chapter expressly imposed on directors and controlling shareholders of mixed enterprises the same fiduciary duties applicable to privately-owned corporations (thus incorporating the relevant provisions by reference), even though it specifically permitted the government to “steer the company’s activity toward the public interest that justified its creation.”\(^97\) Nevertheless, what could look like an intractable tension between standard fiduciary duties and government control was more apparent than real. As ultimately adopted, Brazil’s Corporations Law proved to be quite accommodating to the needs of the government as a controlling shareholder.

The general fiduciary duties created by the 1976 Corporations Law were exceedingly broad – indeed, probably too broad to effectively constrain the extraction of private benefits by controlling shareholders. The pertinent provisions of the statute

\(^95\) Law 6,404 of 1976, Art. 235. This provision stands in sharp contrast to U.S. law, which exempts the U.S. government and GSEs from various securities regulations. See Chapter V, Part IV, infra.

\(^96\) See CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES: A SURVEY OF OECD COUNTRIES 13, 56 (2005) (“in a number of cases, SOEs are to a large extent protected from insolvency or bankruptcy procedures by their specific legal status”). This provision was deemed to offer an undue advantage to SOEs vis-à-vis their private competitors through a lower cost of capital. The constitutionality of this rule was questioned after Brazil’s constitution of 1988, which expressly provides that public enterprises are subject to the same legal regime as private companies as to civil, commercial, tax and labor obligations (in its Art. 173). The provision exempting mixed enterprises from bankruptcy proceedings was eliminated from the corporate statute by Law 10,303 of 2001, but the exceptional regime was once again reinstated upon the enactment of Brazil’s new Bankruptcy Law of 2005 (Law 11,101 of 2005, Art. 2, I), which expressly exempts public and mixed enterprises from its provisions.

\(^97\) Law 6,404 of 1976, Art. 238.
provide that controlling shareholders shall protect the interests not only of shareholders, but also of employees, the community and even the national economy. Not only was the statutory language defining fiduciary duties too expansive, but a sophisticated fiduciary duty regime that could parse complicated controlling shareholder tactics required a degree of technical ability and willingness of Brazil’s judiciary to constrain controlling shareholders which was not present at the time. As a result, fiduciary duties failed to serve as an effective deterrent against minority expropriation.

Moreover, a closer look at the new fiduciary regime applicable to controlling shareholders reveals that, to the extent it conflates corporate control with public interest, it is not merely innocuous, but positively detrimental. In elevating not only the State, but also private controlling shareholders to the legal position of guardians of a diffuse notion of public good, the new Corporations Law would ultimately strengthen their position vis-à-vis that of the minority, which stood for merely private and egoistic interests. As

98 Id., Art. 116 (providing that “the controlling shareholder must use its influence so as to make the company fulfill its purpose and its social function, and has duties and responsibilities to the other shareholders, employees and the community in which it operates, whose rights and interests he must loyally abide by and respect”) and Art. 117, § 1(a) (listing as an instance of controlling shareholder abuse the act of “steering the company towards a purpose foreign to its corporate object or damaging of national interest, or leading it to favor another Brazilian or foreign company, to the detriment of the minority’s shareholder’s participation in the profits or assets of the company, or to the national economy”). However, as legal scholars have noted, broad fiduciary duties to different parties do not in fact make a fiduciary’s life more difficult due to the complex task of reconciling conflicting interests, but rather too easy, as “virtually any management decision, no matter how arbitrary, can be rationalized on the grounds that it benefits some constituency of the corporation.” On the difficulties associated with the multiple masters problems with respect to directors’ fiduciary duties, see Jonathan R. Macey, An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties, 21 STETSON L. REV. 23 (1991).

99 In his study on corporate fiduciary duties, published more than 20 years after the enactment of the Corporations Law, Carlos Klein Zanini notes the continued scarcity of doctrinal works and judicial decisions on fiduciary duties in Brazil. Carlos Klein Zanini, A Doutrina dos “Fiduciary Duties” no Direito Norte-Americano e a Tutela das Sociedades e Acionistas Minoritários Frente aos Administradores das Sociedades Anônimas, 109 REVISTA DE DIREITO MERCANTIL, INDUSTRIAL, ECONÔMICO E FINANCEIRO 137, 139 (1998).

100 See, for the contrary argument that minority protections should not be understood in terms of egoistical interests, but rather in light of the economic and social function of the firm, see José Alexandre Tavares
noted by Calixto Salomão Filho, the formal adoption of an institutional conception of the corporation in Brazil served to increase, rather than constrain, the power of controlling shareholders and, consequently, the potential for abuse.\textsuperscript{101}

The substance and scope of fiduciary duties of corporate directors and controlling shareholders is closely intertwined with the longstanding debate about the purpose of the corporation or, in continental legal parlance, the “social” or corporate interest (\textit{interesse social}, \textit{interesse sociale}, \textit{intérêt social}, as the case may be depending on the jurisdiction). In its most basic form, the debate has revolved around two competing visions of the corporation: the contractarian or “property” approach, according to which the corporation is to serve the (financial) interests of the shareholders qua shareholders, and the institutional approach, for which the purpose of the corporation transcends the interests of shareholders.\textsuperscript{102} A detailed analysis of this debate, which has been a central subject of corporate law scholarship for nearly a century, is outside the scope of the present study.

\textsuperscript{101} Calixto Salomão Filho, \textit{Sociedade Anônima: Interesse Público e Privado}, 127 Revista de Direito Mercantil, Industrial, Econômico e Financeiro 7, 15 (2002) (noting that a similar outcome was observed upon the adoption of Germany’s 1937 Corporations Law which, by identifying the interests of the corporation with an ill-defined notion of public interest, helped increase the power of controlling shareholders to the detriment of minority investors).

\textsuperscript{102} See, e.g., for a non-exhaustive list of representative works on this subject, see Walther Rathenau, \textit{Vom Aktienwesen. Eine geschäftliche Betrachtung} (1917) (for an articulation of an institutional conception of the corporation), Pier Giusto Jaeger, \textit{L’Interesse Sociale} 145 (1964) (for a now-classic study scrutinizing the institutional and contractarian approaches to corporate purpose, and defending a view of \textit{interesse sociale} as the collective interests of shareholders qua shareholders); Milton Friedman, \textit{The Social Responsibility of the Corporation Is to Increase Its Profits}, N.Y. Times Mag., Sept. 13, 1970 (defending profit maximization as the sole purpose of the corporation). See also, for the classic debate between Adolph Berle and E. Merrick Dodd in the 1930s, Adolph A. Berle, \textit{Corporate Powers as Powers in Trust}, 44 Harv. L. Rev. 1049 (1931) (arguing that directors should act in the interests of shareholders alone), and E. Merrick Dodd, \textit{For Whom Are Corporate Managers Trustees?}, 45 Harv. L. Rev. 1145, 1148 (1932) (viewing the “business corporation as an economic institution which has a social service as well as a profit-making function”). For more recent works on the same topic, see William T. Allen, \textit{Our Schizophrenic Conception of the Business Corporation}, 14 Cardozo L. Rev. 261 (1992) (discussing the
For our purposes, suffice it to say that there seems to be an interesting correlation between the presence of State ownership (and mixed enterprises in particular) and the adoption of stronger institutional conceptions of the corporation in a given jurisdiction. Of course, correlation does not imply causation. Nonetheless, it is at least plausible that the State’s interests as a shareholder may have played a role in supporting an institutional conception of the corporation in jurisdictions that have a significant number of mixed enterprises governed by general corporate laws. Because mixed enterprises often pursue public objectives other than profit, an institutional approach to corporate purpose is more amenable to the interests of the State as controlling shareholder under a unitary corporate law regime.

The choice for a unitary corporate law regime applicable to both private and public capital corporations was in line with the general regulatory stance of the military government toward mixed enterprises. The newly enacted Decree Law 200 of 1967 – which its draftsman viewed as initiating a “silent revolution” in public governance – made clear that mixed enterprises were to be subject to regulatory conditions “identical to concept between the two theories of the corporation under Delaware law); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247 (1999) (offering a team-production model of the corporation to challenge the conception of shareholder primacy); Salomão Filho, *supra* note 101; Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 Geo. L. J. 439 (2001) (declaring victory for shareholder primacy as a matter of historical evolution); Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 Harv. Int’l L. J. 129 (2009) (arguing that pro-employee corporate governance regimes can be an efficient solution to hold-up problems arising under concentrated corporate ownership). For an excellent overview of competing views of corporate purpose and interest, see Carlos Klein Zanini, *A Dissolução Judicial da Sociedade Anônima* 81-109 (2005).

103 See Chapter V, Part II(C), infra for a version of this argument in the cases of Germany and France.

104 For instance, it is possible that a third factor (say, socialistic or social-democratic inclinations of the ruling government) could determine both the prevailing legal theory with respect to corporate purpose and the level of State ownership of business enterprise in a given jurisdiction. Additionally, reverse causation remains a possibility: an overly strong institutional conception of the corporation could erode investor protection, decrease capital market activity and, therefore, create the need for State ownership of large-scale enterprises.
those of the private sector." The rationale for instituting a unitary regulatory framework was twofold: assuring the existence of a “level playing field” for the private sector while, at the same time, helping increase the efficiency of public enterprises by subjecting them to private law constraints. Indeed, a key objective of the administrative reform (reforma administrativa) of 1967 was to “enable the public sector to operate with the efficiency of private enterprise.”

Notwithstanding these commendable goals, the experience in Brazil and elsewhere suggests that, at least with respect to corporate law, a unitary regime may not so much constrain the government as controlling shareholder, but in fact be constrained and compromised by State interests, thus putting the very integrity of the general private regime at risk. A more recent assessment by Alfredo Lamy Filho, one of the draftsmen of the Corporations Law of 1976, paints a bleak picture in this regard. In his view,

“[t]he attempt to utilize a private law instrument [the business corporation] did not result in the desired efficiency. The operation of the new institutions created by the State – namely public and mixed enterprises – could not mask the uncomfortable presence of a controlling shareholder enjoying sovereign power, which was not subject to capital constraints, used agents foreign to the business universe (when it did not make these

---


106 Additionally, commentators subsequently argued that the unity of legal regime served to reinforce the alliance of interests between the State and Brazilian elites. See Luiz Carlos Bresser Pereira, Reforma do Estado para a Cidadania [State Reform for Effective Citizenship] 172 (1998) (arguing that the increased flexibility of public administration obtained through the reform sought to increase managerial efficiency by the State and to strengthen the political alliance between the State civil and military bureaucracy and business elites).

107 Roberto Campos, A LANTERNA NA POPA, supra note 49, at 699 (quoting a statement by President Castello Branco on the goals of the administrative reform).
enterprises the center of political trade, with unfortunate choices), and, in the worst cases, *used its power to change the rules of the game.*”

It is difficult to overstate the dominance of State ownership in Brazil’s stock markets in that period. A study commissioned by the newly-created CVM in 1978, just two years after the enactment of the Corporations Law, revealed that government-controlled corporations accounted for 70.8% of Brazil’s market capitalization and 61% of the stock market value held by minority shareholders. This meant that, under a unitary corporate and securities law system, the very integrity of Brazil’s regulatory regime depended on its binding force vis-à-vis mixed enterprises.

Nevertheless, despite the express statutory language subjecting listed SOEs to the same securities law rules governing private sector corporations, the State as controlling shareholder blatantly ignored existing regulations. The CVM, in turn, proved to be unwilling to reprimand the actions of the government as a controlling shareholder when they ran afoul of securities regulations. Consequently, the integrity of Brazil’s capital markets and the CVM’s reputation as an effective sheriff thereof suffered significant damage.

The notorious “Vale case” (“Caso Vale”), involving state-controlled mining giant Companhia Vale do Rio Doce (CVRD), is illustrative of this risk. Just a few years

---


109 Comissão de Valores Mobiliários, *Valor de Mercado do Capital das Companhias Abertas Brasileiras* [Market Capitalization of Brazilian Publicly-Traded Companies], 11 *REVISTA BRASILEIRA DO MERCADO DE CAPITAIS* 289-291 (1978) (also noting that “the State is notoriously the greatest entrepreneurs and the largest raise of dispersed savings”).

110 The Vale case provides a paradigmatic example of violations of securities law by state-owned enterprises, but it was not an isolated example. For a discussion of high-profile allegations of insider trading involving listed SOE Petrobras (“caso Petrobras”) just a few years earlier, see Horacio de
after the enactment of the 1976 Corporations Law, the federal government instructed a brokerage firm to secretly sell a massive number of shares it owned in CVRD in the open market. In doing so, the government intentionally failed to previously disclose its intent to sell a large block of stock as required under Brazil’s Capital Markets Law and CVM regulations. The government justified its action by appealing to the “public interest” involved in the stock sale, which entailed stabilizing stock market prices and raising much-needed funds to finance Brazil’s ethanol subsidization program (National Alcohol Program - Proalcool). In an announcement issued shortly after the incident, the CVM attributed that the massive stock sales to the government’s attempt to alleviate the monetary needs of the Treasury, explaining that, for this reason, the “interest of the nation had prevailed over the principles of market offers.”

This case generated significant controversy among market participants and legal experts. Regulators argued that the credibility of Brazil’s capital markets as an effective financing source for Brazilian companies required that all firms – including the listed state-owned enterprises that dominated Brazil’s equity markets – strictly complied with securities regulations. Other commentators however defended that the State qua controlling shareholder was not, and should not be, subject to the same legal

---


112 *Id.* at 17

113 CVM Inquérito Administrativo 04/80 (Oct. 10, 1980), in Diário Oficial, Oct. 29, 1980 [hereinafter CVM Administrative Investigation 04/80"] at 21581 (noting that, according to a then recent survey, state-owned companies accounted for 55% of the market capitalization in Brazil, with the State owning approximately three-quarters of these firms’ capital).
requirements applicable to private controlling shareholders. Prominent jurist Arnoldo Wald appealed to the public interest associated with State action – and, in particular, with the financial interests of the State qua selling stockholder – in justifying the government’s behavior in the Vale case:

“When the State seeks to dispose of part of its shares, using the market structure organized by the government itself and obtaining funds through the transfer of part of its shares to private participants upon a progressive privatization of mixed enterprises, regulators seek to prevent these operations by imposing a ritual that, in fact, would end up reducing the liquidity of the stock and requiring the public entity to always sell low, realizing losses for the collectivity.

Indeed, according to the law of supply and demand, the mere announcement of substantial sales or continued transfer of shares in small lots has, as a necessary consequence, a decline in the market value of the shares, always to the detriment of the Treasury and the public interest. Hence, as highlighted by Minister Octavio Gouvêa de Bulhões in a recent article, the sales of shares belonging to the Union may constitute a source of non-inflationary resources to address the country’s needs, it being therefore inconceivable that private interests, however respectable they might be, could prevent the legal action of the federal government in its defense of monetary policy and in the rational management of its assets…”

114 Herculano Borges da Fonseca, O Caso Vale: Alienação de Ações de Propriedade da União pelo Regime Especial da Lei n. 4.728/65 [The Vale Case: Alienation of Shares Belonging to the Federal Government under the Special Regime of Law n. 4.728/65], 16 REVISTA BRASILEIRA DE MERCADO DE CAPITAIS 4, 8 (1980). Fonseca noted that “Brazil was by far, among countries adopting a market and neocapitalist economies, the one that presented the largest number of mixed enterprises,” and that “it would not be comprehensible that CVM decisions could clash with the Treasury’s business management or with the government’s economic policy.” Id. at 9.

The CVM ultimately undertook an administrative investigation of the Vale Case, but its enforcement action was exceedingly lax.\textsuperscript{116} The only participant punished was the chairman of the board of the Rio de Janeiro Stock Exchange, who was at the same time a manager of the brokerage firm that performed the stock sales. Even so, the Commission opted not to inflict the maximum possible fine, reasoning that “Brazil’s market culture – which needs to be changed – has been used to thinking that client orders, especially from the government, are not to be discussed, but to be followed.”\textsuperscript{117}

The CVM decision reprimanded the defense attorneys for suggesting that the government is immune from securities regulations and that “government orders must be complied with regardless of other considerations.”\textsuperscript{118} It reasoned that “the existence of a free market, and of an effective and reliable regulatory agency, is not viable if the application of market rules is limited to private participants.”\textsuperscript{119} The Commission added that “there is no doubt that the government itself, as the major shareholder of publicly-traded companies, will be the greatest beneficiary of the development of an active and disciplined stock market.”\textsuperscript{120} While the CVM was right in recognizing that the failure of the government to comply with securities regulations (and the Commission’s own difficulty, or unwillingness, to punish such violations) was harmful to market confidence in Brazil, its diagnosis of the State’s interests under a rigorous legal regime was perhaps

\textsuperscript{116} See \textsc{Modesto Carvalhosa, Comentário À Lei de Sociedades Anônimas [Commentary to the Corporations Law], vol. IV 361 (4th ed., 2009), for a critique of the underenforcement of securities law violations in the Vale Case.}

\textsuperscript{117} \textsc{CVM Administrative Investigation 04/80, supra note 113, at 21574.}

\textsuperscript{118} \textit{Id.} at 21582.

\textsuperscript{119} \textit{Id.} at 21581.

\textsuperscript{120} \textit{Id.}
less accurate. As a controlling shareholder of numerous listed firms, the government often stood to profit by disregarding or even opposing minority shareholder rights, even if to the detriment of the country’s capital market development.

III. The Corporate Law Implications of Privatizations in Brazil

Brazil’s tripod model of business development – based on corporate ownership by the State, domestic capital, and foreign capital – soon began to face its first challenges. In the years following the 1976 statute, state-owned firms, until then perceived as highly successful and beneficial to the economy, entered a period of crisis. In the general environment of international debt crisis and mounting inflationary pressures of the late 1970s and early 1980s, the Brazilian government came to increasingly employ state-owned firms as an instrument of macroeconomic policy. State-owned enterprises were forced to price their output in order to control rising inflation and to increase their rates of borrowing in international markets so as to provide the government with the inflow of foreign currency it needed to manage a worsening balance of payments. These policies resulted in a deterioration of the financial condition of state-owned firms which, combined with an international context favoring a smaller government, gave rise to

121 For a thorough description and analysis of the tripod model, see EVANS, supra note 42.

122 Werner Baer, The Privatization Experience in Brazil, in INTERNATIONAL HANDBOOK ON PRIVATIZATION 221 (David Parker & David S. Saal eds., 2003) (stressing the widespread “benign perception” enjoyed by Brazilian SOEs from the 1950s through the 1970s, which were the beneficiaries from a significant part of World Bank and USAID loans to Brazil).

123 Werner Baer & Annibal V. Villela, Privatization and the Changing Role of the State in Brazil, in PRIVATIZATION IN LATIN AMERICA 5 (Werner Baer & Melissa H. Birch eds., 1994).
pressures for the privatization of Brazilian companies. It was not until the 1990s, however, that a large-scale privatization movement finally took off.\textsuperscript{124}

While the influence of State interests in the development of the 1976 Corporations Law was subtle, subsequent legal reforms that were implemented in connection with Brazil’s privatization process would provide a textbook example of the influence of the State qua shareholder in corporate lawmaking. Indeed, arguably the worst corporate law reform in Brazilian history from the perspective of minority shareholders was sponsored by the federal government itself, with the acquiescence of controlling families. While in the 1940s the State addressed its interests as a shareholder by exempting itself from restrictive corporate law rules, this time around the Brazilian government promoted amendments to general corporate law rules, applicable to all business corporations in the country, with the object of maximizing its revenues from the privatization process. Although many features of the privatization process are unique to the State as a selling shareholder, the device used by the government to extract private benefits of control – insiders’ appropriation of a large control premium not available to minority investors – is familiar in private sector transactions.\textsuperscript{125}

Brazil’s National Denationalization Program (Programa Nacional de Desestatização – PND), enacted into law in 1990, specified the purposes and procedures

\textsuperscript{124} For a description of the three phases of the privatization process in Brazil, see Mauro Rodrigues Penteado, Privatização e Parcerias: Considerações de Ordem Constitucional, Legal e de Política Econômica [Privatization and Partnerships: Considerations of Constitutional, Legal and Economic Policy Nature], 119 REVISTA DE DIREITO MERCANTIL, INDUSTRIAL, ECONÔMICO E FINANCEIRO 9, 10 (2000). Penteado traces the antecedents to the privatization movement in Brazil to the creation of the Secretariat for the Control of State Enterprises (Secretaria de Controle das Empresas Estatais – SEST) by the military government in 1979, which was followed by the first statutes providing for the sale of state-owned enterprises during the Sarney and Collor administrations in the late 1980s and early 1990s. \textit{Id.}

The objectives of the PND were numerous – and conflicting. The program’s stated goals simultaneously included “the reduction of public debt and the balancing of public finances” and “the strengthening of capital markets, through an increase in public offerings and the democratization of the capital of the companies taking part in the Program.”

Nevertheless, in the Brazilian context of low investor protection and, consequently, low stock valuations, public offerings were unlikely to lead to revenue maximization absent major legal reforms. During the 1980s, Brazilian stocks had the lowest price-to-book ratio and the second lowest price-earnings ratio of 25 developed and developing countries worldwide. In the 1990s, price-equity ratios remained extremely low, with three-fourths of firms having a PE ratio below 9 (against an average of 21 for the S&P 500 during the same period), and more than half of such firms displaying share prices of less than 50% of book value. Brazilian policymakers at the time reasoned that public share offerings would not only fail to maximize government revenue, but were

---


127 Id., Art. 1, subitems II and VI. The other four objectives of the program were to “(I) reorder the strategic role of the State in the economy, transferring to the private sector activities that were unduly undertaken by the public sector,” (III) permit the resumption of investments in the firms and activities that are transferred to the private sector,” (IV) contribute to the modernization of Brazil’s industrial facilities, increasing its competitiveness and strengthening business capacity in the various sectors of the economy, and (V) permit the Public Administration to concentrate its efforts in activities in which the presence of the State is fundamental to accomplish national priorities.”

128 Source: MSCI - Morgan Stanley Capital International. For both of these measures, Brazil’s stock prices were more than three times cheaper than the world average. Id.

also unlikely to generate sufficient levels of ownership dispersion and capital market development to justify the effort.\textsuperscript{130}

Empirical studies would later find that jurisdictions displaying low levels of legal investor protection and high levels of private benefits of control were more likely to sell SOEs through private block sales than through share issuance privatizations (SIPs), thus signaling revenue-maximizing behavior by privatizing governments.\textsuperscript{131} This is precisely what Brazil did as a country that had, at an estimated 65\% of firm value, the highest private benefits of control among 39 sampled countries between 1990 and 2000 according to a study by Dyck and Zingales.\textsuperscript{132} According to Megginson et al. ’s study on the choice of the method employed to divest the government’s equity stakes, Brazil was one of the countries with the lowest ratio of SIPs to privatizations worldwide.\textsuperscript{133}

\textsuperscript{130} Coutinho & Rabelo, supra note 88, at 47 (arguing that “a pulverised sale of shares could hardly give birth to genuinely widely held companies in the country. Given the very high level of income-inequality in Brazil, a concentration process would certainly have followed in the secondary market, and the State would have transferred the control premium to private interests”). While the authors’ prediction are reasonable, their diagnosis of the possible causes of ownership concentration is less accurate: ownership concentration was expected to ensue in Brazil not so much because of the country’s high levels of income inequality than because of its low levels of investor protection. In a legal system that provides insufficient shareholder protection and therefore allows for high private benefits of control, dispersed ownership structures are unstable, since prospective controllers have much to gain from acquiring a controlling stake in the open market. See Lucian Bebchuk & Mark Roe, A Theory of Path Dependence in Corporate Ownership and Governance, 52 STAN. L. REV. 127 (1999) (noting the instability of dispersed ownership structures in jurisdictions where private benefits of control are high).


\textsuperscript{132} Dyck & Zingales, supra note 131. According to a different study, which used dual-class price differentials to estimate private benefits of control, an average Brazilian controlling shareholder could expect to extract up to 33.3\% of the value of the company by holding as little of one sixth of total cash flow rights. Tatiana Nenova, The Value of Corporate Votes and Control Benefits: A Cross-Country Analysis (2000), 68 J. FIN. ECON. 325, 327 (2003).

\textsuperscript{133} Megginson et al., supra note 131.
Nevertheless, while the existing studies on the choice of sales method in privatization proceedings take the level of investor protection as given, that was not the case in Brazil – or, for that matter, in Italy or Germany, as discussed in greater detail below.\textsuperscript{134} If Brazil’s government had profit-maximizing ambitions similar to those of a typical controlling shareholder, it had more powerful weapons at its disposal to achieve its objectives. While the political influence of controlling families over the content of corporate and securities regulations is a well-known phenomenon (in Brazil as elsewhere),\textsuperscript{135} the government’s proximity and sway over the lawmaking process is unparalleled.

Taking full advantage of its ability to reshape corporate law rules to further increase the already ample opportunities for extraction of private benefits of control, in 1997 the Brazilian government went on to promote a so-called “mini-reform” of the Corporations Law of 1976. Even though criticized by legal scholars and corporate governance experts,\textsuperscript{136} the reform was seen as “technocratic” and turned out not to be politically controversial.\textsuperscript{137} Controlling families, which paid close attention to any and all

\begin{itemize}
\item \textsuperscript{134} While the choice of private block sales as a privatization method led Brazil to weaken minority shareholder rights upon control sales, the adoption of share offerings by Italy and Germany prompted their governments to improve minority rights and the governance environment of privatized firms in order to maximize their privatization proceeds. \textit{See} Chapter V, Part III, \textit{infra} for the analysis of the Italian and German experience.
\item \textsuperscript{135} \textit{See} Chapter V, Part I, \textit{infra}.
\item \textsuperscript{136} \textit{See}, e.g., Mauro Rodrigues Penteado, \textit{20 Anos da Promulgação da Lei das S/A: Anteprojetos e Projeto Visando Sua Reforma} [20 Years from the Enactment of the Corporations Law: Draft Bills and Proposals Aiming at Its Reform], 105 \textit{REVISTA DE DIREITO MERCANTIL, INDUSTRIAL, ECONÔMICO E FINANCEIRO} 84, 87 (1997) (criticizing the proposed bill as operating a \textit{capitus deminutio} in the status of non-controlling shareholders by eliminating appraisal rights); MODESTO CARVALHOSA, \textit{COMENTÁRIOS À LEI DE SOCIEDADES ANÔNIMAS} [Commentaries to the Corporations Law] LXXVIII (4th ed., 2002) (describing the legal reform as an instance of the oligarchic character of capitalism in Brazilian).
\item \textsuperscript{137} Leslie Elliot Armijo & Walter Ness Jr., \textit{Contested Meanings of “Corporate Governance Reform”: The Case of Democratic Brazil, 1985-2003} at 17, Annual Meeting of the Latin American Studies Association (2004) (“[t]he first wave of reforms of the capital markets in Brazil after its democratic transition thus were
\end{itemize}
corporate law reforms, stood to benefit from the new statute, and therefore had no reason to oppose it. The subject matter of the corporate law reform was not salient enough to attract the attention of broad segments of the Brazilian population, which, in any case, was likely be sympathetic to the government’s attempt to maximize its privatization proceeds to cover the country’s sizable external deficit. Indeed, the most ardent critics of the privatization process in Brazil consistently argued that state-owned firms – whose assets were, quite naturally, regarded as belonging to the Brazilian people – were being sold to private investors at too low a price.138

Prior to the reform, Brazil’s Corporations Law granted statutory appraisal rights (direito de retirada) to dissenting minority shareholders from spin-off transactions, and imposed a mandatory bid requirement (dubbed as “tag-along” rights in Brazil) for common shares held by minority shareholders at the same share price paid to the controlling block upon a sale of control.139 The new Law 9,457 of 1997, while also officially meant to “stimulate capital market development in Brazil,” did away with both of these protections.140 The removal of appraisal rights allowed the government to carry out cheaply its planned strategy of spinning off portfolio companies prior to their sale, conceived both centrally and technocratically. They were implemented with minimal fanfare and discussion, with the exception of making changes to Brazil’s new Constitution of 1988 that would permit privatization of firms in historically symbolic economic sectors”).

138 The purchase price to be paid for privatized firm was a hot button issue in the sales process. Numerous media reports and labor groups at the time express concern that the government would “give away” state-owned firms to foreign capitalists. See, e.g., ALOYSIO BIONDI, O BRASIL PRIVATIZADO: UM BALANÇO DO DESMONTE DO ESTADO [Privatized Brazil: An appraisal of the disassemble of the State] (1999), for numerous variations on the argument that state-owned enterprises were sold at an unfairly low price.

139 See PRADO, supra note 70, at 79-80, for a detailed description of the emergence of a mandatory bid requirement under Brazilian law.

thus avoiding out-of-pocket payments to dissenting shareholders and judicial disputes over the amounts due.\textsuperscript{141} The elimination of the mandatory bid requirement, in turn, permitted the State to appropriate the totality of the control premium to itself.\textsuperscript{142}

To be sure, the efficiency of premium-sharing, or “equal opportunity,” rules (of which the mandatory bid rule is but one example) is the object of considerable controversy. There is a large body of literature suggesting that mechanisms that force controlling shareholders to share a control premium with minority investors are inefficient, as they do not differentiate between value-adding and value-decreasing acquisitions, and thus equally discourage both types of transactions.\textsuperscript{143} At the same time, however, premium-sharing requirements remain an integral part of the law of most advanced economies, including the U.K., Belgium, Australia, and, to a surprising degree,
also the U.S.\textsuperscript{144}

In the Brazilian context, in particular, the controversy surrounding the mandatory bid rule was compounded by the insufficient legal protection afforded to minority shareholders in going-private and freeze-out transactions. Beyond permitting minority shareholders to receive a proportionate part of the control premium, an arguably more important feature of the mandatory bid rule is that it allows minority shareholders to exit at a fair price upon a sale of control, hence operating as a structural protection against abusive delisting transactions and freeze-out mergers. In other words, the elimination of a mandatory bid rule not only meant that minority shareholders would be excluded from sharing the premium paid to controlling shareholders as provided under prior law (and for which they arguably paid for when purchasing stock), but would also be exposed to a serious risk of expropriation through going-private transactions following the transfer of control. At the time, there were no legal prohibitions to undisclosed share purchases by controlling shareholders in the public market in order to reduce the liquidity (and therefore the price) of outstanding securities.\textsuperscript{145} Furthermore, by not imposing appraisal

\textsuperscript{144} For a description of the exceptions to the general rule that controlling shareholders are not required to share a control premium with the minority under Delaware, see Einer Elhauge, \textit{The Triggering Function of Sale of Control Doctrine}, 59 U. CHI. L. REV. 1465 (1992) (arguing that the existing exceptions seek to discourage inefficient transfers of control). \textit{See also} John C. Coffee, \textit{Transfers of Control and the Quest for Efficiency: Can Delaware Law Encourage Efficient Transactions While Chilling Inefficient Ones?}, 21 DEL. J. CORP. L. 359, 360 (1996) ("from a comparative law perspective, the United States stands virtually alone in failing to accord minority shareholders any presumptive right to share in a control premium"). However, Coffee convincingly argues that U.S. law contains multiple legal mechanisms that discourage controlling shareholders from receiving a control premium ([a]lthough commentators have primarily focused on the effects of the state law doctrine that generally permits control premiums… the incentive effects of this rule are likely to be overshadowed by other legal doctrines, such as appraisal rights, the availability of injunctive or damage actions based on Weinberger and Lynch, and SEC rules under the Williams Act. Collectively, these doctrines tend to discourage the payment of a control premium, at least when the intent is to eliminate the minority, because they may entitle the minority to a similar price that is at least reasonably related to what the control seller received"). \textit{Id.} at 396.

\textsuperscript{145} Maria Helena Santana, \textit{The Novo Mercado in Focus – NOVO MERCADO AND ITS FOLLOWERS: CASE STUDIES IN CORPORATE GOVERNANCE REFORM} 1, 12 (2008).
or fairness requirements in delisting tender offers, Brazilian law was highly conducive to minority expropriation following a control sale. As described in greater detail below, the elimination of the mandatory bid rule in Brazil allowed many recently-acquired companies to go private by buying out the minority at a price below the book value of the company, thus contributing to a deterioration of investor confidence in the country’s capital markets.\textsuperscript{146}

Nonetheless, lawmakers defended the reform as attending to “the greatest interests of the Nation: privatizations and the protection of minority shareholders, by reconciling the interests of the latter with those of majority shareholders.”\textsuperscript{147} The new statute sought to compensate for the elimination of shareholder rights upon control sales by granting preferred non-voting shareholders a right to dividends at least 10% greater than those paid to common shareholders. The fact that this provision passed without significant opposition – and that the Brazilian Association of Public Companies, Brazil’s main lobby group for controlling shareholders, supported its applicability to shares already outstanding\textsuperscript{148} – was in itself a warning that the mandatory dividend requirement did not adequately protect minority investors. In fact, one expected consequence of the requirement of a higher dividend rate to preferred (usually minority) shareholders is to discourage meaningful dividend distributions in the first place. In a legal environment that offers insufficient investor protection, controlling shareholders do not depend on dividend distributions to receive a return on their investment, since other means, ranging

\textsuperscript{146} Id.

\textsuperscript{147} EIZIRIK, \textit{supra} note 140, at 15.

\textsuperscript{148} Id. at 51.
from outright tunneling to inflated salaries and perquisites, are available.

Following the enactment of the statute, the Brazilian State went on to sell the cream of its holdings, especially in the telecommunications sector, in return for a significant premium. Figure 2 below shows the significant jump in privatization proceeds following the enactment of the amendments to the Corporations Law in May 1997.

**Figure 2. Privatization proceeds by year (in US$ billions)**

![Privatization proceeds by year](image)

*Source: BNDES (2002)*

The crown jewel of the privatization process was telecom company Telebras. The planned divestiture of the government’s holdings in Telebras – in what would be one of the largest privatization transactions in world history – was a major driver behind the
1997 legal reform. Prior to its privatization in 1998, Telebras alone accounted for approximately 60% of all trades in the São Paulo Stock Exchange. In an attempt to create competition in the newly privatized industries, the government’s divestment model contemplated the spin-off of Telebras’s subsidiaries prior to a control sale. Figure 3 below provides an organizational chart of Telebras and its publicly traded subsidiaries prior to privatization.

Figure 3. *Telebras organizational chart prior to privatization*

<table>
<thead>
<tr>
<th>Company</th>
<th>União</th>
<th>Público</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telebrás</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Embratel</td>
<td>98.75% ON</td>
<td>82.27% ON</td>
</tr>
<tr>
<td></td>
<td>54.37% PN</td>
<td>71.40% PN</td>
</tr>
<tr>
<td>Telesp</td>
<td>67.00% ON</td>
<td>19.70% ON</td>
</tr>
<tr>
<td></td>
<td>45.00% PN</td>
<td>40.50% PN</td>
</tr>
<tr>
<td></td>
<td>56.00% PN</td>
<td>29.80% PN</td>
</tr>
<tr>
<td>Telej</td>
<td>85.22% ON</td>
<td>89.18% ON</td>
</tr>
<tr>
<td>Telemig</td>
<td>87.94% ON</td>
<td>87.94% ON</td>
</tr>
<tr>
<td>Telepar</td>
<td>81.96% ON</td>
<td>81.96% ON</td>
</tr>
<tr>
<td>Telebrasília</td>
<td>81.04% ON</td>
<td>81.04% ON</td>
</tr>
<tr>
<td>Telebahia</td>
<td>945.79% ON</td>
<td>85.44% ON</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ON</td>
<td>common stock</td>
</tr>
<tr>
<td>União</td>
<td>Federal government</td>
</tr>
<tr>
<td>PN</td>
<td>non-voting preferred stock</td>
</tr>
<tr>
<td>Público</td>
<td>public float</td>
</tr>
</tbody>
</table>

---

If eliminating appraisal rights in spin-off transactions addressed the government’s goal of increasing competition following its divestiture, the elimination of mandatory bid requirements upon a control transfer was designed to increase the control premium obtainable by the State. The expected government gains from the legal reform abolishing premium-sharing requirements were substantial. Through the ample use of preferred non-voting shares and, to a lesser extent, a pyramidal structure, the government was in a position to transfer uncontested control of Telebras’s subsidiaries by selling less than one-fifth of their total equity capital. When the company was privatized, the federal government held 51.79% of Telebras common shares, amounting to 19.26% of the company’s total capital, while foreign shareholders held roughly 40% of the company’s total equity. Telebras’s ownership structure, which allowed the State to exercise uncontested control while holding only a minority of the company’s cash-flow rights, distorted the government’s incentives as the controlling and selling shareholder by encouraging it to appropriate a disproportionate amount of the firm’s value.

As planned, the Brazilian government succeeded in obtaining a substantial

---

150 Telebras was broken into 12 different companies prior to its privatization, which were gathered in three different regional groups as part of the sales process. A single controlling shareholder could acquire no more than one company in each group. See Ana Novaes, Privatização do Setor de Telecomunicações no Brasil 153, in A PRIVATIZAÇÃO NO BRASIL: O CASO DOS SERVIÇOS DE UTILIDADE PÚBLICA [Privatization in Brazil: The Case of Public Utilities] 172 (BNDES, 2000).

151 Telebras’s pyramidal structure was a result of its historical self-financing model, in which the sale of telephone lines was financed by the consumers themselves in exchange for shares of stock in the local company. The telephone company would then install the line within 24 months of the purchase/subscription. Id. at 151.

152 Id. at 153.

153 For a model suggesting an exponential increase in agency costs in controlling-minority structures, see George G. Triantis, Lucian A. Bebchuk & Reinier H. Kraakman, Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights, in CONCENTRATED CORPORATE OWNERSHIP (Randall Morck ed., 2000).
premium in the sale of Telebras. The aggregate purchase price of US$ 19 billion paid for the control of companies belonging to the Telebras group exceeded in 64% the minimum auction price set by the government, which in turn already included a significant premium over the share market price on the day of the announcement. Economists estimate that the price received by the government represented a premium of roughly 160% over the price of Telebras non-voting preferred stock. Minority shareholders in Telebras legacy companies following the privatization were then not only subject to expropriatory going-private transactions, as described below, but also to the new opportunities for extraction of private benefits of control in the firm’s operation. In an attempt to lure bidders into offering a substantial control premium, the Brazilian government also resorted to its dual role as regulator by issuing new rules that, by authorizing acquirers to charge management fees from the companies based on sales volume rather than profit following the sale, created ample opportunity for the continued extraction of private benefits of control.

The 1997 reform to Brazil’s Corporations Law provides a paradigmatic example of the risks that State ownership under a unitary corporate law regime poses to the overall corporate governance environment. Since the new statutory amendments were general in nature and by no means restricted to state-owned enterprises, they also benefited controlling shareholders of private firms to the detriment of their outside investors.

154 Novaes, supra note 152, at 172-4.

155 See Bruno Rocha & Iam Muniz, Casos Brasileiros [Brazilian Cases], in GOVERNANÇA CORPORATIVA NO BRASIL E NO MUNDO 82 (Ricardo P. C. Leal et al. eds., 2002).

156 See Getting Brazil to Clean Up its Act, LATIN FIN., Dec. 1, 2000 (and “the Brazilian government has often sanctioned this theft of shareholder value” and, in enacting telecom regulations, the government effectively communicated that “the new majority owners didn’t need to worry about minority investors”).
Consequently, control sales of government and privately-owned firms alike were made at substantial premiums to majority shareholders and at the expense of the minority. In the partial privatization of CEMIG, an electricity company controlled by the State of Minas Gerais, a sale of a 32.96% block of common stock subject to certain contractual veto rights took place at a premium of 120.7% over the then current market price of its common stock.\textsuperscript{157} Other examples of abusive sale-of-control transactions in the electric-power industry alone include Coelba (purchased for R$ 165 per share against R$ 62 offered to the minority), CPFL (in which controlling shareholders received R$ 432 per share compared to R$ 126 offered for the public float) and Cesp Paranapanema (acquired for R$ 34 per share against R$ 9 paid to the minority).\textsuperscript{158}

Tatiana Nenova’s study on the impact of Law 9,457 on the level of private benefits finds that control value increased more than twice following the enactment of the statute.\textsuperscript{159} This rapid rise in the level of private benefits, in turn, decreased investor confidence, hence leading to a sharp reduction in the number of listed firms in Brazilian capital markets. The trading volume on the São Paulo Stock Exchange fell from more

\textsuperscript{157} Flávio M. Rabelo & Flávio C. Vasconcelos, \textit{Corporate Governance in Brazil}, 37 J. BUS. ETHICS 327 (2002). A subsequent administration would later challenge the acquirer’s governance rights conferred by a shareholder’s agreement as invalid for the government lacked the requisite statutory approval to enter into such agreements. For an excellent exposition of this argument, see Fábio Konder Comparato, \textit{Sociedade de Economia Mista Transformada em Sociedade Anônima Ordinária – Inconstitucionalidade} [Mixed Enterprise Transformed into Ordinary Business Corporation – Unconstitutionality], 25 REVISTA TRIMESTRAL DE DIREITO PÚBLICO 63 (1999). The Supreme Court of the State of Minas Gerais (Tribunal de Justiça de Minas Gerais – TJMG) held that the shareholders’ agreement was indeed invalid for the state of Minas Gerais was not allowed to share control of CEMIG with private parties without prior legislative approval. This decision remains subject to the judgment of a final appeal to Brazil’s Superior Tribunal de Justiça.

\textsuperscript{158} \textit{Getting Brazil to Clean Up its Act}, LATIN FIN., Dec. 1, 2000.

than $191 billion in 1997 to $65 billion in 2001.\textsuperscript{160} Between 1995 and 2000, only eight companies went public on the São Paulo stock exchange.\textsuperscript{161}

Gilson, Hansmann and Pargendler have noted that, although that was not the primary intent of contemporary policymakers, the elimination of minority shareholder rights upon control sales and going-private transactions in Brazil can be interpreted as an attempt to buy off existing political and economic elites by granting them a temporary right to exit public markets by extracting substantial premiums.\textsuperscript{162} Such a “grand bargain” strategy, if successful, could significantly decrease the presence of incumbents in the market and, therefore, their opposition to investor protection reforms. In Brazil, more than 100 publicly-traded companies went private between January 2000 and September 2001 alone.\textsuperscript{163} Modesto Carvalhosa and Nelson Eizirik have noted that a number of the companies that opted for a delisting did so in anticipation of future legislative action that would increase minority shareholder rights.\textsuperscript{164}

As it is, however, the results of Brazil’s accidental “grand bargain” experiment were partial at best. While many companies did take up the opportunity to go private in opportunistic transactions, a significant number of Brazilian corporate giants opted to remain listed on the exchange. Government-controlled corporations that remained traded and continued to resort to equity markets in Brazil and internationally include Banco do

\begin{flushleft}
\textsuperscript{160} Source: www.bmfbovespa.com.br.
\end{flushleft}

\begin{flushleft}
\textsuperscript{161} Santana, \textit{supra} note 145, at 9.
\end{flushleft}

\begin{flushleft}
\textsuperscript{162} Gilson, Hansmann & Pargendler, \textit{supra} note 88.
\end{flushleft}

\begin{flushleft}
\end{flushleft}

\begin{flushleft}
\textsuperscript{164} \textit{Id}.
\end{flushleft}
Brasil, the largest bank in Latin America by assets,\textsuperscript{165} and Petrobras, one of the world’s biggest oil companies.\textsuperscript{166}

Not too long after the government closed its major privatization transactions, the worst features of the 1997 legal reforms were reversed, first by the issuance of new CVM regulations in 1999, and then by Congress in 2001. The CVM Instruction 299 of 1999 sought to limit the extraction of private benefits of control in going-private transactions, with apparent success. The new rules imposed new disclosure requirements to purchases of company’s stock in the open market as well as a new mandatory bid requirement when a controlling shareholder increases its stock ownership by more than 10\%.\textsuperscript{167} Tatiana Nenova’s study showed that the value of control fell sharply following the enactment of CVM’s regulations reinstating various minority protections in 1999.\textsuperscript{168}

IV. Corporate Governance under Continued State Ownership

In 2001 the Brazilian Congress amended the Corporations Law once again to reinstate some of the protections eliminated in the late 1990s, but the reform fell short of

\textsuperscript{165} See \textit{Banco do Brasil’s Large Offer Seen Sailing Through}, \textit{REUTERS}, June 28, 2010 (noting that the Banco do Brazil was also among the most profitable in the country, and a more willing lender than its private counterparts).

\textsuperscript{166} See note 186-194 \textit{infra} and accompanying text for a discussion of recent corporate governance developments involving Petrobras.

\textsuperscript{167} See CVM Instruction 299, Art. 6 (requiring a controlling shareholder to immediately disclose any increase in ownership in the firm by more than 5\% as well as the motif behind such an acquisition, including the intention to take the company private); Art. 7 (requiring a mandatory bid for minority shares upon the acquisition of more than 10\% of the company’s equity by a controlling shareholder). \textit{See also} CVM Instruction 345 of 2000

\textsuperscript{168} Nenova, \textit{supra} note 159, at 4.
expectations. The 2001 statute reintroduced tag-along rights, but only partially: they applied only to voting common shareholders and entitled shareholders to receive only 80% of the price paid for the controlling block. Other new protections included in the statute – such as a new provision granting minority shareholders the right to call a special meeting to deliberate on transactions in which the controlling shareholder had a conflict of interest – were vetoed by Brazil’s President. The new law reduced the permissible limit to the issuance of non-voting preferred shares from two-thirds to one-half of a firm’s total capital, but grandfathered existing listed firms, for which the more generous ceiling continued to apply.

In December 2000 the São Paulo Stock Exchange launched the Novo Mercado (New Market), a premium exchange segment whose listing standards imposed much stricter corporate governance rules than those provided under Brazilian law. As explained by Calixto Salomão Filho, the Novo Mercado represented an attempt to use a

---


170 Id., Art. 254-A. At least one author and practitioner in the privatization process has attributed this policy reversal to a change in the structure of equity holdings of the federal government and its agencies, which, following the major privatizations, ended up with a minority stakes in a greater number of companies – and therefore stood to benefit from the revived tag-along rights. See Marcelo Otavio de Lorenzo Fernandez, Prêmio de Controle no Brasil [Control Premium in Brazil], Dissertação de Mestrado Profissional, IBMEC, 2008.

171 The official justification for the veto explained that it was in the public interest to veto such a provision, which was “innocuous” to the protection of minority shareholders, since controlling shareholders could not possibly be excluded from voting.


173 The role of the specific contributions of the New Market for the subsequent development of the Brazilian capital markets have been described in greater length elsewhere. See Gilson, Hansmann & Pargendler, supra note 88.
contractual mechanism to overcome persistent legislative capture. Understanding the political clout of controlling shareholders in blocking legal reforms, the Exchange adopted a simple strategy: if you can’t win them, ignore them. Brazil’s approach to capital market development this time followed what Gilson, Hansmann and Pargendler term “regulatory dualism”: it permitted established firms to continue to be governed by the existing legal regime, while creating a parallel system of stricter shareholder protection that is open to firms that voluntarily choose to adopt it. By preserving the interests of established firms – which, despite the wave of privatizations, continued to include a number of giant state-owned enterprises, such as Banco do Brasil and Petrobras – regulatory dualism helped overcome the political economy constraints to investor protection reform and, ultimately, capital market development.

Interestingly, state-owned enterprises were among the first to opt for a Novo Mercado listing. The São Paulo Stock Exchange in fact explicitly encouraged the listing of SOEs and recently privatized firms by accommodating the rules of premium listing standards to certain legal requirements applicable to such firms. For instance, the Novo Mercado regulations specifically exempt golden shares held by the State from its requirement that companies issue only common shares granting equal voting rights to all holders. Additionally, firms that opted for a Novo Mercado or a Level 2 listing are

174 CALIXTO SALOMÃO FILHO, NOVO DIREITO SOCIETÁRIO [The New Corporate Law] 58 (2006). For an excellent description of the process preceding the creation of the Novo Mercado, see Prado, supra note 141, at 499 et seq.

175 Id.

176 Id.

177 See Chapter IV, Part IV(B) infra and accompanying text for a description of the case of Sabesp.

178 Novo Mercado Regulations, Art. 3.1.
subject to arbitration proceedings administered by the Market Arbitration Chamber for the resolution of internal affairs disputes, but the Chamber’s regulations make clear that it will not exercise jurisdiction over decisions of the State as a controlling shareholder of mixed enterprises that seek to “direct the company’s activities towards the public interest that justified its creation” under Article 238 of the Corporations Law.\textsuperscript{180}

Various commentators heaped praise on state-owned enterprises for their willingness to adopt stringent corporate governance standards. There is however widespread suspicion that the motivation behind such commitments to high corporate governance standards were not economic, but political – more specifically, the desire to insulate state-owned enterprises from future political interference. Sabesp and Celesc, two state-owned enterprises controlled by state governments, opted for a Novo Mercado and a Level 2 listing, respectively, in 2002, a year of presidential and gubernatorial elections that were likely to transfer political power from the centrist Social Democratic Party (PSDB) to Brazil’s Labor Party (\textit{Partido dos Trabalhadores} – PT). Incumbent governors sought to constrain the ability of future rulers to use state-owned firms for political purposes through the combination of a capital market listing and the commitment to high corporate governance standards.\textsuperscript{181}

However, as discussed in greater detail in Chapter V, the State’s attempts to credibly commit to higher corporate governance standards by subjecting its controlled

\textsuperscript{179} For a description and analysis of the multi-tier premium corporate governance standards provided by the São Paulo Stock Exchange, see Gilson, Hansmann & Pargendler, \textit{supra} note 88.

\textsuperscript{180} Regulations of Market Arbitration Chamber, Art. 16.6.1


firms to a private law regime are not bullet proof. As such, the danger remains that the presence and influence of the government as a shareholder may eventually undermine the segment’s strictures in terms of investor protection. The recent attempt by the São Paulo Stock and Futures Exchange (BM&F Bovespa) to revise the Novo Mercado listing rules in order to further strengthen its corporate governance standards met with resistance by existing firms listed on the segment, which vetoed some of the most ambitious proposals. Banco do Brasil, a state-owned bank listed on the Novo Mercado, was among companies firms that voted against the proposed rules requiring the creation of a mandatory audit committee, a mandatory bid rule upon control sales at a 30% threshold, and an increase in the minimum proportion of independent directors from 20% to 30% of the company’s board.

The dramatic expansion of Brazil’s capital market in recent years – which is now among the most active equity markets worldwide – has not entailed a retraction in the SOE sector. The major stock offering of Banco do Brasil in 2010 shows that, despite clear evidence of use of the bank to pursue social and political goals during the credit crisis, the State continues to successfully tap private investment into the firms it

---

182 See Chapter V, Part IV, *infra* for a more detailed discussion.

183 Subject to the approval of the CVM, revisions of the Novo Mercado listing standards are binding upon all firms listed on the segment unless one-third of them expressly oppose the changes during a restricted hearing required under the segment’s regulations. *See* Gilson, Hansmann & Pargendler, *supra* note 88, for a discussion of the Novo Mercado revision process.


185 Brazil’s capital markets accounted for 10% of the global IPO volume in 2007, making it the third most active such market worldwide, after China and the U.S. ERNST & YOUNG, GROWTH DURING ECONOMIC UNCERTAINTY: GLOBAL IPO TRENDS REPORT (2008). Brazil raised $27.3 billion in IPOs, compared to $34.2 billion in the U.S. and $66 billion in China. *Id.*
controls. Moreover, the recent discovery of new oilfields in “pre-salt” areas along the Brazilian coast is illustrative both of the continued vitality of mixed enterprises in emerging economies and of the peculiar behavior of the State as a controlling shareholder.

The discovery of the new oilfields, while an apparent blessing for Brazil, raised some difficult implementation questions for the government as Petrobras’s controlling shareholder. While the federal government owned the oilfields, Brazil’s oil company Petrobras was State-controlled but 60% owned by private (including foreign) investors, which meant that the profits resulting from the exploration of the new fields by Petrobras would need to be shared with minority shareholders. One of the first proposals considered by the Brazilian government in order to maximize the revenue it could obtain from the new oil findings was to create a new wholly-owned government enterprise to explore the fields in partnership with Petrobras or other firms of its choosing. However, this attempt of the Brazilian government as a controlling shareholder of Petrobras to appropriate a corporate opportunity to itself proved to be highly controversial, and was ultimately abandoned – not least because Petrobras had the world-class technical expertise required for deep-water drilling.

The prevailing solution has been for the government to assign to Petrobras its rights in the oil reserves in exchange for additional company shares. This stock issuance,


187 Brazil: A Funny Kind of Reward, THE ECONOMIST, Aug. 30, 2008 (“just as Petrobras has struck a bonanza, Brazil’s government is debating whether to create a new, wholly state-owned, oil company to maximise its profit from the new fields”); Isabel Clemente, “O Petróleo é Nosso” – Parte II (O que está por trás do projeto nacionalista de criar uma nova estatal petrolífera – e por que essa é uma idéia ruim para o país), ÉPOCA, Aug. 15, 2008.
in turn, would take place in connection with a public equity offering designed to raise additional capital to fund the necessary investments in drilling and exploration. In order to circumvent the provisions of the Corporations Law requiring minority shareholder approval of stock subscriptions that are payable in kind, Petrobras’s lawyers structured both operations as separate transactions – even though they were described in the same legal document and openly referred to as a single transaction for the “recapitalization” of Petrobras. The government’s only concession was to institute a committee of prominent lawyers and businesspersons to scrutinize the transaction on behalf of minority shareholders. Still, the committee members were appointed by the State itself and therefore lacked both legal duties and economic incentives to resist the government’s proposal.

The result was a high-profile self-dealing transaction in which the interests of the Brazilian public as indirect beneficiaries of the government’s oil and equity holdings were pitched against the economic interests of Petrobras’s minority (and largely foreign) investors. The Brazilian government stood on both sides of the assignment transaction, with the ultimate responsibility for setting the price of the oil barrels lying with the Ministry of Mines and Energy (Ministério de Minas e Energia), following reports from two appraisers. The prospect of minority expropriation through an inflated appraisal of the deep-water oil which was the object of the assignment and share exchange – and the

---


189 *Id.*
expected dilution of minority investors – contributed to a 25% decline in Petrobras’s market capitalization in the first three quarters of 2010.\textsuperscript{190}

In September 2010, after two months’ delay, the government finally set the price per barrel to be used in the assignment and exchange transaction at $8.51 – a median figure between the price of $5 or $6 per barrel defended by minority investors and the price of $10 or $12 initially hinted by the government.\textsuperscript{191} Minority shareholders have since argued that the price set by the State was artificially inflated to increase the government’s stake in Petrobras, and have threatened to sue.\textsuperscript{192} What is perhaps most worrisome is that a transaction structure that was designed to address national interests in a high-profile SOE transaction may well set a precedent for what constitutes permissible related-party transactions under Brazil’s Corporations Law.

Still, the set price likely reflected a delicate balance between political and economic considerations. On the one hand, self-dealing by the government is politically popular, which in itself constitutes a strong reason for expropriating minority shareholders in a presidential elections year.\textsuperscript{193} On the other hand, Petrobras’s immediate capital raising needs likely deterred the government from setting an overly inflated price. Petrobras’s forthcoming stock offering includes the placement of billions of dollars’ worth of shares with private investors, whose interest in participating in the offering –

\textsuperscript{190} Petrobras: Over a Barrel, THE ECONOMIST, Sept. 4, 2010.

\textsuperscript{191} Id.

\textsuperscript{192} Ana Clara Costa, Minorityários Podem Levar Petrobras à Justiça [Minority Shareholders May Take Petrobras to Court], VEJA, Sept. 2, 2010.

\textsuperscript{193} As described by The Economist, supra note 190, “[w]ith elections due on October 3rd, Brazil’s government was anxious to avoid the accusations of selling the country short that would have followed had it set an investor-pleasing price for the oil.”
crucial as it is to finance the exploration of the new reserves – could be jeopardized by too grave a recent instance of minority abuse.

Petrobras’s record share offering was completed in September 2010. By raising approximately $67 billion, it became the largest share offering in world history, hence making BM&F Bovespa the second largest stock exchange in the globe by market capitalization.194 At any rate, the fact that the government’s stock holdings in Petrobras increased after this record offering (from about 40% to 48% of the company’s total equity) goes to show that the State’s role as a shareholder, and its interests in the surrounding corporate governance regime, are not going away in the near future.195

Indeed, one of the main corporate law innovations in Brazil in 2010 concerned state-owned enterprises. In December of that year, Brazil enacted a new statute mandating employee representation in the board of directors (Conselho de Administração) of government-controlled corporations.196 Prior to this statute, Brazil had little experience with workers’ representation in corporate boards. Although the 2001 revisions to the Corporations Law included a provision that explicitly permitted any corporation (public or private) to allocate board seats to employee representatives in their corporate charters,197 this practice remained virtually non-existent in Brazil.

194 Jonathan Wheatley, Petrobras Offering Raises $67bn, F.T., Sept. 24, 2010; Carla Mozee, Bovespa: Brazil Exchange Now World’s 2nd Largest, MARKETWATCH, Sept. 24, 2010 (following the completion of Petrobras’s offering, the market capitalization of BM&F Bovespa reached $17.8 billion, larger than the London, Nasdaq and New York exchanges combined, and just behind the Hong Kong Stock Exchange, the world’s largest, which boasts a market capitalization of $19.8 billion).

195 Wheatley, supra note 194.


197 Law 6,404, Art. 140, sole paragraph (as amended by Law 10,303 of 2001).
Brazil’s new law provides for a particularly mild version of codetermination in SOE boards, a practice that is not unusual by international standards.\textsuperscript{198} Germany’s corporate law, the paradigmatic example of codetermination (\textit{Mitbestimmung}) in corporate governance, provides a system of “quasi-parity codetermination” for companies with more than 2,000 employees: employee representatives make up 50\% of the supervisory board (\textit{Aufsichtsrat}) of such companies, but the chair of the supervisory board (who is typically appointed by shareholders) has a casting vote.\textsuperscript{199} The Brazilian statute, by contrast, mandates the allocation of only one board seat to a representative of employees in government-controlled corporations having at least 200 employees.\textsuperscript{200} It also specifically preserves the State’s right to appoint a majority of the directors, providing for a proportional increase in board size if necessary.\textsuperscript{201} Moreover, the statute significantly constrains the scope of codetermination with respect to employee-related matters by prohibiting employee representatives from participating in board discussions and deliberations about union relations, employee compensation, and benefits, without

\begin{footnotesize}
\begin{enumerate}
\item\textsuperscript{198} For an overview of workers’ governance rights in comparative perspective, see Luca Enriques, Henry Hansmann & Reinier Kraakman, \textit{The Basic Governance Structure}: Minority Shareholders and Non-Shareholder Constituencies 89 et seq., \textit{in THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH} (Reinier H. Kraakman & Henry Hansmann eds., 2004). The only jurisdictions in the EU that do not provide for any form of codetermination are Portugal, Belgium, Italy and the U.K. However, many of the remaining EU countries limit workers’ board representation to state-owned corporations. \textit{Id.} at 100.
\item\textsuperscript{199} Companies with fewer than 500 employees are not subject to co-determination, while firms having between 500 and 2,000 employees must have one-third of worker representatives in the supervisory board. See Gilson, Hansmann & Pargendler, \textit{supra} note 88. For an excellent analysis of the origins and contours of codetermination in Germany, see Katharina Pistor, \textit{Codetermination: A Sociopolitical Model with Governance Externalities}, \textit{in EMPLOYEES AND CORPORATE GOVERNANCE} (Margaret M. Blair & Mark J. Roe eds., 1999).
\item\textsuperscript{200} Law 12,353, Arts. 2 and 5. The employee representative will by a vote of active employees of the firm in an election organized jointly by the company and the relevant unions (Art. 2, §1).
\item\textsuperscript{201} \textit{Id.}, Arts. 2 and 3.
\end{enumerate}
\end{footnotesize}
prejudice to the general rules on director conflicts of interest under Brazil’s Corporations Law.202

All in all, the new legislation offers a token concession to labor unions (a key constituency of Brazil’s ruling Partido dos Trabalhadores), while refraining from imposing meaningful constraints to the rights and powers of the State as shareholder. Although the direct practical effects of the statutes in shaping SOE governance will likely be modest, its enactment may serve as a signal of the government’s intentions to strengthen the institutional conception of SOEs and increasingly privilege the interests of the State and labor over those of outside investors. Still, as discussed in greater detail in the coming Chapter, a marked benefit of this legislation is that it helps further differentiate the corporate law regime applicable to SOEs, on the one hand, and to entirely private corporations, on the other. Without further reforms, however, the risk remains that the government may continue to influence general corporate laws to the detriment of minority investors.

202 Id., Art. 2, §3.
CHAPTER V

The Political Economy of State Ownership in Comparative Perspective

I. Introduction

After two decades of privatizations and the emergence of an increasing – though not quite conclusive – consensus on the comparative efficiency of private versus State ownership of business enterprise, the pendulum has swung in the opposite direction. The rise of emerging markets adopting a state capitalism model and the wave of government bailouts following the financial crises of 2008 has brought state-owned enterprises back into the spotlight. In a matter of months after the collapse of Lehman Brothers in September 2008, the U.S. federal government became the principal shareholder of some of the country’s largest corporations – among them AIG, Citigroup, and General Motors – and a major investor in numerous other financial institutions. Although atypical in the U.S., mixed enterprises – here defined as corporations in which the government shares ownership with private investors – are still pervasive elsewhere in the world. They account for about one-half of the market capitalization in various

1 See notes 181-182 infra and accompanying text.

2 LLOYD MUSOLF, UNCLE SAM’S PRIVATE, PROFITSEEKING CORPORATIONS (COMSAT, FANNIE MAE, AMTRAK AND CONRAIL) 2 (1982) (“[m]ixed enterprises occupy a political and economic no-man’s-land in the United States, though they are regarded as unexceptional, even commonplace, in many parts of the world”).

223
countries, and for approximately one-fifth of global stock market value, which is more than two times the level observed just one decade ago.

This rapid rise of State ownership in the U.S., historically one of the most inhospitable environments to direct government intervention, helped revive the deep-rooted debate about the merits and risks of government control of enterprise. This time around, a significant part of the debate has centered on the corporate governance implications of State ownership of publicly-traded companies. As a seemingly novel phenomenon, the appearance of government control of listed companies in the U.S. has drawn considerable attention and mixed reactions from U.S. legal and economic scholars.

On the one hand, certain scholars and shareholder activists have viewed the rise of government ownership as a welcome opportunity for corporate governance improvements. As any other large investor, the government could not only help curb agency costs at the firm level through enhanced monitoring, but also use its interests and influence as a shareholder to promote long overdue corporate governance reforms. In his testimony before Congress, Professor B. Espen Eckbo argued that “the government, as a large shareholder, ought to play a proactive role in developing best corporate governance

---

3 See, e.g., Kate Burgess, OECD Scrutinises State Owned Groups, F.T., June 20, 2008 (noting that “[o]nly four years ago, the world’s 10 largest listed companies in terms of market value were private commercial entities domiciled in the US and Europe. Today, five of the top 10 publicly traded corporations are government controlled”); CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES: A SURVEY OF OECD COUNTRIES 13 (2005) [hereinafter “OECD Survey” (finding that “SOEs may represent up to 40% of value added, around 10% of employment, and even 50% of market capitalization in different OECD countries”); OECD, NETWORK ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN ASIA, POLICY BRIEFING ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES: RECOMMENDATIONS FOR REFORM 5 (2010) (noting that listed state-owned firms still account for approximately 20% of total market capitalization in Singapore, one-fourth in India and Thailand, about one-third in Indonesia and Pakistan, to approximately 50% in Malaysia and 60% in China).

4 Why China is Different, THE ECONOMIST, Nov. 11, 2010.
practices,” including the elimination of staggered boards, the separation of the roles of board chair and CEO, and the implementation of director election reform.\textsuperscript{5} Even legendary investor activist Carl Icahn has viewed the role of the government qua shareholder rather favorably as having become the “world’s biggest activist investor, making the same kinds of demands that any activist or creditor should rightfully make in return for its investment.”\textsuperscript{6}

On the other hand, legal scholars have warned against the negative corporate governance implications of government ownership. They have argued, in short, that for a series of legal and political reasons – ranging from the doctrine of sovereign immunity and the delicate balance of power in the U.S. federal system, to the inherent difficulty of verifying breaches of fiduciary duties when the government is in control – existing legal rules and procedures are ill-designed to adequately protect minority shareholders of government-controlled firms.\textsuperscript{7} Marcel Kahan and Edward Rock went as far as to conclude that, in the absence of new institutional arrangements to address this problem, “we ought to end the experiment [with government ownership] as quickly as possible.”\textsuperscript{8}

\begin{itemize}
\item \textsuperscript{5} B. Espen Eckbo, \textit{The Government as Active Shareholder}, Testimony to the Congressional Domestic Policy Subcommittee of The Oversight and Governance Reform Committee (Dec. 16, 2009) (also positing that “[m]inority shareholders benefit from the presence of a large blockholder because only the latter has the economic incentive to exercise voting rights in an efficient manner”).
\item \textsuperscript{6} Carl Icahn, \textit{It’s Up to the Shareholders, Not the Government, to Demand Change at a Company}, \textit{HUFFINGTON POST}, Apr. 15, 2009.
\item \textsuperscript{8} \textit{Id.} at 47.
\end{itemize}
Nevertheless, this growing concern about the negative effects of State ownership on the wealth of minority shareholders of government-controlled companies is somewhat puzzling. Few, if any, commentators have expressed concern that existing shareholders of failing companies were harmed by the government’s investment.\(^9\) Were it not for the State takeover, shareholders of distressed firms would probably have fared even worse in an expected bankruptcy proceeding. And investors who subsequently acquired stock in government-owned firms did so having full knowledge of the government’s stake and governance rights, and thus had ample opportunity to evaluate the ensuing risks and to discount the share price accordingly. Indeed, the securities law filings of these firms not only disclose the government’s ownership interest but also specifically spell out various idiosyncratic risks associated with State control.\(^{10}\) All in all, the recent fixation on the fate of current and future shareholders of U.S. government-controlled firms seems exaggerated.

This Chapter seeks to explore the different question of whether the presence of the State as shareholder can impose negative externalities on the corporate law regime applicable not only to government-owned firms, but also to private sector corporations.\(^{11}\)

---

\(^9\) Nevertheless, it may still be desirable for the legal system to provide special mechanisms that protect shareholders in the event of a government takeover. For instance, Brazil’s Corporations Law specifically protects investors from the enhanced political risks associated with State ownership by conferring appraisal rights upon a governmental taking of control. Law 6,404 of 1976, Art. 236.

\(^{10}\) See, e.g., the section on “Risk Factors” of the 2009 annual reports on form 10-K for AIG (disclosing that a trust formed for the sole benefit the U.S. Treasury holds a controlling interest in the company and that “AIG’s interests and those of AIG’s minority shareholders may not be the same as those of the Trust or the United States Treasury,” and General Motors (“the UST [United States Treasury] (or its designee) owns a controlling interest in us and its interests may differ from those of our other stockholders”), available at http://www.sec.gov/edgar.shtml.

\(^{11}\) In brief, more optimistic commentators have assumed that the government is a large shareholder like any other and can therefore use its influence in promoting beneficial changes to the corporate governance
Drawing from historical and comparative experiments with government ownership, it answers in the affirmative. The different cases examined suggest that government control of business corporations can have unintended consequences that go well beyond the potential mismanagement at the firm level due to the pursuit of political goals inconsistent with shareholder wealth maximization – the concern that dominates both the ongoing debate and the large literature on the relative merits of public and private ownership.\footnote{See note 181 infra and accompanying text.}

An important but so far overlooked byproduct of government ownership stems from the conflict of interest inherent in the State’s dual role as shareholder and corporate governance regulator. That is, where the State is the controlling shareholder of major business corporations, its interests as controller may come to dictate the content of corporate laws to the detriment of outside investor protection and efficiency. In examining various experiments with government ownership in different times and places, this Chapter shows that the potential conflicts deriving from the government’s two hats have been an enduring and almost universal attribute of State ownership.

There is now a vast empirical literature underscoring the importance of legal investor protection to the development of capital markets. In particular, these works show a strong correlation between low levels of protection to minority shareholders, highly concentrated corporate control in the hands of the State and wealthy families, and...
underdeveloped capital markets. A series of studies on the political economy of corporate governance has however demonstrated that the causal link between legal institutions, on the one hand, and corporate ownership structures and capital market development, on the other hand, is unlikely to be unidirectional. While poor investor protection can discourage ownership dispersion and capital market development, concentrated shareholdings in the hands of powerful families may on their own generate strong political opposition to legal reforms providing for stronger minority shareholder rights.

Yet the existing literature on the political economy of corporate governance focuses exclusively on private owners, managers and workers as the relevant political

---

13 For a few representative works of this extensive body of literature, see Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny [hereinafter “La Porta et al.”], Legal Determinants of External Finance, 52 J. FIN. 1131 (1997); La Porta et al., Law and Finance, 106 J. POL. ECON. 1113 (1998); La Porta et al., Corporate Ownership Around the World, 54 J. FIN. 471 (1999); La Porta et al., Investor Protection and Corporate Governance, 58 J. FIN. ECON. 3 (2000). To be sure, the “antidirector rights index” used in these initial works was proved to be faulty. See Holger Spamann, The “Antidirector Rights Index” Revisited, 23 REV. FIN. STUD. 467 (2009) (finding numerous errors in the antidirector index that compromise the initial results obtained by the law-and-finance literature); Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, The Law and Economics of Self-Dealing, 88 J. FIN. ECON. 430 (2008) (for a more recent work that relies on an improved index and corroborates the initial results). To be sure, a significant strand of the literature, although recognizing the correlation between investor protection and capital market development, continues to assert that the causal link runs in the opposite direction, with capital market development prompting, rather than resulting from, stronger legal protection to minority shareholders. See note 14 infra and accompanying text.

14 See, e.g., Lucian A. Bebchuk & Mark Roe, A Theory of Path Dependence in Corporate Ownership and Governance, 52 STAN. L. REV. 127, 131 (1999) (arguing that “[a] country’s initial pattern of corporate structures influences the power that various interest groups have in the process producing corporate rules”); John C. Coffee, Jr., The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control, 111 YALE L. J. 1 (2001) (suggesting the existence of reverse causation between capital market development and legal investor protection, since “strong markets do create a demand for stronger legal rules”); Lucian A. Bebchuk & Zvika Neeman, Investor Protection and Interest Group Politics, 23 REV. FIN. STUD. 1089, 1093 (2010) (noting that “a high level of investor protection may be, at least partly, the product – rather than the cause – of high economic growth, a developed stock market, or an advanced-stage economy”).
Perhaps because of the relative scarcity of listed state-owned firms in the Anglo-American world that is the source of a major part of these studies, the potential role of the State as shareholder in corporate governance is left entirely out of the equation. I argue that, by excluding this key political actor, conventional models have failed to adequately capture the political economy of the large (and recently growing) number of jurisdictions that boast a substantial number of mixed enterprises.

The recognition of the role of the government qua shareholder in corporate law reforms unveils another dimension of the well-known correlation between family and State control of corporate enterprise. The conventional interpretation of why family and State control appear in tandem is that, in a system of poor investor protection and high private benefits of control, controlling shareholders do not give away control for fear of subsequent expropriation. Because robust capital markets fail to emerge in this context, only the State and wealthy families possess enough capital to invest in large-scale productive activity. In fact, the very existence of state-owned enterprises (SOEs) is partially justified by the capital market failure that prevents the financing of large firms to carry out socially beneficial projects.

---


16 See, e.g., La Porta et al., Corporate Ownership Around the World, supra note 13, at 5 (noting that “controlling shareholders – usually the State or families – are present in most large companies” around the world); Kathy Fogel, Oligarchic Family Control, Social Economic Outcomes, and the Quality of Government, 37 J. Int. Bus. Stud. 603 (2006) (finding that “[m]ore family control is associated with more SOEs”).

17 See, e.g., Alexander Gerschenkron, Economic Backwardness in Historical Perspective (1962) (noting that when there is “no sufficient previous long-term accumulation of wealth in appropriate hands which at a propitious moment can be made available to industrial entrepreneurs,” informal capital markets will no longer suffice and the State or some financial institution will have to fulfill this function); Stilpon Nestor & Ladan Mahboobi, Privatisation of Public Utilities: The OECD Experience 6 (1999), available at
Nevertheless, reverse causation remains equally plausible. For example, if State ownership serves as a substitute for capital markets, high levels of government ownership of enterprise may effectively “crowd out” the private sector.\textsuperscript{18} The goal here is to underscore an important but so far overlooked channel for reverse causation: the negative influence of the role of the government as controlling shareholder on the levels of a country’s legal investor protection and, consequently, on its capital market development.

A number of factors render the political economy of corporate law reforms particularly favorable to the interests of the government qua controlling shareholder. Not only does the State have a natural and unmatched proximity to the lawmaking process – and is hence uniquely positioned to influence its outcomes – but legal rules that favor the interests of the State as shareholder over those of outside investors are often politically popular. Although this study mostly refers to the interests of “the State” as a unitary actor for the sake of simplicity, its argument does not depend on a monolithic view of the State. There are, to be sure, differing interests and powers within the State that might \textit{de facto} diminish its capacity to act in a unitary way. Nevertheless, a number of such actors and interests that influence State action – such as popular pressure in democratic

---

\textsuperscript{18} See, \textit{e.g.}, Alexander Aganin & Paolo Volpin, \textit{The History of Corporate Ownership in Italy}, in \textbf{A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD} 326 (Randall Morck ed., 2005) (stating that, in Italy, “[d]irect intervention by the State as an entrepreneur partially replaced and crowded out the role of the private sector in the accumulation of capital”). Still, the relationship between State ownership and capital market development is complex and resists oversimplification. Yet another source of complications relates to simultaneity problems due to omitted variable bias. Following Mark Roe’s work, another plausible hypothesis is that the adoption of a social-democratic regime (due to, say, war destruction) determines the level of both State ownership and capital market development. \textit{See, \textit{e.g.}}, Mark J. Roe, \textit{Political Preconditions to Separating Ownership from Corporate Control}, 53 \textit{Stan. L. Rev.} 539 (2000); Mark J. Roe, \textit{Legal Origins, Politics, and Modern Stock Markets}, 120 \textit{Harv. L. Rev.} 460 (2006).
societies, or the self-interest of government officials – tend to favor the interests of the State as shareholder over those of outside investors.

For example, even the most financially developed jurisdictions have far more taxpayers than shareholders in publicly-traded firms. As a result, many citizens may come to favor legal rules that privilege the interests of the State as controlling shareholder over those of minority (and often foreign) investors. This risk is particularly acute since the same jurisdictions that exhibit higher levels of state-owned enterprises also tend to have less developed capital markets and lower levels of stock ownership by households.

If ordinary citizens are often sympathetic to the State’s interests as a shareholder, controlling families are even more so. In a system of concentrated corporate ownership, collective action problems allow controlling families to exercise disproportionate influence on legislative outcomes so as to stifle the enactment of investor protection laws. However, the coexistence of State and family control significantly reinforces this pattern as it creates a natural alignment between the interests of the government and those of controlling families against minority shareholders. As a result, even if the political clout of such families is discounted, the State as the controlling shareholder of some of the largest publicly-traded firms may have independent reasons to oppose any reforms.

---

19 This is due to a variety of factors, including income inequality, idiosyncratic preferences over risk and asset allocation, misinformation, and the participation of foreign investors in domestic markets. Even in the U.S., only about one-half of the country’s households own stocks. See INVESTMENT COMPANY INSTITUTE AND THE SECURITIES INDUSTRY ASSOCIATION, EQUITY OWNERSHIP IN AMERICA 7 (2005) (for a description of the rise of equity ownership among U.S. households, which jumped from 19% in 1983 to 50.3% in 2005. Of course, the large size of a given constituency is not synonymous with, and can indeed hinder, organized political influence. See MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1965) (arguing that collective action in a group’s interest is facilitated when the group is of a small size). Nevertheless, if taxpayers face collective action problems, so do dispersed minority investors.

20 See, e.g., Bebchuk & Roe, supra note 14.
that redistribute wealth to minority shareholders and to sponsor legal changes that facilitate minority expropriation.

This symbiotic relationship between State and family control of business corporations has been overlooked due to a persistent focus on the distinctiveness of government control vis-à-vis private ownership of enterprise. In this sense, at least two differences stand out. First, state-owned enterprises face lower performance incentives than private firms, since they are generally subject to a “soft” budget constraint, shielded from bankruptcy and hostile takeovers, and limited in their ability to enhance managerial performance through high-powered compensation contracts.21 Second, but more important, state-controlled firms tend to pursue political or non-financial objectives other than shareholder-wealth maximization.22

While differences between public and private ownership certainly exist (and are the subject of a large empirical literature),23 it is easy to overstate the extent to which the interests of the government as controlling shareholder differ from those of private controlling shareholders. First, agency costs and the ensuing distortions in managerial incentives are a time-honored problem in widely-held corporations. Second, the pursuit

---

21 OECD Survey, supra note 3.

22 These reasons for the underperformance of state-owned enterprises are summarized by Albert Chong & Florencio López-de-Silanes, The Truth About Privatization in Latin America, in PRIVATIZATION IN LATIN AMERICA: MYTHS AND REALITY (Albert Chong & Florencio Lopez-de-Silanes eds., 2005).

23 This literature is too voluminous to be cited in full. For a few examples, see Shirley & Walsh, note181 infra; Anthony E. Boardman & Aidan R. Vining, Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed and State-Owned Enterprises, 32 J. L. & ECON. 1 (1989) (finding that mixed and state-owned enterprises perform significantly worse than comparable private companies); Paolo Sapienza, What do State-owned Firms Maximize? Evidence from the Italian Banks, CEPR Discussion Paper No. 3168 (2002) (finding that state-owned banks practice lower interest rates than their private counterparts and have their lending behavior affected by electoral results).
of non-pecuniary objectives beyond shareholder wealth maximization – widely acknowledged as the quintessential characteristic (or main evil) of government ownership – is hardly unique to state-owned enterprises.\(^{24}\)

Yet too much emphasis on the differences between private and public control of enterprise has largely obscured their similarities. Conceding that the model of the firm as a profit maximizer may be a worse fit to state-owned firms does not entail that the government and managing bureaucrats are indifferent to the company’s size, revenue and profit distribution.\(^{25}\) A prominent strand of the public choice literature models State and bureaucratic behavior based on the assumption that governments maximize fiscal revenues and bureaucracies maximize the size of their budgets.\(^{26}\) In disregarding the interests of the State while managing bureaucrats in the distribution of SOE profits, the corporate governance literature has ironically embraced too benign a view of the State as shareholder. Indeed, the same scholars who warn against the risk of political management of state-owned enterprises tend to assume that the government is otherwise

---

\(^{24}\) See, e.g., Einer Elhauge, *Sacrificing Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005) (arguing that the claim that business corporations maximize profits is wrong both descriptively and normatively); Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641 (2006) (stressing that private controlling shareholders pursue non-pecuniary as well as pecuniary private benefits of control).

\(^{25}\) This is so not least because even the effective pursuit of political goals depends on these variables.

\(^{26}\) On prominent theories of State behavior that focus on the government’s fiscal interests, see DOUGLASS NORTH, *STRUCTURE AND CHANGE IN ECONOMIC HISTORY* (1981), and MANCUR OLSON, *POWER AND PROSPERITY: OUTGROWING COMMUNIST AND CAPITALIST DICTATORSHIPS* (2000). For a discussion of the merits and shortcomings of the widely employed assumption that bureaucrats are budget maximizers, see DENNIS MUELLER, *PUBLIC CHOICE III* 362 (3rd ed., 2004) (also noting that “budget-maximizing bureaucrat has a certain resonance with models of the corporation that assume that managers maximize the corporation’s size”). For a collection of empirical works testing the model of bureaucrats as maximizing their budgets, see THE BUDGET-MAXIMIZING BUREAUCRAT 360 (André Blais & Stéphane Dion eds., 1991) (offering evidence that bureaucrats do attempt to maximize their budgets, although they do not always succeed).
unlikely to abuse minority investors. The cases analyzed here confirm the fragility of these assumptions, as the actions of the State as a controlling shareholder too often mirror the archetypal expropriation techniques employed by private controlling shareholders.

Before proceeding, it is worth pausing to examine how this study relates to, and differs from, the main strands of the literature on State ownership and corporate governance. One traditional line of research on State ownership seeks to measure the effects of private and public ownership on firm performance. Most (though not all) of these studies have pointed to the comparatively superior performance of private enterprise, and have helped spur the privatizations movement in the 1990s. In light of the persistence of State ownership despite prior waves of privatizations, scholars and policymakers have more recently begun to explore which corporate governance practices may serve to improve the performance and accountability of government-controlled firms. These questions, while important in their own right, are not the focus of the present analysis.

---

27 Kahan & Rock, supra note 7, at 21 (dismissing concerns that “the government wants to enrich itself financially at the expense of the minority shareholders”).

28 Ronald J. Gilson & Jeffrey N. Gordon, Controlling Controlling Shareholders, 152 U. PA. L. REV. 785 (2003), identify three principle methods for controlling shareholders to extract private benefits of control – namely, by taking for themselves a disproportionate amount of the firm’s operating earnings, by minority freeze-outs, or by selling control at a premium. All of these methods can equally be used by government-controlled firms.

29 See notes 181-182 infra and accompanying text for a selection of works on this topic.

30 As noted by Maria Vagliasini, “[w]e are now getting into the third wave of reforms, and the focus seems to be shifting back to the improvement of SOEs while maintaining public ownership.” Maria Vagliasini, Governance Arrangements for State Owned Enterprises, World Bank Policy Research Working Paper 4542 (2008). For examples of academic studies and policy recommendations on corporate governance practices of state-owned enterprises, see, e.g., OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES (2005) (for various recommendations of corporate governance best practices for SOEs); Simon C.Y. Wong, Improving Corporate Governance in SOEs: An Integrated Approach, 7 CORPORATE GOVERNANCE INT’L 6, 13 (2004) (arguing that “poor corporate governance lies at the heart of the poor
Instead, the aim of this Chapter is to fill a gap in the literature on the political economy of corporate governance. Existing scholarship has failed to fully appreciate the influence of the State qua shareholder in the development of corporate legal regimes – a force that has helped shape virtually every major corporate law issue throughout history in very different institutional settings. The State’s interests as a shareholder have influenced aspects of corporate law as varied as the degree of access to the corporate form, the legal regime of sale-of-control transactions, the structure of shareholder voting rights, the substance of directors’ and controlling shareholders’ fiduciary duties, and the availability of securities class actions.

For instance, in the nineteenth-century U.S., the interests of state governments as shareholders of early corporations led them to delay the adoption of general incorporation and to restrict entry in order to preserve the government’s source of monopoly profits. As described in Chapter IV, the revenue-maximizing ambitions of the Brazilian federal government during the wave of privatizations in the 1990s led it to sponsor an ad hoc reform to the corporate statute in order to eliminate different minority shareholder rights upon control sales. In contemporary China, the prevalence of the interests of the State as a controlling shareholder of recently “corporatized” state-owned enterprises is such that they have arguably “hijacked” the entire corporations law.\(^{31}\) The interests of the State as

a stockholder have also, to varying degrees, helped shape the content of corporate law rules in Continental Europe, as exemplified by the cases of Italy, France and Germany.

This Chapter proceeds as follows. Part II is the heart of the Chapter. It analyzes how the interests of the government qua shareholder have influenced corporate lawmaking in a variety of settings beyond the Brazilian case. It begins by describing the U.S. experience in the nineteenth century, and then turns to the cases of China and Continental Europe in the twentieth century. Part III then speculates on the role that the wave of privatizations in the 1980s and 1990s, by reducing the import of State ownership and therefore the State’s stake in corporate laws, might have played in transforming the political economy of corporate governance and in fostering capital market development. Part IV attempts to translate historical lessons into policy proposals by exploring the promise of different institutional arrangements to constrain the impact of the State’s interests as a shareholder on the corporate governance environment, and offering some counterintuitive recommendations. Part V concludes by reflecting on the continued significance of State ownership and its implications for corporate governance.

II. The State as Shareholder in Comparative Perspective

A. United States

Compared to most other jurisdictions throughout the world, traditional state-owned enterprises were significantly less common in the U.S. throughout the twentieth century. Except for a temporary takeover of enemy property during wartime, the U.S. government largely refrained from nationalizing major industries and embracing a model
of State capitalism in the post-World War II period.\textsuperscript{32} While mixed enterprises have dominated stock markets in many developed and developing countries, they were virtually non-existent in recent U.S. experience until the 2008 financial crisis.\textsuperscript{33} In fact, the very idea of having the federal government acquire equity stakes in distressed financial institutions reluctantly emerged as a policy transplant from England, a country with far greater historical experience and familiarity with state-owned enterprises. The partial nationalizations of distressed firms substituted the U.S. government’s initial plan for its Troubled Assets Relief Program (TARP), which consisted of less intrusive public purchases of troubled or “toxic” assets from the banks’ balance sheets.\textsuperscript{34}

That is not to say, however, that the U.S. government has eschewed the corporate form to achieve public objectives. As the Supreme Court remarked in \textit{Lebron v. National Railroad Passenger Corp.}, the passenger railroad company Amtrak, as a government-owned corporation, “was not a unique, or indeed even a particularly unusual, phenomenon.”\textsuperscript{35} Indeed, U.S. federal and state governments have made lavish use of the

\begin{footnotesize}
\textsuperscript{32} See Naomi Lamoreaux, \textit{Scylla or Charybdis? Historical Reflections on Two Basic Problems of Corporate Governance}, 83 BUS. HIST. REV. 9, 29 (2009) (noting that “[t]he government played an active role in managing the economy during the war, but then for the most part eschewed microeconomic intervention in businesses’ affairs”). For a description and analysis of the implications of the government custodianship of Japanese and German firms, see Kole & Mulherin, note 182 infra. See also \textit{Youngstown Sheet & Tube Co. v. Sawyer}, 343 U.S. 579 (1952) (for a much-criticized case in which the Supreme Court held that President’s Truman seizure of the steel companies involved in a labor dispute during the Korean War was unconstitutional as a violation of the separation of powers).

\textsuperscript{33} \textit{MUSOLF, supra} note 2, at 2.


\end{footnotesize}
corporate form to perform public functions. As of 1990, the official count included as many as 6,937 government corporations in the U.S., including 45 corporations chartered by the federal government – a number that seemed to be growing in recent years.\textsuperscript{36}

Still, the vast majority of these corporations have assumed one of two forms: (i) corporatized public instrumentalities, in which the corporate structure serves as an alternative organizational form to more traditional modes of public governance, or (ii) privately-owned but government-sponsored enterprises. As an example of the first type of organization, both state and federal governments have created corporations liberally in order to obtain greater operational flexibility over conventional public agencies or bureaucracies. President Franklin Delano Roosevelt pitched the creation of the Tennessee Valley Authority in 1933 as “a corporation clothed with the power of government but possessed of the flexibility and initiative of a private enterprise.”\textsuperscript{37}

\textsuperscript{36} JERRY MITCHELL, THE AMERICAN EXPERIMENT WITH GOVERNMENT CORPORATIONS 15 (1999) (noting that the labels commonly used to refer to these corporations include “ad hoc government,” “public authority,” “public benefit corporation,” “public corporation,” “public enterprise,” and “special-purpose government”). A classic example of a federal government corporation performing commercial functions is the U.S. Postal Service; others performing regulatory functions include the Resolution Trust Corporation and the Federal Deposit Insurance Corporation.

\textsuperscript{37} From the New Deal to a New Century: A Short History of TVA, available at www.tva.gov. In response to the proliferation of government corporations following the Great Depression, Congress enacted the Government Corporation Control Act of 1945. The GCCA, designed to restrain the formation of government corporations and enhance their accountability, ordered, among other things, the dissolution and liquidation of federal corporations chartered under state law and to curb their formation and enhance their accountability and required government corporations to be audited by the Comptroller General. For a detailed discussion of the Act, see C. Herman Pritchett, The Government Corporation Control Act of 1945, 40 AM. POL. SCI. REV. 495, 509 (1946) (arguing that an over-enthusiastic and unplanned exploitation of the corporate device has been followed by an increasingly vigorous assault on both the good and bad features of corporate administration).
government is typically the sole owner of these corporations, which are often no more than state agencies organized under a different, and more flexible, legal structure.\footnote{See Lebron, supra note 35 (holding that first amendment protections apply to Amtrak). See also A. Michael Froomkin, Re inventing the Government Corporation, 1995 U. ILL. L. REV. 543, 548.}

Additionally, the U.S. government has availed itself of a number of government-sponsored enterprises (GSEs), of which Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) are the foremost examples.\footnote{All of the six GSEs are financial institutions, a select group that also includes the Federal Home Loan Bank System (housing), the Farm Credit System and Farmer Mac (agriculture), and Sallie Mae (student loans). See Preface to Thomas H. Stanton, Government-Sponsored Enterprises: Mercantilist Companies in the Modern World xi (2002). (“GSEs are hybrids that combine the characteristics of public and private organizations. Their ownership and their control are private, but the government provides them significant subsidies, including tax and regulatory advantages, and permits them to fund their activities almost as if they were part of the government.”)} GSEs are chartered by the federal government to pursue public objectives or cure perceived market failures, but are organized in the form of profit-seeking corporations owned by private shareholders and listed on major exchanges. The government backing to GSEs does not come in the form of an equity stake but rather from its implicit guarantee to the corporation’s debt, which in turn helps advance the company’s public objectives by lowering its cost of capital.\footnote{The 2008 financial crisis made the serious character of these risks all too familiar. For an early and comprehensive description and analysis of the risks and conflicts inherent to GSEs, see also Jonathan G.S. Koppe l, The Politics of Quasi-government: Hybrid Organizations and the Dynamics of Bureaucratic Control (2003).} This hybrid structure mitigates the intra-shareholder conflicts associated with State ownership, albeit at the cost of creating even greater misalignment of interests between corporate shareholders and

\[38\] See Lebron, supra note 35 (holding that first amendment protections apply to Amtrak). See also A. Michael Froomkin, Re inventing the Government Corporation, 1995 U. ILL. L. REV. 543, 548.

\[39\] All of the six GSEs are financial institutions, a select group that also includes the Federal Home Loan Bank System (housing), the Farm Credit System and Farmer Mac (agriculture), and Sallie Mae (student loans). See Preface to Thomas H. Stanton, Government-Sponsored Enterprises: Mercantilist Companies in the Modern World xi (2002). (“GSEs are hybrids that combine the characteristics of public and private organizations. Their ownership and their control are private, but the government provides them significant subsidies, including tax and regulatory advantages, and permits them to fund their activities almost as if they were part of the government.”).

\[40\] The 2008 financial crisis made the serious character of these risks all too familiar. For an early and comprehensive description and analysis of the risks and conflicts inherent to GSEs, see also Jonathan G.S. Koppe l, The Politics of Quasi-government: Hybrid Organizations and the Dynamics of Bureaucratic Control (2003).
management, who benefit from the stock price appreciation due to risk-taking activities, and taxpayers, who are left to pick up the bill in case of failure.41

Neither wholly-owned government corporations nor GSEs pose the agency problems that are typical of multi-owner firms, since in the former case the government is the sole owner and in the latter case it is not an owner at all. Until recently, simultaneous private and public ownership of business corporations in the U.S. was rare and of little practical significance.42 Whereas a number of companies were formally chartered as “mixed enterprises,” most of them have converged to either entirely public or private ownership.43

For instance, Amtrak was officially established as a mixed enterprise, but soon came to be wholly owned by the federal government. Conversely, the Communications Satellite Corporation (Comsat), which was the object of the “most widely-publicized and hotly contested battle involving mixed enterprise in the twentieth century,” turned out not to embrace a mixed ownership model.44 Comsat’s 1962 federal charter allowed the U.S. President to appoint three “public interest” directors out of its 15 board members, but the

41 For an early warning of potential risks from conflicts of interests, see Jonathan G.S. Koppell, Follow the Loan Money, N.Y.T. (Dec. 26, 2004) (“[a]s government-sponsored enterprises, Fannie and Freddie serve two masters with competing priorities: the American public, whose credit implicitly backs their liabilities, and its shareholders, who expect them to maximize profits”). The financial crisis of 2008, leading to the nationalization of Fannie Mae and Freddie Mac, rendered these risks highly visible.

42 MUSOLF, supra note 2, at 2.

43 Froomkin, supra note 38, at 573 (describing a trend toward redemption of the government’s non-voting stock in mixed enterprises and concluding that the conceptual and practical difficulties associated with mixed enterprises are “largely theoretical at present”).

44 LLOYD MUSOLF, MIXED ENTERPRISE: A DEVELOPMENTAL PERSPECTIVE 56 (1972). The reference to mixed enterprises to firms that are not such is not unique to Comsat. Indeed, as noted by the author, “[p]aradoxically, none of the ‘mixed ownership’ government corporations listed in the Government Corporations Control Act are that.” Id. at 51.
firm was to be entirely owned by private sector shareholders. Comsat’s governance structure ensured governmental influence and supervision without implicating the State’s financial interest in the enterprise.

In brief, while the U.S. state and federal governments have frequently (and increasingly) employed the corporate form since the beginning of the twentieth century, they have traditionally done so either as a sole proprietor or as a guarantor, not as co-shareholder or residual owner in partnership with private capital. The upshot is that, at least in the last century, the U.S. government has been largely immune from conflicts of interest in corporate governance regulation stemming from its interests as a corporate shareholder.

Nevertheless, state-owned enterprises and mixed-ownership corporations have a long historical pedigree in the U.S. The establishment of the Bank of North America of 1781 – a mixed ownership corporation and the country’s first bank – preceded the adoption of the U.S. constitution, and was instrumental to the country’s continued independence. Similarly, the First Bank of the United States of 1791 was also a mixed ownership company in which the U.S. government held up to 20% of its stock.

---


46 Alexander Hamilton, Report on a National Bank, communicated to the House of Representatives, Dec. 14, 1790 (noting that “American independence owes much to [the Bank of North America]”); Froomkin, supra note 38, at 547 (noting that the Bank of North America was chartered by the Continental Congress and was 60%-owned by the Superintendent of Finance); LAWRENCE LEWIS, JR., A HISTORY OF THE BANK OF NORTH AMERICA (1882) (for a detailed description of the establishment of the Bank of North America).

47 Lebron, supra note 35, at 387.
The tension between the State’s interests as a shareholder and its role as a regulator was clear from the outset. Take, for instance, the case of early banking in Philadelphia as described by Anna Schwartz.\textsuperscript{48} Facing a budget surplus in 1792, the State of Pennsylvania saw the highly lucrative Bank of North America, which was by then wholly owned by private merchants, as a promising investment opportunity. The State proposed to acquire a significant amount of the bank’s stock, but negotiations with existing shareholders ultimately broke down. Local merchants who were dissatisfied with their accommodation in the Bank of North America saw this as an opportunity to obtain a corporate charter for a competing institution, the Bank of Pennsylvania.\textsuperscript{49} In consideration for the grant of a charter to the Bank of Pennsylvania, the state was allowed to subscribe one-third of the bank’s capital stock, to be paid through a combination of specie, federal government debt, and the proceeds of a loan from the bank.\textsuperscript{50}

In 1803, still another group of credit-hungry merchants petitioned the legislature to incorporate the Philadelphia Bank. The petition met with resistance from the Bank of Pennsylvania, which – itself a direct product of the state’s profit-making objectives – now appealed to the government’s interests as a shareholder to oppose the incorporation of a new bank. It argued that the chartering of another banking institution would reduce the


\textsuperscript{49} \textit{Id.} at 418-419. The primary motivation of bank shareholders in the late eighteenth and early nineteenth century was to obtain access to the bank’s services (discounts and short-term loans), rather than a financial return on the stock. \textit{See} Henry Hansmann & Mariana Pargendler, \textit{Voting Restrictions in 19\textsuperscript{th}-Century Corporations: Investor Protection or Consumer Protection?} (2010) (unpublished manuscript, on file with the author).

\textsuperscript{50} \textit{Id.} at 423-4.
Bank of Pennsylvania’s profits and therefore jeopardize the state’s investment.\textsuperscript{51} Citizens argued before the legislature that, in light of “the extensive interest which the State holds in the Bank of Pennsylvania, they cannot too seriously consider the probable baneful effects of an additional chartered Bank at this period, on the fiscal concerns of the State and on the banking system.”\textsuperscript{52}

The state of Pennsylvania thus faced a familiar dilemma. In the words of Anna Schwartz, “as a stockholder in the Bank of Pennsylvania, its interests presumably coincided with those of the private investors in the bank, but as arbiter of the public welfare, it had to consider the views of the promoters of the Philadelphia Bank. These conflicted with the ambitions of Bank of Pennsylvania stockholders.”\textsuperscript{53} The legislative committee in charge of evaluating the charter petition was initially determined to privilege the interests of the state as shareholder. It issued an unfavorable report on the charter application, deeming it against the “public interest” as possibly damaging to the state’s financial stake in the Bank of Pennsylvania.\textsuperscript{54}

The state’s conflict of interest did not go unnoticed. One legislative proposal argued that elimination of the conflict required the state to divest its stock holdings in banks:

“Whereas, the intimate connexion and union of pecuniary interests between the State and great monied institutions, tends to create an

\textsuperscript{51} Id. at 427.

\textsuperscript{52} Id. at 429.

\textsuperscript{53} Id.

influence, partial to the latter and highly injurious to the former. It being the duty of the government to consult the generally will and provide for the good of all, embarrassments must frequently be thrown in the way of the performance of this duty, when the government is coupled in interest with institutions whose rights are founded in monopoly, and whose prosperity depends on the exclusion and suppression of similar institutions. The government in such cases becomes identified with these establishments, and the means of promoting and extending commerce, manufactures and agriculture equally over the whole state for the general good are too often lost sight of by this dangerous and unnatural union."

This proposal was defeated, but the Philadelphia Bank was able to successfully engage in Coasean bargaining and obtain a charter. In exchange for incorporation, the Bank of Philadelphia offered the state a $135,000 cash payment, permitted the state to make a significant stock subscription, and loaned $100,000 to the commonwealth. After winning a bidding war with the Bank of Pennsylvania – which offered the state significant boons for denying its competitor’s application for a charter – the Bank of Philadelphia was finally incorporated in 1804.

The state’s new holdings in the Philadelphia Bank had the potential to recreate the same conflicts of interest in future charter requests. And sure enough, Pennsylvania’s interests as a shareholder led it one again to oppose an incorporation petition from the Farmers’ and Mechanics’ Bank in 1807. Side payments to the state government were repeatedly employed to satisfy the “public interest” until the liquidation of the state’s

Schwartz, supra note 48, at 427.

Id. at 429.

Id. at 430 (describing that, once again, “[t]he older banks appealed to the selfish interest of the commonwealth itself in their profits in the hope that it would deny the new bank a charter”).
shareholdings in banks in 1837 created the preconditions for a truly liberal chartering policy.\textsuperscript{58}

Pennsylvania was not unique in experiencing a tension between the state’s dual role as a shareholder and regulator. In their seminal work on the role of government intervention in nineteenth-century Massachusetts, Oscar Handlin and Mary Handlin note that the state legislature’s unwillingness to charter new banks was due at least partially to “fear that competition would lower the returns on the Commonwealth’s own investment” – a consideration that persisted until Massachusetts liquidated its banking holdings in 1820, the point in which the state effectively adopted a free banking regime.\textsuperscript{59} Wallis, Sylla and Legler provide systematic evidence that the nature of the state’s financial interests had a substantial impact on the state’s policy towards bank chartering. States whose main source of banking-related revenue came from taxes were significantly more likely to adopt a liberal chartering process than those in which the State was invested as a major bank shareholder.\textsuperscript{60}

The shareholder-regulator conflict was not limited to financial institutions. In the nineteenth century, U.S. state governments were also heavily invested in transportation improvement companies (notably turnpikes, canals, and railroads) and kept these interests

\textsuperscript{58} Sylla, \textit{supra} note 54, at 112.

\textsuperscript{59} OSCAR HANDLIN & MARY FLUG HANDLIN, \textit{COMMONWEALTH: A STUDY OF THE ROLE OF GOVERNMENT IN THE AMERICAN ECONOMY: MASSACHUSETTS, 1774-1861} 116 (1969); Sylla, \textit{supra} note 54, at 111. Moreover, many states not only curbed the grant of new charters, but also strengthened the market power of existing banks by explicitly outlawing unincorporated banking. \textit{Id.} at 112 (describing the adoption of such laws in New York, Pennsylvania and Massachusetts).

in mind when reviewing charter applications from potential competitors. The State of New York’s interest in the economic success of the Erie Canal – which, in a historic example of public entrepreneurship, it built and financed on its own – illustrates the problem, showing that conflicting interests tainted chartering policies not only when the state was a partial shareholder of mixed enterprises but also when it was an independent entrepreneur. Despite its pioneering role in the enactment of general incorporation statutes, New York refrained from passing a general incorporation law for canals so as to prevent competition from impairing the ratings of the Erie Canal’s state bonds.61 Citizens were sympathetic to the state’s fiscal interests, leading to a “loud popular cry”62 against potential competition from railroads. As a result, the New York legislature passed laws preventing railroads from carrying freights, hence guaranteeing the Erie Canal’s monopoly.63

In New Jersey, this pattern was even more prevalent. The state’s infamous “monopoly bill” of 1832, which granted exclusive privileges to the Camden and Amboy railroad, was a bargained-for statute passed in exchange for a significant gift to the state of company stock.64 The state’s equity stake in the railroad turned out to be so profitable that it significantly reduced the taxes levied on its citizenry,65 thus making the monopoly

64 LAWRENCE MEIR FRIEDMAN, A HISTORY OF AMERICAN LAW 133 (3rd ed., 2005) (noting that, by granting the State a higher priority for dividends, the Camden and Amboy’s shares held by the State represented an precedent of preferred stock).
65 Id.
politically popular. When a turnpike company applied for a competing charter a few years later, the committee in charge of the matter opined negatively on the petition so as to “preserve inviolate, sacred and unimpaired, the faith, the integrity, and the revenues of the state, by a strict adherence to the system of policy which has laid the foundation of our Internal Improvements, the principles of protection as a means of revenue.”

Judicial decisions also took note of the interests of the State as a shareholder. Turnpike subscribers in the nineteenth century were typically more interested in the services and ancillary benefits of the road (such as increases in land values) than in the prospect of a profit. In Middlesex Turnpike v. Locke, the court held that a shareholder was no longer obliged to pay assessments if the turnpike’s route was changed following his subscription. Faced with a similar situation, the court in Irvin v. Turnpike, held that the shareholder remained liable under his subscription. In distinguishing this case from other precedents, the defendant’s counsel emphasized that the state’s ownership of two-thirds of the turnpike company’s stock rendered this turnpike company a public venture...

While highly influential in corporate chartering policy, the state’s interests as a

---


67 See Hansmann & Pargendler, supra note 49.

68 8 Mass. 268 (1811).

69 2 Pen. & W. 466 (1831).

70 Id. at 4 (arguing that the cases cited by the plaintiff were inapplicable, since “in those cases, were not to make a road for public purposes, but from one township to another, for the benefit of the inhabitants residing near to it” and “[t]he public had no interest in it”).
shareholder were comparatively less important in shaping general corporate governance rules. The reason is simply that, prior to the advent of general incorporation statutes, there were fewer corporate laws of general application. Most internal affairs rules were set forth in a corporation’s own individual charter granted by the legislature, which were, to be sure, largely responsive to state interests. In defending a charter provision to prohibit foreign shareholders from using proxies to vote their shares in the First Bank of the United States, Alexander Hamilton argued that the bank was “not a mere matter of private property, but a political machine of the greatest importance to the state.”

In the relatively rare situations in which government ownership and general corporate laws coexisted, lawmakers also took into account the state’s interests as a shareholder in defining the appropriate corporate governance regime. In 1846, the Revisors of the Civil Code of Virginia focused on the implications for “the finances of the state” to justify a proposed revision to relax the strict regressive voting scale prevalent at the time, which severely limited the voting rights of large shareholders. They noted that “[t]he state has subscribed largely to works of internal improvement, and to her it is desirable that each work to which she subscribes should be so managed as not to sink capital, but make it a source of some income.” The Revisors deemed that the State’s financial interests would be best served by affording greater voting rights to large shareholders, who had an incentive to make decisions so as to maximize the values of

---


72 Report of the Revisors of the Civil Code of Virginia made to the General Assembly at December session 1846 335 (1847).

73 Id.
their investment, rather than by giving comparatively greater voice to small holders, who could exercise their voting rights so as to privilege their interests as users by favoring low tolls to the detriment of profitability.\textsuperscript{74}

As capital and product markets developed throughout the nineteenth century, mixed enterprises became increasingly rare and remained so well into the twentieth century.\textsuperscript{75} At the same time that governments around the world began to direct business ventures after World War I, the U.S. debated this possibility but declined to follow suit. In a forceful 1924 speech, future U.S. president Herbert Hoover (then Treasury Secretary) rebuffed contemporary proposals for increased government ownership, which he described as the “negation of progress,” whose adoption “would change the major thought and purpose of our Government into the making of money instead of devotion to the preservation of basic human liberties.”\textsuperscript{76} Interestingly, Hoover cited the rise of dispersed ownership of utility companies in the U.S. having as many as between 200,000 and 700,000 shareholders as evidence that State ownership was unnecessary for a “silent revolution is transferring ownership to the public.”\textsuperscript{77}

Yet, throughout the twentieth century, and especially in the post-war period, the

\textsuperscript{74} Id. (“the private stockholder who has a large amount invested will be apt, when he gives his vote, to consider the effect of that vote upon his investment, and go for such a course as seems best calculated to make his stock productive. While the man who has but one or two shares will often be either indifferent as to the measures that are adopted, or be less alive to the interest of a stockholder looking for dividends, than to the interest of one using the work, that the tolls be low”). For a detailed analysis of how regressive voting schemes in the nineteenth-century served to protect the interests of consumers rather than the interests of investors, see Hansmann & Pargendler, supra note 49.


\textsuperscript{76} Herbert Hoover, \textit{Government Ownership}, an address delivered by the Secretary of Commerce in Washington, DC, Sept. 29, 1924, at 3-6.

\textsuperscript{77} Id. at 4.
government continued to share in the profits of business corporations in the U.S. It did so no longer through equity ownership, but rather via taxation. In the years after World War II, while non-U.S. governments were rapidly increasing their equity holdings in important segments of the economy, the income tax rate applicable to business corporations was such as to, in the words of Adolph Berle, “virtually make the state an equal partner [in the corporate enterprise] as far as profits are concerned.”\textsuperscript{78} Meanwhile, the provisions of U.S. corporate law continued to be influenced by the states’ financial interests – no longer as corporate shareholders but rather as collectors of corporate franchise taxes.\textsuperscript{79}

Nevertheless, the government’s financial interest in tax revenues creates different – and arguably more benign – regulatory incentives compared to outright ownership. The federal government’s financial interest in income taxes favors the enactment of efficient corporate and securities regulations that maximize firm revenue. Although the states’ interests in franchise taxes may lead them to enact corporate laws that are more managerialist than is socially desirable, their incentives to favor controlling over minority shareholders are still much weaker than when the state itself is the controlling shareholder.

\textsuperscript{78} Adolph A. Berle, \textit{Property, Production and Revolution, A Preface to the Revised Edition} xxviii (Dec. 1967), \textit{in Adolph A. Berle & Gardiner Means, Modern Corporation and Private Property} (2nd ed., 1992) (“\textit{u}nder the recent tax reduction, the federal government presently taxes corporate profits above $25,000 at the rate of about 50 per cent”).

\textsuperscript{79} See, e.g., Ralph K. Winter, Jr., \textit{State Law, Shareholder Protection, and the Theory of the Corporation}, 6 J. LEGAL STUD. 251, 255 (1977) (noting that both Delaware and its competitors “candidly admit that the purpose of corporate code revisions has been the attraction of charters to their state in order to produce significant tax revenues”).
B. China

China is home to the most recent large-scale experiment with listed state-owned enterprises. In the 1990s, a large number of Chinese state-owned firms, which until then were operated by government agencies, were transformed into business corporations. At the same time that most of the Western world was undertaking standard privatization programs, the Chinese government embraced “corporatization” as an integral part of its economic modernization strategy. China remained strongly committed to government ownership and control of enterprise, but saw the corporate form as a powerful instrument to increase enterprise efficiency and financing. While some observers saw in the corporatization strategy a first step in the transition towards private control of enterprise, the goal of the Communist Party was arguably the reverse, that is, to increase State control of economic activity through leverage.

The Shanghai Stock Exchange opened in 1990 with IPOs of a number of state-owned enterprises. Between 1991 and 1998 alone, more than 600 firms that were

---

80 Cyril Lin, Corporatisation and Corporate Governance in China’s Economic Transition, 34 Economics of Planning 5, 6 (2001) (stating that “the Chinese authorities have sought to improve corporate governance of SOEs as an alternative to, and as a means of avoiding, privatization”). China’s aversion to privatization was largely ideological. Although State assets were transferred to private hands to a significant extent, the process was labeled as “enterprise reform” or “a conversion to people’s ownership.” See Jing Yu, State-Owned Enterprise Reform in China: A Gradual Privatization under an Uncertain Legal Regime 104 (Yale Law School, JSD Dissertation, 2002) (arguing that, due to the prevalent ideology, “[p]rivatization… could only happen under the protection of a terminological haze”). Id. at 11.

81 The goal of increasing State control over business through leverage is explicitly mentioned in a key Communist Party document issued in 1999. See Donald Clarke, Corporatisation, Not Privatisation, 7 China Econ. Quart. 27, 28 (2003) (explaining that sales of minority stakes to outside investors, the Chinese government can exercise control over a larger pool of assets). The shift towards mixed enterprises is therefore consistent with models of bureaucrats as budget maximizers. See note 26 supra and accompanying text.

previously wholly-owned by the government went public in China.\textsuperscript{83} As was the case in a number of capitalist economies in previous decades, minority interests in many of the newly corporatized SOEs were publicly traded and listed on local (and, increasingly, international) stock exchanges.

The capital structure of corporatized SOEs included an intricate system of multiple classes of stock that allowed the government both to retain uncontested control over the firm and to limit foreign ownership of minority shares. Shares held directly by the State or by legal persons (usually controlled by the State) were initially non-tradable, thus creating a structural assurance of continued State ownership. Tradable stock took the form of either “A-shares,” owned by domestic investors, or “B-shares,” held by foreign investors.\textsuperscript{84} By 1999 a typical listed SOE in China had just over 60\% of its equity held by the government in the form of non-tradable shares, with the remainder of the firm’s stock being listed on the exchange and held by domestic or private investors.\textsuperscript{85} A 2005 legal reform allowed for the conversion of non-tradable into tradable shares, a change that is expected to gradually eliminate China’s two-tier share structure.\textsuperscript{86}

While state-owned enterprises still dominate Chinese capital markets, the relative participation of private issuers has been growing in recent years. The proportion of

\textsuperscript{83} Yu, \textit{supra} note 80, at 6.

\textsuperscript{84} In principle, these different types of shares had the same cash-flow and voting rights. For a detailed description of types of shares in China, including classifications based on trading venue, see Xiaonian Xu & Yan Wang, \textit{Ownership Structure, Corporate Governance and Corporate Performance: The Case of Chinese Stock Companies} 7 et seq., World Bank Policy Research Working Paper 1794 (1997).


companies traded in Chinese exchanges having the State as a major or controlling shareholder declined from about 97% in 1997, to roughly 75% in 2003 and 60% in 2007, but remains significant. The largest listed companies in China are still controlled by the State, and dominate the Chinese exchanges’ market capitalization. As of mid 2010, the top ten such firms made up almost 40% of the Shanghai Stock Exchange market capitalization.

As in other jurisdictions, the presence of the State as the dominant shareholder in the economy has had a profound impact on the nature and structure of China’s corporate and securities laws. China’s new Corporations Law, enacted in 1994 in response to the ongoing corporatization process, was designed with the needs and objectives of state-owned enterprises in mind. As in other jurisdictions, however, China’s Corporations Law applies to government and privately controlled firms alike, with the result that the interests of the State as a shareholder turn out to impose negative legal externalities on the legal regime available to private firms. In his overview of corporate governance practices in China, Donald Clarke encapsulates the problem by noting that “the need to provide for the special circumstances of state sector enterprises ends up hijacking the entire Company Law so that instead of state sector enterprises being made more efficient

---


88 See, e.g., Sonja Oppoer & Sylvia Schwaag-Serger, Institutional Analysis of Legal Change: The Case of Corporate Governance in China, 26 WASH. U. J. L. & POL’Y 245, 255 (2008) (noting that all of the largest Chinese companies as of 2007 were controlled by the State).

by being forced to follow the rules for private sector enterprises (the original ambition), potential private sector enterprises are hamstrung by having to follow rules that make sense only in a heavily state-invested economy.”

State interests have molded Chinese corporate laws – hence making them ill adapted to private sector corporations – through numerous different channels. First, as argued by Donald Clarke, China’s 1994 Corporations Law was largely mandatory, rather than enabling, in nature. Tailored to the needs of recently corporatized State firms, China’s corporate statute – which included specific legal mandates about the reinvestment of profits and the minimum and maximum number of board members – offered a regime that was overly rigid and therefore dysfunctional when applied to privately owned companies.

The shortcomings of China’s corporate laws were even more serious when it came to shareholder protection, which earned Chinese capital markets the reputation for being “worse than a casino.” Although on paper Chinese law on its face allocated significant power to shareholders – such as the right to monitor firm management and to make decisions about dividend distributions – in practice these provisions served to protect the government as a controlling shareholder while denying meaningful legal rights to minority investors. Prominent scholars argued that, despite the lack of legal

---

90 Donald C. Clarke, Corporate Governance in China: An Overview, 14 CHINA ECON. REV. 494 (2003).

91 Id. at 501.


93 Yu, supra note 80, at 76.
protection for minority investors, extralegal substitutes existed in China to encourage the adoption of reasonable corporate governance practices. 94 Still, extralegal substitutes, while helpful, are often imperfect – and, given the prominence of the State’s interests as a controlling shareholder in a large number of listed firms, significant legal improvements are unlikely to be forthcoming.

Take, for instance, the example of fiduciary duties. China’s 1994 Corporations Law was largely reticent on the duties of managers and even more deficient in its means of enforcement, since derivative suits were not admitted in China. 95 The Chinese government has enunciated that state-owned enterprises should be managed with the purpose of “preserving and increasing the value of State assets.” 96 Leaving aside whether this is a feasible goal given the incentives faced by Chinese bureaucrats, maximizing the value of State assets differs from – and can easily conflict with – maximizing the value of the firm. In fact, the State as a shareholder (just like any other controlling shareholder) could find it in its interest to maximize its return by tinkering with the distribution of the

---

94 Franklin Allen, Jun Qian & Meijun Qian, Law, Finance, and Economic Growth in China, 77 J. Fin. Econ. 57 (2005) (stating that China has low levels of investor protection, underdeveloped capital markets and corporate control concentrated in the hands of the State or founders’ families). But see Pistor & Xu, supra note 85 (arguing that China’s system of administrative governance through the quota system compensates for the deficiencies of legal governance protections); Liebman & Milhaupt, supra note 87 (arguing that shaming sanctions applied by Chinese stock exchanges helps promote good corporate governance in the absence of a strong legal environment).

95 Clarke, supra note 90, at 502 (noting that although the Company Law specifies a duty of loyalty, it does not provide for a duty of care or for mechanisms of enforcement); Yu, supra note 80, at 57 (“conflict of interest is not a cause of action for shareholders in China”). But see Nicholas Calcina Howson, The doctrine that dared not speak its name: Anglo-American fiduciary duties in China’s 2005 company law and case law intimations of prior convergence, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA (Hideki Kanda, Kon-Sik Kim & Curtis J. Milhaupt eds., 2008). Howson notes that, despite the lack of explicit statutory under the 1994 Corporations Law, Chinese courts spontaneously imposed fiduciary duties in deciding actual cases. The cases he cites, however, primarily concern lawsuits against privately-controlled corporations. Id.

96 Xu & Wang, supra note 84, at 5.
corporate pie to the detriment of the company and its other shareholders. Because State
ownership is pervasive, the opportunities for self-dealing through favorable transactions
with other government-controlled firms are large.97 According to an OECD report on
corporate governance practices in China, Chinese stock markets were rife with instances
of tunneling by the State as a controlling shareholder through related party transactions.98

Subsequent developments concerning the admissibility and requirements of
securities actions in China provide a paradigmatic example of how the interests of the
State as a shareholder can hinder the enforcement of investor rights. Confronting a then
recent rise in the number of securities actions filed in Chinese courts, the Supreme
People’s Court of China issued a notice in 2001 directing lower courts to temporarily
suspend the filing of securities lawsuits.99 A series of interviews conducted by Zhiwu
Chen revealed that one of the main reasons behind the suspension of securities litigation
in China was the Court’s concern that these lawsuits, if successful, could bring about
major financial losses to the State as the controlling shareholder of most corporate
defendants.100

97 Yu, supra note 80, at 77 (“when dealing with another state firm or public entity, the state-shareholder
may tend to charge these customers favorable rates in exchange for reciprocal treatments or in return for
other policy concessions”).

98 OECD Report on China, supra note 87, at 314 (“[t]he most widespread abuse is asset stripping by
controlling “legal entity” shareholders at the expense of the firm itself and its minority shareholders
through abusive related party transactions among firms of the same group, intra-group lending or
guarantees, and excessive cash dividends. Indeed, the parent company will typically transfer productive
assets to its listed subsidiary, retaining liabilities and redundant staff, while remaining an SOE”).

99 For a detailed discussion of securities litigation developments in China, see Walter Hutchens, Securities
(2003)

100 Chen, supra note 82, at 465. Other stated reasons for the suspension included concerns about a massive
inflow of securities cases, a lack of expertise to address the suits, and the risk of conflicting decisions. Id.
at 640.
In 2002 the Supreme People’s Court lifted the general suspension and issued a new set of rules to govern private securities litigation in China. Although praised by the domestic media, foreign commentators viewed the new regulations as posing “several daunting obstacles” to plaintiffs. 101 In addition to other procedural and substantive requirements, the regulations made the filing of securities lawsuits conditional on the prior imposition of administrative or criminal penalties by the government, hence significantly weakening the prospects of successful initiation of securities fraud claims expressly contemplated by Chinese securities laws. The result is that conflicts of interests stemming from the State’s stockholdings – which were likely a key driving force behind the new rules – are likely to frustrate private enforcement efforts, since “the Chinese state will most likely not authorize massive litigation against itself or its assets on a routine basis.” 102

In 2005, China’s Corporations Law underwent a major overhaul, which, according to some commentators, changed the existing statute “almost beyond recognition.” 103 Major amendments to China’s Securities Law approved on the same day were also strongly acclaimed by local scholars as a significant improvement. 104 The new rules imposed fiduciary duties on managers and controlling shareholders, required listed firms to have independent directors, permitted derivative suits, and recommended (but

101 Hutchens, supra note 99.

102 Id. at 640.

103 Howson, supra note 95, at 193.

104 Xin Tang, Protecting minority shareholders in China: A task for both legislation and enforcement 143, in in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA (Hideki Kanda, Kon-Sik Kim & Curtis J. Milhaupt eds., 2008).
did not mandate) cumulative voting. In a few respects, however, the reforms eliminated previously existing shareholder protections, such as a mandatory bid rule at a “fair price” upon the acquisition of a 30% stake in a firm.

Notwithstanding the formal improvements to the “law on the books,” the extent to which the new regime will effectively protect minority investors remains to be seen. As the Brazilian example shows, the mere statutory imposition of statutory fiduciary duties is unlikely to provide effective redress against minority abuse if is not accompanied by simultaneous improvements in judicial expertise and enforcement capacity. There is reason to believe that shortcomings in enforcement – which are compounded when the State is the controlling shareholder – may undermine most protections formally conferred by the statute.

The overt influence of the interests of the State as a controlling shareholder on China’s corporate governance environment have been sufficiently conspicuous to attract the attention of legal and economic scholars of Chinese capital markets. Yet this phenomenon is hardly unique to China; rather, it is widespread among jurisdictions in which the State simultaneously serves as a shareholder and corporate governance

105 Id.

106 Id. at 145. See Chapter IV, Part III, supra for a discussion of the costs and benefits associated with the mandatory bid rule.

107 See Chapter IV supra for a detailed discussion of the Brazilian case.

108 Tang, supra note 104, at 147 (arguing that “[p]rotections for the minority shareholders on the books do not seem bad, but legal enforcement remains a problem”).

109 See, e.g., Lin, supra note 80, at 26-7 (“[t]he disadvantages of State ownership have been transposed to the capital market and are even more pronounced when the equity market comprises largely state-owned and controlled listed companies because there is an inherent and often unresolvable conflict between the role of the State as administrator and regulator and its role as a commercial entrepreneur and market player”); Clarke, Privatisation, supra note 81, at 30.
regulator. This Chapter suggests that the State’s pervasive presence in the Chinese economy has only made more severe a problem that is equally common, if more subtle, in Western economies where mixed enterprises play a significant role.

C. Continental Europe

State-owned enterprises, including mixed enterprises, figured prominently in twentieth-century Europe. As showed in Table 3 below, by 1977, 19 (38%) of the top 50 largest industrial companies in Europe were state-owned, and nine (18%) of them were mixed enterprises.110 While the list of top 50 firms included a number of British companies (including wholly-owned government corporations), eight out of the nine largest mixed enterprises were Italian, German or French.111 By mid-2007, state-owned enterprises still accounted for 22% of the capitalization of France’s blue-chip index (CAC40) and 34% of the capitalization of Italy’s blue-chip index (S&P Mib).112 This section will resort to historical vignettes of Italy, Germany and France to explore the extent to which the interests of the State as a shareholder may have influenced the content of corporate laws in these jurisdictions.


111 The other top mixed enterprise of the time was British Petroleum, previously a wholly-owned corporation that had then recently begun to be privatized by the U.K. government.

### Table 3. *Europe’s 50 largest industrial companies (1977)*

Key to public ownership: 1 (none), 2 (up to 25%), 3 (26-50%), 4 (51-75%), 5 (wholly owned)

<table>
<thead>
<tr>
<th>Name</th>
<th>Country of ownership</th>
<th>No. of employees (in ‘000)</th>
<th>Turnover (excl. VAT) $m</th>
<th>Net profit $m</th>
<th>Public ownership (see key)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Royal Dutch Shell</td>
<td>Britain/Holland</td>
<td>115</td>
<td>43,330</td>
<td>2,554</td>
<td>1</td>
</tr>
<tr>
<td>2. British Petroleum</td>
<td>Britain</td>
<td>81</td>
<td>22,867</td>
<td>580</td>
<td>4</td>
</tr>
<tr>
<td>3. Unilever</td>
<td>Britain/Holland</td>
<td>327</td>
<td>17,470</td>
<td>500</td>
<td>1</td>
</tr>
<tr>
<td>4. IRI</td>
<td>Italy</td>
<td>524</td>
<td>15,696</td>
<td>..</td>
<td>5</td>
</tr>
<tr>
<td>5. Philips</td>
<td>Holland</td>
<td>384</td>
<td>13,669</td>
<td>278</td>
<td>1</td>
</tr>
<tr>
<td>6. Veba</td>
<td>West Germany</td>
<td>66</td>
<td>13,013</td>
<td>33</td>
<td>3</td>
</tr>
<tr>
<td>7. Eni</td>
<td>Italy</td>
<td>103</td>
<td>12,838</td>
<td>-167</td>
<td>5</td>
</tr>
<tr>
<td>8. Fiat</td>
<td>Italy</td>
<td>342</td>
<td>12,594</td>
<td>69</td>
<td>1</td>
</tr>
<tr>
<td>9. Siemens</td>
<td>West Germany</td>
<td>319</td>
<td>11,972</td>
<td>307</td>
<td>1</td>
</tr>
<tr>
<td>10. Daimler-Benz</td>
<td>West Germany</td>
<td>169</td>
<td>11,674</td>
<td>233</td>
<td>1</td>
</tr>
<tr>
<td>11. Volskwagen</td>
<td>West Germany</td>
<td>192</td>
<td>11,475</td>
<td>198</td>
<td>3</td>
</tr>
<tr>
<td>12. Com. Française des Pétoles</td>
<td>France</td>
<td>45</td>
<td>11,356</td>
<td>29</td>
<td>3</td>
</tr>
<tr>
<td>13. Hoechst</td>
<td>West Germany</td>
<td>181</td>
<td>11,069</td>
<td>103</td>
<td>1</td>
</tr>
<tr>
<td>14. BASF</td>
<td>West Germany</td>
<td>126</td>
<td>11,013</td>
<td>185</td>
<td>1</td>
</tr>
<tr>
<td>15. Renault</td>
<td>France</td>
<td>243</td>
<td>10,461</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>16. Bayer</td>
<td>West Germany</td>
<td>170</td>
<td>10,163</td>
<td>150</td>
<td>1</td>
</tr>
<tr>
<td>17. Nestle</td>
<td>Switzerland</td>
<td>140</td>
<td>9,997</td>
<td>413</td>
<td>1</td>
</tr>
<tr>
<td>18. Thyssen</td>
<td>West Germany</td>
<td>134</td>
<td>9,366</td>
<td>74</td>
<td>1</td>
</tr>
<tr>
<td>19. Electricity Council</td>
<td>Britain</td>
<td>159</td>
<td>9,109</td>
<td>253</td>
<td>5</td>
</tr>
<tr>
<td>20. Peugeot-Citroen</td>
<td>France</td>
<td>185</td>
<td>8,901</td>
<td>249</td>
<td>1</td>
</tr>
<tr>
<td>21. ICI</td>
<td>Britain</td>
<td>154</td>
<td>8,888</td>
<td>431</td>
<td>1</td>
</tr>
<tr>
<td>22. Elf-Aquitaine</td>
<td>France</td>
<td>37</td>
<td>8,908</td>
<td>375</td>
<td>4</td>
</tr>
<tr>
<td>23. Ini</td>
<td>Spain</td>
<td>225</td>
<td>7,976</td>
<td>-158</td>
<td>5</td>
</tr>
<tr>
<td>Name</td>
<td>Country of ownership</td>
<td>No. of employees (in '000)</td>
<td>Turnover (excl. VAT) $m</td>
<td>Net profit $m</td>
<td>Public ownership (see key)</td>
</tr>
<tr>
<td>------------------------------------------</td>
<td>----------------------</td>
<td>-----------------------------</td>
<td>--------------------------</td>
<td>---------------</td>
<td>-----------------------------</td>
</tr>
<tr>
<td>24. Electricité de France</td>
<td>France</td>
<td>101</td>
<td>7,681</td>
<td>144</td>
<td>5</td>
</tr>
<tr>
<td>25. BAT Industries</td>
<td>Britain</td>
<td>152</td>
<td>7,397</td>
<td>400</td>
<td>1</td>
</tr>
<tr>
<td>26. ITT Europe</td>
<td>U.S.</td>
<td>204</td>
<td>7,226</td>
<td>..</td>
<td>1</td>
</tr>
<tr>
<td>27. Cie Générale de Electricité</td>
<td>France</td>
<td>170</td>
<td>6,943</td>
<td>58</td>
<td>1</td>
</tr>
<tr>
<td>28. AEG-Telefunken</td>
<td>West Germany</td>
<td>158</td>
<td>6,787</td>
<td>-5</td>
<td>1</td>
</tr>
<tr>
<td>29. St. Gobain-Pont-a-Mousson</td>
<td>France</td>
<td>159</td>
<td>6,764</td>
<td>137</td>
<td>1</td>
</tr>
<tr>
<td>30. Montedison</td>
<td>Italy</td>
<td>135</td>
<td>6,019</td>
<td>-501</td>
<td>$3^{113}$</td>
</tr>
<tr>
<td>31. British Steel</td>
<td>Britain</td>
<td>197</td>
<td>6,011</td>
<td>-857</td>
<td>5</td>
</tr>
<tr>
<td>32. Gutehoffnungshutte</td>
<td>West Germany</td>
<td>84</td>
<td>5,732</td>
<td>45</td>
<td>1</td>
</tr>
<tr>
<td>33. RWE</td>
<td>West Germany</td>
<td>58</td>
<td>5,640</td>
<td>190</td>
<td>$3^{114}$</td>
</tr>
<tr>
<td>34. Empain-Schneider</td>
<td>France</td>
<td>134</td>
<td>5,631</td>
<td>..</td>
<td>1</td>
</tr>
<tr>
<td>35. Mannesmann</td>
<td>West Germany</td>
<td>106</td>
<td>5,565</td>
<td>102</td>
<td>1</td>
</tr>
<tr>
<td>36. Pechiney-Ugine-Kuhlmann</td>
<td>France</td>
<td>97</td>
<td>5,519</td>
<td>80</td>
<td>1</td>
</tr>
<tr>
<td>37. Fried. Krup</td>
<td>West Germany</td>
<td>87</td>
<td>5,306</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>38. Ruhrkohle</td>
<td>West Germany</td>
<td>143</td>
<td>5,214</td>
<td>$\frac{1}{2}$</td>
<td>$2^{115}$</td>
</tr>
<tr>
<td>39. Nat. Coal Board</td>
<td>Britain</td>
<td>303</td>
<td>5,209</td>
<td>39</td>
<td>5</td>
</tr>
<tr>
<td>40. Rhone-Poulenc</td>
<td>France</td>
<td>111</td>
<td>5,017</td>
<td>18</td>
<td>1</td>
</tr>
<tr>
<td>41. British Leyland</td>
<td>Britain</td>
<td>195</td>
<td>4,959</td>
<td>-99</td>
<td>5</td>
</tr>
<tr>
<td>42. Ciba-Geigy</td>
<td>Switzerland</td>
<td>74</td>
<td>4,946</td>
<td>209</td>
<td>1</td>
</tr>
<tr>
<td>43. Petrofina</td>
<td>Belgium</td>
<td>23</td>
<td>4,912</td>
<td>153</td>
<td>1</td>
</tr>
<tr>
<td>44. Ford-Werke</td>
<td>U.S.</td>
<td>56</td>
<td>4,828</td>
<td>275</td>
<td>1</td>
</tr>
<tr>
<td>45. Dunlop-Pirelli</td>
<td>Britain/Italy</td>
<td>169</td>
<td>4,622</td>
<td>..</td>
<td>1</td>
</tr>
</tbody>
</table>

113 The controlling syndicate should have a 50:50 public/private sector make-up when it is re-formed – exact position not known.

114 Local authorities have voting control but the majority of the capital is in private hands.

115 Indirect public holding via Salzgitter and Veba.
### Table

<table>
<thead>
<tr>
<th>Name</th>
<th>Country of ownership</th>
<th>No. of employees (in '000)</th>
<th>Turnover (excl. VAT) $m</th>
<th>Net profit $m</th>
<th>Public ownership (see key)</th>
</tr>
</thead>
<tbody>
<tr>
<td>46. Akzo</td>
<td>Holland</td>
<td>84</td>
<td>4,576</td>
<td>-73</td>
<td>1</td>
</tr>
<tr>
<td>47. GEC</td>
<td>Britain</td>
<td>191</td>
<td>4,466</td>
<td>185</td>
<td>1</td>
</tr>
<tr>
<td>48. Estel</td>
<td>West Germany/ Holland</td>
<td>78</td>
<td>4,447</td>
<td>-183</td>
<td>2</td>
</tr>
<tr>
<td>49. DSM</td>
<td>Holland</td>
<td>33</td>
<td>4,445</td>
<td>48</td>
<td>5</td>
</tr>
<tr>
<td>50. Imperial Group</td>
<td>Britain</td>
<td>96</td>
<td>4,384</td>
<td>204</td>
<td>1</td>
</tr>
</tbody>
</table>

*Source: The Economist (1978)*

### Italy

Historically, controlling families and the State have dominated the corporate landscape in Italy. As capital markets declined after a 1907 liquidity crisis, the State gradually took over industries that had previously been run by private companies, such as railroads, banks, and insurance. In the 1930s, adverse economic conditions prompted an even greater incursion of the State into business activity.

Established in 1933, the *Istituto per la Ricostruzione Industriale* (IRI) would become the government-owned holding company of the State’s equity interests in various banks and industrial corporations, including listed firms.\(^{116}\) In the wake of Italy’s defeat in World War II, the Allied forces regarded the continuing role of state-owned enterprises

---

\(^{116}\) For an excellent description of the evolution of corporate governance and ownership structures in Italy, see Guido Ferrarini, *Corporate Governance Changes in the 20th Century: A View from Italy*, in *CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES, AND MARKETS IN EUROPE, JAPAN, AND THE US* (Klaus Hopt et al. eds., 2005). By taking over the entire equity capital of troubled mixed banks in 1933, the IRI immediately became the holder of more than 20% of the equity of limited companies then in existence in Italy. See Fabrizio Barca & Sandro Trento, *State Ownership and the Evolution of Italian Corporate Governance*, *6 industrial & corp. change* 533, 547 (1997).
as an effective instrument for the country’s reconstruction and development.\footnote{Fabrizio Barca et al., Post-War Institutional Shocks: The Divergence of Italian and Japanese Corporate Governance Models (1998), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=217572 (attributing the differences in the outcome in Japan and Italy’s corporate governance regimes to the different developmental policy preferences of the Allied forces in the post-war period).} The upshot is that, though initially envisioned as a temporary response to economic emergency, State ownership would form, together with family control of corporations, a stable equilibrium for the most part of the twentieth century. As in other jurisdictions, mixed enterprises in Italy were for the most part subject to the same corporate law regime applicable to private sector corporations.\footnote{Maria Teresa Cirenei, Riforma delle Società, Legislazione Speciale e Ordinamento Comunitario: Brevi Riflessioni sulla Disciplina Italiana delle Società per Azioni a Partecipazione Pubblica, 19 DIRITTO DEL COMMERCIO INTERNAZIONALE: PRATICA INTERNAZIONALE E DIRITTO INTERNO 41, 43 (2005) (noting that, save for a few minor deviations from standard corporate law rules, such as the ability of the government to directly appoint firm managers, there has been no structurally and functionally distinct legal regime applicable to mixed enterprises in Italy).}

As the Italian system of corporate governance consolidated into a model of State and family capitalism, attempts to increase investor protections and develop capital markets stalled. A call by leading corporate law jurist Tullio Ascarelli (who was for some time a refugee in Brazil) for legal reforms improving the protection afforded to minority shareholders was ignored for nearly two decades, and then only modestly implemented.\footnote{Tullio Ascarelli, I problemi delle società anonime per azioni, 1956 RIVISTA DELLE SOCIETÀ 3 et seq., cited by Ferrarini, supra note 116, at 39-40.} A “mini-reform” to the corporations’ law of 1974 created a U.S.-inspired Securities Commission (Commissione Nazionale per le Società e la Borsa – Consob), but otherwise failed to meaningfully protect or empower minority shareholders.

In their empirical study on the evolution of corporate ownership in Italy, Alexander Aganin and Paolo Volpin find that, after controlling for other relevant
channels, stock market development is positively correlated with investor protection and openness but negatively correlated with government intervention.\textsuperscript{120} They interpret this finding as evidence that State ownership operates as a substitute for capital markets, arguing that “direct intervention by the State as an entrepreneur partially replaced and crowded out the role of the private sector in the accumulation of capital.”\textsuperscript{121} However, as the authors themselves concede, the relationship between government ownership and listed companies is not a linear one by which every nationalization translates into an automatic decrease in the number of listed firms. Instead, their data reveals a more complex and indirect relationship between these variables.\textsuperscript{122}

Mixed enterprises were quite significant in twentieth-century Italy, accounting for 18% of the number of listed firms and over 25% of total market capitalization by 1992.\textsuperscript{123} Although entirely absent from Aganin and Volpin’s study, the potential of the State as a controlling shareholder to influence corporate lawmaking supplements their account by providing another possible causal link between State presence and legal investor protection which, in turn, facilitates capital market development. The influence of the State over the degree of legal protection afforded to minority shareholders is supported by the authors’ narrative, according to which the greatest improvements in investor protection occurred precisely at the same time as the State was retreating from corporate

\textsuperscript{120} Aganin & Volpin, \textit{supra} note 18, at 342.

\textsuperscript{121} \textit{Id.} at 326.

\textsuperscript{122} \textit{Id.} at 342.

\textsuperscript{123} Andrea Goldstein, \textit{Privatization in Italy}, \textit{in PRIVATIZATION EXPERIENCES IN THE EUROPEAN UNION} 256 (Marko Köthenbürger, Hans-Werner Sinn & John Whalley eds., 2006).
ownership during the privatization process, since “the government coupled the sale of assets with substantial improvement of the legal protection for minority shareholders.”

Some of the new investor protections came in the form of amendments to the Corporations Law, which applied to both government and privately owned firms, but others were made applicable to privatized firms alone, thus showing that the State was more interested in maximizing its own proceeds from stock issuances in privatized companies than in improving the general corporate governance environment. The special rules applicable only to privatized firms included the right to appoint one-fifth of the company’s directors and the establishment of proxy voting by mail.

The Italian case thus raises the question of why the interests of the government as a selling shareholder in the privatization process contributed to greater investor protection and capital market development in Italy when it had precisely the opposite effect in Brazil. One possible explanation – namely, that the Italian government was more inclined to respect minority shareholder rights to begin with – does not find support in the evidence. In the late 1980s and the 1990s, Italian law permitted controlling shareholders, including the State, to extract extraordinary levels of private benefits to the detriment of minority investors.

---

124 Aganin & Volpin, supra note 18, at 327.


126 Id.

127 See Chapter IV, Part III.

128 Alexander Dyck & Luigi Zingales, Private Benefits of Control: An International Comparison, 69 J. FIN. 537, 551 (2004) (finding that Italy had an estimated level of private benefits of control of 37% of firm value, compared to 65% in Brazil); Luigi Zingales, The Value of the Voting Right: A Study of the Milan
Luigi Zingales provides strong anecdotal evidence suggesting that, like private controlling shareholders, the Italian government profited handsomely by engaging in abusive related-party transactions to the detriment of minority investors. In 1992, the IRI, which is 100% owned by the Italian government, transferred its 83.3% equity stake in software company Finsiel to the telecommunications group STET, a mixed enterprise that is 47% owned by small investors but also controlled by the IRI. Even though Finsiel was soon to lose its monopoly position and face increased competition because of then new EEC regulations, the company was priced at 50 times its earnings – a generous valuation compared to a standard multiple of 20 or 30 in similar international transactions. STET’s stock price fell by 20% upon the announcement of the transaction. Zingales estimates that this single transaction resulted in a wealth transfer from minority shareholders to the government in the amount of at least $110 million, or 7% of the equity value held by outside investors.129

Another possible explanation for the divergent outcomes in Brazil and Italy is the difference in the number and scale of enterprises under whole versus partial State ownership in the two countries – the theory being that greater private capital participation in SOEs increases incentives for minority expropriation, while a sale of wholly-owned subsidiaries makes it impossible for the State to maximize revenue by tinkering with the intra-shareholder distribution of sales proceeds, and therefore encourages the adoption of measures that maximize firm value. Since Brazil’s largest and most profitable state-

\[\text{Stock Exchange Experience, 7 REV. FIN. STUD. 125, 127 (1994) (finding that between Italy private benefits of control were worth more than 60 percent of the value of the non-voting stock).}\]

129 Zingales, supra note 128, at 147.
owned firms were publicly traded (such as telecom Telebras, mining firm Vale do Rio Doce, among others), the government stood to profit by expropriating the minority in a control sale. By contrast, a number of important state-owned enterprises to be privatized in Italy were still wholly-owned subsidiaries of the State and organized under public law, thus allowing the government to internalize the benefits of an improved corporate governance environment in the form of higher sales proceeds.130

The stated goals of the privatization process in Brazil and Italy are still another factor that may account for the different outcomes in both jurisdictions. Brazil’s privatization statute listed a number of competing objectives – such as the reduction of public debt through privatization proceeds and the development of capital markets, among others – without establishing any order of priority.131 Conversely, the Libro Verde sulle Partecipazioni dello Stato, presented before Parliament in 1992, listed (i) greater corporate efficiency, (ii) increases in market competition and (iii) the development of financial markets as the three main goals of Italy’s privatization program. The increase of fiscal revenues and the reduction of public debt were specifically ranked as “residual” or secondary objectives.132 This suggests that privatization programs that include mixed enterprises may be more conducive to the enactment of laws that improve


131 See Chapter IV, Part III.

investor protection and corporate governance standards precisely when revenue-maximization is not the sole or foremost objective.

Finally, there were more share issue privatizations in Italy than in Brazil, perhaps because Italy’s policymakers placed a higher priority on capital market development as one of the goals of the privatizations process. Although there were a number of block sales to strategic investors in the early 1990s, public share offerings became the dominant sales method in Italy after 1994.133 And maximizing sales proceeds through public offerings requires increased investor confidence, which in turn encouraged the government to promote legal reforms that improved protections for minority investors.

In assessing the changes in Italy’s corporate governance regime in the last decades, Luca Enriques concludes that, while Italy is now a better place for minority shareholders than it was in the early 1990s, further improvements remain necessary, particularly with respect to enforcement. While the watershed Draghi Law and subsequent reforms have increased minority shareholder rights, the process was not without setbacks. The initially enthusiastic adoption of the E.U. Takeover Bids Directive in 2007 was reversed in short order by a subsequent and more protectionist administration. Even the overall investor friendly reform of 2003 was in fact “a step backward in terms of ensuring effective enforcement of corporate governance laws.”134

Despite recent corporate governance improvements and the implementation of a large-scale and generally successful privatization program, the continued presence of the

133 Goldstein, supra note 123, at 233.

134 Enriques, supra note 125.
government as a shareholder in Italy provides reason for concern.\textsuperscript{135} If, at €121.3 billion, the aggregate revenues of Italy’s privatizations are significant by international standards, the share of proceeds resulting from control transfers (€50.4 billion) presents a different picture.\textsuperscript{136} Although the State’s overall equity interest in publicly-traded companies has nearly halved since the 1990s (Table 5), government control of listed firms of mixed enterprises in Italy remains significant despite the wave of privatizations (Table 6), which suggests that the conflict of interest stemming from the State’s dual role as shareholder and regulator is likely to persist.

Table 4. State ownership of listed firms in Italy

<table>
<thead>
<tr>
<th></th>
<th>1990</th>
<th>1998</th>
<th>2001</th>
<th>2003</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average State ownership in Italian capital markets</td>
<td>12%</td>
<td>4.5%</td>
<td>3.9%</td>
<td>4.9%</td>
<td>4.4%</td>
</tr>
<tr>
<td>Weighted average State ownership in listed firms (by market capitalization)</td>
<td>18.1%</td>
<td>8.8%</td>
<td>10.8%</td>
<td>11.4%</td>
<td>9.5%</td>
</tr>
</tbody>
</table>


\textsuperscript{135} For an assessment of privatizations in Italy, see William Megginson & Dario Scannapieco, The Financial and Economic Lessons of Italy’s Privatization Program, 18 J. APPLIED CORP. FIN. 56, 56 (2006) (concluding that “by any measure, Italy’s program must be considered a huge success”).

\textsuperscript{136} Goldstein, supra note 130, at 9. See also Italy’s Unfinished Business, THE ECONOMIST, Oct. 12, 2000 (“privatisation became little more than a convenient mechanism for raising large sums of cash without giving up control of the companies concerned. By retaining big minority stakes or golden shares, successive governments have kept their capacity to meddle”).
Table 5. \textit{Listed firms under State control in Italy}

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of firms</td>
<td>21</td>
<td>17</td>
<td>15</td>
<td>17</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>% of market capitalization</td>
<td>45%</td>
<td>18%</td>
<td>15.6%</td>
<td>18.7%</td>
<td>18.5%</td>
<td>22.4%</td>
</tr>
</tbody>
</table>

\textit{Source:} Consob (2001)

\textit{ii. France}

Famous for its \textit{dirigiste} approach to economic policy, France boasted a large number of state-owned and mixed enterprises (\textit{sociétés d'économie mixte}) throughout the twentieth century. As elsewhere, the wave of privatizations starting in the 1980s significantly reduced, but did not by any means eliminate, the State’s equity holdings.\footnote{See OCDE, \textit{ÉTUDES ÉCONOMIQUES DE L'OCEDE: FRANCE} 44 (2005) (noting that even after the privatizations, the presence of state-owned enterprises in France is comparatively greater than in other OECD countries).}

As recently as 2004, France established a special Government Shareholding Agency (\textit{Agence des participations de l'État - APE}) in charge of specifically representing the interests of the State as a corporate shareholder (\textit{l'État actionnaire}), as separate and different from the government’s regulatory function.\footnote{For a detailed description, see http://www.ape.minefi.gouv.fr/sections/qu_est_ce_que_l_ape/}.

Perhaps to an even greater extent than Brazil, conventional state-owned enterprises were virtually non-existent in France until the twentieth century. In the few instances in which the State engaged in economic activity in the nineteenth century, it did...
so directly – as in the case of its tobacco monopoly (1810) and the postal service (1815) – without resorting to a separate business entity. ¹³⁹ Mixed enterprise first appeared in France in the interwar period in imitation of or as direct heritage from foreign (notably German) experience. ¹⁴⁰ Both ideological considerations (the rise of socialism and nationalism) and external factors contributed to the rise of state-owned enterprise in France. War reparations and the return of Alsace-Loraine had the result of transferring to the State economic assets which it then allocated to companies in which it held a minority stake or to government departments.¹⁴¹

Some mixed enterprises date back to the 1920s, while others, such as Renault and Francolor, were taken over as enemy property following World War II.¹⁴² The French government initially participated as a minority investor in the first mixed enterprises of the 1920s, although majority State control gradually became the norm in most sociétés d’économie mixte in the following years.¹⁴³ While the French government held a 25% equity stake in Compagnie Française des Pétroles in 1925, by 1931 its participation had

¹³⁹ ANDRÉ DELION, DROIT DES ENTERPRISES ET PARTICIPATIONS Publiques 13 (2003) (citing the Compagnie du chemin de fer de l’Etat of 1887 as the only example of public enterprise in its modern meaning in nineteenth century France).


¹⁴¹ DELION, supra note 139, at 14.


¹⁴³ BREDIN, supra note 140, at 47-8.
risen to 35%. Similarly, the government owned 25% of Air France’s stock in 1932, but by 1948 it held approximately 70% of its shares.\textsuperscript{144}

The interests of the French State as shareholder have also shaped the legal regime applicable to business corporations (sociétés anonymes). Already in the 1950s, French commercial law scholar Roger Houin warned that the emergence of mixed enterprises could impact corporate laws by strengthening the public law character of its rules.\textsuperscript{145} The very institutional orientation of France’s corporate law toward the “interests of the corporation” (intérêt social) – as opposed to the interests of shareholders that arguably dominate U.S. law – is well suited to state-owned enterprises.\textsuperscript{146} However, it is in the area of shareholder voting rights that the interests of the French State were more explicit and influential over time.

Multi-voting stock became popular for the first time in France in the early 1920s, a time in which the devaluation of the franc vis-à-vis other currencies turned French corporations into vulnerable targets for foreign takeovers. The French government led the way by issuing super-voting shares to itself in the Société française de Navigation rhénane and the Compagnie des chemins de fer du Maroc in the 1920s.\textsuperscript{147} Consistent

\textsuperscript{144} \textit{Id.}

\textsuperscript{145} See Roger Houin, \textit{La gestion des entreprises publiques et les methods de droit commercial, in ARCHIVES DE PHILOSOPHIE DU DROIT (La Distinction du Droit Privé et du Droit Public et L’Entreprise Publique) 81 (1952) (arguing that the emergence of state-owned enterprises can impact commercial laws by enhancing the public law character of its rules). Houin also cites Vedel for the proposition that “L’Etat a « exproprié les capitalistes non seulement de leurs entreprises, mais de leur expérience et de leurs recettes ». \textit{Id.}

\textsuperscript{146} See, e.g., James A. Fanto, \textit{The Role of Corporate Law in French Corporations, 31 CORNELL INT’L L. J. 31, 47 (1998) (“t]he concept of the intérêt social, which permeates the French corporate code, permits directors to consider the interests of all constituencies in deciding upon corporate strategy… [allowing] the State-owner to use controlled corporations for purposes other than profit-making”).

\textsuperscript{147} HENRI MAZEAUD, \textit{LE VOTE PRIVILÉGIÉ DANS LES SOCIÉTÉS DE CAPITAUX} (2nd ed., 1929).
with the symbiotic relationship between State and family control, the government also encouraged private companies to follow suit.\textsuperscript{148} As put by France’s Commerce Minister, “I do not believe to be giving away any secret when I say that the government has not frowned upon the creation of multi-voting stock in defense of large French enterprises.”\textsuperscript{149}

The unregulated issuance of multi-voting stock, highly controversial from the outset, would not be long-lasting. A statute enacted in the 1930s prohibited new issuances of multi-voting stock, but grandfathered existing securities to ensure State control over certain companies. A few years later, a 1934 statute finally prohibited the indiscriminate issue of multi-voting stock in \textit{all} firms, including existing ones, but specifically exempted from this provision certain corporations in which the State held a special interest.\textsuperscript{150}

In lieu of conventional multi-voting stock, France instituted its now traditional regime of “tenured” double voting rights. This means that, while French law facially prohibits the issuance of different classes of common stock providing for differential voting rights, it permits corporate charters to grant double voting rights to registered shareholders who have held their shares for a minimum period of two to four years. The stated purpose of this regime is to give a loyalty premium to long-term shareholders, whose interests are supposedly better aligned with those of the company. A practical

\textsuperscript{148} \textit{Id.} at 10.

\textsuperscript{149} \textit{Id.} at 51.

\textsuperscript{150} See Harold H. Neff, \textit{A Civil Law Answer to the Problem of Securities Regulation}, 28 \textit{Va. L. Rev} 1025, 1051 (1942) (describing the adoption of the 1930 and 1933 statutes banning the issuance of stock granting special voting rights).
effect of this rule is however to magnify the voting power of the State, which is, almost
by definition, a long-term holder.  

Charter provisions conferring double voting rights are standard practice among
French corporations up to this day, despite evidence that they facilitate expropriation of
minority shareholders. This rule also benefits controlling shareholders of private
firms, who have fiercely resisted proposals to adopt an unqualified regime of one-share,
one-vote. The French government is said to have forcefully and successfully defended
the exemption of double voting rights from the E.U. takeover directive, which otherwise
prevents the use of multi-voting stock or capped voting as takeover defenses.

iii. Germany

In the twentieth century, mixed enterprises (gemischtwirtschaftliche
Unternehmen) were first popularized in Germany, but later spread rapidly across Europe
and beyond. In the first decade of the twentieth century, partial ownership by

151 See Henry Hansmann & Reinier Kraakman, The Basic Governance Structure, in THE ANATOMY OF
CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 56 (Reinier H. Kraakman & Henry
Hansmann eds., 2004) (noting that the award of double voting rights “serves to deter takeovers and
enhances the power of the State as a shareholder”).

152 Edith Ginglinger & Jacques Hamon, Ownership, Control and Market Liquidity 11 (2007), available at
http://ssrn.com/abstract=1071624 (finding that double voting rights are used by over 70% of France’s
CAC40 corporations); Chiraz Ben Ali, Disclosure and Minority Expropriation: A Study of French Listed

153 Ben Clift, The Political Economy of the Market for Corporate control in France and the Hamstrung
Harmonisation of European (and French) Corporate Governance (working paper, 2008), available at

154 Trajano de Miranda Valverde, Sociedades Anónimas ou Companhias de Economia Mista, 1 REVISTA DE
DIREITO ADMINISTRATIVO 429, 433 (1945). See also HENRI ZWAHLEN, DES SOCIÉTÉS COMMERCIALES
AVEC PARTICIPATION DE L’ÉTAT 65 (1935) (attributing the great popularity enjoyed by mixed enterprises in
Germany to political reasons, as the adoption of the private corporate form arguably served to
“camouflage” the socializing ambitions of the German State).
municipalities emerged as a response to the rapid advance of private utility companies. By 1930, mixed corporations accounted for approximately one-third of total electricity supply in Germany.155

Interestingly, Germany is widely recognized as the birthplace of modern institutional theories of the business corporation, according to which the purpose of the firm is not merely to maximize shareholder value, but rather to satisfy the public interest. For Walther Rathenau, a prominent German industrialist and statesman whose work is cited by Berle and Means, “[t]he depersonalization of ownership, the objectification of enterprise, the detachment of property from the possessor, leads to a point where the enterprise becomes transformed into an institution which resembles the state in character.”156 The relationship between theories of corporate purpose and ownership structure is likely to be a complex one, but it is at least suggestive that conceptions as state-like entities in charge of promoting the public good first gained ascendancy precisely in the jurisdiction that led the way in the use of mixed enterprises.

Even though the general appeal and popularity of privatization programs owe much to the British experience under Margaret Thatcher, Germany was in many ways also a pioneer in the privatization movement. The very English term “privatization” traces back to 1930s Germany, when the National Socialist Party engaged in a comprehensive strategy of reprivatization (Reprivatisierung) of state monopolies in order

---


156 See WALTHER RATHENAU, IN DAYS TO COME 120-121 (1921), quoted by Berle & Means, supra note 78, at 309.
obtain the support of the business sector to the regime.\textsuperscript{157} In more conventional terms, however, it was during the Adenauer administration in the 1960s that Germany engaged in its first “ideologically-motivated” sale of state-owned enterprises such as Volkswagen and VEBA to small investors.\textsuperscript{158}

As in Italy and France, the interests of the government as a shareholder have played a visible role in Germany’s corporate lawmaking process. As in France, public authorities supported deviations from the one-share-one-vote standard in order to maintain or magnify their own influence as corporate shareholders. A 1965 corporate law reform failed to outlaw the issuance of multi-voting stock because of strong opposition from local authorities, who used special shares to exert a degree of control disproportionate to their capital contributions.\textsuperscript{159} In the 1990s, when Germany moved for the first time to adopt a broad one-share-one-vote rule, regional and local governments once again resisted the loss of influence that was expected to result from the adoption of proportional voting rights. The statute as enacted was the result of a political compromise.\textsuperscript{160}


\textsuperscript{159} Ulrich Seibert, \textit{Control and Transparency in Business (KonTraG): Corporate Governance Reform in Germany}, 10 EUR. BUS. L. REV. 70, 72 (1999) (noting that the failure to eliminate super-voting stock “served to take account of the interests of local authorities, which wished to retain their influence on corporate policy by means of multiple-voting shares without needing to participate in necessary capital increases”).

\textsuperscript{160} See Sigurt Vitols, \textit{From Banks to Markets: The Political Economy of Liberalization of the German and Japanese Financial Systems, in THE END OF DIVERSITY? PROSPECTS FOR GERMAN AND JAPANESE CAPITALISM} 223 (Kozo Yamamura & Wolfgang Streeck eds., 2003) (“KonTraG was passed when these provisions were changed and thus opposition was dropped”); Susanne Lütz, \textit{From Managed to Market Capitalism? German Finance in Transition}, 9 GERMAN POLITICS 149 (2000) (noting that “[a]gainst the
Kontrolle und Transparenz im Unternehmensbereich – KonTraG) of 1998 prohibited voting caps and multi-voting rights, contrary provisions contained in special statutes on mixed enterprises – notably the Volkswagen law, which imposed voting caps and granted veto rights to the state of Lower Saxony – remained unaffected by the new legislation.¹⁶¹

The interests of the German government as a shareholder also played an important part in the promotion of a “shareholder culture” in connection with its privatization process in the 1990s, of which the record-breaking IPO of Deutsche Telekom, in what was the largest public offering in European history, is a prominent example. A key government objective behind the sale of its stake in Deutsche Telekom was to maximize revenue so as to help Germany meet the budget requirements for the Economic and Monetary Union. Nevertheless, as in Italy, but in sharp contrast to Brazil, the profit-maximizing ambitions of the German government led it to support, rather than suppress, outside investor rights.¹⁶²

initial plans of the Justice Ministry,” the Volkswagen law remained intact follow the adoption of the KonTraG”).

¹⁶¹ Nonetheless, the European Court of Justice has subsequently challenged the validity of the Volkswagen law. See Case C-112/05 Commission v. Germany [2007] E.C.R. I-8995 (finding that the special shareholder rights of the State of Lower Saxony provided by the Volkswagen law violate the E.U. principle of free movement of capital). For a discussion of the case and its legal implications, see Wolf-Georg Ringe, Company Law and Free Movement of Capital, 69 CAMBRIDGE L. J. 378 (2010). For a recent decision by the European Court of Justice holding Portugal’s golden shares in Energias de Portugal as illegal under E.U. law as “an unjustified restriction on free movement of capital,” see Case C-543/08, Commission v. Portugal [2010].

¹⁶² For a description of the impact of the Deutsche Telekom privatization on the corporate governance environment in Germany, see Jeffrey N. Gordon, The International Relations Wedge in the Corporate Convergence Debate, in CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 166-87 (Jeffrey N. Gordon & Mark J. Roe eds., 2004) (“[t]he Telekom privatization in turn led the German government, eager to obtain a high price, to promote shareholder capitalism by cultural, market, and legal intervention”). But see, for an earlier and less optimistic assessment of the transaction by the same author, Jeffrey N. Gordon, Deutsche Telekom, German Corporate Governance, and the Transition Costs of Capitalism, 1998 COLUM. BUS. L. REV. 187, 188 (arguing that “the Telekom offering does not take the idea of a shareholding culture very far”).
As in Italy but in contrast to Brazil, the more benign role of the German government in the corporate governance reform process was not the product of good intentions alone, but was rather facilitated by the ownership structure of the firms to be privatized. In Brazil, the crown jewels among the state-owned enterprises were already listed on the exchange and had a substantial number (often a majority) of public shareholders – which permitted the government to profit financially by exploiting the minority and appropriating the control premium to itself. By contrast, Deutsche Telekom was previously a wholly-owned subsidiary of Germany’s national government, and it soon became clear that a flotation of the company in a good corporate governance environment would maximize the government’s revenue from privatization. As explained by Jeffrey Gordon, “public shareholder protection thus became politically popular and fiscally prudent.”

III. Corporate Governance after the Wave of Privatizations

The foregoing case studies have illustrated how the interests of the State as shareholder in different historical and legal contexts have played a key role in shaping the corporate law regimes applicable to both public and private firms. This section speculates on whether and to what extent the (relative) retreat of State ownership

163 Id. at 187. Nonetheless, the main corporate governance improvements that helped attract retail investor interest to Germany’s capital markets following the IPO of the Deutsche Telekom were not supplied by public law, but rather by stock exchange listing standards. The Neuer Markt was a special listing segment targeting high-tech firms and requiring stricter corporate governance standards than corporate statutes and the standard exchange listing rules. For an examination of the political economy and legal mechanisms associated with the rise and fall of the Neuer Markt, see Ronald J. Gilson, Henry Hansmann & Mariana Pargendler, Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the U.S. and the EU, 63 STAN. L. REV. (forthcoming 2011).
worldwide following the wave of privatizations in the 1980s and 1990s has impacted the political economy of corporate governance and, consequently, the observed levels of capital market development.

It is now well established that the implementation of privatization strategies and rising levels of capital market activity worldwide in the late 1980s and 1990s were roughly contemporaneous.\textsuperscript{164} Just as the international wave of privatizations reached its apex, equity markets around the globe experienced unprecedented growth. A study by Maria Boutchkova and William Megginson shows that the increase in market capitalization and liquidity levels in non-U.S. markets, where privatizations were most common, far exceeded the contemporaneous financial boom experienced in the U.S. Non-U.S. markets saw a 12-fold increase in market capitalization and a 20-fold increase in trading volumes between 1983 and 1999. Increases in market capitalization and trading volumes in developing countries were even greater, at 26 times and 92 times, respectively, during the same period.\textsuperscript{165}

While the privatization literature initially focused on the effects of ownership changes on firm-level performance, the temporal coincidence between the implementation of privatizations strategies and the expansion of global equity markets

\textsuperscript{164}See Bernardo Bortolotti, Frank de Jong, Giovanna Nicodano & Ybolia Schindele, \textit{Privatization and Stock Market Liquidity}, 31 J. BANKING \& FIN. 297, 298 (2007) ("[a] remarkable wealth of evidence shows the correlation between financial market development and privatization"); Narjess Boubakri \& Olfa Hamza, \textit{The Dynamics of Privatization, the Legal Environment and Stock Market Development}, 16 INT. REV. FIN. ANALYSIS 304 (2007) (finding that while privatizations have no simultaneous effect on the development of equity markets, it has a lagged effect of one or two years depending on the quality of the legal regime, the privatization method, and the intensity or depth of the privatizations strategy).

\textsuperscript{165}For these and other detailed data on the development of capital markets worldwide during the 1990s, and the role played by share issue privatizations, see Maria K. Boutchkova \& William L. Megginson, \textit{Privatization and the Rise of Global Capital Markets}, 29 FIN. MANAGEMENT 31 (2000).
has recently begun to attract scholarly attention. To be sure, the association between privatization and capital market growth is hardly surprising. The very withdrawal of the State as a source of equity and debt financing (through the privatization of government-owned banks) was reasonably expected to increase demand for private financing sources. Moreover, many, if not most, privatization programs worldwide were specifically devised to promote the development of local capital markets.166 A number of jurisdictions opted to privatize state-owned firms through public share offerings or share issue privatizations (SIPs), in which the very divestiture of government shareholdings directly contributed to increase liquidity and market capitalization of local exchanges. By mid-2000, all of the ten largest (and 30 out of the top 34) stock offerings in history were the result of share issue privatizations.167

Nevertheless, the floating of state-owned enterprises on stock markets – which represents a direct contribution of privatizations to capital market development – accounts for only a minor fraction of the growth in capital markets worldwide during the period.168 Economists Enrico Perotti and Pieter van Oijen have suggested that privatizations may have contributed to capital market development indirectly, through a decrease in discount rates and new stock issuances. They provide some initial empirical

166 Id. at 31 (“[a]lthough governments usually adopt privatization programs primarily to raise revenue, and in order to improve the economic efficiency of former state-owned enterprises, most also hope that privatizations implemented through public share offerings will develop their national stock markets”).

167 Id. at 50. Bortolotti et al., supra note 164, find that share issue privatizations contribute to the development of capital markets by increasing market liquidity.

evidence to support the view that privatizations have an indirect effect on capital market development by helping decrease “political risk,” suggesting that, prior to a privatization sale, governments are uniquely motivated to improve the regulatory framework and strengthen private property rights which, in turn, helps create the institutional preconditions for capital market growth.  

Another plausible but overlooked mechanism through which privatizations might have indirectly contributed to capital market development is by facilitating the adoption of stronger investor protection laws. The 1990s were not only the golden age of privatizations, but also a period of significant global convergence in corporate governance practices and corresponding improvements in the observed level of shareholder rights. In a study of five large economies, John Armour et al. find that, while the level of legal protection of minority shareholders was diverging until the late 1980s, there was significant convergence towards greater investor protection since the mid-1990s – a trend that was not matched by similar levels of convergence in creditor rights and labor regulations. By the turn of the century, Henry Hansmann and Reinier Kraakman argued provocatively that “there is no longer any serious competitor to the

169 Specifically, Perotti and van Oijen argue that privatization helps reduce a country’s political risk, and political risk, in turn, is correlated with capital market development. Id. at 44-45. See also Enrico C. Perotti & Luc Laeven, Confidence Building in Emerging Stock Markets (working paper, 2001), available at http://papers.ssrn.com/abstract=265440.

170 For a compilation of works on the advances and challenges of corporate governance convergence, see CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

view that corporate law should principally strive to increase long-term shareholder value” and that “[t]his emergent consensus has already profoundly affected corporate governance practices throughout the world.”

This present study raises the hypothesis that the privatization movement might have had the unintended consequence of improving the political economy of corporate law reforms in at least two ways. First, as was the case in Italy and, to a lesser extent, Germany, the interests of the State as a selling shareholder in share issue privatizations induced the government to improve investor protections so as to maximize its sales proceeds. Second, even in cases like that of Brazil, where the State helped decrease investor protection to increase the control premium it was able to obtain in private sales of corporate control, privatizations might have had a lagged effect on the improvement of investor protection and the development of capital markets by reducing the magnitude of the State’s financial interests as a controlling shareholder, and, consequently, of its vested interest in opposing minority shareholder rights. Thus far, even the economists’ laundry lists of the multiple benefits of privatizations have overlooked the possible impact of the removal of the State as a major player in the political economy of corporate law reforms.

172 Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439 (2001) (also noting that “[t]he triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured, even if it was problematic as recently as twenty-five years ago”). See also Henry Hansmann, *How Close is the End of History?*, 31 J. CORP. L. 745 (2006) (finding even greater convergence towards shareholder capitalism in the early twenty-first century).

173 Nevertheless, the persistence of significant levels of State ownership in Brazil and Italy following privatizations predict that political economy constraints to corporate governance reforms are likely to persist in these countries.
Nonetheless, the long-term effects of the privatization sales of the 1990s on the political economy of corporate law reforms are likely to be ambiguous at best. Many countries not only failed to eradicate State ownership in its entirety but even maintained or increased the existing number of publicly-traded mixed enterprises by engaging in partial privatizations that floated minority equity interests in SOEs.\(^{174}\) A recent study by Bernardo Bortolotti and Maria Faccio shows that governments remain the largest ultimate shareholder of one-third of “privatized” firms.\(^{175}\) While the State’s interest in maximizing revenue from partial privatizations may have supported the adoption of minority investor protections in the 1990s, the government’s continued financial stake in listed firms may lead it to disfavor further improvements in shareholder rights if no additional equity sales or issues are in sight. This is so especially because, in a number of cases, the government remains the controlling shareholder by resorting to leveraging devices such as dual-class stock, pyramids, and the like, without holding a proportionate equity interest in the company\(^{176}\) – hence further increasing the incentives and opportunities for minority expropriation.\(^{177}\)

\(^{174}\) See Table 6 \textit{supra} for data on the magnitude of listed SOEs’s contribution to stock market capitalization in Italy in recent years.

\(^{175}\) Bernardo Bortolotti & Mara Faccio, \textit{Government Control of Privatized Firms}, 22 REV. FIN. STUD. 2907 (2009).

\(^{176}\) \textit{Id.} at 2916 (noting that 52.38\% of privatized firms in which the government remained the largest shareholder had leveraging devices (such as pyramids or dual-class shares) in place).

IV. Addressing Conflicts of Interest

The previous sections showed how pervasive the conflicts of interest inherent in the government’s dual role as shareholder and regulator can be in a variety of historical and legal contexts. This section will explore the potential of different institutional arrangements to mitigate the influence of the government qua shareholder in corporate governance institutions. Unlike more conventional instances of conflicts of interest, disclosure in this case is unlikely to provide an adequate remedy.\textsuperscript{178} The influence of the State as a shareholder in corporate lawmaking is often not only subtle and unverifiable but also politically popular. This means that merely exposing the State’s conflicts of interest in corporate law reforms is unlikely to eliminate the problem, as the general electorate and courts will often be sympathetic to the State’s fiscal interests. In Brazil, the 1997 amendments to the Corporations Law eliminating minority shareholder rights upon control transfers was explicitly marketed in terms of the revenue-maximizing ambitions of the federal government with respect to privatization sales – a goal that seemed legitimate enough to be openly defended.\textsuperscript{179} Similarly, nineteenth-century U.S.

\textsuperscript{178} For examples of corporate law rules which use disclosure as a remedy for conflicts of interest, see Delaware General Corporation Law (“DGCL”), § 144(2) (providing that interested director transactions will not be voided if “[t]he material facts as to the director’s or officer’s relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders”); item 407(e)(3)(iii) of Regulation S-K, requiring disclosure of fees paid to compensation consultants for consultancy on executive compensation and other matters, with the goal of permitting investors to assess the conflicts, if any, faced by consultants in providing advice to the board on compensation matters. Since changes to general corporate laws do not require a vote of the shareholders of the companies affected, disclosure is unlikely to provide an adequate remedy.

\textsuperscript{179} See Chapter IV, Part III.
citizens also forcefully defended the fiscal interests of the government in erecting entry barriers to industries where the State was a shareholder in monopolistic firms.\textsuperscript{180}

If disclosure is insufficient to eliminate the State’s conflicts of interest, a structural approach becomes necessary to prevent the special interests of the government as a shareholder from frustrating the enactment of an efficient legal regime. Solutions to this problem invariably involve a tradeoff between the strength of the proposed remedy in eliminating the conflict and its political acceptability. I will examine the promise and challenges of two main categories of institutional arrangements to address the conflicts of interest arising out of the State’s two hats as a corporate governance player and referee: ownership strategies and legal strategies. Ownership strategies eliminate or mitigate the impact of the first hat by improving the State’s incentives as a shareholder through a conscious choice among different corporate ownership structures. Legal strategies take the existing ownership structure of state-owned enterprises as given, and instead seek to address the State’s second hat as a general corporate governance regulator either by differentiating the corporate legal regime applicable to private firms and SOEs, or by assigning regulatory authority to a private organization or foreign jurisdiction.

A) Ownership Strategies

At least three ownership arrangements exist to mitigate the State’s conflicts of interest as a shareholder and a corporate governance regulator. Listed in order of decreasing effectiveness against the State’s conflict of interest and of increasing political

\textsuperscript{180} See Part II(A) supra.
acceptability, these approaches are (i) wholesale privatization, which eradicates the conflict by eliminating the State’s hat as a shareholder in its entirety, (ii) whole (as opposed to mixed) ownership of SOEs, which eliminates the State’s interest in most governance rules typical of multi-owner firms, and (iii) minority (as opposed to controlling) shareholdings by the State, which may serve to align the government’s interests with that of outside investors in promoting corporate governance reforms.

i. **Privatization**

A simple – indeed simplistic – solution is to describe the shareholder-regulator conflict as yet another evil of State ownership of enterprise and join the numerous advocates in favor of privatization. Although complete privatization of government stock holdings would surely eliminate the State’s extra hat, such a proposal is unlikely to be effective. While individual privatizations can have an almost immediate impact on firm level performance, a transformation in the political economy of corporate lawmaking requires the State to relinquish ownership over a critical number of firms. Yet recent experience demonstrates that this is more easily said than done, since even governments that undertook large-scale privatization programs often retain significant shareholdings in major listed corporations.

State ownership has proven to be incredibly resilient in spite of the voluminous, if contentious, literature pointing to the comparative efficiency of private ownership.\(^{181}\)

---

Moreover, various works have cast doubts on the inherent superiority of private versus public ownership of enterprise. \(^{182}\) And, as the 2008 financial crisis made clear, pragmatic considerations in times of economic turmoil may lead to the emergence of state-owned enterprises even in inhospitable environments such as the U.S. It is therefore unlikely that recognizing State ownership’s indirect effect on the political economy of corporate lawmaking will tip the balance in favor of divestiture.

\(\text{ii. Whole ownership of SOEs}\)

Falling short of privatization, a more politically acceptable alternative to isolate the effects of State equity holdings on the corporate governance environment is through the choice of ownership structure. In order to mitigate the State’s conflicts of interest in corporate lawmaking, whole government ownership may in fact be preferable to partial

\(^{182}\) See, e.g., for works denying the unequivocal superiority of private ownership, see Stacey R. Kole & J. Harold Mulherin, *The Government as a Shareholder: A Case from the United States*, 40 J. L. & ECON. 1 (1997) (finding no significant differences between the performance of government-controlled companies and private sector firms in the same industry); Stephen Martin & David Parker, *Privatization and Economic Performance throughout the UK Business Cycle*, 16 MANAGERIAL & DECISION ECON. 225 (1995) (finding no evidence that private ownership is inherently more efficient than state ownership); Clifford Zinnes, Yair Eilat & Jeffrey Sachs, *The Gains from Privatization in Transition Economies: Is “Change of Ownership” Enough?*, 48 IMF STAFF PAPERS 146 (2001) (finding that privatization fails to produce economic performance improvements in the absence of deep institutional reforms); Yair Aharoni, *The Performance of State-Owned Enterprises*, in PIER ANGELO TONINELLI, *THE RISE AND FALL OF STATE-OWNED ENTERPRISE IN THE WESTERN WORLD* 49 (2000) (noting that the empirical evidence is ambiguous and “lends only limited support to the hypothesis that SOEs are inherently less efficient than private enterprises”). Aharoni remarks that, since most SOEs are created to maximize social welfare rather than profits, any comparisons of state-owned and private firms performance based on financial results alone will be deeply flawed. *Id.* at 52.
ownership. From the perspective of the political economy of corporate governance, the benefits of State ownership of 100% of a firm’s equity holdings, as opposed to a lower threshold, are two-fold. First, in eliminating the typical agency problems associated with multi-owner firms, whole ownership neutralizes the government’s interest (and influence) in most legal provisions that govern the internal affairs rules of corporations. Second, as described in the analysis of the Italian and German cases, whole ownership creates superior incentives for the implementation of efficient corporate governance rules upon control sales. In the absence of expropriation opportunities against a non-existent minority, the government has an incentive to implement a legal regime that increases firm value in order to maximize its sales proceeds.

Even if unconsciously, the U.S. adopted precisely this approach when it created numerous wholly-owned government corporations in the twentieth century, while eschewing mixed enterprises.\(^{183}\) Mixed enterprises were also historically less common in the U.K. compared to Germany, Italy, and France.\(^{184}\) China, by contrast, embraced an opposite strategy when it launched its sweeping policy of corporatization and sale of partial stakes in SOEs – a strategy that is sensible given China’s primary goal of enhancing the financing options available to state-owned enterprises, not to private firms.\(^{185}\)

\(^{183}\) See Part II(A) supra.


\(^{185}\) See Part II(B) supra.
In the twentieth century mixed enterprises – as opposed to wholly-owned State enterprises – came to be more prevalent in countries traditionally labeled as belonging to the civil law tradition compared to common-law countries. According to the entry on “Government Owned Corporation” in the Encyclopaedia of the Social Sciences, published in 1932, “[i]n the United States and in Great Britain outright government ownership of all outstanding capital stock, or at least of all securities giving participation in control, and responsibility by the directors and managers of the corporation only to the government have predominated.” By contrast, it explained that “the so-called mixed corporation” – defined as the firm in which corporate ownership and control is divided between one or more governmental entities and the private sector – is “especially common in Germany and France.” Similarly, in his 1937 study on government ownership, John Thurston noted that “the practice of governmental participation with private investors has not proved popular in the English-speaking countries.” He observed that, “[c]ontrary to the Continental practice, the English countries appear to favor entire rather than partial government control.”

Although an analysis of the relationship between the ownership structure of state-owned enterprises and a country’s legal tradition is outside the scope of this piece, the greater incidence of enterprises in “civil law” jurisdictions seems to support the notion

---

186 Webbink, supra note 155, at 106.

187 Id.

188 JOHN THURSTON, GOVERNMENT PROPRIETARY CORPORATIONS IN THE ENGLISH-SPEAKING COUNTRIES 5 (1937). The reasons why mixed enterprises proved to be more popular in the civil law world were however unknown to the author (“it is somewhat difficult to discover why the mixed corporation has not proved equally attractive in English-speaking countries”). Id. at 6.
that the State’s interests as a shareholder have been an important but so far neglected variable that can affect the level of a country’s legal investor protection. While the law-and-finance literature finds that greater legal investor protection and capital market development are correlated with common-law origin, Raghuram Rajan and Luigi Zingales’s work on the “Great Reversals” suggested that civil-law jurisdictions were actually no less financially developed than common-law countries in the early twentieth century.189 Subsequent work by economic historian Aldo Musacchio verified and corrected Rajan and Zingales’s figures, and found that there was a significant degree of legal convergence around the world circa 1900, but no significant correlation between the level of financial development and a country’s legal tradition.190 Interestingly, the incidence of mixed enterprises in civil law-countries for the most part postdates World War I.191

However, even if the greater incidence of mixed enterprises in civil-law jurisdictions is relatively recent, it has since then proved to be enduring. Bortolotti and Faccio’s survey of the control structures prevailing after privatizations reveals that governments in civil-law jurisdictions were far more likely to remain a controlling


191 See Pier Angelo Toninelli, The Rise and Fall of Public Enterprise, in PIER ANGELO TONINELLI, THE RISE AND FALL OF STATE-OWNED ENTERPRISE IN THE WESTERN WORLD 15-18 (2000). Toninelli notes that “[a]lthough government and other public agencies had increased their participation in the economy during the 1914-18 war period, a real change in climate and approach occurred in the following fifteen years.” Id. at 15-16. The “great age of public enterprise” did not begin until after World War II. Id. at 18.
shareholder of “privatized” companies. Strikingly, governments were the largest blockholders in 48.5% of privatized companies in civil-law jurisdictions, compared to only 4.5% in common-law countries. The governments of common-law countries were more likely to divest most of their equity holdings, even as they retained control over corporate affairs through a greater utilization of golden shares.192

In any event, a main lesson of this Chapter is that, from the perspective of the overall corporate governance environment, it may be better if the government invests in industry as a 100% owner rather than as a partial owner together with private investors. This lesson runs contrary to conventional wisdom in general and to OECD recommendations in particular. As put by a recent OECD report, “the listing of a minority stake in SOEs is considered a good practice both in establishing credibility and in dealing with a host of other corporate challenges.”193 The OECD’s perspective however pays insufficient attention to the political role of the State as a controlling shareholders and, therefore, its potential to undermine much needed investor protection reforms.

Still, the benefits that whole over partial State ownership may bring to the political economy of corporate governance by eliminating the government’s conflict of interest will have to be balanced against the implications of different ownership structures for corporate performance. Intuitively, one may expect mixed enterprises to perform

192 Bortolotti & Faccio, supra note 175, at 2924 (noting that “in common law countries, 86.5% of firms have outstanding golden shares, compared to only 49.2% of companies in civil law countries”).

better than wholly-owned government firms, as the former are subject to monitoring and pressures from private market participants from which the latter are immune.

As discussed in Part II(B) supra, the belief in the comparative efficiency of mixed enterprises was a key driver of China’s corporatization strategy of the 1990s. The available empirical evidence on the relative efficiency of mixed enterprises vis-à-vis wholly-owned SOEs is however mixed, but overall seems to provide mild support for the performance advantages of mixed enterprises.\textsuperscript{194} These efficiency advantages in part explain why, despite the obvious conflicts from a corporate governance standpoint, and numerous predictions of their imminent demise throughout the twentieth century,\textsuperscript{195} mixed enterprises have proved to be remarkably durable.\textsuperscript{196}

\textsuperscript{194} Catherine Eckel & Aidan Vining, \textit{Elements of a Theory of Mixed Enterprise}, 32 SCOTTISH J. POL. ECON. 82 (1985) (for a theoretical model suggesting that mixed enterprises may perform better than SOEs, but worse than private firms). For empirical works, see Boardman & Vining, supra note 23 (finding that wholly-owned SOEs and mixed enterprises are both significantly less efficient than private firms, and that mixed enterprises are equally or less profitable than wholly-owned SOEs); George Lihui Tian, \textit{State Shareholdings and the Value of China’s Firms} (2001), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=275910 (finding that while corporations under private control perform better than firms under government control, the relationship between government holdings and performance is non-monotonic, as there is a positive relation between corporate value and government ownership when the State is a large shareholder and a negative relationship when the State is a small shareholder); Sumit K. Majumdar, \textit{Assessing Comparative Efficiency of the State-Owned Mixed and Private Sectors in Indian Industry}, 96 PUB. CHOICE 1 (1998) (finding that the performance of private firms is superior to that of SOEs, with mixed enterprises falling in between); Aidan R. Vining & Anthony E. Boardman, \textit{Ownership versus Competition: Efficiency in Public Enterprise}, 73 PUB. CHOICE 205 (1992) (finding that SOEs and mixed enterprises are less profitable than private companies, and that wholly-owned SOEs are less profitable than mixed enterprises).

\textsuperscript{195} See, e.g., RIPERT, supra note 140, at 318 (condemning mixed enterprises as an attempt to “reconcile the irreconcilable”); Bilac Pinto, \textit{O Declínio das Sociedades de Economia Mista e o Advento das Modernas Empresas Públicas} [The Decline of Mixed Enterprise and the Advent of the Modern Public Enterprise], in \textit{ESTUDOS SOBRE A CONSTITUIÇÃO BRASILEIRA} (1954) (predicting, that given the intractable conflicts of interest between State and private interests, mixed corporations would soon be eclipsed by wholly-owned government corporations). For a recent critique of hybrid firms, see Schumpeter: \textit{The rise of the hybrid company (The problem with state-backed firms)}, \textit{THE ECONOMIST}, Dec. 5, 2009 (arguing that “[t]he clearer the line between the state and the private sector, the better it is for those on both sides”).

\textsuperscript{196} See note 3 supra and accompanying text.
iii. The State as minority shareholder

Most cases described throughout this and the previous chapters illustrate how the presence of the State as controlling shareholder can distort the political economy of corporate lawmaking to prevent the enactment of legal minority investor rights. This raises the question about what role the government may play in corporate governance reforms when it is not the controlling shareholder, but rather a minority shareholder that does not enjoy special prerogatives. For the government to qualify as a minority shareholder it must hold less (in fact, far less) than a majority of the firm’s shares, not have special legal rights (such as golden shares) or otherwise exercise de facto influence over the firm.

The extent to which these conditions can be satisfied in practice remains an open empirical question. For instance, although the Brazilian government holds less than a majority of Petrobras’s equity capital, the company’s dual-class structure permits the State to exercise uncontested control over the company.197 Likewise, the early French experience with minority shareholdings by the government showed that the State did not behave as a shareholder like any other, but instead all too often conferred special powers upon itself.198

---

197 For a discussion of Petrobras, see Chapter IV, Part III. As of August 2010, the Brazilian federal government held approximately 32% and the BNDESPar (the equity arm of the BNDES) approximately 7.7% of the firm’s total capital. ADRs represent 30% and additional foreign investors an additional 10% of Petrobras’s total capital. See http://www2.petrobras.com.br/portal/frame_ri.asp?pagina=/ri/port/index.asp&lang=pt&area=ri.

198 See supra note 144 and accompanying text. See also BREDIN, supra note 140, at 73 (“the State is always considered as a necessary and privileged shareholder. It rejects the principle of equality among shareholders, since it desires to monitor or manage the firm and impose its will. It is sovereign and it sets the law. If it is a small shareholder, it will attribute to itself considerable management powers. If it is a large shareholder, it increases its authority by attributing to itself special powers”); JEAN DUFUAU, LES
Provided that the government is indeed a minority shareholder and is otherwise unable to exercise informal control over management and obtain private benefits of control – and this is big “if” – the cases analyzed throughout this Chapter suggest that minority State ownership could be more conducive to the adoption of legal investor protections (though not necessarily of other types of efficient market regulation)\(^{199}\) than a system in which the government is the controlling shareholder. In nineteenth-century Virginia, the financial interests of the state government as a minority shareholder were an important factor in the transition from highly regressive voting schemes to voting rules that bear greater proportion to equity ownership.\(^{200}\) State-owned pension funds – perhaps most notably the California Public Employees’ Retirement System (CalPERS) – have played an influential role in promoting higher corporate governance standards. There is anecdotal evidence that the increase in the Brazilian government’s minority holdings following the wave of privatizations may have made increases in shareholder rights more palatable from its perspective.\(^{201}\)

The interests of Brazil’s National Development Bank (\textit{Banco Nacional de Desenvolvimento Econômico e Social} – BNDES) as a minority shareholder of various Brazilian companies have arguably had an overall positive effect on the legal rights of

\begin{footnotes}
\footnote{\textsc{Entreprises Publiques} 130 (1973) (noting that the French State is usually overrepresented in the boards of mixed enterprises in which it holds a minority interest).}

\footnote{As described in Part II(A) \textit{supra}, the state governments’ minority holdings in monopolistic industries in the nineteenth-century U.S. were often sufficient to gather popular support to the enactment of regulations ensuring the preservation of monopoly power.}

\footnote{See notes 72-74 \textit{supra} and accompanying text.}

\footnote{See Chapter IV, Part III \textit{supra}.}
\end{footnotes}
minority shareholders over time. According to the Exposition of Motives to the 1976 Corporations Law, the rule authorizing corporate charters to confer board representation and veto rights to special classes of preferred stock was designed to legitimize existing practices adopted by the National Development Bank as a minority investor. Similarly, the interests of the German state as a shareholder were also behind the new rule in the 1937 Corporations Law authorizing charter provisions that allow blockholders to directly nominate members of the supervisory board.

Moreover, the BNDES is a minority shareholder in the vast majority of “old” companies that have migrated from the traditional listing segment to the Novo Mercado. While this pattern is usually interpreted as a policy effort to promote the adoption of stronger corporate governance standards, it is also plausible that the Bank’s financial interests as a shareholder and creditor might have played a role in encouraging such migrations. Future research is needed to elucidate the precise dynamics and

---

202 A recent study by Sergio Lazzarin and Aldo Musacchio suggests that the presence of BNDES as a minority shareholder has a positive effect on firm performance, but that such effect is reduced when the BNDES’s participation is associated with state-owned and private pyramidal groups. Sergio G. Lazzarini & Aldo Musacchio, Leviathan as a Minority Shareholder: A Study of Equity Purchases by the Brazilian National Development Bank (BNDES), 1995-2003 (working paper, 2010), available at http://ssrn.com/abstract=1713429 (covering a sample of 296 firms listed on the São Paulo Stock Exchange between 1995 and 2003).

203 Exposition of Motives n. 196 by the Treasury Secretary (June 24, 1976).

204 Detlev F. Vagts, Reforming the “Modern” Corporation: Perspectives from the German, 80 HARV. L. REV. 23, 80 (1966).

205 Gilson, Hansmann & Pargendler, supra note 163. But see Alexandre di Miceli da Silveira, The Role of BNDES (Brazilian Development Bank) on the Corporate Governance of Large Companies in Brazil 6 (working paper, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1639097 (challenging the view that the BNDES promotes higher corporate governance standards in the companies in which it invests).

political implications of minority holdings by the State, a subject that will be particularly useful for guiding public policy on domestic and international sovereign-wealth funds.

B) Legal Strategies

Even if it is impossible or undesirable to alter existing ownership structures of state-owned firms, other legal and institutional arrangements exist to mitigate the shareholder-regulator conflict. Instead of proposing to eliminate or change the structure of the State’s equity holdings, this section will explore proposals to reduce the strength of the government’s interest as a shareholder in corporate law outcomes either by passing separate corporate laws applicable only to State-owned firms, or by giving foreign or non-State regulatory authorities the power to design and enforce corporate and securities regulations.

i. Dual regulatory regimes

A less intrusive and politically more promising alternative is to address directly the negative externalities generated by State ownership on general corporate laws by creating a dual regulatory regime that supplies a different set of rules for State and mixed corporations, on the one hand, and private corporations, on the other. The suggestion that government-owned corporations should be governed by a different set of rules than those applicable to private sector companies is by no means novel.\textsuperscript{207} The traditional rationale

\textsuperscript{207} For a early instances of proposals for a separate statute for state-owned firms, see José Cretella Junior, \textit{Sociedades de Economia Mista no Brasil}, 80 REVISTA DE DIREITO ADMINISTRATIVO 37, 37 (1965) (Brazil); BREDIN, supra note 140, at 279 (France) (arguing that public enterprise and the corporate form are irreconcilable, and defending the adoption of a special statute for state-owned firms); Lamy Filho, \textit{Alfredo, O Estado Empresário} [The State as Entrepreneur] 48, \textit{in} ESTUDOS EM HOMENAGEM AO PROF. CAIO TÂCITO
behind this proposal is that private firms and state-owned enterprises have different functional characteristics and objectives, and would therefore be best served by different legal regimes.\textsuperscript{208}

A traditional economic rationale for State ownership is to exploit natural monopolies in a non-profit-maximizing fashion – so as to avoid the deadweight loss that would ensue if the monopoly were operated by a profit-maximizing private firm, which would presumably restrict output to allow for price and revenue increases. Additional justifications for State ownership of enterprise include the pursuit of distributive, developmental, or other public policy goals, such as inducing market competition.\textsuperscript{209} It is therefore not difficult to see why a legal regime tailored to profit-maximizing firms may be inadequate to non-profit-maximizing firms, and vice-versa. However, despite numerous recommendations to the contrary, separate corporate law statutes for state-owned firms remain the exception, not the rule.\textsuperscript{210}

But there is another overlooked justification for establishing a distinct corporate regime for state-owned enterprises, which is to relieve State interests in corporate

\begin{footnotesize}
\begin{itemize}
\item 208 Gilson, Hansmann & Pargendler, \textit{supra} note 163, term this rationale for a dual regulatory regime “regulatory diversification,” which they define as occurring when “[t]he actors being regulated are not homogeneous in their needs for regulation,” so that efficiency requires “two or more parallel forms of regulation, with each form designed to deal with the characteristics of a distinct set of actors.”


\item 210 Among these exceptions are Israel and Argentina. \textit{See} Luiz Gastão de Paes de Barros Leães, \textit{O Conceito Jurídico de Sociedade de Economia Mista}, 79 \textit{REVISTA DE DIREITO ADMINISTRATIVO} 1 (1965) (describing the exceptional character of special corporate statutes for SOEs, and citing the Argentinean statute of 1946 as one of the few such instances); Kahan & Rock, \textit{supra} note 7, at 58 (for a brief description of the Israeli statute).
\end{itemize}
\end{footnotesize}
lawmaking. As argued by Gilson, Hansmann and Pargendler, the creation of a dual regime can be a second-best solution when powerful political actors effectively block the enactment of a single efficient legal regime.\textsuperscript{211} As a variation on regulatory dualism, the regime applicable to state-owned and private firms would be separate and different from the legal regime governing private sector corporations precisely to permit the private regime to develop along more efficient lines by exempting it from the interests and pressure of the government as shareholder.

This proposal for a strict differentiation between the legal regime applicable to public and private firms is a variation on, rather than an instance of, regulatory dualism. Under regulatory dualism, both old and new firms can freely choose between the old regime of low investor protection and the new regime of high investor protection.\textsuperscript{212} The benefits of this feature in lessening incumbents’ opposition to the new regime are at least twofold: old firms can either continue to be governed by the old regime without the stigmatization associated with grandfathering or opt for the more stringent new regime (and therefore obtain a lower cost of capital) if they are so willing.\textsuperscript{213} By contrast, the proposal for a dual and different regime for private and public firms in principle does not permit the government to opt into the private regime, or allow controlling families to opt into the government regime. As such, this proposal is less accommodating to the

\textsuperscript{211} Id. (regulatory dualism is a strategy that “seeks to mitigate political opposition to reforms by permitting the existing business elite to be governed by the old regime, while allowing other firms to be regulated by a new parallel regime that is more efficient”).

\textsuperscript{212} Id.

\textsuperscript{213} Id.
interests of the State and controlling families than a standard form of regulatory dualism and may therefore be less politically feasible.

This proposal for strict regulatory differentiation, although relatively modest in scope and practically attainable, stands in sharp contradiction with existing best practices recommendations for state-owned enterprises. Conventional wisdom suggests that the same set of laws and regulations should, to the greatest degree possible, govern private sector entities and government-owned firms alike. For example, the Guidelines on Corporate Governance of State-owned Enterprises of the Organisation for Economic Cooperation and Development (OECD) prescribe that “[w]hen streamlining the legal form of SOEs, governments should base themselves as much as possible on corporate law and avoid creating a specific legal form when this is not absolutely necessary for the objectives of the enterprise.”214 Additionally, the Guidelines suggest that “SOEs should be subject to the same high quality accounting and auditing standards as listed companies” and “[l]arge or listed SOEs should disclose financial and non-financial information according to high quality internationally recognised standards.”215

Interestingly, the main rationale behind this traditional prescription for a unitary legal regime to govern public and private firms also lies in the State’s conflict of interest as a shareholder and market (rather than corporate governance) regulator. The concern – which is not merely conceptually possible, but also corroborated by experience – is that the government will try to impose more favorable regulatory standards (e.g., in pricing, quality, environmental or competition rules) on the firms it owns versus those controlled

214 OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES (2005).
215 Id.
by the private sector. The imposition of a single regime on public and private companies alike would prevent the government from disadvantaging private firms through special regulatory hurdles that do not apply to SOEs, thus assuring the creation of a “level playing field” when both types of companies compete in the marketplace.

With respect to corporate law rules, in particular, another justification for a unitary legal regime is that the imposition of a private legal regime helps enhance efficiency of state-owned enterprises by constraining corporate waste and overly politicized decision-making by managing bureaucrats. This line of reasoning was made explicit in Brazil in the 1960s, as well as in China in connection with its large-scale process of “corporatization” of SOEs in the 1990s. As described in greater detail below, the adoption of the same corporate laws applicable to private firms is but one technique adopted by state-owned enterprises in an attempt to credibly commit to higher corporate governance standards.

But while a unitary corporate law regime may be in the interests of state-owned enterprises, it may in fact be detrimental to private firms. Notwithstanding the looming risk of State abuse, SOEs have a number of advantages over private firms in attracting investors. Mixed enterprises typically enjoy an implicit or explicit government guarantee, rendering them effectively bankruptcy proof. Government-controlled firms


[217] See, e.g., for a statement of the commitment rationale, OECD, SOEs Operating Abroad, supra note 193 (“it is generally held that the credibility of a commitment to “commercial commitment” in an SOE is a function of the degree of which the SOE is made subject to generally applicable corporate law”).

[218] PINTO JUNIOR, supra note 209, at 77 (arguing that investors in state-owned firms face a tradeoff between a lower market risk and a higher political risk).
are far more common in monopolistic industries, whereas private firms often face significant competition. And because they do not enjoy the same degree of government support and have fewer rents to distribute, private firms arguably have greater need than SOE’s of an effective investor protection regime in order to attract investors. A unitary regime, however, is less likely to provide the efficient level of investor protection to private firms.

The proposal for a dual regime thus entails a tradeoff typical of regulatory dualism: while a dual regulatory approach can improve the legal regime available to private firms, it may arguably worsen the quality of the legal regime governing state-owned enterprises. The recognition of this tradeoff helps understand why guidelines on corporate governance of state-owned enterprises favor a unitary regime. Such conventional recommendations, however, tend to overlook the political economy of corporate lawmaking and, in so doing, ignore that a unitary law regime may not only fail to constrain State behavior as a shareholder but also be positively detrimental to the legal environment applicable to private firms.

As this Chapter illustrates, the government’s dual role as shareholder and regulator prevents it from credibly committing not to change its corporate law rules in an opportunistic manner in the future if opportunities for profit-making through expropriation are sufficiently attractive. Indeed, this risk of exploitative policy reversal is precisely the reason why most countries do not promulgate the most important limitations

---

219 This tradeoff is typical of other classical forms of regulatory dualism. See Gilson, Hansmann & Pargendler, supra note 163 (“under regulatory dualism, the introduction of the reformist regime may actually cause the established regime to become even less efficient than it would be if it were the sole regime, since the reformist regime draws off some of the constituency for reform of the established regime”).
to State action via standard private laws, but rather inscribe them in public constitutions that are particularly difficult to amend. Moreover, the net effects of a unitary legal regime may be positively detrimental to private companies and their shareholders, since the unsuccessful attempts of the State to commit to a private law regime in fact undermines the ability of private firms to credibly commit to investor protection. As suggested throughout this piece, the State is not necessarily constrained by, but rather shapes and constrains, the development of corporate laws – with possible negative consequences for the corporate governance environment of private firms.

J.P. Morgan’s acquisition of Bear Stearns in 2008 is illustrative of how little deference even a democratic and limited government such as that of the U.S. is willing to pay to corporate law rules in carrying out its objectives. To be sure, in that case the U.S. government was not interested in the transaction as a shareholder, but rather as the architect and financier – or “investment banker”220 – of a deal designed to avoid the macroeconomic crisis that was expected to result from the collapse of Bear Stearns. In an attempt to ensure completion of the transaction, the merger agreement contemplated a number of deal protection devices – including a share exchange agreement for 39.5% of Bear Stearns’s stock – that effectively disenfranchised the target’s shareholders, and, for this reason, were unlikely to pass muster under Delaware takeover law.221


221 Id. at 736 (noting that the merger agreement “flouted ordinary Delaware corporate law” and “might well have been struck down if the merger did not have the government’s imprimatur”); Marcel Kahan & Edward Rock, How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware and the Strategic Use of Comity, 58 Emory L. J. 713 (2009).
As described by Marcel Kahan and Edward Rock, Delaware courts were “between a rock and a hard place” in facing the dilemma between maintaining the integrity of its case law and upsetting the interests of the federal government (on whose goodwill the very subsistence of Delaware’s corporate law depends).\(^{222}\) Delaware’s ingenious solution was to avoid making a decision altogether by taking advantage of a pending lawsuit in New York and deferring the case to its sister court.\(^{223}\) This alternative, while available in the U.S. federalist system, is lacking in most other countries. Hence, the possibility remains that the courts’ sympathy to the interests of the government could jeopardize the integrity of corporate laws, as ad hoc (and public-interest inspired) decisions favoring the interests of the government as controlling shareholder may set the tone for what type of behavior is permissible for controlling shareholders generally (both public and private) within a given jurisdiction.

A dual regime for state-owned and private enterprises is not without precedent. State-owned enterprises around the world are, to varying degrees, subject to distinctive rules set forth in special statutes or corporate charters, even if regular corporate laws still maintain residual application. The multiplicity of regulatory regimes stemming from different statutory charters that derogate general corporate laws has led French jurist George Ripert to disparage the existing system of “une loi par société!”\(^{224}\) Moreover, a number of jurisdictions (including Brazil since December 2010) mandate worker

\(^{222}\) Id. at 713.

\(^{223}\) Id. at 715.

\(^{224}\) RIPERT, supra note 140, at 317.
representation in the board of directors for SOEs, but not for private sector corporations.225

In Germany, a dual approach served to appease resistance to investor protection improvements: local authorities ceased to oppose the enactment of a corporate governance law in 1998 when it became clear that their rights under a special statute would not be affected by the reform.226 Although formally China has adopted a unitary corporate law regime, there is reason to believe that it may have embraced a dual approach in enforcement. Even though SOEs dominate China’s capital markets, they receive sanctions from the Chinese Securities Regulatory Commission less frequently than private firms.227 A recent event study about found that only private firms, but not State-owned firms, experienced large abnormal returns around the announcement of regulatory changes designed to improve minority investor protection in China, thus suggesting that investors do not expect regulators to enforce these more stringent standards against SOEs.228 Even though regulatory and enforcement distinctions of this kind have earned a bad reputation, additional differentiation in the legal regimes applicable to private and government corporations may further improve the political economy of corporate lawmaker.

225 See Chapter IV, Part IV supra.

226 See notes 159-161 supra and accompanying text.

227 Allen & Shen, supra note 89, at 21 (also warning that the possibility that SOEs are more law abiding cannot be discarded).

Adopted by most countries that have recently undertaken large-scale privatizations, golden shares provide a more prominent and general example of a special regime applicable only to privatized firms. Golden shares are essentially a special class of stock issued to the privatizing government that grants special voting and veto rights that are disproportionate to, or even independent of, its cash-flow rights in the company. In most countries the issuance of golden shares requires the enactment of a special enabling statute (often in the form of a separate section of the privatization law), which typically specifies that only the State can be a holder of, and exercise the rights granted by, these securities. 229 Despite golden shares’ drawbacks for corporate decision making and the operation of the market for corporate control, a marked advantage of this mechanism is that it addresses the government’s interests while keeping the legal regime applicable to private firms intact – and is therefore a more attractive alternative to a single regime molded by the State’s interests. 230

Moreover, the current legal system in the U.S. to a large extent already provides such a dual regime – and has come under sharp criticism for precisely that reason. Legal scholars have recently condemned the failure of U.S. law to afford the same minority protections to shareholders of private and government-controlled companies, with the latter being comparatively disadvantaged. 231 In testimony before Congress, J.W. Verret remarked that “[g]overnment shareholders don’t have to play by the same rules as the rest

229 See Grundmann & Möslein, supra note, at 184.

230 Nonetheless, the E.U. Court of Justice has closely scrutinized golden shares and special State voting rights and impermissible restrictions to its common market. See, e.g., note 161 supra.

231 Kahan & Rock, supra note 7; Verret, supra note 7.
of us, a fact which will strain the governance mechanisms of the capital markets at a time when they are already in crisis.” 232 For instance, existing doctrines of sovereign immunity severely restrict suits against the government for breaches of fiduciary duties of controlling shareholders, and the U.S. government is expressly exempted from insider trading laws. 233 Moreover, the securities of government-sponsored enterprises are generally exempt from federal securities laws and the jurisdiction of the U.S. Securities and Exchange Commission (SEC) more generally, despite official calls for a unitary regime. 234

This dissertation suggests that such criticism of the existing duality of legal regimes is unwarranted once the political economy component of corporate lawmaking is taken into account. Perhaps counterintuitively, the award of a different treatment to outside shareholders of state-controlled enterprises can in fact permit the provision of greater protection of minority investors in private firms. This line of reasoning strongly favors the adoption of a dual and different regulatory regime applicable to state-owned firms.

A 1998 amendment to Brazil’s Constitution provides for the adoption of a new statute setting forth the legal regime applicable to state-owned enterprises (estatuto

---


233 Id.

234 STANTON, supra note 39, at 23. For a report of three major government agencies calling for the elimination of such exemptions, see DEPARTMENT OF THE TREASURY, SECURITIES AND EXCHANGE COMMISSION, AND BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, JOINT REPORT ON THE GOVERNMENT SECURITIES MARKET (1992) (“[t]he Agencies support legislation removing the exemptions from the federal securities laws for equity and unsecured debt securities of Government-sponsored enterprises (“GSEs”), which would require GSEs to register such securities with the SEC.
Although the Constitution continues to make clear that public enterprises that engage in economic activity in competition with the private sector must be subject to “the legal regime characteristic of private firms, including with respect to civil, commercial, labor and tax rights and obligations,” there is significant leeway for the new statute to institute a dual legal regime with respect to corporate laws. Ideally, the new statute should provide for a special corporate law regime for state-owned and mixed corporations, thus eliminating the applicability of Brazil’s general Corporations Law to government-controlled companies. The current draft of the statute submitted to Brazil’s Chamber of Deputies however falls short of expectations, as it largely fails to differentiate the corporate legal regime applicable to state-owned firms.

ii. Dual regulatory authorities

When the creation of a dual regime is driven by political considerations, the adoption of a dualist regulatory structure by a single regulatory authority faces practical hurdles, which Gilson, Hansmann and Pargendler have termed as the “problem of a unitary lawmaker.” Apart from possible difficulties associated with the implementation and administration of different standards within a single jurisdiction, the risk exists that the same political constituency that blocks the establishment of a single efficient legal regime will stymie the creation of a dual regime. This section explores the potential of

---


236 Bill (Projeto de Lei) 5,345 of 2009.

237 Gilson, Hansmann & Pargendler, supra note 163.

238 Id.
a split in regulatory authorities to address the conflicts of interest inherent in the State’s dual role as a shareholder and regulator.

a. *Dual regulatory authorities within the same State*

Unlike the proposal for a different legal regime for state-owned and private firms discussed above, which conflicts with conventional best practices recommendations, the proposal for a separation of regulatory authorities within a given jurisdiction is standard in the literature. The OECD Guidelines on Corporate Governance on State-owned Enterprises defend a “strict separation of the state’s ownership and regulatory functions” as a “fundamental prerequisite for creating a level playing field for SOEs and private companies and for avoiding distortion of competition.”239 Consistent with these recommendations, France established in 2004 a Government Shareholding Agency designed to segregate the State’s ownership function from its regulatory function.240 Similarly, the U.S. Treasury’s controlling stake in AIG is held by a trust (of which the Treasury is the sole beneficiary) in an attempt to avoid political interference in the trust (and, therefore, the company’s) management.241

The effectiveness of the separation of the public agencies responsible for managing the government’s equity holdings, on the one hand, and regulating the industry,

239 OECD GUIDELINES, supra note 214. See also, OECD, SOEs OPERATING ABROAD, supra note 193 (“[t]he annotations to the SOE Guidelines particularly recommend the creating of a centralised ownership entity as an effective way to clearly separate the exercise of ownership functions from other activities performed by the state”).

240 For a detailed description, see http://www.ape.minefi.gouv.fr/sections/qu_est_ce_que_l_ape/.

241 See AIG’s 2009 annual report on form 10-K for a description of the AIG Credit Facility Trust and its role in the governance of AIG.
on the other, with respect to product and service markets regulation remains an open question. This Chapter suggests that recommendations for institutional separation within the same jurisdiction as a solution to conflicts in corporate governance regulation should be taken with a grain of salt. In virtually all cases of conflicts of interest in corporate law reforms analyzed throughout this piece, an institutional separation between the public body in charge of elaborating corporate laws (usually Congress or courts) and those responsible for managing the enterprise (the executive branch) was already in place, but this institutional separation was insufficient to eliminate the State’s conflicts of interest and influence over the legal regime. Even though the State is certainly not a unitary actor, its different agencies and branches often behave as such when it comes to defending the government’s interests as a shareholder.\(^{242}\)

\[b. \quad Federalism\]

In addition to separate public agencies, federalism provides another way to quarantine a government’s lawmaking from its ownership function. In Germany and Brazil, corporate law is generally federal (national) law even though at least some state enterprises belong to state (sub-national) governments.\(^{243}\) By contrast, in the early

\(^{242}\) See note 19 supra and preceding text.

\(^{243}\) See Mario Engler Pinto Jr., A Atuação Empresarial do Estado e o Papel da Empresa Estatal [The State as Entrepreneur and the Role of State Enterprise], 151-152 REVISTA DE DIREITO MERCANTIL, INDUSTRIAL, ECONÔMICO E FINANCEIRO 256, 260 (2009) (highlighting that, under the Brazilian constitution, states and municipalities are barred from issuing corporate law rules, so state-owned firms created at the state and municipal levels are subject to federal (national) corporate laws).
twentieth-century U.S., federally-owned corporations were habitually chartered under state laws.\textsuperscript{244}

The federal solution may therefore be helpful in reducing conflicts of interest in corporate lawmaking, but it is not free from difficulties. State interests often play a prominent role in federal lawmaking. A case in point is the significant (and successful) opposition of German state governments to a 1998 federal corporate law reform mandating a one-share-one-vote rule, which would impair the states’ prior influence in portfolio firms through veto rights and voting caps.\textsuperscript{245} Moreover, this type of duality has been partially outlawed in the U.S., as the Federal Government Corporation Control Act of 1945 restricted what it saw as the “anomaly” of using state charters for the creation of federal corporations, requiring a specific act of Congress for their establishment.\textsuperscript{246}

c. Private and public regulatory authorities within the same State

Another possibility is to have a dual regulatory regime imposed by a private regulatory authority. As described in greater detail elsewhere, Brazil’s Novo Mercado, a voluntary listing standard of the São Paulo Stock Exchange providing for more stringent corporate governance standards than those required under Brazilian law, offers precisely such an example.\textsuperscript{247} However, as a paradigmatic example of regulatory dualism, the Novo Mercado does not differentiate between the regime applicable to private firms, on

\textsuperscript{244} Pritchett, supra note 37, at 508.

\textsuperscript{245} See notes 160-161 supra and accompanying text.

\textsuperscript{246} Pritchett, supra note 37, at 508.

\textsuperscript{247} Gilson, Hansmann & Pargendler, supra note 163.
the one hand, and state-owned enterprises, on the other. On the contrary, as described in Chapter IV, the Novo Mercado explicitly welcomed listings of state-owned and recently privatized firms.

Brazilian state-owned enterprises began to take advantage of domestic bonding opportunities through the Novo Mercado soon after they became available. Sabesp, a sewage company that was until then wholly owned by the São Paulo state government, was the second firm to pursue a listing on the Novo Mercado. Sabesp’s IPO was coupled with the issuance of ADRs in the U.S., where most of the company’s public float is now traded. It is telling that the offerings were not driven by capital raising considerations, since all of its traded stock was the product of secondary offerings. Instead, the incumbent government’s motivation behind the listing was to achieve greater efficiency in the company’s management and to render it immune from future political interference.248 Since Sabesp’s offering in 2002, other SOEs and recently privatized firms have embraced a Novo Mercado listing. In 2006 government-controlled banking giant Banco do Brasil restructured its capital structure to convert its preferred non-voting

248 For a description of Sabesp’s decision to go public on the Novo Mercado, see André Franco Montoro Filho, O Ingresso da Sabesp ao Novo Mercado Amplia Horizontes, GAZETA MERCANTIL, June 21, 2002 (arguing that Sabesp’s Novo Mercado listing will mitigate or even avoid the use of the enterprise for electoral purposes) and Carlos Mauricio S. Mirandola, Hybrid Capital Structures and the Governance of State-Owned Enterprises: The Case of Sabesp (working paper, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1641377. See also Mario Engler Pinto Jr., O Novo Mercado da Bovespa e o Compromisso da Sociedade de Economia Mista com Práticas de Boa Governança Corporativa, 128 REVISTA DE DIREITO MERCANTIL, INDUSTRIAL, ECONÔMICO E FINANCEIRO 54, 60 (2002) (describing a Novo Mercado listing and the commitment to more stringent corporate governance standards as creating a barrier to the use of mixed enterprises for political ends).
stock into voting common stock in order to become eligible for a Novo Mercado listing.\textsuperscript{249}

Local commentators have applauded the willingness of SOEs to commit to the higher corporate governance standards of the Novo Mercado as a significant step forward.\textsuperscript{250} However, such a strategy is not without risks, since the Exchange’s private regulations do not eliminate the State’s extra hat as regulator. Any private regulatory regime depends on the State’s regulatory acquiescence and contractual enforcement. In Brazil, as in the U.S., stock exchange regulations are not immune from legal and political interference. The issuance of Novo Mercado regulations requires the approval of Brazil’s Securities and Exchange Commission (\textit{Comissão de Valores Mobiliários} – CVM), just as changes to the New York Stock Exchange rules require prior U.S. SEC approval. Consequently, the risk persists that the interests of the government as a shareholder may come to hamper the revision and updating of Novo Mercado’s listing standards over time.

Falling short of the creation of a special premium listing segment especially devoted to SOEs, an alternative approach to facilitate the sustained success of the Novo Mercado while continuing to admit government-owned firms would be to further embrace a dual approach within the segment. In exempting golden shares from the segment’s ban on differential voting rights, the Novo Mercado was able to lure privatized firms without compromising its strictures with respect to other companies. And there is evidence that such a dual approach exempting state-owned or privatized firms from some

\textsuperscript{249} The Brazilian government held a majority of the firm’s total capital and therefore continued to hold uncontested control over the bank after the conversion of non-voting into voting stock.

\textsuperscript{250} See, \textit{e.g.}, Montoro Filho, \textit{supra} note 248.
of the segment’s requirements continues to be adopted. For instance, a recently proposed revision to the Novo Mercado listing rules seeks to outlaw voting caps below 5% of total capital, but exempts privatized firms from such a requirement.251

d. Dualism across different jurisdictions

More promising than the split of regulatory authorities within a single jurisdiction is the attempt of listed SOEs to subject themselves to regulatory and enforcement action by a different State or an international institution. Outsourcing of enforcement of State legal obligations is now a conventional mechanism by which national governments can tie their hands and therefore credibly commit not to expropriate foreign investors through abusive policy reversals. To encourage foreign direct investment, governments typically enter into such credible commitments by signing bilateral investments treaties providing for international arbitration as a means of dispute resolution.252

State-owned enterprises, in turn, have resorted to a dual regulatory approach across different jurisdictions by cross-listing and issuing ADRs in foreign countries. Perhaps surprisingly, state-owned corporations are more likely than family-controlled firms to cross-list or issue ADRs abroad253 – a decision that a significant strand of the


252 For a discussion of the role of bilateral investment treatises as a commitment device, see Jennifer Tobin & Susan Rose-Ackerman, Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties, Yale L. & Econ. Res. Papers 8 (2008), available at http://ssrn.com/abstract=557121 (noting that the adoption of dispute resolution clauses providing for international arbitration instead of national courts was crucial to give these treaties “real bite”). By the early 2000s, there were more than 2,000 BITs in force involving approximately 176 countries. Id. at 6.

253 GOUREVITCH & SHINN, supra note 15, at 114 (“for a sample of countries whose private blockholders might care to cross-list in the United States in order to reap a venue-shopping valuation premium, the
literature attributes to the desire to lower their cost of capital by “bonding” to higher corporate governance standards than those available in their home countries. 254 According to the “bonding hypothesis,” a cross-listing helps firms from countries offering low investor protections to credibly commit to protecting investors by piggybacking on more protective NYSE corporate governance standards. This Chapter suggests that the particular susceptibility of state-owned firms to governmental conflicts of interest in the enforcement of investor protections may help explain why SOEs are more likely than private firms to cross-list their shares in foreign markets, particularly in the U.S.

Nonetheless, while cross-listing may be a promising approach to deal with State’s conflicts of interest in SOEs, it is not without challenges. First, securities regulations applicable to foreign issuers are significantly more lenient than those applicable to domestic firms. Second, a recent study finds evidence that the SEC tends to be more forgiving of, and therefore bring fewer claims against, foreign issuers, thus further

---

254 Legal and economic have advanced the “bonding hypothesis” to explain a foreign firm’s choice to cross-list in the U.S. For works supporting the bonding hypothesis, see John C. Coffee, Jr., Law and the Market: The Impact of Enforcement, 156 U. PA. L. REV. 229, 235 (2007); Craig Doidge et al., Why Are Foreign Firms Listed in the U.S. Worth More?, 71 J. FIN. ECON. 205 (2004) (finding that foreign firms that cross-list in the U.S. have a significantly higher Tobin’s q compared to similar companies from the same country of origin); Craig Doidge et al., Has New York Become Less Competitive than London in Global Markets? Evaluating Foreign Listing Choices Over Time, 91 J. FIN. ECON. 253 (2009) (finding that the U.S. cross-listing premium persists following the enactment of the Sarbanes-Oxley Act). But see Kate Litvak, The Relationship Among U.S. Securities Laws, Crosslisting Premia, and Trading Volumes 5 (CELS 2009 4th Annual Conference on Empirical Legal Studies, Working Paper), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1443590 (providing evidence that only firms having an above-median ratio of U.S. to total trading evidence enjoy a cross-listing premium, a that finding that can be interpreted to weaken the bonding hypothesis).
undermining the effectiveness of a bonding strategy.\textsuperscript{255} It is also reasonable to suppose that, all things being equal, the SEC may be more willing to file enforcement actions against private firms than government-controlled firms so as to avoid diplomatic tensions. Consequently, the risk of a reverse bonding strategy persists, in which “weak corporate governance practices of the home countries are exported to the foreign listing environment.”\textsuperscript{256}

V. Conclusion

Criticism to the State as entrepreneur is virtually as old as the modern state and modern business corporations. Already in the eighteenth century Montesquieu advised, “que le prince ne doit point faire le commerce.”\textsuperscript{257} Adam Smith, notoriously a skeptic of business corporations generally (which he saw as condemned by agency costs and monopoly), was likewise an early detractor of government incursion into enterprise. In his view, “[n]o two characters seem more inconsistent than those of trader and sovereign. If the trading spirit of the English East India Company renders them bad sovereigns, the

---

\textsuperscript{255} Natalya Shnitser, \textit{A Free Pass for Foreign Firms? An Assessment of SEC and Private Enforcement against Non-U.S. Issuers}, 119 \textit{Yale L.J.} 1638 (2010). Shnitser’s sample contains 3 enforcement actions relating to Brazilian issuers, all of which were claims for insider trading against privately-owned firms.

\textsuperscript{256} \textsc{Curtis J. Milhaupt \& Katharina Pistor}, \textsc{Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World} 134 (2008) (describing the case of China Aviation Oil, a Chinese company having tight links to the State that was cross-listed in Hong Kong as “an inversion of the theoretical model: rather than receiving additional protections, minority investors are (at least potentially) victimized by a distant parent company operating according to very different rules”).

\textsuperscript{257} \textsc{Charles Louis de Secondat Montesquieu}, \textit{De l’esprit des lois} 261 (1784).
spirit of sovereignty seems to have rendered them equally bad traders.”

Nevertheless, just as the agency costs associated with the corporate form were insufficient to doom the future of the business corporation, the conflicts between the State’s dual role as sovereign and entrepreneur did not eradicate government ownership of business enterprise.

Indeed, to the extent that the world’s largest firms have controlling shareholders, they are all too often States rather than individuals, families, or financial institutions. Despite the earlier waves of privatizations, State ownership remains pervasive around the globe. Corporations that are government controlled and publicly traded account for a sizable (and growing) fraction of the market capitalization in numerous jurisdictions, particularly in emerging markets. Yet despite their economic significance and legal complexity, state-owned enterprises remain surprisingly understudied. The existing literature has all but neglected the political economy implications of State ownership with respect to the content of a country’s corporate laws in general and its level of investor protection in particular. Yet, this Chapter insistently demonstrates, the conflicts of interest inherent in the State’s dual role as a player and referee are both evident and enduring – and manifest themselves in a variety of historical and institutional contexts. I suggest that this mechanism may account for an overlooked channel for reverse causation in the relationship between legal investor protection and ownership structure: while a deficient legal regime and underdeveloped capital markets may prompt the State to assume an entrepreneurial function, the political role of the State qua controlling

shareholder may, in turn, hinder the development of an effective investor protection regime as a precondition for further financial development.

This study represents an initial attempt to illustrate and address this problem. The conflicts of interest stemming from the State’s two hats, although serious, are hardly sufficient to condemn government ownership of enterprise. Alternative institutional arrangements, ranging from different ownership structures to dual regulatory systems, can be used to mitigate the State’s interest in the design and enforcement of corporate law rules applicable to private firms. State ownership is not going away and, absent institutional innovations, nor is the government’s conflicts of interest as a corporate governance regulator.
CHAPTER VI

Conclusion

In the last five years, Brazil’s capital markets have experienced an unprecedented boom. Following a period of stagnation in equity offerings and increased delistings in the 1990s, Brazil became the third largest IPO market worldwide in 2007, after China and the U.S. Since the mid-2000s, the São Paulo Stock Exchange has demutualized, merged with the local commodities and futures exchange, and launched an IPO on the exchange itself. In September 2010, following Petrobras’s record-breaking offering, it became the world’s second largest exchange by market capitalization.

While no single cause can account for the recent expansion of Brazil’s equity markets, Ronald Gilson, Henry Hansmann, and I have suggested elsewhere that “regulatory dualism” played an important part in improving corporate governance practices and earning investors’ support for Brazil’s market development. In 2000 the São Paulo Stock Exchange established the “Novo Mercado,” a voluntary listing segment on the exchange that requires stricter corporate governance standards than those


261 Ronald J. Gilson, Henry Hansmann & Mariana Pargendler, Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the U.S. and the EU, 63 STAN. L. REV. (forthcoming 2011).
mandated under Brazilian corporate and securities laws. The creation of the Novo Mercado represented a deliberate attempt to establish a parallel regime affording greater protection to minority investors while at the same time circumventing the lobbying efforts of established firms that had stymied reform in the legislature. Because a Novo Mercado listing is entirely voluntary, existing firms could opt to continue to be governed by the old and permissive legal regime and thus lacked a strong interest in opposing the experiment. Inspired by the country’s capital market growth and corporate governance movement, Brazil’s Securities and Exchange Commission (Comissão de Valores Mobiliários – CVM) played an increasingly bold and active role in promoting further investor protection reforms.262

But while much has changed in the last years, some of the same patterns shaping the evolution of corporate law since the nineteenth century continue to shed light on current developments in Brazil. Brazilian lawmakers have historically resorted to a vast array of foreign legal models in designing corporate law reforms, but the interests of incumbent elites have shaped local adaptations of, or deviations from, international standards over time. The ongoing legal controversy surrounding the proper scope of executive compensation disclosure provides a case in point.263

In 2009 the CVM undertook to revise its disclosure regulations with the explicit goal of curing the deficiencies of Brazilian laws on executive compensation disclosure.

262 Id.

263 For an overview of the debate about the apparent tension between local values and international standards in executive compensation disclosure in Brazil, see Viviane Müller Prado, Judiciário mediará os valores locais e internacionais na divulgação da remuneração dos administradores, ESPAÇO JURÍDICO BM&FBOVESPA, May 7, 2010.
The Commission had initially proposed requiring disclosure of individualized remuneration packages for each executive, but it settled on a watered-down version of the rule after a significant backlash from managers and controlling shareholders during public hearings. The resulting compromise required companies to disclose the aggregate amounts paid to executives as well as the highest and lowest salaries for board and management members.264

Whereas individualized executive compensation disclosure is now the norm in developed markets, Brazilian executives and their lawyers argued that the country’s particular legal and factual environment required deviations from internationally accepted practices. They argued that – given the privacy rights guaranteed by the Brazilian constitution and the country’s particularly high levels of violence – the CVM regulations were unconstitutional as a violation of the executives’ rights to privacy and security. So far, courts have agreed with executives and granted an injunction to suspend application of the disclosure mandate until final judgment is rendered.265 While local creativity and ingenuity can foster the adoption of an improved legal regime, such as the Novo Mercado, interest groups can also employ local considerations opportunistically to resist legal reforms that are against their interest.

Similarly, state-owned enterprises continue to play a major role in Brazilian equity markets. As discussed in greater detail in Chapter IV, government-controlled

264 For a more detailed discussion and analysis of the enactment and challenges to the CVM regulations on executive compensation disclosure, see Diego Werneck Arguelhes & Mariana Pargendler, Los Costos Colaterales de la Violencia: Cómo la Inseguridad Moldea las Instituciones Jurídicas en Brasil, in SELA 2010: INSECURITY, DEMOCRACY, AND LAW (2010).

265 See id.
Banco do Brasil and Petrobras launched major equity offerings in 2010. At $67 billion, Petrobras’s recent stock offering was the largest in world history. President Lula bragged about the achievement by proclaiming that “[i]t wasn’t in Frankfurt, it wasn’t in New York, it was in our São Paulo exchange that we carried out the biggest capitalization in the history of capitalism.”

Nevertheless, the role of the shareholding State in corporate governance remains controversial. As discussed in greater detail in Chapter IV, investors were highly critical of the State’s behavior as a controlling shareholder of Petrobras in a related-party transaction with the government that assigned rights to Brazil’s recently-discovered oilfields. Similarly, Banco do Brasil, which has been listed on the Novo Mercado since 2006, has voted against some of the most rigorous proposed changes to the segment’s regulations, which ultimately failed to receive the requisite approval.

* * *

This study of the evolution of corporate law in Brazil not only illuminates contemporary developments in the country’s capital markets but also offers theoretical contributions to the literature on comparative law and on law and finance more generally. In describing the development of corporate law institutions in the nineteenth century, Chapter II showed that there was a far greater degree of agency, reflection, and choice in the formulation of Brazilian laws governing business organizations than is conventionally assumed. Departures from foreign models were less due to local ignorance than to deliberate attempts to suit elite interests. The policies that stymied financial development

---


in Brazil for the greater part of the nineteenth century were the product not of legal
heritage, but of conscious political choices. References to legal families or traditions
were conspicuously absent from the discourse and debate among early Brazilian
lawmakers when considering institutional alternatives.

Chapter III then explored the extent to which the solidification of conventional
understandings about legal families and traditions took place in the twentieth rather than
in the nineteenth century, in Brazil as elsewhere. By tracing the intellectual history of
comparative law in general and of its taxonomic efforts in particular, Chapter III
demonstrated that now-conventional understandings about legal families are in fact of
remarkably recent vintage. A combination of factors ranging from economic liberalism,
anti-colonialist sentiment in then-young nations, and the reigning faith in world progress
led nineteenth-century lawyers to underplay – indeed, overlook – notions of legal
tradition and overstate the feasibility of legal convergence. These findings suggest that
the habitual utilization of legal family categories to describe nineteenth-century
phenomena in the law-and-finance literature raises serious risks of anachronism.

The second part of this dissertation turned to the State’s thus far overlooked role
as shareholder in the political economy of corporate governance. Chapter IV described
the proliferation of mixed enterprises in Brazil since the 1940s and their rise as the
country’s largest publicly-traded corporations. It showed that the tension between the
State’s interest as controlling shareholder and its role as a corporate regulator were
manifest from the outset in both its lawmaking and enforcement functions. In the 1990s
especially, the government’s financial interests as a selling shareholder during
privatizations led it to promote a major reform to the Corporations Law that eliminated
various minority investor rights during control sales. While the State succeeded in appropriating to itself a hefty control premium in privatization transactions, investor confidence in the country’s capital markets suffered as a result.

Of course, the existence of a conflict of interest stemming from the State’s two roles as a shareholder and regulator – that is, as a simultaneous player and referee in the corporate arena – was particularly acute in Brazil thanks to the predominance of mixed enterprises in the country. Chapter IV then tested the role of the State as a shareholder in shaping corporate law regimes in different historical and institutional contexts outside Brazil. By employing a series of historical vignettes narrating developments in the nineteenth-century U.S., twentieth-century Europe, and contemporary China, Chapter IV showed that the influence of the government as shareholder has been a significant but so far neglected factor in the evolution of corporate law around the world. It then offered a careful examination of different ownership and legal strategies to mitigate the conflicts of interest between the government’s regulatory and ownership functions. The recognition of the impact of State ownership on the corporate governance environment and the discussion of institutional mechanisms to address this conflict of interest assumes special importance in light of the recent expansion of state-owned enterprises in global capital markets.
**BIBLIOGRAPHY**

*Articles, Books, and Other Materials*


Almeida, F. P. Lacerda de, O Direito Civil e sua Codificação, in Livro do Centenário dos Cursos Jurídicos (1827-1927) (1928).


Amsden, Alice H. The Rise of “The Rest”: Challenges to the West from Late-Industrializing Economies (2001).


Ascarelli, Tullio, I problemi delle società anonime per azioni, 1956 Rivista delle società 3.

Azcárate, Gumersindo de. Ensayo de una Introduccion al Estudio de la Legislacion Comparada (1874).
Baer, Werner, and Annibal V. Villela, Privatization and the Changing Role of the State in Brazil, in Privatization in Latin America (Werner Baer & Melissa H. Birch eds., 1994).

Baer, Werner. The Privatization Experience in Brazil, in International Handbook on Privatization (David Parker & David S. Saal eds., 2003).


Fabrizio Barca & Sandro Trento, State Ownership and the Evolution of Italian Corporate Governance, 6 Ind. & Corp. Change 533 (1997).


Barreto Filho, Oscar, Seminário sobre a Reforma das Sociedades Anônimas, Promovido pelo Instituto dos Advogados Brasileiros, 77 Revista de Direito Mercantil, Econômico e Financeiro 119 (1972).


Bastos, Tavares. Cartas do Solitário (1863).

Bebchuk, Lucian A., Efficient and Inefficient Sales of Corporate Control, 1994 Q. J. Econ. 957.


Bevilaqua, Clóvis. Resumo das Licções de Legislação Comparada sobre o Direito Privado (1897).


Brazil Report – A Who’s Who of the Brazilian economy prepared by Visão, the country’s leading business news magazine (1973).


Bryce, James, The Extension of Roman and English Law throughout the World, in Select Essays in Anglo American Legal History (1907).


Camara, Jose Gomes B. Subsídios para a História do Direito Pátrio, Tomo III (1822-1889) (1966).


Cardoso, Fernando Henrique. Empresário Industrial e Desenvolvimento Econômico no Brasil (1972).


Carvalhal-da-Silva, André, and Ricardo Leal, Corporate Governance, Market Valuation and Dividend Policy in Brazil, 1 Frontiers Fin. & Econ. 1 (2004)


Clarke, Donald C., Corporatisation, Not Privatisation, 7 China Econ. Quart. 27 (2003).


Congrès international de droit comparé tenu à Paris du 31 juillet au 4 août 1900, Procès-Verbaux des Séances et Documents (1905).


Coutinho, Luciano, and Flavio Marcilio Rabelo, Brazil: Keeping It in the Family, in Corporate Governance in Development: The Experiences of Brazil, Chile, India and South Africa (Charles P. Oman ed., 2004).
Couto e Silva, Clovis do, O Direito Civil brasileiro em perspectiva histórica e em visão de futuro, 40 Revista AJURIS 128 (1987).

Cretella Junior, José, Sociedades de Economia Mista no Brasil, 80 Revista de Direito Administrativo (1966).


Djankov, Simeon, Rafael LaPorta, Florencio Lopez-de-Silanes, and Andrei Shleifer, The Law and Economics of Self-Dealing, 88 J. Fin. Econ. 430 (2008).


Dodd, E. Merrick, For Whom Are Corporate Managers Trustees?, 45 Harv. L. Rev. 1145 (1932).


Eckbo, B. Espen, The Government as Active Shareholder, Testimony to The Congressional Domestic Policy Subcommittee of The Oversight and Governance Reform Committee (Dec. 16, 2009).


Feasse, Andre. Les sociétés anonymes dans la République Argentine (1928).


Ferrarini, Guido, Corporate Governance Changes in the 20th Century: A View from Italy, in Corporate Governance in Context: Corporations, States, and Markets in Europe, Japan, and the US (Klaus Hopt et al. eds., 2005).

Ferreira, Waldemar. As Diretrizes do Direito Mercantil Brasileiro (1933).


Fletcher, James C., and Daniel P. Kidder. Brazil and the Brazilians Portrayed in Historical and Descriptive Sketches (6th ed., 1866).


Fjord, Vera Maria Jacob de, Brazil, in Party Autonomy: Constitutional and International Limits in Comparative Perspective (George A. Bermann ed., 2002).


Freyre, Gilberto. Ingleses no Brasil (1948).


Garnier, M. Joseph. Traité de finances (1862).


Gilson, Ronald J., Henry Hansmann and Mariana Pargendler, Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the U.S. and the EU, 63 Stan. L. Rev. (forthcoming 2011).


Goldstein, Andrea, Privatization in Italy, in Privatization Experiences in the European Union (Marko Köthenbürger, Hans-Werner Sinn & John Whalley eds., 2006).


Gorga, Érica, Changing the Paradigm of Stock Ownership from Concentrated Towards Dispersed Ownership? Evidence from Brazil and Consequences for Emerging Countries,


Guerreiro, José Alexandre Tavares, Direito das Minorias na Sociedade Anônima, 63 Revista de Direito Mercantil, Industrial, Econômico e Financeiro 106 (1986).


Handlin, Oscar, and Mary Flug Handlin. Commonwealth: A Study of the Role of Government in the American Economy: Massachusetts, 1774-1861 (1969);


Hoover, Herbert, Government Ownership, an address delivered by the Secretary of Commerce in Washington, DC, Sept. 29, 1924.

Houin, R., La gestion des entreprises publiques et les méthodes de droit commercial, in La Distinction du Droit Privé et du Droit Public et L’Entreprise Publique, Archives de Philosophie du Droit (1952).


Howson, Nicholas Calcina, and Vikramaditya S. Khanna, The Development of Modern Corporate Governance in China and India, in China, India and the International Economic Order (M. Sornarajah & J. Wang eds., 2010).

Howson, Nicholas Calcina, The doctrine that dared not speak its name: Anglo-American fiduciary duties in China’s 2005 company law and case law intimations of prior
convergence, in Transforming Corporate Governance in East Asia (Hideki Kanda, Kon-Sik Kim & Curtis J. Milhaupt eds., 2008).


Kahan, Marcel, Sales of Corporate Control, 9 J. L. Econ. & Org. 368 (1993).


La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny, Legal Determinants of External Finance, 52 J. Fin. 1131 (1997).


La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny, Corporate Ownership around the World, 54 J. Fin. 471 (1999).


La Porta, Rafael, Florencio Lopez-de-Silanes, and Andrei Shleifer, Government Ownership of Banks, 58 J. Fin. 265 (2002).


Leme, Ernesto. Das Ações Preferenciais nas Sociedades Anonimas (1933).


Lisboa, José da Silva (Visconde de Cairú), Princípios de Economia Política (1804).


Lobo, Eulalia Maria Lahmeyer, O Encilhamento, 5 Revista Brasileira de Mercado de Capitais 261(1976).


Matos, Odilon Nogueira de, Café e Ferrovias (1974).


McQueen, Rob. A Social History of Company Law, Great Britain and Australian Colonies (2009).


Miller, Rory. Britain and Latin America in the Nineteenth and Twentieth Centuries (1993).


Musacchio, Aldo, and Ian Read, Bankers, Industrialists and Their Cliques: Elite Networks in Mexico and Brazil during Early Industrialization, 8 Enterprise & Soc’y 842 (2007).


Musolf, Lloyd, Uncle Sam’s Private, Profitseeking Corporations (Comsat, Fannie Mae, Amtrak and Conrail) (1982).

Nabuco, Joaquim. Um Estadista do Império (1936).


Normano, J.F. Evolução Econômica do Brasil (1939).


OECD, SOEs Operating Abroad: An application of the OECD Guidelines on Corporate Governance of State-Owned, Enterprises to the cross-border operations of SOEs (2009).


Oliveira, Candido Luiz Maria de. Curso de Legislação Comparada (1903).


Pinto, Bilac, O Declínio das Sociedades de Economia Mista e o Advento das Modernas Empresas Públicas, in Estudos sobre a Constituição Brasileira (1954).


Pistor, Katharina, Codetermination: A Sociopolitical Model with Governance Externalities, in Employees and Corporate Governance (Margaret M. Blair & Mark J. Roe eds., 1999).


Pontes de Miranda, Francisco Cavalcanti. Fontes e Evolução do Direito Civil Brasileiro (1928).


Prado, Roberta Nioac, Mercado de ações brasileiro: proteção dos acionistas não controladores, regulação, autorregulação e desenvolvimento, in Os Juristas na Formação do Estado-Nação Brasileiro de 1930 aos Dias Atuais (2010).


Prodi, Romano, Italy, in Big Business and the State (Raymond Vernon ed., 1974).


Rathenau, Walther. In Days to Come (1921).


Rocha, Bruno, and Iam Muniz, Casos Brasileiros, in Governança Corporativa no Brasil e no Mundo (Ricardo P. C. Leal et al. eds., 2002).

Rocha, Francisco José da, Sociedades em Comandita Segundo o Código Commercial do Império do Brazil (1884).


Santos, Theophilo de Azeredo, As Sociedades de Economia Mista no Direito Brasileiro (1964).


Sauser-Hall, Georges. Fonction et méthode du droit comparé (1913).


Schwarz, Roberto, Cuidado com as Ideologias Alienígenas, in O Pai de Família e Outros Estudos (Roberto Schwarz ed., 1978).


Shearman & Sterling, Proportionality between Ownership and Control in E.U. Listed Companies: Comparative Legal Study (2007).


Simonsen, Mario Henrique. O Brasil e as Multinacionais (1975).


Souza, Inglez de, Convém Fazer um Código Civil?, 17 Revista Brasileira 257 (1899).


Streichenberger, Jean. Sociétés anonymes de France et D’Angleterre (1933).


Tang, Xin, Protecting minority shareholders in China: A task for both legislation and enforcement 143, in Transforming Corporate Governance in East Asia (Hideki Kanda, Kon-Sik Kim & Curtis J. Milhaupt eds., 2008).

Tarde, G., Le droit comparé et la sociologie, in Congrès international de droit comparé tenu à Paris du 31 juillet au 4 août 1900, Procès-Verbaux des Séances et Documents (1905).


Telles, José Homem Correa. Commentário Crítico a Lei da Boa Razão (1865).


Trebat, Thomas J., Brazil’s State-Owned Enterprises: A Case Study of the State as Entrepreneur (1983).


Vagts, Detlev F., Reforming the “Modern” Corporation”: Perspectives from the German, 80 Harv. L. Rev. 23, 80 (1966).


Valverde, Trajano de Miranda. Sociedades Anônimas (1937).

Valverde, Trajano de Miranda, Sociedades Anônimas ou Companhias de Economia Mista, 1 Revista de Direito Administrativo 429 (1945).


Vampré, Spencer, Das Sociedades Anonymas: Comentário a Consolidação das Leis sobre Sociedades Anonymas e em Commandita por Acções (Decr. N.o 434 de 4 de julho de 1891) (1914).


Veiga, Dídimo Agapito da. O Amigo e Conselheiro dos Commerciantes (1873).

Veiga, Dídimo Agapito da. As Sociedades Anonymas (1888).


Vernon, Raymond, Enterprise and Government in Western Europe, in Big Business and the State: Changing Relations in Western Europe (Raymond Vernon ed., 1974).


Vivante, Cesare. Trattato di Diritto Commerciale, v. 2 (1903).

Wald, Arnold, Doit-on repenser les «familles juridiques»?, in De Tous Horizons: Mélanges Xavier Blanc-Jouvan (Société de Législation Comparée, 2005)

Wald, Arnold, As Sociedades de Economia Mista e as Empresas Públicas no Direito Comparado, 152 Revista Forense (1954).


Zitelmann, Ernst. Die Möglichkeit eines Weltrechts (1888; 2nd ed. 1916).


Official Documents

Anais da Câmara dos Deputados.

Anais do Senado.

Coleção de Leis do Brazil.
CVM. Inquérito Administrativo 04/80 (10 de outubro de 1980), in Diário Oficial de 29 de outubro de 1980.

Exposição de Motivos ao Anteprojeto convertido em Decreto-Lei n. 2627 de 1940.

Exposição de Motivos ao Decreto-Lei n. 6.464 de 1944.

Exposição de Motivos n. 196 de 24 de junho de 1976.

Exposição ao Decreto Lei 21.536 de 1932.

Imperiaes Resoluções do Conselho de Estado na Secção de Fazenda (1870).


**Cases**

Middlesex Turnpike v. Locke, 8 Mass. 268 (1811).

Irvin v. Turnpike, 2 Pen. & W. 466 (1831).


Case C-543/08, Commission v. Portugal [2010].

**Magazine and Newspaper Articles**

Banco do Brasil’s Large Offer Seen Sailing Through, Reuters, June 28, 2010.


Burgess, Kate, OECD Scrutinises State Owned Groups, F.T., June 20, 2008.
Clemente, Isabel, “O Petróleo é Nosso” – Parte II (O que está por trás do projeto nacionalista de criar uma nova estatal petrolífera – e por que essa é uma ideia ruim para o país), Época, Aug. 15, 2008.


Rathbone, John Paul, and Andrew Downie, Banco do Brasil Plans to Raise Up to $6.1bn, F.T., June 29, 2010.


Why China is Different, The Economist, Nov. 11, 2010.