CORPORATE REFORM IN FRANCE: THE INFLUENCE OF CULTURE

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My earlier comments referred to some of the international effects of the Enron and Worldcom scandals. Major banks such as Crédit Lyonnais, Nikko Cordial, Sumitomo Misui Corporation, the Bank of Tokyo–Mitsubishi, the National Australia Bank and the Canadian Imperial Bank, to name just a few, collectively lost billions of dollars as a result of the Enron malfeasance.[1] The international impact is, of course, not limited to international finance. Enron, Worldcom, and others were multinational companies with shareholders, employees, suppliers, and customers in the United States and abroad. Their actions impact, in varying ways, foreign investment in U.S. companies, the strength of the U.S. dollar, and international forms of capitalism.

Previous panelists have commented on U.S. reforms developed to respond to the problems posed by the current scandals. As we ask ourselves whether the U.S. reforms will accomplish their intended objectives, we should also ask what we can learn from other countries' approaches to corporate governance and whether reforms that have proven successful abroad would be effective here in the United States. In the next few minutes, I will make a few observations on several aspects of French law that are relevant to today's discussion.

My comments are based in part on the new French business corporation law[2] that was enacted in 2001 and became effective a few months before the Enron collapse began, or at least became public. Although both the United States and France are industrialized western countries, in many respects, the two nations have adopted different approaches to corporate governance. As we consider whether aspects of the French approach would work in the United States, we must also ask to what extent the choices made reflect each country's respective social, political, and economic history and to what extent a given approach is useful to another culture.

The French tradition is one of strong central government (think Louis XIV and Napoleon), a government-controlled economy, and nationalized industry. However, since the 1980s, the French have systematically moved

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1. *See* BBC News, *Enron 2001* (providing estimates for the amount international financial institutions lost as a result of the Enron collapse), *at* http://news.bbc.co.uk/hi/english/static/in_depth/business/2002/enron/timeline/12.stm (last visited Apr. 17, 2003).

2. Law No. 2001-420 of May 15, 2001, J.O., May 16, 2001, p. 7776–807.

toward a market system and have undergone a significant program of privatization of its large companies.[3] In contrast, U.S. traditions include a strong emphasis on individual rights, an equally strong suspicion of strong centralized power, and the promotion of private enterprise operating in a market system. These observations are consistent with the findings of a study of 15,000 business managers working for companies in Western and Asian industrialized countries. Conducted by two professors of business administration, Charles Hampden-Turner and Alfons Trompenaars, the results of the study were published in 1993 under the title *The Seven Cultures of Capitalism*.[4] The book was based primarily on the results of a questionnaire completed by "upper–middle" level managers with international responsibilities within their respective companies.[5] The methodology of the research presented the managers with a series of dilemmas, each one of which required them to choose between competing values, perspectives, and attitudes.[6] I would like to take a few minutes to share with you some of the results of the study.

One question in the study asked participants to choose between two very different views of a company—one view describing a company functionally, as a system of tasks, with the other view of a company as a group of people working together.[7] Seventy-four percent of Americans chose the task-based description, while only 35% of the French business people agreed.[8] A significant majority of French considered a company as a community of social relations.[9]

In another question,[10] subjects were asked to choose between alternative ways to improve the quality of life, with one approach based on individual freedom and opportunity to develop oneself, while the second approach emphasized looking out for others as the basis of improvement.[11] Seventy-eight percent of U.S. business persons chose individual freedom and opportunity to develop oneself, while only 45% of the French agreed.[12]

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3. *See* Alexander Marquardt & Ellen H. Clark, *French Privatizations and International Capital Markets*, 15 NW. J. INT'L L. & BUS. 408, 408–11 (1994) (discussing the economic evolution of the French market system).

4. CHARLES HAMPDEN-TURNER & ALFONS TROMPENAARS, THE SEVEN CULTURES OF CAPITALISM (1993).

5. *Id.* at ix.

6. *Id.* at 10–12.

7. *Id.* at 31–32.

8. *Id.* at 32.

9. *Id.*

10. *Id.* at 340.

11. *Id.*

12. *Id.*

Again, a significant majority of the French emphasized looking out for others as a means of improving overall quality of life.[13]

There were similar divisions in the responses of managers asked to identify the type of job they preferred[14]—one in which no one is singled out for personal honor, or one in which personal initiatives are encouraged and individual initiatives are achieved. U.S. managers decidedly preferred jobs emphasizing individual achievement, whereas the French preferred those in which no one is specially recognized.[15]

In these and other questions, American business people, to a significantly greater degree than the French, viewed a corporation as a collection of tasks, rather than as a human endeavor comprising a collection of social relations. Americans valued individual opportunity, achievement, and individual qualifications as being more important than group cohesiveness. The French, in contrast, tended to emphasize communitarian concerns.

The conclusions of this study are consistent with the observations made by Jonathan Charkham in his book *Keeping Good Company*,[16] a comparison of corporate governance in five countries. Charkham described American and French business leaders in the 1990s in the following way. According to Charkham, "[t]he USA discarded monarchy and aristocracy and substituted a wealth-measured meritocracy . . . [in which the] style at the top of USA companies to this day is more presidential/military than it is collegiate . . . [and in which] the typical CEO is heavily personalized by the media."[17] Charkham adds that "[t]he Americans are so secure in their individuality that they can become great joiners without fear of impairing it . . . . The emphasis on individuality sits well with a pioneering entrepreneurial society."[18] In contrast, according to Charkham, in France the national attitude of business leaders "was that their role was to assist in the creation of a strong national economy, that quick money was immoral money, and that financial wizardry was less important than building up major industries."[19]

The emphasis on individuality in the United States and on group responsibility in France can be further illustrated by comments reportedly made by American and French business leaders. Fifty or so years ago, Charles Wilson, then head of General Motors, said, "What is good for

13. *Id.* at 340–41.
14. *Id.* at 56–57.
15. *Id.*
16. JONATHAN P. CHARKHAM, KEEPING GOOD COMPANY (1995).
17. *Id.* at 178.
18. *Id.*
19. *Id.* at 122.

General Motors is good for the U.S." Later, Jacques Calvet, then head of the French automobile manufacturer Peugeot, responded to Wilson's observation by saying, "What was good for General Motors, was good for the U.S.A.? Well, I consider what is good for France is good for Peugeot."[20]

Let's pause for a moment to think about how these observations connect with the recent scandals. Enron, particularly during the time Jeffrey Skilling was its CEO, prided itself on creating a culture of rewarding individual initiative by hiring very bright people and giving them substantial free rein to think creatively and act upon their ideas. There were apparently few controls on individual action as high-level managers were encouraged to develop creative and profitable approaches to doing business. At least two employees, Andrew Fastow, the former Chief Financial Officer, and Michael Kopper, one of his associates, allegedly directed their creativity to improving their personal coffers. That is the downside of excessive emphasis on individuality.

Having considered briefly some differences in the business culture of the two countries, let us now briefly compare a few key provisions of the French corporate code with their American counterparts. This comparison is not intended to suggest that we should necessarily adopt some, all, or even any of the components of the French approach. Nor will these reforms prevent a clever person from committing fraud. However, a comparison may be useful in helping us consider ways to curb some of the consequences of our cultural bias toward individual autonomy, a bias that, at least at Enron and Worldcom, has operated at the expense of a broader view of corporate role and responsibility.

Some of the new French corporate code's provisions, such as those dealing with outside auditors, will now seem familiar. In expanding companies' reporting requirements and strengthening the role of outside auditors, the new French code anticipated some of the U.S. reforms found in the Sarbanes–Oxley Act[21] discussed in the previous panel. In France, auditors must be registered by the national government, will incur criminal penalties for failing to comply with reporting requirements, must comply with a code of ethics established by the national government, and may engage only in the business of auditing.[22] Auditors must also report problems to the directors and, in certain situations, may call an emergency

20. HAMPDEN-TURNER & TROMPENAARS, *supra* note 4, at 340–41.

21. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

22. Law No. 2001-420 of May 15, 2001, J.O., May 16, 2001, p. 7796–98, 7802–03; C. COM. Art. L. 225-218 – Art. L. 225-228.

shareholders' meeting when irregularities occur.[23] Although some of the specifics in the French code may be different from those found in the Sarbanes-Oxley Act, the intent and effects of the two pieces of legislation have significant similarities. The key difference was in the timing of the legislation. France had anticipated the potential conflicts in the auditor's role and had acted to minimize their effects. The U.S. regulators waited until the problem occurred to take similar measures.

Let us now consider the membership of the board of directors in each country. In the United States, directors of large public companies are, typically, executives who work for the company in question, high-level executives of other companies, lawyers, government officials, and members of academia. Typically, only representatives of high-level management are members of the board. In certain of the largest French companies, board membership must also include representatives of the company's employees,[24] including as a separate group those who are also shareholders, with at least one seat reserved for a representative of professional salaried employees, such as engineers, and one seat reserved for hourly employees.[25] Thus, in France, as elsewhere in Europe, board membership reflects the larger corporate community: high-level executives, employee shareholders, and both salaried and hourly workers.

Charkham has reported that in the United States, company employees are increasingly acquiring and holding collectively significant amounts of stock of the firms in which they work, as much as 12 to 15% as of 1995.[26] Perhaps U.S. employee/shareholders should also have a seat on the board, affording them the opportunity to play an increased and potentially positive role in corporate governance in the United States. One wonders whether employee/shareholder presence and voice would have in any way affected the current excesses in executive compensation or decisions regarding funding of pension funds.

There is U.S. precedent for increased employee participation on the board of directors. During the 1970s, when the then Chrysler automobile corporation was approaching insolvency and hourly workers were asked to take a pay cut in order to keep the company operating, union representatives served on the Chrysler board of directors until the wage cuts were restored. There are, of course, problems with this approach. One is, as Charkham has described, that Americans often use "a confrontational and individual

23. C. COM. Art. L. 234-1 – Art. L. 234-2.
24. C. COM. Art. L. 225-22 – Art. L. 225-23.
25. *Id.*
26. CHARKHAM, *supra* note 16, at 230–31.

approach [to solving problems]—not a co-operative or collegiate one."[27] This approach to problem solving raises the question whether employee representatives would view themselves primarily as representatives of the employees or would serve the interests of the entire corporate community. The same question may, of course, be asked of a board excluding the voice of employees.

If, as just suggested, expanded board membership may make corporate decision-making responsive to a broader community of interests within the corporation, the French code suggests that broader representation of a different type may offer increased protection for shareholder interests. In the United States, prevailing state law requires members of the board of directors to be individuals.[28] The U.S. requirement that the board members be elected as individuals rather than as representatives of another company is, historically, consistent with Americans' traditional suspicion of large concentrations of financial power, concentrations that are more readily accepted in France and other European countries.

In contrast, in France, both individuals and companies, through their representatives, may be members of the board of a French company.[29] Statutory provisions permitting banks and other companies to have representation on the boards of the companies in which they invest likely reflect France's traditional approach to capital finance, in which banks rather than capital markets played an important role. (Market capitalism has increased significantly in France during the past twenty-five or more years.) An example of this difference between the French and U.S. Corporate Codes is that CalPERS[30]—the giant California pension fund with significant equity investments in U.S. companies—may not, as CalPERS, be elected to a seat on the board of a U.S. company, whereas it may in France.

Having institutional investors act as monitors to management conduct was suggested in 1992 by Professor Bernard Black when he said the "[i]nstitutional voice is potentially valuable because of the need for *someone* to monitor corporate managers, with financial intermediaries as the only available candidates."[31] In his remarks earlier today, Professor

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27. *Id.* at 177–78.

28. *See, e.g.*, 8 DEL. CORP. CODE § 141(b) (2002) (describing the composition of the board of directors).

29. C. COM. Art. L. 225-20.

30. *See Welcome to CalPERS On-line!*, *at* http://www.calpers.ca.gov (last visited Apr. 17 2003).

31. Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 886–87 (1992).

Baldwin[32] suggested that some aspects of the Hartzell and Starks[33] study of firms suggest that financial institutions may influence the behavior of firms whose stock they own. Thus, the formal presence of an independent investor entity might in itself be a deterrence to some of the types of activities that are currently being reported. However, this option requires us to face what Charkham described as the crux of the American dilemma—a dislike of concentrations of power versus a respect for effective accountability.[34]

We must also consider that although in past years funds such as CalPERS, TIAA-CREF, and others have taken an increasingly active role in influencing corporate governance, the broad diversification of their investments may limit their ability to exercise consistently the desired level of influence. It is also possible that a board including representatives of other companies, and thus representatives with divided loyalties, would not serve either company well.

The new French code has also anticipated U.S. concerns with how best to regulate the exercise of stock options used as executive compensation.[35] French tax laws use a combination of long holding periods and favorable tax rates to encourage executives to hold stock acquired from options during their tenure with the company.[36] To qualify for the most favorable tax treatment, the sale of stock acquired through the exercise of a stock option must take place at least six years after the option was granted and at least two years after the option was exercised.[37] If the holding periods are not met, then significantly higher tax rates apply.[38] As it happens, the six year holding period is consistent with the average tenure of a CEO in the United States.

Let me close with a word of caution. The French corporate code contains provisions that may possibly discourage some of the kinds of reprehensible conduct we have been witnessing in recent months. However, if we seriously consider adopting any reforms originating in another culture, including other Western cultures, we must be mindful that to be effective, the objectives of the law must be supported by broader U.S.

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32. William L. Baldwin, *The Corporation and Society: An Evolutionary/Institutional Approach*, 27 VT. LAW. REV. 841 (2003).

33. Jay C. Hartzell & Laura T. Starks, *Institutional Investors and Executive Compensation* (2002) (working paper), *available at* http://www.bus.utexas.edu/AIMCenter/working%20Papers/Hartzell8.pdf.

34. CHARKHAM, *supra* note 16, at 176.

35. Law No. 2001-420 of May 15, 2001, J.O., May 16, 2001, p. 7802–03.

36. *Id.*

37. *Id.*

38. *Id.*

social institutions and cultural values. Otherwise, even the most modern and well intentioned law may be ineffective.

Russia's new corporate code provides an example of the problems associated with trans-cultural reform of corporate law.[39] Russia's current corporate code was heavily influenced by U.S. law. It was apparently not significantly based on Russian legal tradition and culture. In addition, at the time it was drafted, Russia's legal and financial institutions did not provide the necessary support for the law. Consequently, in Russia, an innovative and very modern corporate code reportedly languishes in the statute books. The lesson to be learned from the Russian experience is that as we look to other countries for possible avenues of reform, we must consider what would be effective in the context of U.S. history, culture, and legal tradition.

39. *See, e.g.*, Bernard Black et al., *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. 1731 (2000); Richard P. Cunningham Jr., *Corporate Governance and Foreign Investment Nightmares in Russia: A Case Study of Unified Energy Systems*, 42 VA. J. INT'L L. 889, 890 (2002) (noting that the Russian corporate code was "hastily adopted in the initial momentum of political reform and without the benefit of hindsight, [and] lack[s] the legal and cultural underpinnings necessary to effect successes in more mature markets over time").