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The International Law of Corporate Governance

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ABSTRACT

International economic agreements increasingly touch on fundamental principles of corporate governance. The trend contrasts with existing scholarship, which assumes corporate law evolves via domestic mechanisms. This Article introduces the EU-Japan Economic Partnership Agreement, with its dedicated chapter on corporate governance, as a case study. At the normative level, the emergence of corporate governance in international agreements represents a positive development by enabling countries to signal and put into action commitments for better governance. Given these recent developments, the field of comparative corporate governance should incorporate international agreements as an emerging source of law.

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INTRODUCTION

In February 2019, a new Economic Partnership Agreement (EPA) came into force between the European Union and Japan.[2] The parties have touted a remarkable innovation in the text: for the first time, an EU trade agreement includes an entire chapter dedicated to corporate governance.[3] Thus far, no academic article has analyzed this agreement nor its relation to past corporate governance initiatives. This gap is striking, given the expected scale and influence of the agreement. The two signatories cover a combined economic area equal to a third of global GDP and over 600 million people.[4]

The addition of a corporate governance chapter in the EPA is seemingly groundbreaking. However, it actually follows a broader pattern of international economic agreements impacting domestic corporate law and governance.

This Article seeks to expand the existing literature on international law and corporate governance by analyzing provisions in the EU-Japan Economic Partnership Agreement and previous economic agreements. Through explicit and implicit provisions, international economic agreements have a major but unappreciated influence on intra-firm dynamics between shareholders, managers, directors, and other stakeholders. These agreements can encourage convergence over a shared set of corporate governance principles.

The increased focus on corporate governance in international agreements represents a positive development by enabling countries to signal and put into action a commitment to better governance. Looking ahead, the European Union, and even the United States, may push similar corporate governance

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[2] European Commission Press Release IP/19/785, EU-Japan Trade Agreement Enters Into Force (Jan. 31, 2019).

[3] European Commission MEMO/18/6784, Key Elements of the EU-Japan Economic Partnership Agreement (Dec. 12, 2018).

[4] Foo Yun Chee, *EU-Japan Free Trade Deal Cleared for Early 2019 Start*, REUTERS (Dec. 12, 2018, 7:21 AM), https://www.reuters.com/article/us-eu-japan-trade/eu-japan-free-trade-deal-cleared-for-early-2019-start-idUSKBN1OB1EN.

initiatives in future economic agreements. Such initiatives could strengthen domestic reformers in countries looking to implement more accountable corporate governance regimes.

Part I will provide the current landscape for debates in comparative corporate governance. Part II introduces the new EU-Japan Economic Partnership Agreement, with its dedicated chapter on corporate governance. Part III will seek to identify theoretical explanations for the appearance of corporate governance provisions in international agreements. Part IV places the EPA within the broader history of international agreements that explicitly and implicitly impact intrafirm governance.

I. THE CURRENT LANDSCAPE

The Economic Partnership Agreement (EPA), with its dedicated corporate governance chapter, emerges amidst ongoing discussion about the role of corporate governance in economic growth. Research has demonstrated that improvements in corporate governance, such as investor protection, can have a positive impact on firm performance.[5] Such improvements can scale across an economy. More broadly, a debate rages on whether corporate law can promote capital markets, which are seen as an important tool for development.[6] The literature has broadly assumed that corporate governance is a matter of firm choice under the constraint of a given country's laws.

The discipline of corporate governance delves into the web of relationships, rights, and responsibilities of different actors involved in a corporation. The Organization for Economic

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[5] *See, e.g.*, Sanjai Bhagat & Brian Bolton, *Corporate Governance and Firm Performance*, 14 J. CORP. FIN. 257, 257 (2008) (finding positive correlations between difference governance measures and firm operating performance).

[6] *See* Rafael La Porta et al., *The Economic Consequences of Legal Origins*, 46 J. ECON. LITERATURE 285, 285 (2008) (describing the differing economic consequences of the common and civil law systems); *c.f.*, Mark J. Roe, *Legal Origins, Politics, and Modern Stock Markets*, 120 HARV. L. REV. 460, 527 (2006) (legal origins data is not a strong indicator for predicting financial outcomes of countries in the twentieth century).

Cooperation and Development (OECD) defines corporate governance as "a set of relationships between a company's management, its board, its shareholders, and other stakeholders."[7] Corporate governance also includes "the structure through which the objectives of the company are set, and the means of attaining those objectives . . . ."[8] Corporate law regulates these interactions, focusing on reducing conflicts inherent between major actors in the corporation: managers and shareholders, controlling and non-controlling shareholders, and shareholders and other contractual parties (such as employees and creditors).[9] Private sources of regulation also exist. Stock exchanges, for instance, set requirements for listed firms. "Soft law," involving voluntary corporate commitments, plays an influential gap-filling role.[10] A prominent example includes the Cadbury Code in the United Kingdom, which was developed by the Financial Reporting Council, the Stock Exchange and the accountancy profession.[11]

A. The Convergence Debate

Globalization has raised the stature of corporate governance, as companies subject to one set of national rules trade, operate, and compete with counterparts operating under other sets of rules. Such interactions have raised questions of whether current economic and political trends will result in one set of principles, or whether domestic differences and the rise of new players, such as China, will result in divergent trajectories.

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[7] Organization for Economic Cooperation and Development, G20/OECD Principles of Corporate Governance 1, 11 (2015), https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf (hereinafter OECD Principles); *see infra* Section I.D (discussing further the OECD's approach to corporate governance).

[8] OECD Principles, *supra* note 7.

[9] John Armour et al., *The Essential Elements of Corporate Law: What is Corporate Law?*, *in* ANATOMY OF CORPORATE LAW 2, 3 (Gerard Hertig et al. eds., 2017).

[10] *See* Douglas M. Branson, *Teaching Comparative Corporate Governance: The Significance of "Soft Law" and International Institutions*, 34 GA. L. REV. 669, 670 (2000) (arguing that "soft law" has overtaken law itself as the "principal determinant of corporate behavior").

[11] Mohammed B. Hemraj, *Preventing Corporate Failure: The Cadbury Committee's Corporate Governance Report*, 10 J. FIN. CRIME 141, 142 (2002).

On the side of convergence, Henry Hansmann and Reinier Kraakman argue in *The End of History for Corporate Law* that the remaining differences in national systems are relatively minor.[12] Corporations around the world benefit, by law, from a similar set of features, including a recognized legal personality, limited liability, and transferable share ownership. An emerging consensus of jurisdictions gives shareholders control of the corporation, obligates managers to focus on shareholder interests, and segregates other stakeholders to the realm of regulatory or contract enforcement.[13] Such changes have emerged from three dynamics of the global economy: "the failure of alternative models, the competitive pressures of global commerce, and the shift of interest group influence in favor of an emerging shareholder class."[14] These justifications connect to the centrality of globalization in the convergence hypothesis. In a competitive environment, effective corporate governance can serve as an advantage for individual companies and nations. Better practices can result in increased investor confidence, and in turn, a lower cost of capital. Companies and individuals are thus incentivized towards a natural uptake of efficient norms.[15] Alternatively, investors and acquirers operating in global capital markets seek to standardize corporate governance practices to facilitate the flow of capital.[16]

Other scholars have opposed the convergence hypothesis, highlighting the persistence of nation-specific corporate governance practices.[17] Lucian Bebchuk and Mark Roe have

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[12] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001).

[13] *Id.* at 440.

[14] Henry Hansmann & Reinier Kraakman, *Reflections on the End of History for Corporate Law*, *in* THE CONVERGENCE OF CORPORATE GOVERNANCE 32 (Abdul A. Rasheed & Toru Yoshikawa eds., 2012).

[15] *See* Jeffrey N. Gordon & Mark J. Roe, CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 1, 2 (Jeffrey N. Gordon & Mark Roe eds., 2004) (discussing the diffusion of corporate governance norms through investors, international organizations, and other actors).

[16] *Id.; see infra* Section III.D (discussing standardization in corporate governance practice, reducing the costs for investors to understand and operate under different regimes).

[17] *See generally* Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999) (identifying initial legal structures as an impediment to global convergence).

proposed a path dependence theory: the initial ownership structures of a society, and the precedent of corporate law and practice, insulate domestic corporate structures from global pressures to conform.[18]

The emergence of international regimes for corporate governance appear, at first glance, to support the convergence hypothesis. Particularly where provisions require specific binding actions, such agreements push domestic law towards similar outcomes. However, as discussed below, international agreements may also leave room for, or explicitly permit, significant amounts of domestic variation.

B. Comparative Corporate Governance and International Regimes

Analyses of comparative corporate governance have largely neglected the role of state-to-state or multilateral agreements in influencing corporate governance practice. The preceding convergence debate highlights the role of decentralized participants in the evolution of corporate governance: (i) local actors, including the political and business sectors; and (ii) foreign actors, typified by investors and acquirers.[19] The model focuses on a domestic view of corporate governance diffusion, where each nation, and actors within each nation, engage in a decentralized process of reform or resistance.

Newer scholarship has begun exploring the role of global governance on corporate law practice. For instance, Jeffrey Gordon has critiqued an approach that ignores international regimes, noting that:

> To an extent that might surprise academics focused on the political economy of races to the top or bottom driven by local political economy, convergence on a common set of corporate governance

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[18] *Id.* at 129.

[19] Jeffrey Gordon, *Convergence and Persistence in Corporate Law and Governance, in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 28, 28 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2017).

principles and practices has been driven by various forms of global governance.[20]

One thread of scholarship has embraced international regimes for corporate governance. Jeffrey Gordon and Curtis Milhaupt have proposed a multilateral regime to regulate outbound M&A activity for firms under potential government influence.[21] The proposal aims to ensure that "the prospective buyer is motivated by private economic gain-seeking," and not by nationalist/mercantilist goals.[22] Their work emerges from the rise of Chinese-style entities that threaten the model of a profit-driven corporate entity.[23]

Mariana Pargendler has raised doubt on the viability of international corporate governance regimes by highlighting protectionism in corporate law.[24] Nationalism has shaped corporate law into a tool to prevent competition, impeding convergence towards a shareholder-friendly governance model.[25] Resurgent nationalist impulses may weaken the prospects for corporate governance in international agreements.

Other works have narrowly assessed the role of specific provisions of international economic agreements, often focusing on the role of international arbitration provisions in intra-firm governance.[26] Arbitration agreements may violate principles of corporate governance by privileging one group of equity holders (foreign shareholders) with remedies unavailable to another

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[20] Jeffrey Gordon, *Convergence and Persistence in Corporate Law and Governance* 28, 50 (Columbia Law & Econs., Working Paper No. 574, 2017).

[21] *See generally* Jeffrey N. Gordon & Curtis J. Milhaupt, *China as a 'National Strategic Buyer': Towards a Multilateral Regime for Cross-Border M&A* 192 (Columbia Law & Econs., Working Paper No. 585, 2018).

[22] *Id.* at 196.

[23] *Id.* at 225.

[24] Mariana Pargendler, *The Grip of Nationalism on Corporate Law* 1, 3 (European Corp. Governance Inst. Law, Working Paper No. 437, 2019).

[25] *Id.* at 4.

[26] *See, e.g.,* Vera Korzun, *Shareholder Claims for Reflective Loss: How International Investment Law Changes Corporate Law and Governance*, 40 U. PENN. J. INT'L L. 189, 189 (2018) (highlighting the issues associated with permitting shareholders to bring indirect reflective loss claims through arbitration, while traditional corporate law frowns on such suits without director approval or coordination with the corporation).

group of equally situated equity holders (domestic shareholders).

C. Harmonization and Unification

Global corporate governance could involve harmonization, or in the more extreme case, unification. Harmonization aligns domestic laws to address an externality or need for collective action (for example, to stem a race to the bottom in terms of tax treatment). Unification takes the concept further, resulting in parties that are bound by the same authority and the same law.

In the corporate governance space, the European Union (EU) provides a conspicuous example of international coordination in corporate law. Brussels has included corporate governance as part of a broader integrationist agenda because domestic corporate law can impinge on the free movement of capital and support protectionist tendencies.[27] In response, the EU created the Societas Europaea, which facilitates cross-border transfers and mergers.[28] Other EU initiatives have focused on harmonization of national laws. Directives have forced member states to facilitate shareholder voting and activism,[29] and force disclosure of large voting blocks.[30] However, the EU has also failed quite significantly in imposing uniform rules, most obviously in the optional implementation of 2004 Takeover Directive.[31] This Article will instead focus on relatively understudied international efforts beyond internal EU policies. For instance, the OECD has provided a particularly useful set of

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[27] Martin Gelter, *EU Company Law Harmonization Between Convergence and Varieties of Capitalism*, *in* RESEARCH HANDBOOK ON THE HISTORY OF CORPORATE AND COMPANY LAW 323–25, (Harwell Wells ed. 2018); *see also* Luca Enriques, *A Harmonized European Company Law: Are We There Already?*, 66 INT'L & COMP. L.Q. 323, 333–34 (2017) (discussing company law harmonization within the European Union).

[28] Council Regulation (EC) No. 2157/2001, of 8 Oct. 2001, art. 24.

[29] Caspar Rose, *The New European Shareholder Rights Directive: Removing Barriers and Creating Opportunities for More Shareholder Activism and Democracy*, 16 J. MGMT. & GOVERNANCE 269, 269 (2012).

[30] Marco Becht & Ailsa Röell, *Blockholdings in Europe: An International Comparison*, 43 EURO. ECON. REV. 1049, 1050 (1999).

[31] Ben Clift, *The Second Time as Farce? The EU Takeover Directive, the Clash of Capitalisms and the Hamstrung Harmonization of European (and French) Corporate Governance*, 47 J. COMMON MKT. STUD. 55, 55 (2009).

guidelines that have set the agenda for corporate governance reforms in both developed and emerging markets.[32]

D. Global Standards: The Role of the G20/OECD Principles on Corporate Governance

Since the late 1990's, the non-binding OECD Principles have emerged as a prominent building block for the diffusion of corporate governance practices. Today, many of the international agreements on corporate governance explicitly adhere to these Principles. Such alignment between international agreements and the OECD Principles has the potential to speed up convergence in rules and practices.[33]

The International Monetary Fund (IMF), World Bank, and other international organizations participated in the formation of the OECD Principles and use the output to assess individual country performance.[34] Using one comprehensive document enables these international organizations and other observers to evaluate disparate corporate governance regimes on a similar basis. Among OECD members, Japan's recent corporate

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[32] OECD Principles, *supra* note 7.

[33] *Id.* at 5 (The OECD Principles focus on six components: (i) "ensuring the basis for an effective corporate governance framework," focused on transparency and fairness, the rule of law, and supervision and enforcement; (ii) "the rights and equitable treatment of shareholders and key ownership functions," setting out the requirements for effective shareholder participation, protection of minority shareholders, related-party transactions, and fair processes for transfer of control; (iii) "institutional investors, stock markets, and other intermediaries," to align incentives for capital markets to support sound economic growth; (iv) "the role of stakeholders in corporate governance," establishing that stakeholder rights based on law, contract, or other agreements must be respected; (v) "disclosure and transparency," focused on "all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company;" and (vi) "the responsibility of the board," establishing the board's obligation to monitor management and the board's own accountability to the company and its shareholders).

[34] *E.g.*, *Corporate Governance,* WORLD BANK, (Feb. 24, 2016), http://www.worldbank.org/en/topic/financialsector/brief/corporate-governance (discussing the work of the World Bank's Corporate Governance group, which engages with the OECD to set standards); *Reports on the Observance of Standards and Codes,* INTERNATIONAL MONETARY FUND, https://www.imf.org/external/NP/rosc/rosc.aspx (last updated: June 21, 2019) (using the OECD guidelines to evaluate country performance on corporate governance).

governance discussions are typical—policymakers have explicitly cited the Principles in formulating and messaging changes.[35] Non-OECD members also look to the Principles—recently, Colombia drafted corporate law reforms as part of its OECD accession efforts.[36] Even when formal legal changes do not immediately take place, the Principles operate as "soft law" by influencing corporate practices.[37] The OECD Principles have emerged as the fundamentally voluntary starting position for many global efforts to reform corporate governance.

II. CASE STUDY: THE CORPORATE GOVERNANCE CHAPTER IN THE EU-JAPAN ECONOMIC PARTNERSHIP AGREEMENT

The 2018 EU-Japan Economic Partnership Agreement (EPA) includes a unique provision—an entire chapter dedicated to corporate governance.[38] The EPA aims to facilitate trade and investment between EU member states and Japan, where existing economic ties had stagnated or even declined. The agreement primarily tackles tariffs and regulatory frameworks. By including corporate governance among these topics, the EPA responded to a convergence of private and public sector concerns

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[35] Masato Kanda, *Corporate Governance for Growth: Japan's Initiative Along with OECD* (Oct. 29 2015), https://www.fsa.go.jp/common/conference/danwa/20151029.pdf ("It is a great honor for me to have this opportunity to introduce Japan's recent initiatives of corporate governance reforms which are in line with the new OECD Principals and the mutual relationship between them.").

[36] OECD, *Corporate Governance in Colombia* (2017), http://www.ciando.com/img/books/extract/9264281134_lp.pdf (discussing reforms Colombia made in preparation of OECD accession).

[37] Ruth V. Aguilera & Alvaro Cuervo-Cazurra, *Codes of Good Governance Worldwide: What is the Trigger?*, 25 ORG. STUD. 415, 417 (2004) (discussing the use of voluntary corporate governance principles to overcome legal obstacles and change business practices); LaPorta et al., *Law and Finance*, 106 J. POL. ECON. 113, 113 (1998) (discussing the significant critiques of the Principles have focused on insufficient attention to the relative strength of controlling and minority shareholders. Pre-2015 versions of the Principles focused on resolving conflicts between management and shareholders and did not address abusive actions by controlling shareholders. Today, the Principles suggest low share ownership thresholds for proposing agenda items, supermajority requirements for important decisions, redress against abusive actions, and directors independent of dominant shareholders); *see also* Victor Zitian Chen et al., *Are OECD-prescribed "Good Corporate Governance Practices" Really Good in an Emerging Economy?*, 28 ASIA PAC. J. MGMT. 115, 115 (2011) (assessing the application of an earlier version of the G20/OECD Principles).

[38] European Commission MEMO/18/6784, *supra* note 3.

about Japan's corporate governance practices.[39]

The inclusion of a new subject matter within a trade agreement raises questions about the motivations of the parties, and the rationale for its inclusion in a broader trade and investment agreement. This agreement provides Japan with a strong signaling device to highlight recent efforts to improve corporate governance. The agreement's flexible language correctly avoids the risks of overly-constraining language, as the agreement must be reconciled with the varieties of capitalism present in EU member states and Japan.

A. The Stated Rationale: Corporate Governance for Economic Integration

Publications from the European Union frame the investment and anti-protectionist justifications for a chapter for corporate governance. A European Commission report focused on the expected investment benefits: "the corporate governance chapter has the potential to impact FDI not only in quantitative terms, by increasing the attractiveness of the investment environment in both Parties, but also in qualitative terms, by encouraging responsible and sustainable investment."[40] The improvement in the investment environment impacts both cross-border financial flows (which are largely within scope of the EPA), but also domestic investment (by encouraging more "responsible and sustainable" practices). The report focuses on corporate governance "as an essential tool to attract and encourage investment by promoting well-functioning markets and sound financial systems based on transparency, efficiency, trust and integrity."[41]

A second report by the European Parliament embraced a more comprehensive rationale focused on both investment protection and avoiding protectionism. The study explained that:

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39 *Id.*

40 European Commission Directorate-General for Trade, *The Economic Impact of the EU-Japan Economic Partnership Agreement (EPA)*, at 33, (June 2018), http://trade.ec.europa.eu/doclib/html/157116.htm.

41 *Id.*

> These new [corporate governance] commitments were made with the aim to: i) set high standards in corporate governance; ii) reduce behind-the-border barriers on investment arising from diverging regulations on the management of firms; and iii) increase investor confidence, investment and competitiveness.[42]

The parliamentary study acknowledges the importance of investment, while also introducing two other goals. First, it asserts a normative judgement: the EPA establishes "high standards," implying that practices diverging from these principles would be, in effect, substandard and fail to promote investment and sustainable economic growth.[43] Second, it reframes corporate governance as a "behind-the-border barrier" to trade—more similar to an effort that reduces the protectionist impact of countries' differing regulatory regimes.[44] The parliamentary study reframes corporate governance as another building block to encourage economic integration—on par with other technical regulatory alignments frequently included within trade and investment agreements.[45]

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[42] Policy Department for External Relations, Directorate General for External Policies of the Union, Study of *The EU-Japan Economic Partnership Agreement*, at 20 (Sept. 2018), http://bruegel.org/wpcontent/uploads/2018/10/EXPO_STU2018603880_EN.pdf .

[43] *Id.*

[44] Marta Wajda-Lichy, *Traditional Protectionism Versus Behind-the-Border Barriers in the Post-Crisis Era: Experience of Three Groups of Countries: The EU, NAFTA and BRICS*, 7 J. INT'L STUD. 141, 148 (2014) (listing examples such as: "technical barriers to trade, subsidies to exporters, administrative regulations concerning public procurement, sanitary and phytosanitary regulations").

[45] *See* Reeve T. Bull et al., *New Approaches to International Regulatory Cooperation: The Challenge of TTIP, TPP, and Mega-Regional Trade Agreements*, 78 L. & CONTEMP. PROBS. 1, 1 (2015) (discussing regulatory alignment efforts).

B. The Japanese Context: Corporate Governance Reforms for Economic Growth

Japan engaged in extensive corporate governance reforms concurrently with the negotiation of the EPA. "Abenomics," named after Japanese Prime Minister Shinzo Abe, seeks to address long-standing barriers to economic growth through three "arrows": monetary policy, financial stimulus, and structural reform.[46] Corporate governance is a major element of structural reform, along with improved female workforce participation, education reform, and other industry-specific efficiency improvements.[47]

This section focuses on Japan's efforts given the extensive push among policymakers and private sector leaders in Tokyo to reform corporate governance. The European Union certainly maintains an active corporate governance harmonization agenda. However, the corporate governance chapter can be more easily seen as a response to Japan's excessively pro-manager corporate governance regime and traditional hostility to foreign control.

Long-standing concerns with Japanese corporate governance have emerged in previous economic agreements. In 1990, Japan and the United States negotiated the Structural Impediments Initiative (SII) to address trade imbalances, with a focus on non-tariff contributors, including corporate governance.[48] One initiative included increased enforcement against the *kereitsu* system,[49] where extensive cross-holding of shares between different companies creating interlocking corporate relationships across the economy.[50] The EPA's

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[46] James McBride & Beina Xu, *Abenomics and the Japanese Economy*, COUNCIL ON FOREIGN RELATIONS (Mar. 23, 2018), https://www.cfr.org/backgrounder/abenomics-and-japanese-economy#chapter-title-0-4.

[47] Rob Harding, *The Third Arrow of Abenomics: A Scorecard*, FIN. TIMES (Sept. 8, 2015), https://www.ft.com/content/ee40a73c-521d-11e5-8642-453585f2cfcd.

[48] Mitsuo Matsushita, *The Structural Impediments Initiative: An Example of Bilateral Trade Negotiation*, 12 MICH. J. INT'L L. 436, 436 (1990).

[49] *See id.* at 443 (discussing the *kereitsu* system).

[50] Taizo Wada, *Asset Managers Raise Pressure on Japan's Board Appointments*, NIKKEI ASIAN REV. (June 14, 2018),

corporate governance chapter can be seen as an extension of this decades-old concern about Tokyo's trade and investment barriers.

More recently, Milhaupt summarized the main challenges relevant to Japan's corporate sector:

> (1) low profitability/low productivity of capital, reflected in the low return on equity (ROE) of Japanese firms in comparison to their global counterparts . . . (2) loss of international competitiveness, particularly in markets where Japanese firms were once global leaders . . . (3) weak internal compliance systems and lax board oversight, manifest in a series of widely publicized scandals.[51]

Japanese corporate governance has tended to insulate management and exacerbate existing challenges. In addition to the cross-holding of shares, former executives often fill seats on boards, undercutting oversight efforts unfavorable to current company management.[52] Among shareholders, there is relatively little meaningful participation: hundreds of shareholder meetings are held on the same day of the year and a negative perception exists around activism.[53]

The Abe government has engaged in multiple corporate governance reforms seeking to change laws, corporate behavior, and shareholder norms. The 2015 Companies Act revision added a third board option to increase board effectiveness.[54] The new framework eliminated the separate *kansayaku* board of auditors, and instead requires an audit committee composed of members of the board of directors.[55] Reformers hoped this measure would encourage the addition of independent directors

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https://asia.nikkei.com/Business/Business-trends/Asset-managers-raise-pressure-on-Japan-s-board-appointments.

[51] Curtis J. Milhaupt, *Evaluating Abe's Third Arrow: How Significant are Japan's Recent Corporate Governance Reforms?* 1, 3 (Columbia Law & Econs., Working Paper No. 561, 2017).

[52] Eric Pfanner, *Corporate Japan Looks for Outside Advice*, WALL ST. J. (June 8, 2015), https://www.wsj.com/articles/corporate-japan-looks-for-outside-advice-1433789544.

[53] Hiroko Tabuchi, *In Japan, Hundreds of Shareholder Meetings on Same Day*, N.Y. TIMES (June 23, 2014), https://dealbook.nytimes.com/2014/06/23/in-japan-hundreds-of-shareholder-meetings-on-same-day/.

[54] Milhaupt, *supra* note 51, at 1.

[55] *Id.* at 4.

and address the perceived ineffectiveness of the boards of auditors, who do not have a vote on the board of directors.[56] To improve shareholder oversight, a new Stewardship Code developed for institutional investors seeks to increase engagement and voting disclosure.[57] Other updates in the Corporate Governance code push for independent directors, reduced cross-shareholdings (by requiring companies to explain the rationale and objective of cross-holdings), and improved disclosure.[58]

C. Assessing the Text: Aspirational Language, and Highly Flexible Implementation

The language of the EPA's individual provisions highlights cornerstone concepts of corporate governance. In its approach, the governance chapter provides guiding principles but refrains from requiring specific actions. As a result, the text highlights Japan's willingness to promote broadly-accepted corporate governance goals, but avoids the pitfalls of an overly-constricting agreement.

The following section analyzes the different articles of the chapter: (1) Objectives, (2) General principles, (3) Rights of shareholders and ownership functions, (4) Roles of the board, and (5) Takeovers.

1. Article I: Objectives

The Corporate Governance chapter opens by stating the rationale for including corporate governance in the EPA. The rhetoric aligns with the broader push by stakeholders and academics to consider corporate governance as a tool of economic development.

For one, the parties link the chapter to economic growth. The parties recognize "the importance of an effective corporate governance framework to achieve economic growth through well-functioning markets and sound financial systems based on

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[56] *Id.* at 10.
[57] *Id.* at 4–5.
[58] *Id.* at 5.

transparency, efficiency, trust and integrity."[59] Next, the parties focus on investment protection as a means of fully following through on the agreement's opportunities: "[e]ach party . . . recognize[s] that those [corporate governance] measures will attract and encourage investment by enhancing investor confidence and improving competitiveness, thus enabling best advantage to be taken of the opportunities granted by its respective market access commitments."[60]

The parties place the corporate governance commitments within the broader goals of facilitating market access: "[t]he Parties commit to respect the principles and adhere to the provisions of this Chapter to the extent that they facilitate access to each other's markets . . . ."[61] This text clarifies that the commitments respect each party's autonomy in corporate governance ("[w]ithout limiting the ability of each Party to develop its own legal, institutional and regulatory framework in relation to the corporate governance of publicly listed companies . . .").[62] In a recurrent theme, the agreement specifies a certain standard, but nonetheless provides an open door for the parties to maintain, tailor, and experiment.

2. Article III: General Principles

The General Principles article addresses the typical agency issues of corporate governance.[63]

First, the text encourages accountability in a myriad of relationships: between "management and the board towards shareholders," between the management and the board, relying on "board decision-making based on an independent and objective standpoint," and between shareholders, based on "equal treatment of shareholders of the same class."[64] In

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[59] Agreement between the European Union and Japan for Economic Partnership, Dec. 8, 2017, art. 15.1(1), *available at* http://trade.ec.europa.eu/doclib/docs/2018/august/tradoc_157228.pdf#page=433 [hereinafter EU-Japan EPA].

[60] *Id.* art. 15.1(2).

[61] *Id.* art. 15.1(3).

[62] *Id.*

[63] *Id.* art. 15.3.

[64] *Id.* art. 15.3(1).

particular, the language around "independent" and "objectives" boards addresses the Japanese problem of excessive board deference to management.[65]

The agreement also recognizes the importance of public disclosure, "including the financial situation, performance, ownership and governance of those companies."[66] Such policies are the cornerstone for robust capital markets.

For implementation, the General Principles endorse comply-or-explain provisions, which align to both Japanese and European models. Comply or explain provisions require companies to either implement a code's requirements, or instead disclose a rationale for not doing so.[67] Milhaupt finds comply-or-explain regimes to be a particularly weak solution for the Japanese context, where companies who would benefit most from new corporate governance provisions choose to explain and not comply.[68] Comply-or-explain approaches assume market pressures will force firms into efficient governance choices.[69] This approach reflects the existing policies of Japan and the European Union.[70]

The parties also provide for exemptions to the agreement's requirements, based on objective and nondiscriminatory criteria.[71] The text provides examples—exclusions may apply based on a company's size or early phase of development.[72] These exceptions appear to be reasonable. Corporate governance requirements, particularly around disclosure, have

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[65] EU-Japan EPA, *supra* note 59, art. 15.3(2).

[66] *Id.* art. 15.3(1).

[67] *See* Maria Elisabeth Sturm, *Corporate Governance in the EU and U.S.: Comply-or-Explain Versus Rule* 1, 1–15 (Stanford-Vienna Transatlantic Tech. Law Forum, Working Paper No. 16, 2016).

[68] *See* Milhaupt, *supra* note 51, at 8 (critiquing the utility of comply-or-explain for corporate governance reform in the Japanese context); *see also* George Hadjikyprianou, *The Principle of 'Comply or Explain' Underpinning the UK Corporate Governance Regulations: Is There a Need for Change?*, 7 CORP. GOVERNANCE L.J. 1, 3 (2015) (arguing against using "hard law" to address deficiencies in the U.K. comply-or-explain regime).

[69] Milhaupt, *supra* note 51, at 15.

[70] *Id.* at 6.

[71] EU-Japan EPA, s*upra* note 59, art. 4.4(1).

[72] *Id.* art. 4.6.

historically generated complaints about the high cost and smaller benefit for certain classes of companies. Again, the agreement allows for deviation and experimentation.

3. Article IV: Rights of Shareholders and Ownership Functions

Next, the agreement focuses on the rights of shareholders and ownership functions—principally, effective shareholder democracy and information disclosure.[73] These sections focus on the goal of meaningful shareholder engagement and oversight, while avoiding specific rules.

Addressing shareholder democracy, the agreement requires parties to allow "participation and voting in the general meeting" and "election and removal of members of the board."[74] The agreement includes provisions "facilitating the effective exercise of shareholders' rights . . . allowing shareholders to oversee board behaviour and participate in important decision-making . . . ."[75] Problematically, meetings of many Japanese companies are set for the same day of the year, limiting meaningful shareholder participation and voting in the general meetings.[76] Furthermore, members of the board are often drawn from the ranks of managers of the firm—rather than serving as shareholder representatives.[77] The EPA highlights the need for new practices.

Meaningful decision-making also requires timely information disclosure.[78] The disclosure provisions noted here complement the procedural push for shareholder democracy. As examples, the provision suggests disclosure of "the capital structure, with an indication of the different classes of shares where appropriate, direct and indirect shareholdings which are considered to be significant, and special control rights."[79] This

[73] *Id.* ch. 15.
[74] *Id.* art. 15.4(1).
[75] *Id.*
[76] Milhaupt, *supra* note 51, at 10.
[77] *Id.* at 15.
[78] *Id.* at 5.
[79] EU-Japan EPA, *supra* note 59, art. 15.4(2).

disclosure framework may help domestic investors argue for additional disclosure. But, a disclosure regime may actually be more powerful for foreign investors—who are the primary targets of an investment agreement. Foreign investors often face significant risk investing in a country with very different corporate governance laws and practices.[80] For example, joint ventures in Brazil with foreign investors have a high failure rate in part because investors do not realize how to protect against partners with pyramidal controls.[81] Similarly, the European and Japanese corporate governance models diverge significantly, raising issues of investor awareness and understanding of differing practices.[82] Disclosure requirements focusing on control rights may help educate foreign investors and managers.

4. Article V: Roles of the Board

The agreement defines the types of board accountability and the means of achieving this accountability. The agreement highlights three goals of board-related accountability: (1) the board's effective monitoring of management; (2) board accountability to shareholders; and (3) disclosure of information about the board to shareholders.[83]

Independent directors emerge as a tool for achieving this level of accountability. The agreement promotes the "effective use of a sufficient number of independent directors" as a means of ensuring effective monitoring.[84] The provision acknowledges a diversity of interpretations: "[e]ach Party may determine in its jurisdiction what constitutes a 'sufficient number of independent directors' in either qualitative or quantitative terms."[85] Such flexible terms match the needs of Japan and EU member states, given the diversity of corporate ownership patterns. The

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80 Susan Perkins et al., *Innocents Abroad: The Hazards of International Joint Ventures with Pyramidal Group Firms*, 4 GLOBAL STRATEGY J. 310, 311 (2014).

81 *See id.* at 311 (introducing data and drivers for the failure of joint ventures in Brazil).

82 *Id.* at 312.

83 EU-Japan EPA, *supra* note 59, art. 15.5.

84 *Id.* art. 15.5(a).

85 EU-Japan EPA, *supra* note 59, n. 126.

definition of independence should be determined based on the agency problem to be solved—for instance, in some countries, independence must be from dominant family owners or blockholders, while in countries dominated by diffuse shareholding, directors should be independent from corporate insiders.[86]

Within Japan, a newly-emergent legal movement favoring independent directors aligns with the commitments made in the EPA. The 2015 Corporate Governance Code requires companies, on a comply-or-explain basis, to appoint two or more independent directors.[87] The agreement does not appear to require further action—but it does reiterate an underlying commitment to independent directors. These provisions also align with OECD guidance, which promotes independent directors but recognizes the range of practices.[88]

5. Article VI: Takeovers

The takeover provisions involve short and weak language. Article 15.6 requires that "[e]ach Party shall provide rules and procedures governing takeovers in publicly listed companies. Such rules and procedures shall aim to enable those transactions to occur at transparent prices and under fair conditions."[89] This outcome reflects the lack of consensus within Europe or Japan on appropriate takeover laws. Europe has historically had difficulty aligning takeover practices, resulting in watered-down

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[86] Gordon & Roe, *supra* note 15, at 36; Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Corporate Governance Standards*, 157 U. PA. L. REV. 1263, 1302 (2009); Dan W. Puchniak & Umakanth Varottil, *Related Party Transactions in Commonwealth Asia: Complexity Revealed* 1–27 (European Corp. Governance Inst., Working Paper No. 404, 2018) (discussing the challenges of regulating related party transactions in Asian firms of varying ownership types).

[87] Jones et al., *Japanese Corporate Governance is Changing with the Adoption of a New Code in 2015*, JONES DAY (Feb. 2015), https://www.jonesday.com/en/insights/2015/02/japanese-corporate-governance-is-changing-with-the-adoption-of-a-new-code-in-2015.

[88] OECD, OECD Corporate Governance Factbook (2019), http://www.oecd.org/daf/ca/corporate-governance-factbook.htm ("National approaches on the definition of independence for independent directors vary considerably, particularly with regard to maximum tenure and independence from a significant shareholder.").

[89] EU-Japan EPA, *supra* note 59, art. 15.6.

and non-binding EU policies.[90] Japan, for its part, has had a long-standing anti-takeover orientation from the extensive cross-holding of shares[91] and government approval of facially neutral takeover defenses.[92] As a result, neither party has an interest in using the EPA to facilitate takeover activity.

The provisions of the EPA tackle the details of corporate governance in an unprecedented manner. Beyond individual provisions, broader theoretical questions emerge as to why corporate governance regulation has emerged in international economic agreements. The following section proposes several explanations and applies those theories to the case of the EU-Japan EPA.

III. THE THEORETICAL RATIONALE FOR CORPORATE GOVERNANCE REGULATION IN INTERNATIONAL ECONOMIC AGREEMENTS

Corporate governance provisions, interwoven within trade and investment agreements, represent an emerging avenue of legal diffusion. This section addresses the theoretical rationale for corporate governance in international economic agreements.

A. A Credible Commitment Mechanism

Parties signing international agreements may use these documents as credible commitment mechanisms. A straightforward reading of corporate governance provisions focuses on the substantive impact: international agreements provide specific rights, particularly for foreign investors or minority shareholders. In some instances, compliance with an agreement requires domestic legal reforms that result in a more pro-investor orientation. Reneging on these provisions constitutes a costly breach of international commitments.[93]

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[90] *See* Mark Humphrey-Jenner, *The Impact of the EU Takeover Directive on Takeover Performance and Empire Building*, 18 J. CORP. FIN. 254, 260–272 (2012) (providing a history and critique of the EU Takeover Directive).

[91] Joseph Lee, *The Current Barriers to Corporate Takeovers in Japan: Do the UK Takeover Code and the EU Takeover Directive Offer a Solution?,* 18 EURO. BUS. ORG. L. REV. 761, 766 (2017).

[92] Pargendler, *supra* note 24, at 23.

[93] *See* Robert O. Keohane, INTERNATIONAL INSTITUTIONS AND STATE

International relations theory recognizes treaties as signaling devices. Neumayer and Spess identify that "[Bilateral investment treaties (BITs)] are likely to fulfil the dual function of both signaling and commitment."[94] Büthe and Milner have identified the commitment mechanism as a key driver for the increase in foreign direct investment after the signing of an international trade agreement.[95] Kerner postulates that the more BITs a country signs, the more credible its commitment is to treat foreign investors as good, or better, than its domestic counterparties.[96] A less developed country may use the treaty as evidence of a newfound *willingness* to protect foreign investors' property rights. Researchers have postulated that the commitment signal increases investment for two subgroups of foreign investors: (1) foreign investors from the party nations, and (2) foreign investors from other, non-party nations.[97] Foreign investors from party nations would invest due to the substantive protections and signaling effect. Meanwhile, non-party foreign investors may increase investment due to the signaling inherent in signing these agreements.

The signaling effect from corporate governance provisions are unlikely to apply uniformly. Instead, there is likely a credibility requirement. Tobin and Rose-Ackerman argue that the signaling benefit of a BIT "is dependent on the broader institutional environment in the host country."[98] Pistor argues

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POWER: ESSAYS IN INTERNATIONAL RELATIONS THEORY 5 (1989) (discussing international regimes); *see* Beth A. Simmons, *International Law and State Behavior: Commitment and Compliance in International Monetary Affairs*, 94 AM. POL. SCI. REV. 819, 821 (2000) (discussing markets and international monetary law, specifically expectations regarding commitment and compliance).

[94] Eric Neumayer & Laura Spess, *Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?*, 3 WORLD DEV. 1567, 1572 (2005) (identifying spill-over effects from signing a BIT that protects foreign investment).

[95] Tim Büthe & Helen V. Milner, *The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI Through International Trade Agreements?*, 52 AM. J. POL. SCI. 741, 744 (2008).

[96] Andrew Kerner, *Why Should I Believe You? The Costs and Consequences of Bilateral Investment Treaties*, 53 INT'L STUD. Q. 73, 74 (2009).

[97] Neumayer & Spess, *supra* note 94, at 1571.

[98] Jennifer L. Tobin & Susan Rose-Ackerman, *When BITs have Some Bite: The Political-Economic Environment for Bilateral Investment Treaties*, 6 REV. INT'L ORG. 1, 5 (2011).

that "reforms depend on the existence of a fairly developed and well-functioning legal infrastructure. Absent this infrastructure, [standardization] reforms in the areas of accounting standards, securities legislation, insurance regulation, and even corporate governance will remain at the surface."[99]

B. Overcoming Domestic Opposition to Reform

International agreements can wrestle control of the policy agenda away from domestic opposition to reform. In their absence, nationalist instincts within corporate law may result in suboptimal governance regimes.[100] For instance, economic agreements can wrest corporate governance away from certain business and political elites who benefit from protectionist policies.

International organizations and scholars have recognized the potential impact of corporate governance commitments. A World Bank analysis of Vietnam asserts that "[State-owned enterprises (SOEs)] corporate governance reforms would respond to TPP implementation needs and principles."[101] In discussions over a proposed China-EU BIT, advocates highlighted that an agreement would enable interest groups within the Chinese bureaucracy to push for better SOE governance.[102]

Scholars have different assessments of the depth of potential opposition that international agreements must overcome. Sykes, in discussing the broader category of

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[99] Katharina Pistor, *The Standardization of Law and its Effect on Developing Economies*, 50 AM. J. COMP. L. 97, 100 (2002).

[100] Pargendler, *supra* note 24, at 3.

[101] World Bank and Vietnam Ministry of Industry and Trade, *Seizing the Opportunities of New-Generation Free Trade Agreements*, WORLD BANK 2, 124 (Sep. 2016), http://documents.worldbank.org/curated/en/101021521557242199/pdf/124458-WP-PUBLIC-VietNamSeizingopportunitiesfromnewgenerationFTAsEng.pdf.

[102] *See* Alicia García-Herrero & Jianwei Xu, *How to Handle State-owned Enterprises in EU-China Investment Talks*, BRUEGEL 1, 6 (June 2017), http://bruegel.org/wp-content/uploads/2017/06/PC-18-2017_2.pdf (discussing the multiple binding and non-binding mechanisms for encouraging alignment in corporate governance standards in the EU and China).

investment protectionism, asserts that such protections benefit from less popular support than trade protectionism.[103] He explains that "barriers to inbound investment will protect domestic capital but may create no benefit or even cause harm to domestic labor because foreign investors often employ significant amounts of domestic labor in their operations."[104] Thus, labor's benefits from the free flow of capital would reduce popular support for investment barriers.

On the other hand, this reading underplays the possibility of a broader anti-foreign alliance: labor and other interest groups may also embrace investment protectionism. Foreign business owners may be less tied to the local community and more freely push for cost-cutting measures.[105] Foreign-owned firms may embrace international supply chains at the expense of local producers. More broadly, foreign owners may be less cognizant of negative externalities, and foreign management and shareholders are less likely to experience those impacts.[106] Corporate governance thus falls into the same theme as other areas tackled by the agreements—another subject matter where an international commitment is needed to overcome opposition by an alliance of domestic interest groups.[107]

C. Changing Domestic Norms

Corporate governance provisions also serve a more intermediary function of changing domestic norms. While the previous explanation assumed that provisions actually have a direct substantive impact on domestic corporate law, the provisions might be written to have little binding impact.[108] In such cases, provisions may instead function to change the domestic conversation on corporate governance standards.

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[103] Alan O. Sykes*, The Economic Structure of International Investment Agreements with Implications for Treaty Interpretation and Design*, 113 AM. J. INT'L. L. 482, 489 (2019).

[104] *Id.*

[105] Pargendler, *supra* note 24, at 39 (discussing the potential divergence between foreign owners and local managers).

[106] *Id.* at 7.

[107] *Id.* at 3.

[108] *See infra* Section III.B.

The clearest analogy emerges from the experience of shareholder activist battles. Kahan and Rock have identified controversies over seemingly meaningless provisions as examples of low-impact, but high-volume, conflicts between domestic activist investors, managers of firms, and other stakeholder groups.[109] They have advanced that "activism has a significant 'symbolic' element and cannot be fully explained by the material stakes at issue in a given controversy."[110] These fights aim to project power and change behavioral norms (rather than necessarily achieve high-impact results).

The codification of corporate governance commitments in international agreements may serve to educate domestic actors on proper standards. Looking at changing U.S. norms, Kahan and Rock see that, "[i]n the shift in U.S. boardrooms from a managerial conception of the board to a more 'shareholder-centric' view, these [activist] battles almost certainly were important in reorienting directors' understanding of their roles."[111] Provisions in international provisions may have a similar role as activist battles: as tools to reshape a country's corporate governance norms, even without substantive legal changes.

D. Reducing Differential Costs in Compliance and Transactions

Individual nations' varying disclosure requirements result in companies facing different compliance costs based on their legal domicile. Standardizing requirements for disclosure can (1) eliminate the cost advantage of competitors subject to a less onerous disclosure regime; and (2) reduce the cost of investing in different jurisdictions. In jurisdictions with less onerous disclosure requirements, compliance costs less—leading to lower recurring legal and financial control costs. Companies in higher-regulated jurisdictions may face a competitive disadvantage on the basis of regulatory differences, rather than operational or

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109 *See* Marcel Kahan & Edward Rock, *Symbolic Corporate Governance Politics*, 94 B.U. L. REV. 1997, 1998–99 (2014) (discussing ongoing corporate debates such as poison pill proposals, proxy access, majority voting, and supermajority requirements).

110 *Id. at* 1998–99.

111 *Id.* at 2024.

strategic performance.[112] Another impact of compliance costs emerges through investors themselves. Investors operating in different jurisdictions must spend considerable sums navigating the thicket of unique rules governing business entities in each jurisdiction. International agreements can establish greater coherence among different legal regimes. At a minimum, agreements could supply a common terminology or framework. More comprehensive agreements can force parties to adapt similar specifications that reduce the expenses of learning, navigating, and complying with the rules.[113]

E. Cross-Border Gains and Losses from Domestic Corporate Governance

The push to harmonize global corporate governance standards may emerge, in part, from the realization that the bad corporate governance can result in cross-border harm. The East Asian financial crisis in the late 1990s demonstrated the systemic risk to entire regions from weak governance.[114] As the downturn began, managers and controlling shareholders began expropriating value. Managers began moving money offshore while other firms transferred funds to related companies (to the detriment of minority shareholders).[115] These actions had broad regional implications by exacerbating the existing trend of capital outflows, the fall of exchange rates, and cratering investor confidence.[116]

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[112] *See generally* Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment*, 85 VA. L. REV. 1335 (1999) (further discussing the benefits of standardized disclosure).

[113] *See* Luca Enriques, *Company Law Harmonization Reconsidered: What Role for the EC?* 9–10 (European Corp. Governance Inst., Working Paper No. 53, 2005) (discussing how the transactional benefits of corporate law harmonization have been discussed in the context of the European Union, and recognizing that in theory, harmonization may reduce transaction costs, but in practice, European Commission actions have created overly rigid rules that actually *raise* transaction costs and fail to address market failures).

[114] IMF, *Corporate Governance, Investor Protection, and Financial Stability in Emerging Markets*, *in* GLOBAL FINANCIAL STABILITY REPORT: FOSTERING STABILITY IN A LOW GROWTH, LOW-RATE ERA, 82 (Oct. 2016) (discussing how weak corporate governance contributes to global instability).

[115] Simon Johnson et al., *Corporate Governance in the Asian Financial Crisis*, 58 J. FIN. ECONS. 141, 142–43 (2000).

[116] *Id.* at 142.

Conversely, the benefits of good corporate governance may also flow across national borders. Academics have promoted good corporate governance as a tool for spurring economic growth in developing countries—leading to increased opportunities for trade and investment.[117]

F. Addressing the Pitfalls of Homogenizing Agreements

Homogeneity reduces the diversity of corporate governance regimes. Ideally, parties would standardize on an optimal regime, but parties may also end up in a sub-optimal state. In particular, too-rigid requirements may be appropriate for one party, and not another, with homogenization placing barriers to the natural evolution of law. Pistor argues that "[t]he standardization of 'best practice' or 'efficient' law replaces the Schumpeterian process of 'creative destruction' with the ideal of the 'perfect construction' of law."[118] The pitfalls of such displacement are the side effects of the commitment mechanism: standardization requires countries to adhere potentially suboptimal legal regimes, with high costs of reneging or changing the agreements.[119]

Homogeneity exposes the global economic system to the same pitfalls, as standardized widespread rules leave all countries with immunity to one set of problems and vulnerability to another set of problems. Romano has posited that the Basel architecture for financial regulation increases systemic financial risk.[120] In her reading, "[b]y incentivizing financial institutions worldwide to follow broadly similar business strategies, regulatory error contributed to a global financial crisis."[121] Similarly, encouraging converging corporate governance standards may also result in an analogous

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[117] *See* Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131, 1132 (1997) (identifying the pathways explaining how good corporate governance leads to capital growth).

[118] Pistor, *supra* note 99, at 98.

[119] *Id.* at 104 ("[I]n most cases, harmonization will lock a large number of jurisdictions into suboptimal rules and prevent flexible adaptation to better rules and changing circumstances.").

[120] Roberta Romano, *For Diversity in the International Regulation of Financial Institutions: Critiquing and Recalibrating the Basel Architecture*, 31 YALE J. REG. 1, 6 (2014).

[121] *Id.* at 1.

regulatory error.

However, corporate governance provisions often specify principles, rather than mandatory rules. The flexible nature of corporate governance agreements thus departs from the rigidness, and pitfalls, of other accords, such as the Basel architecture.

G. Comparing the EU-Japan EPA to Theoretical Explanations

The EPA's corporate governance provisions align with a subset of the theoretical explanations explaining corporate governance regulation in international agreements.

First, the EPA's corporate governance chapter can serve as a commitment mechanism.[122] Japan has now provided a treaty-level commitment to corporate governance principles.[123] The country has a strong rule-of-law environment, giving credence to the government's ability to implement commitments. Problematically, despite these commitments, the parties excluded the corporate governance chapter from the EPA's dispute resolution mechanism.[124] As a result, neither party will have an effective way to challenge the implementation of the chapter, other than via diplomatic pressure. Again, the agreement appears to highlight the parties' renewed focus on corporate governance while avoiding truly binding impacts.

The agreement may also support changing domestic norms. While Japan has implemented legal reforms and a new Code of Conduct, these changes are only meaningful with actual take-up among the corporate community. An international agreement can provide another jolt out of an excessively insider-captured mindset and encourage more shareholder oversight.

By contrast, the explanation of overcoming domestic opposition is relatively weaker in this case. Japan already engaged in reforms prior to this agreement, so the country

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[122] EU-Japan EPA, *supra* note 59, Ch. 15.

[123] *Id.*

[124] EU-Japan EPA, *supra* note 59, art. 15.7 (discussing the process of mediation and arbitration panels for disputes).

already appears largely in compliance with the agreement's language.[125] Nor is there any evidence that the agreement pushed forward this tide of domestic reform.[126] Looking ahead, the provisions are unlikely to serve a major role in forcing action from reluctant domestic parties.[127]

Finally, the agreement appears to make minimal efforts at reducing the differential costs of compliance and transactions. Investors may benefit slightly from Article IV's disclosure provisions, which bring transparency to control rights among shareholders.[128] Such information can ease the challenges of due diligence and structuring investment. However, this agreement does not delve into sufficient details to meaningful address differential costs.[129]

The EPA provides a new opening for the study of comparative corporate governance, highlighting how international agreements may take on a more significant role in shaping domestic corporate law. The agreement provides the appropriate gestures towards convergence, with the parties defining and embracing shared vocabulary and text around the goals of corporate governance.[130] The chapter ultimately emerges as a signaling exercise, maintaining significant leeway for each party to interpret and implement its provisions.[131]

IV. PROVISIONS IN INTERNATIONAL AGREEMENTS IMPACTING GOVERNANCE PRINCIPLES

Even before the EU-Japan Economic Partnership Agreement, international agreements have impacted corporate governance. This subject has remained largely ignored in existing legal scholarship, which focuses extensively on domestic corporate law. In state-to-state agreements, explicit provisions and secondary impacts have redrawn the rights of shareholders,

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125 *See infra* Section II.B.
126 *See infra* Sections III.B, III.C.
127 *See infra* Sections III.B, III.C.
128 *Id.* art. 14.
129 EU-Japan EPA, *supra* note 59, Annex 23.
130 *Id.* art. 7.12.
131 *Id.* Ch. 7.

directors, management, and other stakeholders. The following section covers three topics: (1) accountability and composition of management and boards; (2) state-owned enterprises; and (3) the equality of shareholders.

A. Accountability and Composition of Management and Boards

International agreements include provisions permitting or restricting nationality restrictions on members of the board and corporate management. The provisions touch on a core question in corporate governance: the composition of a company's leadership.[132] Such limitations undercut the power of investors to freely nominate board members, who in turn, may not freely hire corporate officers. Such provisions can encourage convergence towards greater investor control of boards and management.[133]

1. Nationality Restrictions on Management

The recent Trans-Pacific Partnership (TPP) language typifies frequent language pertaining to discrimination based on nationality. For management roles, the TPP completely disallows such discrimination: "[n]o Party shall require that an enterprise of that Party that is a covered investment appoint to a senior management position a natural person of any particular nationality."[134]

Investors may gain confidence to invest as anti-discrimination provisions can boost enterprise performance and mitigate the agency costs of using a purely local management team. As a starting matter, anti-discrimination provisions enable investors to tap into a global labor pool. Foreign managers can arrive with a proven track records and expertise unavailable in the local market. These experienced managers can use their expertise to strengthen a company's performance.[135] Second, anti-discrimination provisions may also

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132 EU-Japan EPA, *supra* note 59, art. 15.3(2).

133 *Id.* art. 15.4(2).

134 *See* Trans-Pacific Partnership Agreement Ch. 9, art. 11(1), Off. of Trade Representative, https://ustr.gov/sites/default/files/TPP-Final-Text-Investment.pdf [hereinafter TPP].

135 *See, e.g.,* Ksenia Yudaeva et al., *Does Foreign Ownership Matter? The*

reduce agency issues between shareholders and management.[136] While domestic managers may bring important local knowledge, these same links may actually disadvantage performance. Managers are likely linked to other market players through social connections and as repeat players. As a result, domestic managers may accrue significant non-pecuniary benefits that extend beyond the scope of employment, such as social capital and future employment opportunities. These benefits may prevent managers from taking a course of action beneficial to shareholders but detrimental to managers' local standing. In a more extreme example, domestic managers may decline to implement cost-cutting initiatives to avoid angering local suppliers, employees, and other stakeholders. Thus, local management's incentives would diverge from those of foreign shareholders, exacerbating the perennial problem of agency costs between shareholders and management. By contrast, foreign managers may be more aligned to shareholder incentives, given the lower likelihood of these non-pecuniary benefits.[137] Taken in sum, provisions restricting nationality-based discrimination can strengthen investor confidence by improving enterprise performance and reducing agency costs.

2. Nationality Restrictions on Board Members

By contrast, the TPP and other agreements frequently do permit some nationality restrictions on board members:

> [A] Party may require that a majority of the board of directors, or any committee thereof, of an enterprise of that Party that is a covered investment, be of a particular nationality or resident in the territory of the Party, provided that the requirement does not

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Russian Experience, 11 ECON. OF TRANSITIONAL AND INSTIT. CHANGE 383 (hypothesizing that Russian "foreign-owned firms can benefit from managerial experience and the distribution network of their foreign owners.").

[136] *See* Anders Edström & Jay R. Galbraith, *Transfer of Managers as a Coordination and Control Strategy in Multinational Organizations*, 22 ADMIN. SCI. Q. 248 (discussing the use of foreign managers as a means of effective decentralized control).

[137] *See, e.g.*, Masayasu Ito & Takashi Sugimoto, *Carlos Ghosn: The Expensive Cost Cutter*, NIKKEI ASIAN REV. (Nov. 20, 2018, 5:56 JST), https://asia.nikkei.com/Business/Nissan-s-Ghosn-crisis/Carlos-Ghosn-The-expensive-cost-cutter (comparing Carlos Ghosn's implementation of cost-cutting and workforce reduction in Nissan to the apparent conservatism of Japanese managers).

> materially impair the ability of the investor to exercise control over its investment.[138]

Such restrictions may be justified on the basis of legal enforceability and stakeholder-leaning corporate governance. The enforceability of legal judgements is particularly difficult against foreign board members. Foreign board members may avoid liability by fleeing a jurisdiction, and likely have few in-country assets. By contrast, domestic courts may more easily enforce judgments on locally-based board members, who are more likely to have in-country interests and assets. Nationality requirements prevent corporate directors from skirting the reach of domestic law.

In addition, nationality requirements promote stakeholder consideration and reduce shareholder dominance. Domestic directors tied to the domestic context may serve as a check on the profit-making motives of a company, similar to the dynamic noted above with domestic executives. Boards with heavy domestic representation may be less likely to engage in corporate activities damaging to corporate stakeholders, such as layoffs. Nationality restrictions could even mitigate national security risks. For instance, the Committee on Foreign Investment in the United States requires boards to nominate highly trusted individuals, including former intelligence and military officials.[139] Nationality restrictions can serve as a low-touch mechanism to achieve the same protective effect, assuming domestic directors also view their roles as protecting their home nations' security interests.

Despite these justifications for nationality restrictions, the provisions may come at the cost of a level playing field in managerial labor markets, and even firm performance. Miletkov et al. have found a positive association between foreign directors and firm performance under certain conditions; in particular, the association "is more positive in countries with

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[138] TPP, *supra* note 134, art. 11(2).

[139] *See generally* Andrew Verstein, *The Corporate Governance of National Security*, 95 WASH. U. L. R. 775, 775 (2018) (detailing CFIUS practices impacting the corporate governance of companies involved in sensitive national security matters).

lower quality legal institutions, and when the director comes from a country with higher quality legal institutions than the firm's host country."[140] Restrictions on the share of foreign directors may undercut this potential mechanism for improved firm performance.

In contrast to the TPP and other agreements, the European Union—Canada Comprehensive Economic and Trade Agreement (CETA) does not allow any nationality restriction for boards: "[a] Party shall not require that an enterprise of that Party, that is also a covered investment, appoint to senior management or board of director positions, natural persons of any particular nationality."[141] Both parties have strong legal systems, highly-integrated economies, and an explicit project of cross-border integration. As a result, the agreement prioritizes the free flow of highly skilled labor and a vibrant cross-border market for oversight and management. Each individual jurisdiction has much lower concerns about the enforceability of judgments and the need to maintain locally-tied directors or officers. The European Union—Canada agreement presents a counterexample to the TPP, which involves countries of different economic weights, legal systems, and sensitivity to foreign ownership.[142] Countries of similar levels of openness to trade, economic development, and the rule of law may more readily embrace nationality nondiscrimination for boards.

B. State-Owned Enterprises: Equality of Market Participants, Disclosure, and Conflicted Transactions

State-owned enterprises (SOEs) and government-authorized monopolies play leading economic roles in countries with underdeveloped private markets. International agreements have increasingly tackled SOEs due to their government-provided benefits, including preferential treatment in taxes, regulations, direct or indirect transfers, and

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[140] Mihail Miletkov et al., *Foreign Independent Directors and the Quality of Legal Institutions*, 48 J. INT'L BUS. STUD. 1, 1 (2016).

[141] See European Union—Canada Comprehensive Economic and Trade Agreement (CETA), Oct. 30, 2016, art. 8.8, *available at* https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22017A0114(01) [hereinafter CETA].

[142] TPP, *supra* note 134.

government purchasing. These benefits tend to disadvantage foreign companies and foreign investors, as domestic SOEs obtain preferential market access and an unfair cost advantage. Provisions tackling the governance of state-owned enterprises impact broader corporate governance issues, including the equality of market participants, disclosure standards, and conflicted transactions.

In recent years, the OECD has produced an influential set of guidelines focused on this subfield of corporate governance—the OECD Guidelines on Corporate Governance of State-Owned Enterprises.[143] This document complements the G20/OECD Principles of Corporate Governance with a more specific effort to address the challenges of government ownership. On the one hand, these efforts are a domestic matter—countries benefit from SOEs that operate "efficiently, transparently and in an accountable manner."[144] Many essential public services, such as utilities, are provided by SOEs and monopolies.[145] On the other hand, SOE governance is also a challenge on the global stage, as these enterprises operate and invest outside the domestic context. The OECD explains the importance of SOE corporate governance outside home markets: "[a] number of countries are paying increasing attention to the foreign SOEs that operate in their jurisdictions—including in the context of trade and investment agreements—with a view to gauging their commercial orientations and likely impacts on the competitive landscape."[146] The presence of government-owned "golden shares," and along with other formal and informal mechanisms for government influence, may create significant discrepancies between the behavior of SOEs and privately-held corporations engaged in cross-border trade and investments.[147] The rise of the Chinese economy raises particular issues: Beijing has created numerous state-controlled "national champions" that provide a seemingly successful alternative to liberal economies'

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143 OECD, OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES 3 (2015) [hereinafter OECD Corporate Guidelines].

144 *Id.* at 11.

145 *Id.*

146 *Id.* at 8.

147 *Id.* at 52.

preference for private ownership.[148]

Recent trade and investment agreements, such as the TPP, have reflected concerns about the distortionary impact of government ownership. The solutions to these concerns about SOEs touch on the basic principles of corporate governance.

1. Equality between Foreign and Domestic Actors

Provisions covering SOEs can promote equality in treatment between foreign and domestic entities. Governments may use procurement or other commercial transactions in SOEs to favor domestic entities at the expense of foreign companies and investors. Article 17.4 of the TPP, dealing with "Non-discriminatory Treatment and Commercial Considerations," requires parties to "act[] in accordance with commercial considerations in its purchase or sale of a good or service, except to fulfil any terms of its public service mandate."[149] Foreign enterprises must receive "treatment no less favourable than . . . [treatment received] by enterprises of the Party, of any other Party or of any non-Party."[150] In effect, these provisions create a minimum floor of treatment that applies to both domestic or foreign entities. The emphasis on commercial considerations and national non-discrimination work against the protectionism built into many SOEs' business models.

2. Disclosure and Transparency

International agreements covering SOEs emphasize disclosure and transparency provisions as a tool for fairer market access and oversight. The disclosure regime typically requires party nations to provide information explaining SOEs' governance structure and financial information—pushing SOEs towards similar disclosure requirements as for publicly-held companies. For instance, Article 17.10 of the Trans-Pacific Partnership requires parties to identify state-owned enterprises on an official public-facing website.[151] Parties may request more

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[148] *Id.* at 29.
[149] TPP, *supra* note 134, art. 17.4.
[150] *Id.* art. 17.4.
[151] *Id.* art. 17.10.

detailed information about the listed entities.[152] Such information includes important powers based on the government's position as a shareholder:

> [T]he percentage of shares that the Party, its state-owned enterprises or designated monopolies cumulatively own, and the percentage of votes that they cumulatively hold, in the entity. . . a description of any special shares or special voting or other rights that the Party, its state-owned enterprises or designated monopolies hold, to the extent these rights are different than the rights attached to the general common shares of the entity.[153]

Transparency requirements also provide insight on the commercial orientation of the enterprise. Parties are required to reveal:

> [T]he entity's annual revenue and total assets over the most recent three year period for which information is available . . . any exemptions and immunities from which the entity benefits under the Party's law; and . . . any additional information regarding the entity that is publicly available, including annual financial reports and third-party audits, and that is sought in the written request.[154]

Additional provisions also require disclosure of "any policy or program . . . for non-commercial assistance," its legal basis, and policy objectives.[155]

These requirements not only force disclosure about publicly-owned enterprises, but also establish a broader norm around transparency. The transparency provisions may exceed the existing regulations under domestic law.

3. Mitigating Conflicted Transactions

Trade negotiators are concerned with indirect subsidies from SOEs giving an unfair advantage to domestic enterprises.[156] Provisions that require SOEs to apply commercial considerations in transactions attempt to halt this

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[152] *Id.* art. 17.10(3).
[153] *Id.* art. 17.10.
[154] *Id.* art. 17.10.
[155] TPP, *supra* note 134, art 17.10.
[156] *Id.* art. 17.6.

form of market distortion. Surprisingly, these same provisions can also address the broader governance issues stemming from improper related-party transactions (RPTs).

Improper RPTs involve an insider or dominant shareholder engaging in a transaction for the purpose of siphoning wealth.[157] Such behavior, termed "tunneling," transfers value from the company to another entity controlled by a dominant shareholder or a corporate insider.[158] In cases where a dominant shareholder extracts resources, minority shareholders lose the value of their investment.[159] In cases where a corporate insider extracts resources, shareholders as a class lose the value of their investment.[160] Such transfers of wealth can be used to support other companies owned by the controlling shareholder—a phenomenon termed "propping."[161] In related corporate groups, some companies may suffer from tunneling, while simultaneously, other companies in the corporate group may benefit from propping.[162]

These trends are present and problematic for SOEs. RPTs between a government and its controlled company provide opportunities for siphoning wealth from minority private shareholders by mispricing assets. For instance, a controlled oil company may purchase government-held exploration rights at an inflated value, or the government may underpay for electricity produced by a controlled utility.[163] These transactions hurt private shareholders in the enterprises and benefit the

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157 Simon Johnson et al., *Tunneling*, 90 AM. ECON. ASS'N. 22, 22 (2000).

158 *Id.*

159 *Id.* at 24.

160 *Id.* at 22.

161 Eric Friedman et al., *Propping and Tunneling*, 31 J. COMP. ECONS. 732, 733 (2003).

162 Curtis Milhaupt & Mariana Pargendler, *RPTs in SOEs: Tunneling, Propping, and Policy Channeling* 1, 3–4 (European Corp. Governance Inst., Working Paper No. 386, 2018).

163 Mariana Pargendler, *State Ownership and Corporate Governance*, 80 FORDHAM L. REV. 2917, 2941–42 (2012) (discussing how the Brazilian government is suspected to have leveraged its majority control of the oil company Petrobras to receive excessive payments for the purchase of oil exploration rights); Milhaupt & Pargendler, *supra* note 162, at 3 (discussing how the government used its control of the electric utility Eletrobras to renegotiate contracts on terms unacceptable to private actors).

government as a controlling shareholder. In cases where SOE insiders (e.g., managers) engage in improper RPTs, the transactions may actually hurt all shareholders, including the government and private investors.

Beyond RPTs, governments can use SOEs to achieve public policy or political objectives. Such "policy channeling" sacrifices financial returns for political pay-off, hurting the interests of private investors.[164] As an example, providing cheap fertilizer from a government company benefits farmers at the expense of shareholders—but since farmers are not related parties, the traditional tools of corporate law to cleanse such transactions would not apply. Under standard corporate law, there is an assumption that shareholders—and especially controlling shareholders—will monitor and prevent activities that do not contribute to profitability. However, the government obtains a non-pecuniary benefit from these transactions—its upside is measured in votes during an election, or popular support for an autocratic regime, and not in financial returns.

International agreements can limit "tunneling" behaviors by requiring commercial considerations (with narrow public policy exemptions). These provisions originally emerged to level the playing field between domestic and foreign actors. The same provisions also reduce the opportunities for the state or insiders to expropriate wealth from private shareholders.[165] Take, for example, an SOE with majority government ownership and private minority investors. Under provisions requiring commercial considerations, the government cannot use uneconomical transactions to unfairly "tunnel" resources from the partially-privatized SOE to other enterprises. In such a case, private investors in the SOE benefit from the protections of the economic agreement.[166]

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[164] Milhaupt & Pargendler, *supra* note 162, at 5.

[165] *Id.* at 6 (discussing how fair treatment also works to bring additional players into constrained domestic markets, as foreign companies and private domestic companies can gain equal footing).

[166] *Id.* at 3 (discussing how the constraints of commercial considerations may harm minority investors in the subset of SOEs that had previously benefited from the government "propping" the SOE).

International agreements tackling SOEs may solve other existing gaps in corporate law by empowering foreign enterprises as monitors. Milhaupt and Pargendler have outlined that existing corporate law based, on shareholder oversight may be unable to stop certain "propping" activities:

> Corporate law strategies are generally conceived with the interests of shareholders in mind, who often play a key role in their enforcement. This means that, even when they work well (which is often not the case in jurisdictions where SOEs are prevalent), these strategies may help deter tunneling, which harms shareholders, but not propping, which benefits shareholders . . . .[167]

Agreements can similarly fill "propping" activities. Foreign enterprises, empowered by the agreements, have a vested interest in identifying and stopping propping activities between the government and competitor SOEs.

4. Limitations of Current SOE Provisions

While international agreements present opportunities to improve corporate governance, some details within the agreements limit the functionality of the provisions.

For instance, in some cases, the very definition of the SOE limits the usefulness of the previously discussed provisions. The TPP defines SOEs as:

> [E]nterprises . . . engaged in commercial activities in which a Party . . . directly owns more than 50 per cent of the share capital . . . controls, through ownership interests, the exercise of more than 50 per cent of the voting rights; or . . . holds the power to appoint a majority of members of the board of directors or any other equivalent management body.[168]

The definition leaves out many instances in which the government can exercise decisive control as a minority shareholder. In such contexts, the government may form an implicit or explicit agreement with other dominant shareholders to defer to government preferences. The government clearly has the upper hand, with vast powers to change tax and regulatory

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167 *Id.* at 9.
168 TPP, *supra* note 134, art. 17.1.

preferences. In addition, politicians often have links to broader stakeholders that may pressure a corporation—such as employee unions. In cases where dispersed shareholders hold the remaining control rights, the state, even with a minority stake, could exert effective control.

Treaties should incorporate a more flexible standard for government control. The EU-Vietnam Agreement defines SOEs to include instances where a party "can exercise control over the strategic decisions of the enterprise."[169] This definition allows for an enterprise-specific analysis of government control, rather than using a binary analysis of whether the state is a majority owner.[170]

Another weakness emerges from the multitude of exemptions providing safe harbors for many SOEs.[171] The public interest and public service exemption in the TPP permits commercial activities on a non-commercial basis.[172] Especially problematic is the exclusion of sovereign wealth funds (SWFs). SWFs serve broad roles in the allocation of capital and exercise of governance rights in domestic and foreign corporations. The 1MBD scandal, involving the Malaysian sovereign wealth fund, underlined that SWFs can suffer from similar tunneling issues as more traditional SOEs.[173] Finally, nations may carve out specific provisions applicable only to their own enterprises. In the TPP, such policies may focus on favoring particular ethnic groups—Malaysia protects its Bumiputera affirmative action program for ethnic Malays, while Australia protected preferences for indigenous people.[174] Similarly, entire sectors

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169 European Union-Vietnam Trade and Investment Protection Agreement, Sept. 24, 2018, art. 11.1 [hereinafter EVIPA].

170 *Id.*

171 *Id.* at 11.

172 *See generally Summary of the Trans-Pacific Partnership Agreement*, U.S. EMBASSY IN URUGUAY (Oct. 6, 2015), https://uy.usembassy.gov/summary-trans-pacific-partnership-agreement/ (discussing the summary of the Trans-Pacific Partnership Agreement).

173 Shamim Adam et al., *The Story of Malaysia's 1MDB, the Scandal That Shook the World of Finance*, BLOOMBERG (May 24, 2018, 3:05 AM), https://www.bloomberg.com/news/articles/2018-05-24/how-malaysia-s-1mdb-scandal-shook-the-financial-world-quicktake.

174 Chin Y. Whah & Benny Teh Cheng Guan, *Malaysia's Protracted Affirmative Action Policy and the Evolution of the Bumiputera Commercial and*

may be excluded, including electricity for Mexico and Vietnam, oil and gas for Malaysia, and certain financial services for the United States.[175]

As a final note, while much of this discussion has focused on the implicit corporate governance regulation of SOEs in agreements, the recent EU-Vietnam agreement has actually explicitly brought the issue to the fore. The agreement discusses corporate governance under the broader discussion of the "Regulatory Framework": "[t]he Parties shall endeavour to ensure that state-owned enterprises, enterprises granted special rights or privileges, and designated monopolies observe internationally recognized standards of corporate governance."[176] The EU-Vietnam agreement is relatively soft—the parties merely "shall endeavor"—but, it provides an explicit instance of corporate governance situated in the context of SOE regulation.[177]

C. Equality of Shareholders in the Same Class

The OECD Principles on Corporate Governance establish that corporate governance should promote "equal treatment for foreign and domestic shareholders," and that, "all shareholders of the same series of a class should be treated equally."[178] In a departure from the other instances noted above, international agreements often infringe on these principles by providing additional protections to foreign investors, above and beyond the protections offered to their domestic counterparts.[179] These unequal rights artificially skew corporate decision-making and capital markets. These protections represent a tension with other agreements that have promoted and signaled greater commitment to corporate governance tenets.

Industrial Community, 32 J. SOC. ISSUES IN SE. ASIA 336, 336 (2017).

175 *See generally* David A. Gantz, *The U.S.- Mexico Trade Relationship Under AMLO: Challenges and Opportunities*, RICE U. BAKER INST. PUB. POL'Y, Apr. 2019 (discussing the affects of the U.S.-Mexico trade relationship under AMLO).

176 EVIPA, *supra* note 169.

177 *Id.* at 8.

178 OECD Principles, *supra* note 7, at 19.

179 *Id.*

This quandary emerges from foreign investors' disadvantage: they have relatively less influence via established political mechanisms to protect their investment, especially from government expropriation. In addition, some countries' weaker institutional settings raise the risks of all investment—foreign and domestic—as property rights and contract enforcement are less secure. Investment protections in treaties minimize these risks and reduce the cost of capital for inbound investment.

Protections promoting the equal treatment of shareholders—whether domestic or foreign—can promote investment. First, the transferability of shares increases, as the value of shares does not vary based on the nationality of the shareholder. If one set of investors has fewer legal rights than another, the weaker investor class will discount the value of the investment to account for the increased risk. A discrepancy between the market price for investment and an individual shareholder's valuation, adjusted for legal risk, undercuts capital market liquidity. Equal treatment ensures that individual investors do not discount the market value of an investment based on discriminatory legal treatment.

Second, the battle for corporate control may become more dynamic, as foreign investors would face fewer barriers to buying or selling stakes on the basis of nationality. Transfers of corporate control, or the threat of such transfers, constitute a mechanism of market-driven discipline. Boards and management are aware that a new shareholder may purchase a controlling stake and impose new board and management members. Equal treatment of foreign shareholders strengthens this mechanism for improved firm performance by creating a more active market for corporate control. Problematically, protections for foreign shareholders often exceed parity, and instead, place domestic shareholders at a distinct disadvantage.

The first of the three categories regulating the treatment of foreign investors, national treatment provisions, support equality. Parties are forbidden from discriminating in favor of domestic investors. The typical language, here excerpted from the US-Colombia Free Trade Agreement, compels that:

> Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.[180]

Next, agreements also include a most-favored nation (MFN) provision, which sets a minimum floor for treatment based on the treatment provided to non-parties. A typical provision, again excerpted from the US-Colombia Free Trade Agreement, requires that:

> Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.[181]

Scholars have referred to such provisions as reasonable and "modest," due to the limitation to "like circumstances."[182] In cases where the provision does apply, foreign shareholders would benefit from improved treatment based on the text of other agreements. Meanwhile, domestic shareholders remain subject to potentially sub-standard domestic law. Such discrepancy violates the equality promoted by corporate governance principles.

Finally, agreements include broader language to establish fair dealing standards. The typical standard of treatment, here from the TPP draft, obligates that, "[e]ach Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security."[183] Dozer explains that "the purpose of the clause as used in [bilateral investment treaty] practice is to fill gaps which may be left by the more specific standards, in

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180 United States-Colombia Trade Promotion Agreement, May 15, 2012, art. 10.3.1 [hereinafter Trade Promotion Agreement].

181 *Id.* art. 10.4.1.

182 Don Wallace & David B. Bailey, *The Inevitability of National Treatment of Foreign Direct Investment with Increasingly Few and Narrow Exceptions*, 31 CORNELL INT'L L.J. 615, 620 (1998).

183 Trade Promotion Agreement, *supra* note 180, art. 10.5.1.

order to obtain the level of investor protection intended by the treaties."[184] This standard can be based on multiple reference points, including the law of the host nation at the time of investment, or principles of due process.[185] This provision, though appearing on its face as encouraging equality, may actually require disparate treatment: if existing domestic practice falls below "customary international law," foreign shareholders could benefit from improved treatment while domestic shareholders would remain subject to sub-standard domestic law.[186] Again, foreign investors benefit from rights unavailable to domestic investors of the same or similarly-situated enterprises.

As a whole, the provisions already in effect underline the emergence of corporate governance regulation in international agreements. While the EU-Japan EPA represents the first instance of a dedicated chapter on the subject, past agreements have tackled the field despite its perception as an arena for domestic law.

CONCLUSION

The study of corporate governance has thus far largely ignored an emerging source of regulation: international economic agreements. State-to-state agreements implicitly and explicitly tackle issues related to corporate governance—where provisions alter the web of relationships governing the actors within a firm. The signing of the EU-Japan Economic Partnership Agreement has brought this trend to the fore. For the first time, negotiations have produced a dedicated corporate governance chapter. This development requires greater study, as the European Union or the United States may push corporate governance initiatives in other agreements. Such initiatives would enable domestic reformers to push for new legal frameworks that encourage accountability.

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[184] Rudolf Dolzer, *Fair and Equitable Treatment: A Key Standard in Investment Treaties*, 39 INT'L LAWYER 87, 90 (2005).

[185] *See id.* at 93, 97 (discussing the 2004 U.S.- Model BIT and its fair and equitable treatment).

[186] Sykes*, supra* note 103, at 511.

Future comparative work should consider how these agreements fit into the evolution of corporate law. These developments complicate a view that comparative corporate law should focus only on domestic legal developments. Instead, corporate governance via international agreements may support greater convergence across jurisdictions. Such changes signal progress, as long as individual states can maintain the power to shape domestic codes to address unique local concerns. Ultimately, future agreements may follow the positive lead of the EU-Japan Economic Partnership Agreement: effective signaling mechanisms, rather than fully binding commitments to specific rules.

In recent years, new topics, such as labor and environmental chapters, have become essential components in international economic agreements. These disciplines acknowledge the vast impact of economic agreements on different stakeholders within party nations. A similar transformation could occur on the corporate governance front. Recent accords, such as the TPP and the EU-Japan Economic Partnership Agreement, may be on the vanguard of international agreements influencing domestic corporate governance and the firm's constituents.