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THE CAREFUL USE OF COMPARATIVE LAW DATA: THE CASE OF CORPORATE INSOLVENCY SYSTEMS

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I. INTRODUCTION

I am not a comparative lawyer and I was somewhat surprised to be invited to open this conference with a lecture on comparative law methodology. I had the impression that comparative law and academics entered that field of endeavor to exploit previously acquired expertise in the laws of a foreign country. Comparatists are convinced that the knowledge of foreign laws and legal institutions is valuable. Yet, more than legal scholars in any other field, they struggle to define the purpose to which their knowledge should be applied. The objectives of comparative law are sometimes divided into practical and scientific aims.[1] The usually cited practical objectives are (a) to facilitate communication between participants of various systems, (b) to provide the framework for the harmonization of national laws and the interpretation and application of supranational laws, and (c) to inform domestic law reform by evaluating the experience of foreign systems.[2] The scientific aims are stated in more

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1. MARY ANN GLENDON ET. AL., COMPARATIVE LEGAL TRADITIONS 9 (1985).

2. *See* Max Rheinstein, *Comparative Law—Its Functions, Methods and Usages*, 22 ARK. L. REV. 415 (1968); RUDOLPH B. SCHLESINGER ET. AL., COMPARATIVE LAW 2-8, 17-41 (5th ed. 1988); GLENDON, *supra* note 1, at 9.

general terms: (a) to understand the relationships between law and the social, economic, historical, political and cultural context in which it operates and (b) to reveal the existence and relevance, if any, of universal principles of law. In the latter more academic vein, the study of foreign legal systems by comparatists produces an enormous amount of data that is of great potential value in the study of legal theory. Unfortunately, this empirical enterprise has been compromised by two problems that comparatists have yet to address: the absence of falsifiable hypotheses and the tendency to construct theories ex post to fit the observed data (sometimes known as data mining).

For some time, comparative law scholars have emphasized the merits of a functional approach to comparing legal systems. The leading casebooks refer to this approach as examining law in action rather than law in the books.[3] If societies are viewed as systems which seek to enhance the collective welfare of their respective members, they may face the same types of challenges and yet respond with different combinations of legal and extralegal techniques. Thus, a comparatist should examine the combined operation of law and other mechanisms of private ordering and social control.[4] Notwithstanding this emphasis on functional analysis, comparative law scholars are traditionally generalists in that their inquiries tend to cut across several areas of law. Although a broad interest in law may seem more conducive to the search for universal principles, specialization in a given area of law facilitates a priori theorizing and thereby discourages ex post rationalizations of comparative data. Specialists in specific areas of law can test the theories they have developed by studying their national systems (and perhaps one or two others) against the experiences in a broader set of foreign systems. This ensures that specialists construct a priori hypotheses from their understanding of lawmaking processes in their home system(s), and that these hypotheses are uncontaminated by observations of data from foreign systems. Recently, comparative analysis has attracted the attention of American corporate law scholars who have been intrigued by the governance systems of Japan and Germany,[5] as well as the opportunity to participate in the law making process in countries emerging from centrally

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3. GLENDON, *supra* note 1, at 11; *see also* SCHLESINGER, *supra* note 2, at 880-90.

4. *See, e.g.*, O. Kahn-Freund, *Comparative Law as an Academic Subject*, 82 L.Q. REV. 40, 45-52, 55-58 (1966).

5. *See* Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871 (1993); Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927 (1993) [hereinafter Roe, *Some Differences*].

planned economies.[6] The organizers of this conference have also chosen the approach of field-specific comparative analysis in the areas of corporate law and bankruptcy. The conference promises to reveal a great deal of information about the laws and legal institutions in other countries. Moreover, by focusing the discussion on a set of practical problems, the organizers have encouraged the participants to describe how their various systems function in fact, rather than merely restate (or translate) relevant legislative provisions. Nevertheless, at the end of the day, we continue to face a significant danger of overstating the conclusions we mine from the data that are no more than hypotheses at this stage about the evolution of corporate and bankruptcy law.

While a significant amount of scholarly comparative analysis has been undertaken in corporate law, less has occurred in the area of insolvency.[7] Bankruptcy scholarship, however, is sufficiently rich in theory that we should be able to generate falsifiable hypotheses to be tested against data produced in this conference and elsewhere. Insolvency scholars have proposed various explanations of bankruptcy based on observations of the American system: for example, that bankruptcy effects a desired redistribution from secured lenders to other corporate stakeholders[8] or that reorganization procedures provide a cushion for employees and managers of firms in contracting industries. Most recently, a theory of insolvency law is evolving that views bankruptcy as a corporate governance mechanism. Perhaps because my interest in bankruptcy has evolved from earlier research into patterns of debt financing, I have subscribed to a governance view of bankruptcy.[9] Through terms of repayment, covenants, events of default, acceleration and enforcement rights, debt contracts impose a discipline on corporate decision makers that complements other governance mechanisms controlled by shareholders, or arising from the factor, product and capital markets in which the corporation operates. When shareholders and equity markets have failed to address managerial slack in a firm, control passes to debtholders either through exercise of

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6. *See, e.g.*, Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911 (1996).

7. Several very good comparative studies have been published in bankruptcy law. *See, e.g.*, CURRENT DEVELOPMENTS IN INTERNATIONAL AND COMPARATIVE INSOLVENCY LAW (Jacob S. Ziegel ed. 1994); Theodore Eisenberg & Shochi Tagashira, *Should We Abolish Chapter 11? The Evidence from Japan*, 23 J. LEGAL STUD. 111 (1994).

8. *See, e.g.*, Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987).

9. *See* George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CAL. L. REV. 1073 (1995); George G. Triantis, *Debt Financing, Corporate Decision Making and Security Design*, 26 CAN. BUS. L.J. 93 (1996).

their individual creditor rights or in a collective process in bankruptcy. In this sense, bankruptcy procedures may be thought of as last-resort governance mechanisms. Many features of insolvency and bankruptcy laws in the U.S. and Canada are structured to correct slack and improve managerial decision making.[10] The study of foreign insolvency systems permits a more rigorous testing of various hypotheses that may be generated from a bankruptcy-as-governance theory. These hypotheses should be falsifiable and have predictive power. Starting from an assumption that governance mechanisms are needed whenever corporate decision makers do not fully bear the costs and benefits of their decisions, a set of hypotheses might predict the existence of a limited number of combinations of governance rules and institutions and thereby exclude the possibility of other patterns. In particular, we might conjecture as to the nature and role of bankruptcy within these configurations. To give a simple example, bankruptcy reorganization structures are more likely to be found where there are developed public equity and debt markets and a sophisticated judiciary (as in the U.S.), and less likely to be used (even if they exist in the books) in countries where ownership and debtholdings are concentrated and courts are less sophisticated.

II. COMPARATIVE LAW METHODOLOGY

The exercise of comparative law is the identification and explanation of similarities and differences among legal systems. Observations of similarities and differences can inform or provide support for theories about the role of the law in society. Three brief examples illustrate the point. First, a legal philosopher who postulates a natural law based on universal principles is comforted by evidence of uniformity among systems. Second, from a functional perspective, a comparatist begins with the premise that societies face the same problems and they address these challenges through sometimes different combinations of legal and extralegal mechanisms, though often with similar outcomes. The rules of law, legal institutions, combinations of legal and extralegal forces, and

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10. *See* Lynn M. LoPucki & George G. Triantis, *A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies*, 35 HARV. INT'L L.J. 267 (1994); George G. Triantis, *The Interplay Between Liquidation and Reorganization in Bankruptcy: The Role of Screens, Gatekeepers and Guillotines*, 16 INT'L REV. L. & ECON. 101 (1996) [hereinafter Triantis, *The Interplay*]; George G. Triantis, *A Theory of the Regulation of Debtor-in-Possession Financing*, 46 VAND. L. REV. 901 (1993); George G. Triantis, *The Effect of Insolvency and Bankruptcy on Contract Performance and Adjustment*, 43 U. TORONTO L.J. 679 (1993).

even the result of this combination may differ among societies. Third, a legal historian, anthropologist or sociologist expects that laws are molded by or reflect social phenomena. These observers are more intrigued by differences across geography, time and culture. To them, the shape of law and legal institutions is determined by context and the presence of similarities across significant discrepancies in context may be simply accidental.

Two of the more prominent recent explanations for similarities are the transplant and efficiency theories. The former claims that law is made by elite groups of lawyers who are keen to adopt the rules and institutions from those systems they regard as prestigious, and who care little about the functional consequences in their own systems.[11] The efficiency theory also predicts a high degree of uniformity, but with the opposite argument: legal rules and institutions are driven by functional imperatives and tend to evolve toward efficient solutions to societal problems. The systematic convergence of laws over time that is predicted by both transplant and efficiency theories is at best equivocally supported by observations of comparative law that also reveal many instances of diversity in legal rules. Indeed, at the most basic level, two societies may not even view the same phenomenon as being problematic.[12]

The transplant and efficiency theories have been qualified to accommodate observations of diversity. Ugo Mattei suggests that there is an international market for legal ideas.[13] Societies are both producers and consumers of legal mechanisms that address challenges to the collective welfare. An efficient solution can evolve independently in various societies, but it can also move from producer to consumer through associations among lawyers and policy makers. Legal transplants avoid the costs of duplicative law production. However, the migration of an efficient legal rule from one system to another can be blocked by what Mattei calls

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11. This theory is proposed and elaborated by Alan Watson in a large number of publications. *See, e.g.*, ALAN WATSON, LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW (1974).

12. *See, e.g.*, Jonathan Hill, *Comparative Law, Law Reform and Legal Theory*, 9 OXFORD J. LEGAL STUD. 101, 108 (1989). "The Soviet legal system, for example, as a result of its ideological biases, faces the 'problem' of how to prevent citizens from acquiring unearned income through the purchase and resale of consumer goods at a profit . . . . In Western legal systems, however, the resale of goods at a profit is regarded as legitimate economic activity." *Id.*

13. Ugo Mattei, *Efficiency in Legal Transplants: An Essay in Comparative Law and Economics*, 14 INT'L REV. L. & ECON. 3 (1994).

at various times, legal parochialism, tradition or ideology in the receiving society.

Mattei's efficient transplant theory is not contradicted by the observed patterns of similarities and differences. Indeed, his theory could fit a wide spectrum of possible observations. His thesis is that the market for legal ideas promotes efficient transplants except where they are blocked by parochialism, ideology or tradition. The qualification makes the theory malleable and somewhat tautological. A more creditable attempt to produce falsifiable theory of private law is made by Saul Levmore, who begins with the premise that societies face similar problems that threaten their stability and general welfare. He therefore expects to and does find a substantial amount of uniformity in tort and property rules that maximize collective welfare. The driving force toward such uniformity seems to be an evolutionary process that selects for the fittest societies. Levmore explains variety as existing in rules (a) that ultimately lead to similar behavioral effects or (b) over which reasonable lawmakers could disagree over which is the best.[14] Although Levmore seems to suggest that cost-effectiveness in controlling inefficient behavior is the metric for predicting uniformity or variety in any type of rulemaking, the question of whether in any given case reasonable lawmakers could disagree over the best rule is subject to some ex post rationalization. In less capable hands, it would be tempting to identify a close call in order to explain differences in laws. Levmore heightens this problem by suggesting that other factors, such as cultural influences and attitudes toward wealth distribution may come into play when reasonable people could disagree about the relative efficiency merits of various rules.[15]

It is common in the social sciences to assess a theory by its predictive power: that is, its capacity to predict phenomena of which the theory's architect was not aware at the time the theory was constructed.[16] Yet, one

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14. Saul Levmore, *Rethinking Comparative Law: Variety and Uniformity in Ancient and Modern Tort Law*, 61 TUL. L. REV. 235 (1986) [hereinafter Levmore, *Rethinking Comparative Law*]; *Variety and Uniformity in the Treatment of the Good-Faith Purchaser*, 16 J. LEGAL STUD. 43 (1987); *Waiting for Rescue: An Essay on the Evolution and Incentive Structure of the Law*, 72 VA. L. REV. 879 (1986).

15. Levmore, *Rethinking Comparative Law*, *supra* note 14, at 239. Although he expressly declines to endorse "any specific view of the development and evolution of legal rules," he asserts that his analysis "most readily supports a position that combines an emphasis on law as 'a device shaped by the members of society in response to internal conditions in the search for ways and means to translate their basic social postulates into action' with a view that changes [of these postulates] are stimulate when a culture's rules are not consonant with its survival." *Id.* (quoting E. HOEBEL, THE LAW OF PRIMITIVE MAN 327 (1954).

16. Milton Friedman has stated that "theory is to be judged by its predictive power for

needs some experience with the matter being explained in order to develop a tentative hypothesis. There are sophisticated methods of data experimentation that allow the production of a small number of explanatory variables from a set of data (rather than a priori), but they are complex and one needs to be cautious and conservative in stating the significance of the results.[17] The more straightforward approach is to use part of the data for hypothesis production and the other part for testing the predictive force of the hypothesis.[18] Jonathan Hill observes the following:

> the data which comparative law provides can be of some assistance in verifying (or falsifying) legal theory. . . . If comparative law provides limited support for a variety of theories, rather than unequivocally endorsing any particular philosophy, this might be thought to reveal something about both the complex nature of law, and the limited explanatory power of any model or theory which is designed to illuminate the essence of legal phenomena.[19]

This counsels in favor of a modest functional approach. Experts within defined areas of law should construct hypotheses based on experience in their own countries and then test them against the data from foreign systems.

Considerable progress in this respect has been made recently in the area of corporate law. Corporate governance scholars have taken the first steps toward generating hypotheses about the evolution of corporate law by looking at the systems of three countries: Japan, Germany and the U.S.[20] Based on observations of differences in the governance structures of corporations in the U.S. and the other two countries, corporate scholars have produced a theory of path dependent evolution.[21] The laws and

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the class of phenomena which it is intended to 'explain' . . . [the theory's predictions] may be about phenomena that have occurred but observations on which have not yet been made or are not known to the person making the prediction." MILTON FRIEDMAN, ESSAYS IN POSITIVE ECONOMICS 8-9 (1969).

17. *See, e.g.*, Michael C. Lovell, *Data Mining*, 65 REV. ECON. & STAT. 1 (1983).

18. One needs to be careful also when the same data set is subject to a sequence of empirical studies undertaken by many individuals. Future research is often motivated by the successes and failures of past investigations and over time, and it may be difficult to correct for the consequent bias in hypothesis selection. *See* Andrew W. Lo & A. Craig MacKinlay, *Data Snooping Biases in Tests of Financial Asset Pricing Models*, 3 REV. FIN. STUD. 431 (1990).

19. Jonathan Hill, *Comparative Law, Law Reform and Legal Theory*, 9 OXFORD J. LEGAL STUDIES 101, 112-13 (1989).

20. *See, e.g.*, Roe, *Some Differences*, *supra* note 5.

21. *See, e.g.*, Marcel Kahan & Michael Klausner, *Path Dependence in Corporate*

institutions of each country evolve along a path that is generally determined by moves from less to more efficient positions, but that is periodically bumped by the forces of culture and politics. This framing of comparative theory is not different in kind from the efficiency theories qualified by context which have been embraced by other comparatists to explain differences by diversity in extralegal context. A theory that predicts efficient developments in law and related institutions but that admits to interruptions by cultural or political forces is not falsifiable. What distinguishes the proponents of path dependence, however, is a concerted effort to detail the cultural and political forces and to place them in time along the evolutionary path of the countries they study. Yet, some problem of ex post rationalization remains unless the conditions in which efficiency defers to culture and politics are defined a priori. This is an extremely complex and perhaps impossible enterprise. Sidestepping it, however, will limit what we can learn from foreign systems and, therefore, our understanding of domestic laws and universal principles of law.

III. BANKRUPTCY AS A CORPORATE GOVERNANCE MECHANISM

Several years ago, Lynn LoPucki and I conducted a comparative study of the bankruptcy reorganization systems of the United States and Canada.[22] We predicted that differences in culture, history and politics would not affect the functioning of the systems—at least at the level we were examining—and that despite differences in legislation and even judicial law, the two systems would work in the same way because of certain economic imperatives. During the development of bankruptcy law in Canada, legislators and judges rejected many legal doctrines that are thought to be fundamental to the operation of the U.S. system of bankruptcy reorganization: such as the cram down, the estate, the debtor-in-possession and the debtor's option to assume or reject executory contracts. Transplant proponents in particular should note that Canadian lawmakers expressly stated this desire to avoid several key features of the U.S. system. Our theory predicted that regardless of differences in doctrine or in political, cultural and social contexts, common functional imperatives would cause the two systems to converge over time. Economic

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Contracting: Increasing Returns, Herd Behavior and Cognitive Biases, 74 Wash. U. L.Q. 347 (1996); *see also* MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994); Black & Kraakman, *supra* note 6; Gilson & Roe, *supra* note 5.

22. LoPucki & Triantis, *supra* note 10.

imperatives not only influence the evolution of law in the legislatures and in the courts, but more importantly, they determine the reactions of private parties to legal rules. The evidence supported our thesis. We found, for example, a guillotine rule in Canadian legislation that provides for the liquidation of a debtor firm if a restructuring proposal is voted down by the creditors. In contrast, the U.S. Bankruptcy Code does not prevent the debtor from filing a new plan. It is quite common in Canada, however, for the parties to hold a straw poll in order to avoid the guillotine. The cost to the parties of reaching an agreement to circumvent the rule is low enough in this case that the difference in the law in the books is of little functional significance. We uncovered many other instances of the same phenomenon. In each reorganization case under the Canadian bankruptcy legislation, a licensed trustee must agree to act and must approve of the cash flow statement required to be filed by the debtor. In most Chapter 11 cases in the U.S., a trustee is not appointed. The debtor's attorney, however, serves many of the same gatekeeping functions as the Canadian trustee. Thus, even if law makers are indifferent or mistaken to some degree as to the merits of legal rules, the evolution of extralegal institutions and conventions are predicted to push the systems toward similar patterns of behavior.

One might argue that our conclusions missed the point. It should not be surprising that two countries as similar as the U.S. and Canada would have reorganization systems that share common functional objectives. What is probably more interesting is the differences in the mechanisms used in each country to fulfill those functions. Before looking at comparative data, an investigator should specify the level of detail which is or is not relevant. To borrow terminology from Sir Otto Kahn-Freund, we need to decide to what extent it is more informative to act as a comparative physiologist rather than a comparative anatomist.[23] A reader of the comparative study that LoPucki and I wrote may find the differences in doctrinal tools more interesting than the similarities in function.[24] Moreover, it is significant that the same function may be achieved at a higher cost in one system than another because of the need to work around different rules and institutions in each.

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23. Kahn-Freund urged the comparative lawyer to see himself or herself as "a comparative physiologist rather than as a comparative anatomist." Kahn-Freund, *supra* note 4, at 45.

24. Jean Braucher makes this point persuasively in this issue. Jean Braucher, *Harmonizing the Business Bankruptcy Systems of Developed and Developing Nations: Some Issues*, 17 N.Y.L. SCH. J. INT'L & COMP. L. 473 (1997).

In the commercial context, bankruptcy law is conventionally viewed as a process that resolves the financial distress or insolvency of a business enterprise. In a classic statement of the purpose of bankruptcy law, Thomas Jackson stated that bankruptcy prevents the destruction of going concern value by the exercise of individual creditor remedies against the assets of a financially distressed firm.[25] This perspective views insolvency as the problem and bankruptcy as the solution to that financial problem.

There is, however, an easier way than a bankruptcy proceeding to avoid financial distress—firms might borrow less and rely more on equity financing. Given that the vast majority of business entities are leveraged, any theory of bankruptcy law must start with an explanation of a firm's decision to issue debt rather than equity and of observed patterns of debt contracting. Recent scholarship has begun to clarify the role of debt in deterring and correcting managerial slack: for example, lapses in managerial competence or effort, excessive managerial compensation or perquisite consumption, and managerial entrenchment that diminish the value of the firm.[26] Often, managerial slack is a failure to respond in a timely manner to changes in the firm's environment.[27] A number of mechanisms deter and correct slack while the firm is solvent. For example, shareholders exercise their voting rights and engage in proxy contests to remove incompetent or ineffective management. If incumbent shareholders remain passive (perhaps because of a collective action problem) in the face of inefficient management, they too must be replaced. As the invisible hand would have it, there is an incentive for third parties to acquire voting control through the purchase of shares and to remove management. Debt, and particularly the enforcement rights that accompany it, can complement the disciplinary effect of governance measures such as shareholder voting and hostile takeovers, by setting trip wires that instigate the removal of managers and redeployment of assets. The critical purpose of debt is to *cause* financial distress at times when, despite the availability of other devices to keep managers in line, firm assets are not being optimally deployed. Default and insolvency alert debtholders (as well as other stakeholders) to the possibility of such inefficiency and thereby prompt the correction of managerial slack. When debt is concentrated in the hands of a sophisticated party such as a bank, its intervention (or threat of intervention) can correct the problem in management. At other times,

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25. THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW, ch. 1 (1986).

26. Triantis & Daniels, *supra* note 9.

27. *Id.*; Michael C. Jensen, *The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems*, 48 J. FIN. 831 (1993).

however, the principal debtholder may not be qualified to assume that role or the firm's debt may be widely dispersed.

Bankruptcy provides a collective mechanism to the same remedial objective. It is therefore a serious policy error to regard bankruptcy as a method of solving financial distress while *preserving* the debtor's going concern value. The financial distress is a signal of the need for economic restructuring to *enhance* going concern value. Bankruptcy should facilitate the correction of managerial slack and improvements in the efficiency of asset deployment. Resolving the financial distress without addressing these efficiency concerns is as dangerous as disconnecting a ringing fire alarm without ascertaining the location or cause of the fire.

Thus, a theory of bankruptcy should start with the following postulates. First, financial distress or insolvency is typically not the problem, but a symptom of the underlying economic problem—a mismanagement of business assets. This mismanagement need not be anything sinister or grossly negligent; it can be simply the failure to respond in a timely fashion to exogenous changes in economic conditions. Second, when invoked, bankruptcy acts as a governance mechanism to correct the managerial slack and corresponding economic inefficiency. It might be characterized as a governance measure of last resort which comes into play after shareholders have failed to correct the problem and when there is no dominant lender with expertise and concentrated holding of the firm's debt. Third, bankruptcy is therefore about enhancing the value of firm assets, rather than simply preserving the value by resolving the financial distress. To be sure, there may be non-governance motivations for postponing financial distress through a bankruptcy process. For instance, bankruptcy can defer the layoff of workers or can postpone the sale of firm assets to permit the dissemination of information to potential buyers.[28] Yet, a bankruptcy regime that pursued only the latter would be an ineffective governance tool and would largely undermine the disciplinary value of debt. To translate the foregoing normative theory into positive terms, one would expect that parties would either contract around a bankruptcy regime that did not address the governance issue or firms would issue significant amounts of debt only to a single dominant (and probably secured) lender. A theory that regards bankruptcy (either liquidation or reorganization) as a governance mechanism can nevertheless yield a number of testable hypotheses.

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28. On the information-producing properties of bankruptcy proceedings, *see* Triantis, *The Interplay*, supra note 10.

The focus of this conference is the bankruptcy regimes of emerging nations. Their economic and political conditions contrast sharply with those of the U.S. Before constructing these hypotheses, it is useful to outline in very broad terms some features of emerging economies. They are characterized by weak legal and market institutions. Their judiciary is relatively unsophisticated and sometimes corrupt. Their factor and product markets are often not competitive and their capital markets consist of relatively unsophisticated players. In the transition economies, ownership is often held by managers and employees. In emerging countries of the third world, ownership of business entities tends to be concentrated in families. Liquid markets for equity interests are in their infancy and there is limited turnover in control positions. There being little external finance and therefore little separation between ownership and control, decision makers typically have reasonably appropriate incentives to maximize firm value and they are monitored by holders of concentrated interests, often within their own families. There is often an extensive web of interfirm shareholdings and trading among cross-held entities. Sources of external financing are limited, however, and to the extent that external financing exists, it tends to be dominated by commercial banks. In the absence of liquid debt markets, the banks hold and exercise considerable monitoring authority and should be willing to intervene at the first signs of financial or economic distress. Given that most financing comes from retained earnings, interfirm transfers within families of companies and bank lending, emerging economies bear a closer resemblance to the patterns of financing and governance in Japan than the U.S.

The last-resort governance role of the collective process of bankruptcy is of much less significance in this account of financing patterns in emerging nations than it is in the U.S. economy, which is characterized by more dispersed holdings of debt and equity interests, liquid capital markets and a separation of ownership and control. In emerging markets with concentrated ownership and substantial cross-holdings, owners are a more reliable disciplinary force, as is the principal lender. The need for either takeover activity or a collective governance process in bankruptcy is less pressing and, at the same time, the various stakeholders may have misgivings about turning over significant business decisions to less experienced courts. As a first stab and without identifying cause and effect, it is reasonable to expect to see more intricate bankruptcy regimes (i.e. beyond individual creditor remedies) being used in countries with dispersed holdings of debt and equity and sophisticated courts. In the emerging nations, we would predict instead a more urgent economic and political emphasis on the protection of property rights, a market for business assets and the evolution of individual creditor enforcement

remedies. To be sure, more complex bankruptcy schemes might be transplanted from the more to less developed economies as a result of interactions among lawyers, academics and policy makers. Transplanting may explain how statutes that go beyond individual creditor collection devices get in the books in transition or emerging nations. However, a transplanted set of rules or institutions may remain unused. To argue, for instance, that the advice of American experts contributed to the enactment of a reorganization statute in an emerging country is quite different from saying that the statute operates as such and is in fact used as a collective governance mechanism rather than, for example, a tax collection device. If nothing else, the country may lack the judicial infrastructure (courthouses, filing systems, judges, etc.) to support a more elaborate regime.

IV. CONCLUSION

Corporate law scholars have made important steps toward identifying a limited number of governance patterns in the leading industrialized nations. Debt is increasingly viewed as a factor in corporate governance and therefore the bankruptcy process must be integrated into these patterns of governance. Even in the shadow of path dependence, if we believe that efficiency drives much of the evolution of legal rules and institutions, we would expect to find that some things go with others and some configurations do not survive. This allows us to isolate a finite number of patterns of governance and provides us with falsifiable hypotheses. With the functional data produced in this conference and, I hope, others like it in the future, our understanding of the mechanisms of corporate governance and decision making will grow immeasurably.