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COMPARATIVE ANALYSIS OF SHAREHOLDERS RIGHTS IN COMMON LAW AND CIVIL LAW JURISDICTIONS

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(I) ABSTRACT

In every nation, the growth of financial markets and corporate governance depends on the legal protection of company shareholders. The protection of shareholder rights in general, particularly minority shareholder rights, is the greater concern, even though my study focuses on a comparative aspect of shareholder rights belonging to Common Law and Civil Law jurisdictions, which have been mainly classified by the US & UK versus Germany and France. I employed the Legal Origin Theory (LLSV)[696], a comparatively well-known and significant theory in comparative company governance. According to the argument, the Common Law system is better than the code-defined rigidity of the Civil Law systems based on the French model because judges' flexibility and independence offer better protection of property and shareholder rights. But this study reconsiders this argument, which is supported by historical longitudinal data, leads to the counterargument that most civil law nations offer superior, if not clearly superior, protections for minority shareholders.[697] Rules intended to shield minority interests from majority demands are responsible for the most notable disparities. Minority shareholders have statutory safeguards in civil law nations that are known for their concentrated ownership. The fact that many jurisdictions' current regulations are growing more and more hybrid is also noteworthy. For instance, India increases protections for all shareholders by contemporary legislation and regulatory modifications. This highlights once more how crucial the relationship between the "law in action" and the "law on the books" is.

(II) KEYWORDS: Shareholder Rights, Common Law, Civil Law, Corporate Governance, Legal Origin, Minority Protection.

[696] GAROUPA N., TRENDS IN COMPARATIVE LAW AND ECONOMICS 21–28 (Anthem Press 2022).

[697] Prabirjit Sarkar, *Common Law vs. Civil Law: Which System Provides More Protection to Shareholders and Creditors and Promotes Financial Development*, 2 JARLE 143-161 (2011).

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(III) INTRODUCTION

There is a lot of global debate about the structure of corporate law and how well it protects shareholders, particularly minority shareholders. The main purposes of strong laws are to address the agency problem that arises from the separation of ownership (shareholders) and of control (managers and majority shareholders). When the legal system does not work properly, then investors will not be willing to invest their capital. This slows the development of financial markets and the economy in general.

Most legal systems around the world fall primarily into two traditions: Common Law (originating in England, and used in the US, UK, India, and so on), and Civil Law (derived mostly from Roman law). Within both Common and Civil Law traditions, there are different legal systems, e.g., Civil Law still has origins in French, German, Scandinavian, and so on. The earliest consensus, popularized by La Porta, Lopez-de-Silanes, Shleifer, and Vishny (LLSV), suggested that Common Law systems were better.[698] The reason was that Common Law systems relied on the concept of judicial precedent to better adapt to new corporate issues that arose, since judges were able to shape law, based upon a specific case, rather than simply apply an explicit code, as was true in Civil Law systems. There was also a political argument, whereby judges in Common Law systems would have more independence and less government influence over private property rights. However, the empirical evidence supporting this assertion has been heavily scrutinized, leading to a profound re-evaluation of the legal origins paradigm. Critics argue that the traditional **LLSV data lacked transparency** and relied on a static view of "law on the books" rather than the operational "law in action".

This study aims to provide a critical examination of the shareholder protection systems in Common and Civil Law systems, concentrating on protection from the board/management and the majority shareholders (minority protection). It is informed by current comparative legal studies. In order to achieve this goal, the article examines which legal regimes or combinations of legal features offer the best protections for shareholders in the twenty-first century. It does this by drawing on recent data and legal developments, such as recent changes to the Indian corporate context.

(IV) LITERATURE REVIEW

The comparative analysis of shareholders rights is linked to the "Law and Finance" school of thought, where legal origin is taken as a basic "endowment" leading to different economic outcomes.

(A) The Legal Origin Thesis (LLSV)

La Porta et al. provided the foundational premise, asserting that Common Law countries offer comparatively better protection to shareholders and creditors, which leads to greater financial development. This could also result from two important structural differences:

1. **Adaptability:** The Common Law system's reliance on judicial interpretation allows the law to evolve in response to changing market conditions, as opposed to the rigid legislative process to update Civil codes.

2. **Judicial Independence:** The greater political and structural independence of the Common Law judiciary allows judges to be a more significant counter-balance to the legislature, protecting individual property rights from and restrictions by the state, a critical concern under the French Civil Law system, which has historically been founded on the connection to the state. As Mahoney pointed out, the greater degree of judicial independence and lower level of executive control seen in Common law implies "more

[698] Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1115 (1998).

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scope for governments to alter property and contract rights" in Civil Law structures.[699]

(B) The Comparative Law Challenge

The LLSV model of corporate governance has faced significant theoretical and empirical challenge. Certain comparative law scholars argue that a rigid classification of legal origin is problematic, because most modern legal systems are hybrids. For example, due to the influence of the European Union, even the law of the United Kingdom has become more "continental," and Japanese company law, which was originally based in the German law, has been heavily influenced by US law.

The important point is that the more contemporary research makes clear is that there is a distinction between "law on the books" (formal rules) and "law in action" (its practical operation, enforcement and its cultural context). The social or economic effect of a legal rule is intimately tied to a system of "interlinked norms, some of which are extra-legal". Moreover, the empirical basis of the LLSV indices has also been criticized for relying on unweighted binary variables (0, 1) that do not account for nuances of legal uncertainty or the different functional roles that different rules perform in different jurisdictions.

(C) Alternative Empirical Findings (CBR Data)

The criticism culminated in the longitudinal study involving CBR data that tracked legislative developments in four OECD nations (UK, USA, France, Germany) from 1970-2005. The CBR indices provided a broader range of values and more functional substitutes of "hard" law, with longitudinal evidence of legal transformation.

Overall, the major finding from the counter-analysis was that Civil Law countries (France and Germany) provided more aggregate shareholder protection (ALLSP)[700] than Common Law (UK and USA) countries during the observation period. This upward deviation was not observed in "Protection for against the Board and Management (SPBRD)" where the Common Law and Civil Law were largely similar, but in "Minority Shareholder Protection (SPMIN)" where Germany and France provided a greater range of protection. This would suggest that the Civil Law tradition, in confronting stewardship issues in concentrated ownership, provided a compensating effort through difficult statutory requirements regarding supermajority provisions, anti-dilution material, and mandatory disclosure rules for acquisition rules that would prohibit or provide indirect limits to limit majority suppression of minority interest.

(V) METHODOLOGY

This will be a qualitative comparative legal study that only draws upon the synthesis and critical reading of academic research papers and legal documents. This research will be two-part methodology:

(A) Theoretical Comparison and Empirical Comparison: The first portion will summarize and compare the literature on two competing theories of shareholder powers.

(B) The "Legal Origin Theory" (LLSV), contending that a Common Law system predominates via the judicial process and consequently independence of the judiciary.

(C) The "CBR/Longitudinal Study" perspective, argues that those operating in a Civil Law system showcase better overall shareholder protection through time-series dynamic data amidst specifically minority rights.

(D) Case Study: The second aspect that is merely illustrative will be to merge some specific legal development and case law from a major Common Law jurisdiction of India. This will demonstrate how Common Law adapts with legislation (e.g. SEBI enactments and the Companies Act, 2013) in conjunction with judicial activism not to say nothing about the possible nuances of law in practice irrespective of its legal origin. Two to four cases will be prioritized which relies on the policy nature of

[699] Paul G. Mahoney, *The Corporate Law Economic Literature*, 25 J. CORP. L. 46, 51 (2001).
[700] John Armour et al., *How Legal Origin Affects the Evolution of Shareholder Protection: A Study of the UK, US, France and Germany*, 55 AM. J. COMP. L. 165, 170 (2009).

shareholder rights litigation to offer an understanding of the judiciary's role/trials and tribulations in finding itself as protector of the shareholder.

(VI) RESULTS

The examination of the documents presented, comes down to several key findings that rebuke the basic principles of the Legal Origin Theory.

(A) Civil law is superior to common law in minority protection.

The longitudinal data (1970-2005) demonstrates that aggregate shareholder protections (ALLSP) tend to be lower in Common law countries (UK, USA) than Civil law countries (France, Germany) and the main reason for this lies within one of the sub categories: Protection of Minority Shareholders against the Majority (SPMIN).

Although laws associated with protection of board and management (SPBRD) regarding director appointments and assets sales are no different between these countries, Civil law jurisdictions have stronger statutory protections for minorities historically. These statutory protections include rules like supermajority requirements to take corporate actions (e.g.2/3 for mergers) or mandatory bids in takeovers, which weaken the majority's power significantly.

(B) Importance of "law in action" and hybridization.

The data demonstrates that legal rules evolve and hybridize. UK law has become more "continental" while French judges, despite codes, are able to interpret the law through lenses, like "good faith."

(C) Common Law Adaptability in Practice (India Case Study)

The experience of India, a Common Law jurisdiction, illustrates the practical process of legislative strengthening of rights. Recent legal developments have aimed to strengthen shareholder participation and protection through **amendments to the Companies Act, 2013, and SEBI Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015**. Key recent amendments include mandating:

- Periodic reviews of special rights conferred to shareholders.
- Shareholder approval for directorships once every five years.
- Mandatory disclosure of binding agreements affecting control.

These changes directly address concerns regarding power concentration, effectively empowering minority shareholders through statutory means a legislative response similar to the historical development in Civil Law systems.

(D) Judicial Support of Shareholder Rights (Case Laws)

The judiciary, in Common Law regimes, provides decisive support to shareholders' rights through precedent decisions of the courts. Examples of these decisions reflecting the proactive nature of the judiciary to interpret laws and protect the interests of minorities are as follows:

(1) *Invesco Developing Markets Fund v. Zee Entertainment Enterprises Limited (2022)*: The Bombay High Court supported shareholders' rights to call for an extraordinary general meeting (EGM) with a strong affirmation. The court stressed that shareholders have a right to exercise their rights, free from the board's interference, thereby enhancing the elements of accountability and transparency.[701]

(2) *M.K. Ranjitsinh v. Union of India (2019)*: The Supreme Court considered the rights of minority shareholders as a part of the restructuring and merger of the corporate entity. The court ruled that the minority shareholders should not be unduly dealt with on account of the decisions made by the majority when it comes to major corporate activities.[702]

[701] Invesco Developing Mkts. Fund v. Zee Ent. Enters. Ltd., (2022) SCC OnLine Bom 1725.
[702] M.K. Ranjitsinh v. Union of India, (2019) 15 SCC 659.

(3) *T.N. Godavarman Thirumulpad v. Union of India (1997 onwards)*: The case exemplifies the Indian judiciary's role in guiding corporate governance by interpreting the laws in favour of accountability, but often dealing with matters of an even complex nature that exceed conventional matters of corporate litigation.[703]

(VII) DISCUSSION

The conversation concerning Common Law versus Civil Law shareholder protection is now much less an issue of jurisdiction superiority of one over the other and much more about finding functionally equivalent rules that provide adequate protection. The paramount tension becomes two distinct agency problems: that of protecting dispersed shareholders from managers (which historically has been better addressed in Common Law systems through fiduciary duties and litigation) and protecting minority shareholders against the controlling majority (which has been better addressed through explicit statutory rules in Civil Law systems).

The empirical evidence that Civil Law has greater protection for minority shareholders is inconsistent with the LLSV thesis. It can be understood in the context of ownership structure of corporations. Civil Law countries (e.g. Germany and France) have historically had companies with concentrated ownership in which the controlling shareholder exerts power over the company. The law consequently made explicit, rigorous and mandatory rules to prevent the majority from appropriate illegitimate private benefits - problems that were much less pronounced under the more dispersed ownership structure that has been historically present in the US and UK.

In contrast, the Common law model is fundamentally rooted in private enforcement mechanisms, particularly through the law of fiduciary duties, securities law, and a more relaxed approach by the judiciary to shareholder enforcement, including derivative actions, to temper managerial power. This approach also needs good judicial quality and process, but is considered more flexible and open to change. However, India, as a Common law jurisdiction, illustrates that legislative acts can readily adopt Civil law-like features which distinguishes judicial practice. Thus, amendments of the Securities and Exchange Board of India (SEBI), which included the LODR Regulations 2015 in their primary memorandum, are effectively statutory good governance mandates (as good governance) that create "positive legal rules" in a legislative context that strengthen minority protections. Again, akin as before, the notions of convergence demonstrate that legal systems can borrow "successful" protective mechanisms regardless of jurisdictional origin or miss the mark on protecting minority interest ever more so weakening the distinctive or exclusivity of a classification. Ultimately the success of these provisions, are also a function of judicial quality, legal process, and enforcement factors that form "law in action" and are likely equally different in their effectiveness among all countries. The judicial decisions, including Invesco and Ranjitsinh, reflect what the Common law judiciary can do to ensure that legislative intent allows for tangible rights, at any point, enforcing accountability for minority interests and deterring disproportionate harm to minority interests with respect to major corporate actions. This judicial proactivity is the embodiment of the **"adaptability" argument** put forth by the original Legal Origin theorists, confirming that while the *source* of the protective rule may be statutory (Civil Law style), the *mechanism of enforcement* remains the flexible, case-by-case judicial interpretation characteristic of Common Law.

(VIII) CONCLUSION

The comparison shows that the difference between Common Law and Civil Law routines with respect to shareholder protection is one of emphasis, and enforcement mechanism, rather than absolute superiority. The traditional Legal Origin Theory that put Common Law at the

[703] T.N. Godavarman Thirumulpad v. Union of India, *1997 (2) SCC 267.*

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pinnacle due to judicial flexibility is complicated by showing Civil Law systems, which derive orders from prescriptive statutory codes, provide a higher level of minority shareholder protection (SPMIN), at least statistically. Corporate law is converging, with Common Law jurisdictions like India adopting Civil law-style statutory measures to remedy concentrated power, and Civil Law systems developing a greater scope of judicial interpretation. Whether the legal origin system is Common Law or Civil Law is less important than the quality and certainty and consistency of the "law in action." Quality and certainty includes strong regulatory bodies and a robust, active, independent judiciary. Suffice it to say - robust corporate governance requires a hybrid system - the flexibly of precedent based jurisprudence combined with required, and precise rules in the statutes to protect the weak minority from the entrenchment of the majority.