INTRODUCTION

Until recently national legislatures within the European Union (EU) had few incentives to introduce legal innovations in the context of closely held business firms, despite potential benefits for governments, such as tax revenue and economic growth. In many European jurisdictions, the provisions of the dominant closely held business form, the close corporation, are somehow linked to its publicly held counterpart. This may account for a ‘lock-in’ to the existing legal framework and mandatory provisions. Some take it for granted that when network or learning benefits are present, the value of legal products such as business forms increases. The effect of these benefits is to create standard provisions in corporation and partnership law. For example, the fact that the majority of closely held business firms select the domestic close corporation law to govern their rights and duties may actually lead to a network benefit for the firms using this particular business form. As a result, domestic close corporation forms maintain and strengthen their leading position.

Indeed, newly formed firms will likely migrate to those business forms that confer large network and learning benefits to the user. This will mean that demand will be higher than it otherwise might be, which in turn will lead to the supply of standards rather than customized terms that benefit a variety of closely held firms. Because standardized terms offer certainty, when advising clients about choice-of-business-form decisions, domestic lawyers will contribute to the

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unwillingness of firms to substitute the standard form for new structures. The upshot is that lawmakers are arguably reluctant to innovate.

A number of other reasons limit legal innovation in business organization law. The involvement of the European legislature in developing a harmonization programme designed to create a degree of uniformity in the law regarding creditor and investor protection throughout the European Union has tended to restrict innovation in business organization law in general. This harmonization process, which introduces essential minimum standards and tolerates a degree of diversity at a national level, applies mainly to the public corporation. Even though the EU directives initially focused on public corporations, both national and EU lawmakers tend to extend their reach to the close corporation when introducing policy reforms. Given the network and learning effects, imposing mandatory rules could be thought to encourage the standardization effect, hence decreasing the prospects for changing European business organization laws.

The evolution of European business organization law may well turn on the prospect of national lawmakers finding compelling reasons to abandon the defence of well-entrenched legal forms and the mandatory rules that reinforce their position and so block the diffusion of new innovative legal rules. Yet given the way in which lawmakers have responded to date, the emergence of new separate legal business forms responsive to the needs of closely held firms would appear improbable, particularly in absence of the conditions necessary for competitive lawmaking. For several reasons, in most European jurisdictions, the small and medium-sized business community is not likely to play an important part in the development of business organization legislation. Except for the United Kingdom, where accountants have already played a central role in the adoption of a ‘limited liability partnership’ statute, the national lawmaking process in Europe is led by lawmakers and civil servants who give priority to the preferences of large firms. Thus, unless small and medium-sized enterprises and affiliated interest groups are able to influence the pattern of lawmaking, any statutory changes made will not be particularly beneficial to closely held firms.

Lawyers and other professional advisors can indeed play a significant role in the ‘lock-in’ to adopted contracts. If a particular lawyer spends time and money on customizing an alternative term that will benefit other lawyers and their clients generally, that lawyer may face a potential free-rider problem. As a result, the drafting and designing of innovative contract terms is not in itself always cost-effective. Efforts to enhance change will not live up to expectations. The possible failure of the new term, which might damage the lawyer’s professional reputation and even ruin his career, also tends to confine lawyers to a more passive role by encouraging them to follow the herd and to some extent to ignore their own information and judgments regarding the merits of their decisions. See, e.g., Kahan, M. and Klausner, M., Path Dependence in Corporate Contracting: Increasing returns, Herd Behavior and Cognitive Biases, Washington University Law Quaterly 74, (1996), pp. 353-358.