Legal Families and the Birth, Growth and Death of a Corporate Law Rule

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Abstract

This paper explores the limits of the concept of legal family in the context of corporate law, where scholarship has given it a prominent role in explaining differences in legal evolution. It does so by comparing the lifespan of a single rule which, owing to historical coincidence, Japan and Ontario both enacted in the 19th century. By examining the rule's 'birth' (reception), 'growth' (judicial development) and 'death' (repeal) in these jurisdictions from different legal families, the paper highlights four factors. First is that reception of a legal system does not imply reception of a given way of regulating an issue. Second is that convergent evolution will often lead to the development of similar interpretations of rules regardless of legal family. Third is that legal development does not always follow the narrative arcs assigned to given families. Finally, comparative legal elements not captured by the legal family may sometimes better explain divergences.

I. Introduction

This paper approaches the topic of the conference – the limits of legal families – from the perspective of corporate law, where economists in particular have played a major role over the past twenty years in reviving the concept to the sometime consternation of comparative law scholars. The literature is dominated by what is often referred to as the 'legal origins theory'[1] though for consistency in usage this paper will use the term 'legal families'. The theory posits that historically received legal families, through their influence on the substantive rules present in law, have led common law countries to better protect shareholders than civil law countries. This in turn is determinative of certain differences in economic outcomes which correlate with differences in legal family.

This theory set off a wave of literature which attempted to explain why legal families would have such an effect. Early papers focused on the historical divergences between English and French systems, with differences in political imperatives and degree of adaptability to change being suggested as mechanisms through which legal families would matter.[2] Given the strong degree of path

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[1] First popularized in R. La Porta et al, 'Law and Finance' 106 *Journal of Political Economy*, 1113 (1998).

[2] T. Beck et al, 'Law and Finance: Why Does Legal Origin Matter?' 31 *Journal of Comparative*

dependence from a single historical event (a country's reception of a given legal system) which the theory suggested, broader studies also focused on the question of how legal rules and economic conditions evolve over time.[3] In short, the debate sparked interest in how membership in a given legal family influences the subsequent development of black letter corporate law, and how this in turn relates to economic differences across countries.

This paper concentrates on the first aspect of this interest – the influence of legal families on subsequent development of black letter corporate law – in a hitherto unexplored substantive area: the regulation of the pay of corporate directors. While the legal origins literature has largely used a leximetric approach involving large scale quantitative comparisons of legal rules across dozens of countries, this paper uses a 'lifespan' comparison of the main rule governing director remuneration in two jurisdictions: Japan and the Canadian province of Ontario. In terms of legal family, Ontario is consistently classified as belonging to the English common law system. Japan's classification on the other hand is subject to more controversy as numerous taxonomies classify it differently but most of its laws in the 19th century were based on German models and the legal origins literature classifies it as German, a convention which this paper follows.

Despite their reception of different legal families, these two jurisdictions both implemented rules on director pay in their early corporate law statutes which were very similar to the rule found in the 1862 Companies Act in the United Kingdom. This rule subjected the remuneration of directors to approval by the general meeting of shareholders. The fact that both received a specific English rule gives us the opportunity to test some of the underlying hypothesis of the legal origins literature based on how they subsequently developed in systems with differing legal families. This paper traces the legislative and jurisprudential history of the rule in these two jurisdictions from their inception in the 19th century in order to highlight four limits in the use of legal families which are relevant at three distinct phases of a legal rule's lifespan: its inception, its subsequent development, and its ultimate demise or survival.

The first is that, as is perhaps obvious, membership in a legal family does not imply the historical reception of a particular way of regulating some aspect of the corporate form. This obviously applies to Japan, which did not use the then current German rule when it enacted its Commercial Code in 1899, but also to Ontario, which only adopted one similar to that contained in the English Companies Act several years after it had established its first corporate law using a different model. The second is that the judiciary in both played the main role in developing the rule, filling in gaps and providing necessary interpretations.

Economics, 653 (2003).

[3] C.J. Milhaupt and K. Pistor, *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development Around the World* (Chicago: University of Chicago Press, 2008).

The route by which they accomplished this was quite different – Ontario courts weaving back and forth and spawning competing authorities before higher courts settled a matter, while in Japan the courts provided interpretations in a more direct and coherent way. Nonetheless, the development provides examples of convergent evolution – the judiciary in each independently providing many of the same answers to problems that arose because they were simply the best way of doing so. Third we have the fact that sometimes legal systems act against type. Ontario, the common law jurisdiction which the legal origins theory would hold should have evolved rules that offered shareholders greater protection instead abolished the rule in 1982 and removed the requirement for shareholder approval. In Japan, on the other hand, the rule has survived to the present, giving Japanese shareholders greater control over the remuneration of directors than those in Ontario companies have. This brings us to the final point, which is that while legal family does not provide us with a useful comparative lense for understanding this ultimate divergence of the rules, constitutional differences do. Canada's federal system inspired the provinces including Ontario to mimic the highly successful Federal Canadian Business Corporations Act in the late 1970s and early 1980s, which led to the abandonment of Ontario's rule, while Japan, being a unitary state, did not have its corporate law molded by such a process.

The paper proceeds to address each of these points in the lives of the rules – their 'birth' (taking the language of legal 'parent' systems literally), growth and death or survival – in turn. In Section 2 it provides a brief overview of the legal families literature. Section 3 looks at the reception of the rule on director remuneration in each jurisdiction and its initial content. Section 4 provides an overview of how the rule was developed in the case law of each and Section 5 discusses the rule's demise in Ontario and continued survival in Japan. Conclusions follow.

II. Legal Families and Corporate Law

The root of the interest in legal families among economists began in the late 1990s[4] with a theory that attempted to explain differences in capital market development around the world. The earliest study created an index of legal rights that shareholders had against directors (not including any related to remuneration) and, after quantitatively measuring them, found that countries in the English legal family provided higher levels of protection to shareholders than were found in the civil law families and this explained the differing levels of capital market development across countries. Comparative law based scholarship found numerous grounds to criticize this work – the use of the concept of legal

[4] R. La Porta et al, n 1 above.

families in a context to which it was ill-suited,[5] bias in rule selection that favored English law[6] and simple mistaken understandings of the content of the rules in question[7] among these. Nonetheless a follow up paper in 2008[8] reiterated the theory and identified differing approaches to social control as the key which explains the relevance of legal families.

In the meantime the need emerged to provide some theory as to why a single event in the legal evolution of a country – its reception of a parent legal system – would have such long lasting consequences. Historical divergences in the early development of English and French law which resulted in the former giving greater protection to private property rights was one explanation.[9] A second, borrowing from Richard Posner's work,[10] argued that common law developed in an adaptable way, weeding out economically inefficient rules while providing more efficient ones (which presumably protected shareholders better) over time.[11]

These explanations have also been met with skepticism from legal scholars. The emphasis on long ago divergences between French and English history ignores subsequent developments,[12] and doesn't offer a convincing explanation with regard to countries from other legal families.[13] Likewise the argument that the judicial rule making of the common law favors evolution towards efficient rules, even if accepted as true, is not well placed in the context of the debate since judicial rule making also occurs in most civil law countries despite the formal lack of a rule of stare decisis.[14] One study, looking at indices of changes in law over time, further found that substantive legal development is not well explained solely by reference to legal family as divergent trajectories are found within them.[15]

[5] M. Siems, 'Legal Origins: Reconciling Law & Finance and Comparative Law' 52 *McGill Law Journal*, 55, 62 (2007).

[6] ibid.

[7] H. Spamann, 'The Ani-Director Rights Index Revisited' 23 *The Review of Financial Studies*, 367 (2010).

[8] R. La Porta et al, 'The Economic Consequences of Legal Origins' 46 *Journal of Economic Literature*, 285 (2008).

[9] T. Beck et al, n 2 above. See also P.G. Mahoney, 'Legal Origin?' 35 *Journal of Comparative Economics*, 278 (2007).

[10] Especially R.A. Posner, 'Utilitarianism, Economics and Legal Theory' 8 *Journal of Legal Studies*, 103 (1979).

[11] See for example T. Beck et al, n 2 above.

[12] Many papers explore this point and other historical points of divergence, see for example M.J. Roe, 'Legal Origins, Politics and Modern Stock Markets' 120 *Harvard Law Review*, 460 (2006).

[13] The focus on differences between the French and English systems ignores tends to obscure the stories of Scandinavian and German families where the original data obtained by the early literature is sometimes an awkward fit with the overall narrative, see R. La Porta et al, n 1 above.

[14] As Haley notes, 'all legal systems adhere to judicial precedents to some degree'. J. Haley, 'The Role of Courts in "Making" Law in Japan: The Communitarian Conservatism of Japanese Judges' 22 *Pacific Rim Law & Policy Journal*, 491, 492 (2013).

[15] J. Armour et al, 'How do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor and Worker Protection' 57 *The American Journal of Comparative*

Another took issue with an underlying assumption implicit in the theory that laws evolve gradually over time, demonstrating through the use of case studies that law tended to evolve more rapidly in response to exogenous shocks before returning to states of equilibrium for extended periods.[16]

This is by no means an exhaustive review of the literature, but it can be said that while comparative law has been quite skeptical of this use of legal families it does at least serve as a useful point of departure for considering their limits. We can distill three questions which the legal origins theory suggests which this paper explores: does legal family coincide with the reception of a given way of regulating a given area? Does legal family provide a different way for rules to evolve over time even if they begin the same? Does legal family lead to a particular way of regulating something in favor of shareholders? These are addressed in the following sections.

III. Birth: Divergences in Reception

The legal origins theory presupposes that legal families are associated with distinctive ways of regulating economic activity.[17] For the purposes of this paper this raises the question of whether legal families have different ways of regulating director pay in their corporate law. A comparison of Japan and Ontario suggests that insofar as such a style is historically determined by their reception from a parent legal family, there are limits to the usefulness of such a generalization.

If we look at the corporate laws of the 'parent' of each immediately prior to the reception of their first corporate law – The United Kingdom and Germany – there are significant differences between them. In England Section 54 of the Companies Act 1862[18] stated that remuneration of directors was to 'be determined by the company in general meeting' – an approach which persists in English law to this day albeit in significantly modified form in the 2006 Companies Act. The German Commercial Code of 1897, in contrast, did not require shareholder approval of the pay of members of the two boards which German corporations possessed, but required that where they were to be remunerated by a share of the profit it had to be calculated in accord with a net profit and provision of a reserve fund. So far so good for the theory.

These rules, varying with each other, did not however directly find their ways into the statute books of Ontario or Japan even though both would ultimately enact rules closer to that found in English law. Ontario's first corporate law, Ontario Joint Stock Companies Letters Patent Act[19] passed in 1874, was broadly

Law, 579 (2009).

[16] C. Milhaupt and K. Pistor, *Law and Capitalism* (Chicago: Chicago University Press, 2008).

[17] R. La Porta et al, n 8 above.

[18] 25 & 26 Victoria c. 89.

[19] RSO 1877, c. 150.

similar to the first law passed at the national level, the Province of Canada's 1864 Act to Authorize the Granting of Charters of Incorporation to Manufacturing, Mining and Other Companies[20] ('Province of Canada Act'). Neither of these used the Companies Act 1862 as a model however as they both adopted an earlier letters patent based approach to incorporation. In terms of the remuneration of directors, Section 7 of the Province of Canada Act defined the powers of a corporation's directors and gave them the power to, among other things, pass by-laws setting their own remuneration, but limited this power by stating that such by-laws

> 'unless in the meantime confirmed at a General Meeting of the company duly called for that purpose, shall only have force until the next Annual Meeting of the company, and in default of confirmation thereat, shall, from that time only, cease to have force'.

Following Confederation this provision would be copied into Section 13 (c) of the Companies Clauses Act [21] at the Federal level.

Section 29 of the 1874 Ontario act, in a curious omission, copied the wording of Section 7 of the Province of Canada Act almost *verbatim* but made no mention of director remuneration. This oversight was remedied in the 1897 Ontario Act,[22] Section 48 of which stated:

> No by-law for the payment of the president or any director shall be valid or acted on until the same has been confirmed at a general meeting.

This led to a substantive distinction between Ontario and Canadian Federal law since the latter acknowledged the validity of by-laws regarding director pay until they were approved by the general meeting while the Ontario rule established that shareholder approval was a condition precedent to any such by-law coming into force.

In Japan the first permanent Commercial Code[23] came into force in 1899 and included in Art 179 its original provision governing director pay:

> The amount of compensation to be received by the directors is fixed by the general meeting of shareholders if it has not been fixed in the articles of association.[24]

German law heavily influenced the drafting of the Commercial Code,[25] though

[20] 27-28 Victoria, c. 23.
[21] 32-33 Victoria, c. 12.
[22] RSO 1897, c. 191.
[23] Act no 48 of 9 Mach 1899.
[24] English translation contained in Y.Y. Hang, *The Commercial Code of Japan* (Boston: The Boston Book Company, 1911).
[25] H. Baum and E. Takahashi, 'Commercial and Corporate Law in Japan: Legal and Economic

while the 1897 German Commercial Code was consulted it was not used as a direct model since it was felt to be too advanced for the state of the Japanese economy of the time.[26] While the rule on director remuneration bears no resemblance to the rule in the German Code it is quite similar to the rule in the English Companies Act, the only difference being mention of the articles of association (which, as they also require assent of the general meeting of shareholders, is not a major difference).

The point to be noted about the reception though is that both Ontario and Japan found their way to enacting largely the same rule (with some differences in wording that will be discussed further below) in rather awkward relation to their parent. Ontario initially enacted a rule in variance with the English model and only moved towards it decades later in a move that, ironically, marked its divergence from the Canadian Federal law upon which it had originally been based. Japan likewise bucked the trend of its German parent in adopting a rule that largely followed the English model.

While this shows us a quirk in the legal family story early in each jurisdiction, which it must be emphasized may be idiosyncratic to this particular comparison, we can move on to the second question of how the legal systems themselves developed the rule. Even if they both adopted the English rule, did their civil and common law institutional mixes cause it to develop differently?

IV. Growth: The Courts and Convergent Evolution

Posner's argument that the common law generally tends towards efficiency has been used as one of the arguments for why rules, regardless of the historical origin of their substance, evolve towards greater emphasis on shareholder protection in common law countries than civil law ones.[27] This argument misses an important point, which is that Posner and subsequent authors in that field were not referring to the 'common law' in comparison to civil law systems per se, but rather to judge made rules. It's a well established fact that the judiciaries in civil law countries like Japan do create rules even if there is no formal recognition of stare decisis,[28] so this distinction does not tell us much. A comparison of how the courts in Japan and Ontario interpreted their rules on director remuneration reveals a marked contrast in the pattern of development that may be attributable to their differing legal families, but that this was not in itself determinative of the substantive result.

Developments After 1868', in W. Rohl ed, *History of Law in Japan Since 1868* (Leiden: Brill, 2005), 360.

[26] ibid.

[27] T. Beck et al, n 2 above.

[28] N. Garoupa and C. Gomez Liguerre, 'Efficiency of the Common Law', in M. Faure and J. Smits eds, *Does law Matter?* (Cambridge: Intersentia, 2011), 226.

The rules on director remuneration in both jurisdictions, taking the Ontario iteration that existed from 1897 to 1970 and the Japanese one which existed from 1899 to 2002 as a basis of comparison,[29] were not exactly the same and raised some unique questions in each. The Japanese rule for example did not specify whether the phrase 'the directors' meant directors individually or the board as a whole and the courts eventually favored the latter interpretation,[30] so the practice in Japan came to be for resolutions regarding director pay to ask the shareholders to approve a global amount for the entire board rather than for each individual director. In Ontario on the other hand the wording of the provision made it quite clear that it applied to individual directors and the president, so the courts never had to address the issue.

In other respects though the provisions left the judiciary in each with many of the same unresolved gaps that needed filling in. Was it necessary to have the shareholders approve director pay every year? Both Ontario[31] and Japan[32] declined to make this a requirement. This type of development can be considered a form of convergent evolution – the rules independently evolved in significantly different contexts since they were the best suited solution to the issue at hand – forcing annual voting would have added an unnecessary formality since in both it was possible to set limits on remuneration that would persist for multiple years.

This is illustrated in a further issue that the rule in both called up which is worth examining in greater detail. Directors in corporations also often serve as regular employees of the corporation. The rules on director remuneration in both however were unclear on whether shareholder approval was necessary for all remuneration they received from the company or only that related to their duties as directors. Interpreting it either way would pose problems. Requiring all remuneration be subject to the rule could deprive workers of legitimate claims to pay based on failure to meet the formalities. On the other hand, removing such pay from being covered by the rule would create a potential loophole for directors to avoid shareholder oversight of their pay. The judiciary in both would eventually favor the latter option, the 'directors as directors' rule, though the development towards that would follow different paths in each. The following subsections trace the case law development of this interpretation of the rule in each.

1. Evolution of the Rule in Ontario

[29] In 1970 the Ontario rule was updated to reflect case law developments, while in Japan a 2002 amendment did the same. In both cases the essential requirement of the rule was unchanged by these amendments, though Ontario's would later be repealed, see discussion below.

[30] *Saiko Saibansho* (Supreme Court) 26 March 1985, 557 *Hanrei Times* 124.

[31] *Hood* v *Caldwell* 1923 Canlii 3 (SCC).

[32] No case challenging the lack of an annual approval reached the courts in Japan, but the practice sanctioned by the courts from the earliest cases was to have resolutions approve a pay limit for the entire board, which naturally lent itself to only requiring subsequent resolutions when changes to that limit were sought. *Ōsaka Chihō Saibansho* (Osaka District Court) Judgment 29 June 1953, 34 *Hanrei TAIMUZU* 63.

While case law related to director remuneration in Ontario first appears in 1887[33] it was not until 1894 that the first case in which the distinction between remuneration for directors as directors and remuneration for the same directors for other positions was addressed. In *Re The Ontario Express and Transportation Company*[34] Rose J. first articulated the directors as directors interpretation of the rule:

> '(…) I am not of the opinion that where a director is appointed an officer of the company, he holds such appointment as director. It seems to me that the words referred to apply to the payment of money for the services of a director qua director'.

This seemed to have settled the issue in the very first case in which it was raised, but this iteration of the rule did not last long. Eight years later in *Birney* v *The Toronto Milk Co., Ltd*[35] Street J. expressly declined to follow it and moved to the opposite extreme – holding that all pay to directors in any form required shareholder approval:

> '(…) we should hold the section as requiring the sanction of the shareholders as a condition precedent to the validity of every payment voted by directors to any one or more of themselves whether under the guise of fees for their attendance at board meetings or for the performance of any other services for the company'.

His basis for this change was the fact that the 'directors as directors' interpretation provided an obvious loophole through which directors could avoid the necessity of shareholder approval of their pay, by merely making their salary come under the guise of some other office. In Street J's words, it 'would in fact render the section nugatory, for nothing would be easier than to evade it'.

Street J's interpretation in *Birney* largely supplants Rose J's interpretation in *Ontario Express and Transport* as the point of departure for cases from this point.[36] In *Mackenzie* v *Maple Mountain Mining Co.*,[37] Meredith JA would however open a wedge that would allow subsequent case law to drift back towards the 'directors as directors' interpretation when he stated:

> 'The purpose of the enactment is that those who govern the company shall not have it in their power to pay themselves for their services in such

[33] *Re Bolt and Iron Company Livingstone's Case* [1887] O.J. no 153.

[34] [1894] O.J. no 179, 25 O.R. 587.

[35] [1902] O.J. no 2.

[36] This is illustrated in the decisions of Riddell J in the 1907 *Benor* v *Canadian Mail Order Co*. case in which he first issued a decision reluctantly following Rose J's interpretation ([1907] O.J. no 694), then three weeks later issued a more enthusiastic decision ([1907] O.J. no 740) reversing himself on the grounds that he had not known of Street J's decision.

[37] [1910] O. J. no 192, 20 O.L.R. 615.

government without the shareholders' sanction'.

The case did not turn on the point, but this clearly suggested that the rule intended to draw a distinction between a director's 'services in such government' and other functions they might perform.

The strict approach in *Birney* was also applied by Riddell J in *Re Morlock and Cline Limited Sarvis and Canning's Claims*.[38] There the plaintiff had only served as a 'dummy' director who took no part in management and was employed as a commercial traveller. Riddell J chose to strictly follow the rule in Birney and deny the claim for pay on the basis that

> '(…) the law does not draw any distinction between 'dummy' and non-dummy directors – and one who has accepted the position of director must continue to be so dumb that he cannot say he was not a director – it would never do to allow a director to better his position by asserting that he did not do his duty as director'.

The pushback against this strict interpretation and a move back towards the directors as directors interpretation began in 1912 with *Matthew Guy Carriage and Automobile Co. (Re)*.[39] In this case the plaintiff was a mechanic who worked as such for the company and was later appointed to the board. Since his pay as mechanic under his employment contract had not been put into a by-law and passed by the shareholders the court had to consider whether he had any claim to such pay. Relying on his own statement in *Mackenzie* v *Maple Mountain Mining Co*. Meredith JA explicitly established that the rule did not apply to regular employment positions whose appointment did not require a by-law. He expressed some wariness in light of the Bliney decision but held that

> 'I do not think that there is any warrant for extending the principle to cases in which the director has acted as a mere workman or clerk and has been remunerated at a rate not exceeding the real value of the services rendered, at the ordinary market-price'.

This new distinction was elaborated in the Ontario Supreme Court in 1918. In *Canada Bonded Attorney and Legal Directory* v *Leonard-Parmiter Ltd*.,[40] Ridell J held:

> 'If the services are such that only a director can perform them, eg, attending board meetings or acting in other regards as a director, he can recover compensation, payment, for such services, only by complying with the statute; but, if he is employed in a subordinate capacity and at a

[38] [1911] O.J. no 115.
[39] [1912] O.J. no 136.
[40] [1918] 42 D.L.R. 342.

reasonable figure, there is no necessity for a by-law confirmed at a general meeting'.

In 1919 the Supreme Court of Canada finally had its say on the rule. Anglin J settled the matter in favor of the 'directors as directors' rule, citing with approval Middleton J in the Matthew Guy Carriage and Automobile Case and Riddel J in Canada Bonded Attorney.[41] He held:

> 'The commission was not paid to Doran as a director of the company, but as an agent employed by it to sell its property. I think such a payment does not fall within Section 92 of the Ontario Companies Act (…).'

Duff J (dissenting on other grounds) also stated:

> '(…) I am inclined to concur in the view that this section does not contemplate special payments of the character here in question which are not made by way of remuneration for services of a director as director, but a special allowance on some other ground'.

It remained unclear whether these statements actually settled the matter since neither represented the majority opinion (concurring judgments having avoided addressing the issue and deciding the case on other grounds) and this uncertainty was commented on, but not resolved, by Anglin J five years later in *Hood* v *Caldwell*.[42] Despite this, the Supreme Court's decision did have the effect of ending judicial decisions on the issue in Ontario Courts, as no further cases on this point appear afterwards. The Ontario legislature put the final word on the matter by codifying the 'directors as directors' rule in its 1970 overhaul of the Companies Act.[43]

2. Evolution of the Rule in Japan

Owing to the limited availability of pre-war Japanese decisions [44] our discussion of the jurisprudential story there begins in the post-war period. The case law related to its director remuneration rule, then found in Art 269 of the Commercial Code,[45] begins in 1953 in the Osaka District Court,[46] where most litigation related to it played out until the 1980s, by which time it had largely

[41] [1918] 42 D.L.R. 342.
[42] [1923] S.C.R. 488.
[43] R.S.O. 1970 Ch. 53.
[44] The main commercial Japanese case law databases which were consulted for this paper, Westlaw Japan and LexDB, have coverage only extending to the postwar period.
[45] Until 2005 since when it has been in Art 361 of the Companies Act, Act no 86 of 26 July 2005.
[46] *Ōsaka Chihō Saibansho* (Osaka District Court) Judgment 29 June 1953, 34 *Hanrei Taimuzu* 63.

migrated to Tokyo. Unlike Ontario, where the earliest decision formulated the directors *qua* directors rule and subsequent decisions waved back and forth between opposing viewpoints before decades later returning the rule to one quite similar to that at which it started, the directors as directors rule would not see its first iteration in Japanese case law until 1985.

This difference is partly explained by differences in the corporate framework that the Commercial Code set. In keeping with its German origins the Commercial Code gave corporations not one but two boards: a board of directors (*torishimariyaku*) and a board of auditors (*kansayaku*). The board of directors was tasked with administering the affairs of the corporation, while the board of auditors played a monitoring role over the board of directors and was tasked with examining and investigating the documents of the directors and making reports regarding such to the shareholders.

Art 269 applied not only to the remuneration of directors, but also to that of auditors, which created a governance problem. Since resolutions regarding pay were submitted to the general shareholders meeting by the board of directors, this allowed the directors to set and request shareholder approval not only for their own pay levels but also those of the auditors, the very people tasked with supervising them.

The Osaka District Court in 1953[47] first had to deal with a case in which a shareholder, among other things, sought to invalidate a resolution which approved a change in the articles of incorporation to increase the pay of the board of directors and the board of auditors. The source of the Plaintiff's claim may have laid in the fact that the corporation's main asset, a hotel in Osaka, was being used by the American occupation authorities at the time of the resolution which meant that there was little work for the directors to be doing that would have justified a raise.

More specifically though the Plaintiff had two legal bases for seeking invalidation which were not relevant in Ontario. The first was that allowing the pay of auditors to be set alongside that of directors at the latter's motion seriously undermined the ability of the auditors to perform their function. The second was that the resolution did not actually set the pay of the directors or auditors individually, but rather set a cumulative pay limit for each board as a whole. While the wording of the Ontario statute made it clear that the pay of individual directors had to be approved by the shareholders, the Japanese rule was more vaguely worded in this respect and open to interpretation. The delegation of decisions on how to divide pay to the board of directors was particularly problematic in light of Arts 260 and 262 of the Code, which prohibited directors from voting on resolutions of the board in which they had a personal interest. Since all directors would obviously have an interest in their own pay, this rule seemed to disqualify them from making such decisions.

[47] ibid.

The Court made a number of pronouncements that, despite coming from a lower court, would be followed thenceforth. The first was the observation that the purpose of Art 269 was the need to prevent the directors from having unfettered discretion to decide their own pay since they might abuse that to pay themselves in excess of their worth to the detriment of the company. The second was to establish that resolutions did not have to approve the pay of each individual director but rather could set a global limit for the entire board to meet the requirements of Art 269. The third was that the pay of auditors could be set by the same resolution as the directors.

In 1968 the first case[48] to deal with the distinction between pay for directors in their roles as directors and that in their roles as employees appears. This case, which first arose in the Nagoya District Court and was appealed up to the Supreme Court of Japan, dealt with employee-directors who had not been paid as directors but rather had all of their earnings come from their employment. The main issue was not related to Art 269 but rather to Art 265 of the Code, which required that any contract which a director enters into with the corporation on his or her own behalf must be approved by the board of directors. The Court held that

> 'when a director of a corporation also holds a position as an employee of the corporation, the remuneration that person receives as an employee, rather than as a director, should be interpreted as being remuneration paid under a contract between that director and the corporation, which must be approved by the board of directors pursuant to Art 265 of the Commercial Code'.

The Court's narrow answer to the question in the case avoided addressing whether this pay also needed to be approved by the shareholders pursuant to Art 269. It did, however, establish a precedent for differential treatment of a director's pay in each role.

The case law then returns to the District courts for several years. In one 1973 case the Osaka High Court[49] issued a decision which went the opposite direction from Riddel J's famous line about dummy directors in Ontario sixty years earlier. There the Court upheld the Plaintiff's claim to a retirement bonus despite the fact that she had been a director of the corporation and the bonus had neither been approved by the shareholders nor the board of directors. It held that since she held the position of director in name only (in other words, she was a dummy director) at a closely held corporation where the formalities were largely ignored, the concerns related to protecting the corporation from

[48] *Saikō Saibansho* (Supreme Court 3rd Petty Bench) Judgment 3 September 1968, 92 *Hamji Shumin* 163.

[49] *Ōsaka Kōtō Saibansho* (Osaka High Court) Judgment 29 March 1971, 298 *Hanrei Taimuzu* 227.

damages which were behind both Arts 265 and 269 were not in play.

A 1972 Osaka District Court case[50] provides a further exploration of the distinction between pay for directors and pay for employees. The Plaintiff in that case had been receiving pay as a director that had been duly approved by the shareholders as required by Art 269. He suffered an injury which prevented him from attending at the corporations (he was the director of two related corporations which were both defendants), after which they stopped paying him as a director even though he continued to hold that position. The Court, in upholding the Plaintiff's claim for pay, noted that corporation had erred in treating the position of director as one of an employee. Since the Plaintiff still had the duties of a director despite his injury, he continued to be entitled to pay as such.

In 1985 the Supreme Court of Japan in the Citizen's Watch case[51] was the first, and last, to directly deal with the question of whether the rule on director remuneration contained in Art 269 covered payments for non-director duties. In a short one page judgment which upheld the decision of the Tokyo Court, the Court held:

> 'Where the system for establishing employee pay is clearly established, it cannot be said that a resolution of the general shareholders meeting which sets only their pay as directors is insufficient to allow the general shareholders meeting to perform its oversight function and determine whether or not the actual pay of directors is excessive. Therefore such a resolution does not fail to comply with the requirements of Article 269 of the Commercial Code'. (Author's translation)

Of note is that the Court used a very similar device as the Ontario courts to assuage the danger that the directors as directors rule would provide an avenue for directors to avoid shareholder scrutiny. The requirement that such pay be subject to a clearly established pay system was the functional equivalent of Meredith JA's requirement that the remuneration not exceed 'the real value of the services rendered'[52] for the directors as directors rule to apply. By inserting that objective standard, the courts found a balance that prevented directors from abusing their position to overpay themselves free from shareholder oversight while at the same time reducing the formalities that might have frustrated valid claims for work performed. With this single judgment the issue was resolved in Japan and does not appear in further cases involving Art 269.

The comparison of how the courts in Ontario and Japan developed the rule

[50] *Ōsaka Chihō Saibansho* (Osaka District Court) Judgment 21 December 1972, 298 *Hanrei Taimuzu* 414.

[51] *Saikō Saibansho* (Supreme Court 3rd Petty Bench) Judgment 26 March 1985, 557 *Hanrei Taimuzu* 124. The author's English translation of the Supreme Court of Japan and Tokyo High Court decisions in the case can be accessed here https://tinyurl.com/y8rhuuj8 (last visited 15 November 2018).

[52] *Matthew Guy Carriage and Automobile Co. (Re)* n 39 above.

shows us both that they followed different paths of development and that this difference doesn't seem to have had much effect on actual substance. The back and forth between competing lines of authority in Ontario courts as they narrowed the question of how to treat pay directors receive from regular employment through multiple factual cases over decades has no parallel in Japan, where specific questions like that were settled directly the first time they appeared. In both however the courts hit upon largely the same interpretation of the rule and the same way of resolving the underlying problem it posed.

V. Death and Survival: The Rule Ends with a Whimper in Ontario, Japan Carries On

In 1970 Ontario's Corporations Act underwent a large scale reform following the release of the Lawrence Report that had been commissioned by the Legislative Assembly in 1967.[53] The rule on director remuneration was revised to codify the directors as directors interpretation and further clarify the content of by-laws on director remuneration but otherwise made no changes to it.[54] The rule would however find the seeds of its demise with movements at Canada's Federal level shortly thereafter. Federal corporate law, which as noted above had diverged from Ontario's in the 19th century, gave directors the discretion to set their own pay.[55] In 1975, following the recommendations of the Dickerson Report of 1971,[56] Parliament enacted the Canada Business Corporations Act (CBCA).[57] The introduction of the CBCA had a major impact on corporate law across all provinces, which until that point in history had been quite diverse. Within a decade nine out of ten provinces had completely reformed their corporate laws based on the CBCA model.[58] Ontario did so in 1982 Ontario by enacting a completely new Corporations Act[59] almost entirely based on the CBCA, including its provision on director remuneration. This marked the end of director pay being subject to approval by the general shareholders meeting in Ontario, a situation that continues to this day.

[53] Ontario Legislative Assembly, *1967 Interim Report of the Select Committee on Company Law*, 5th Session, 27th Legislature 15-16 Elizabeth II.

[54] The amended rule stated:

22 (1) A by-law relating to the remuneration of a director as director shall fix the remuneration and the period for which it is to be paid.

(2) A by-law passed under subsection (1) is not effective until it is confirmed at a general meeting of the shareholders duly called for that purpose.

[55] Section 94 *Canada Corporations Act*, 1964-65 c. 52, s. 1.

[56] R.W. Dickerson et al, *Proposals for a New Business Corporations Law for Canada* (Ottawa: Information Canada, 1971).

[57] R.S.C. 1985 c. 44.

[58] R.J. Daniels, 'Should Provinces Compete? The Case for a Competitive Corporate Law Market' 36 *McGill Law Journal*, 130, 152 (1991).

[59] *Business Corporations Act, 1982,* SO 1982, c. 4.

This divergence of Ontario's law from Japan's and a path it had followed for close to a century is notable for two reasons. The first is that it occurred as a small part of a much larger reform in which it was not viewed as significant. Neither the Lawrence Report or the Dickerson Report devoted any discussion to the rules on director remuneration. The second and more important is that the divergence with Japan is clearly not explained by legal family. The creation of the CBCA in 1975 was a watershed moment in the development of corporate law across all jurisdictions in Canada, which responded to perceived competitive pressures it created and modelled what until then had been quite diverse corporate rules on it.[60] Japan's solitary Commercial Code (and from 2005 Companies Act) was not subject to any such interjurisdictional competition or diversity in rules and the general shareholders meeting still has the final say on the remuneration of directors at most Japanese companies.[61] Constitutional differences rather than legal family offers a better comparative explanation for this, ultimate, divergence.

VI. Conclusion

To return to the overall topic which the paper began with – the limits of legal families – the comparison of the lifespan of the same corporate law rule in jurisdictions from differing legal families provides us with some insights that the larger scale, quantitative studies which dominate the legal origins literature miss out on. The first is that historical receptions of legal families did not always imply the reception of a given substantive rule. The second is that subsequent development of rules by the courts might vary in style across legal families, but also show signs of convergent evolution – rules by their nature offer limited potential interpretations and courts may often independently hit upon the same ones regardless of other differences. Third is that jurisdictions may act against type, with common law jurisdictions abandoning shareholder protections that civil law ones maintain. Finally we have the fact that other comparative legal differences not captured by the concept of legal family, such as constitutional ones, may offer better explanations for such divergences in the evolution of corporate laws in some instances.

This is not to suggest that these results are likely to be repeated across comparisons of different rules in different jurisdictions, clearly much of this is idiosyncratic to the comparison here presented. The point, however, is that the

[60] R.J. Daniels, n 58 above.

[61] Since 2002 an exception has been made for companies which adopt the Companies with Committees system, but this only represents about two percent of listed corporations. See D. Green and S. McGinty, 'What Shareholders in Japan Say about Pay: Does Art 361 of Japan's Companies Act Matter?' *Asian Journal of Comparative Law*, 1-31 (2018).

lifespan of a black letter law provides so many points for divergence in their birth, growth and death that the concept of legal families is of limited use in understanding the substantive differences that exist across countries today.