

PEKKA TIMONEN:

Määräysvalta, hinta ja markkinavoima. Julkisesti noteeratun yrityksen määräysvallan siirtymisen oikeudellinen sääntely (Summary: Control, Price and Market Power. The judicial regulation of transfers of control in quoted corporations). Kauppakaari Oy Lakimiesliiton Kustannus. Helsinki 1997. XLVIII + 384 p.¹

ANMÄLD AV JUKKA MÄHÖNEN

Pekka Timonen's doctoral dissertation "Määräysvalta, hinta ja markkinavoima" (hereinafter *MHM*) is the first dissertation written in the Finnish language on Finnish law in which an economic analysis of law is used. The history of Finnish law and economics is very short. The first articles which actively employed law and economics together were published as recently as 1995. The role of a pioneer might cause problems both to the writer and the reader. The production and consumption of law with economics are more problematic than the production and consumption of traditional legal dogmatics. From the point of view of *law*, it is a question of introducing, apparently, alien economic material into the closed system of legal dogmatics; from the point of *economics*, it is a question of introducing alien normative material into the closed system of economics.

Both legal dogmatics and economics are ways of simplifying reality. The question is

how they can be combined, either in legal research or in research in the field of economics, and whether the results are then identical? Most probably they are not. The study generated by the legal *scholar* is different from that of an economics specialist, even where both explicitly use an economic analysis of law as their research method. For the *reader*, the problems connected with law and economics are converse. A lawyer reads a law-and-economics paper from a different perspective than an economist.

The subject-matter of Timonen's thesis is (*MHM* pp. 1, 16-17, summary p. 360) mergers and acquisitions of Finnish public companies and their judicial regulation. Timonen has written his thesis from the point of view of a legal scholar on grounds of legal dogmatics (p. 2) using economics. This means that the book is more problematic for an economist than for a lawyer. These problems were also stressed by Timonen's official opponents, Professors

¹ An earlier version of this review was published in Finnish in *Oikeus*, Vol. 27, No. 2, pp. 105-9 (1998).

Veikko Reinikainen and *Juha Pöyhönen*, at his doctoral disputation (see *Lakimies* 1998 pp. 149 ff. and pp. 159 ff. (in Finnish)).

The structure of the thesis is threefold: it consists of a theoretical part (introduction and sections 2 and 3), a part dealing with theoretical dogmatics (section 4) and a part comprised of practical dogmatics (sections 5-7). The thesis ends with a summary (section 8), where the writer evaluates the method used and the results achieved.

The main problem of the thesis lies in its incoherence. Firstly, the writer seeks new methodological openings, though does not always succeed in exploiting them; secondly, he tries to give a comprehensive overview of *neoinstitutional economics* (hereinafter the *NIE*) and its relations to Finnish mainstream legal dogmatics; and thirdly, he tries to grasp the concrete legal problems connected with corporate mergers and acquisitions.

On the Methods Used

Timonen's thesis is, first and last, a book on methodology. According to him (*MHM* pp. 4 f., pp. 361 f.), the methodological emphasis in the book arises both from his own interest in methodological and theoretical issues and from the problems in the specific field of law he has chosen as his field of research. The study was originally entitled "The Regulation of Takeovers in Finland and in the European Union." When Timonen chose his field of study, the original proposal for the thirteenth company law directive had not yet been replaced by the new proposal of 1996. The new proposal does not have the far-reaching impacts on European corporate governance as the old one, which has affected negatively the coherence of Timonen's arguments. After

the new proposal, the focus of the work shifted from specific legal problems to deeper methodological and theoretical problems.

Unfortunately, Timonen proposes quite a narrow interpretation of the relationship between an economic analysis of law and Finnish legal dogmatics. Timonen claims (*MHM* p. 107) that in law-and-economics research the point of view is that of a common law judge. According to Timonen, a common law judge sees legal problems as open situations, where existing legal regulation does not limit outcomes available or rules for achieving them and where the judge may legitimately take the most efficient outcome as his goal. Timonen takes for granted the view of the fundamentally different roles of a (US) common law judge and a (Finnish) civil law judge. According to Timonen, when a common law judge in using precedents (case law) he seeks the right policy outcome, a civil law judge is a bureaucrat, who, in using logical deduction mechanically, determines the right outcomes from the provisions of the written law.

This view of the different roles of a common law judge and a civil law judge is misleading and outdated (see, e.g. *Ugo Mattei, Comparative Law and Economics* (Ann Arbor 1997) pp. 79 ff). In the same way, other traditional differences between common law countries and civil law countries, for example, the greater importance of systematics or theoretical legal dogmatics in civil law countries than in common law countries, or claims about differences in the importance of higher court decisions as precedents, can be questioned.

Additionally, the traditional dichotomy common law/civil law is exceptionally ill-suited for Finland (and other Nordic) countries. We do not have comprehensive civil

codes as a main phenomenon of civil law. These codes (e.g., the German BGB and HGB, the French Code civile, the Swiss OR, the Italian Codice civile), constituting undoubtedly the foundations of civil law systems, have nowadays less and less importance. The amount of special legislation is growing and legal systems are fragmenting – as it has traditionally been in the Nordic countries. The growing importance of written law is astonishing. The whole twentieth century may be described as an “orgy of statute making” on both shores of the Atlantic.

The growing importance of written law has inevitably influenced the decision-making processes of common law judges. No common law judge can ignore provisions in written law, circumventing them by using only efficiency or policy arguments is no longer possible, with the exception perhaps of the United States Supreme Court Justices. On the other hand, case law is an exceptionally important source of law in Nordic contract law and company law. In these fields of law, it is no exaggeration to call cases, for example, from the Finnish Supreme Court, precedents.

Timonen’s field of research is company law, securities markets law and competition law. What is typical of these fields of law is that they are *traditionally* regulated *also* in the United States and the United Kingdom by written law. The oldest Western company laws are from England and the US states. Securities markets were regulated early in both countries. Competition law (*antitrust*) is, as is well known, a US-originated field of law.

Therefore, there is no need to disallow a law-and-economics approach as a legitimate method for legal interpretation. Why does Timonen do so, though? The answer may be

found in his view of what law and economics is.

On Neoinstitutionalism

Timonen commits himself (*MHM* p. 48 ff., pp. 360 and 362) to the NIE. This approach is not a problem, but the way in which Timonen sees mainstream economics or “neoclassical” law and economics is. Even more problematic is his almost emotional approach to *Richard Posner*. Timonen uses heavy artillery against both. This attack is, however, more or less symbolical: besides NIE literature, Timonen readily uses “neoclassical” *corporate governance* literature of the worst kind. To my mind, the NIE is for Timonen a way of justifying his law-and-economics approach to the Finnish legal academia. “Neoinstitutionalism” feels more familiar than “neoclassicism” for classical Finnish legal dogmatics.

The modern economist’s concept of rationality is not the “neoclassical” concept of rationality that Timonen is describing and criticizing. The concept of *bounded rationality* according to *Herbert Simon* (*MHM* p. 71) and *Mancur Olson* is generally accepted by both “neoclassical” economics and the NIE. Examining Timonen’s “main man,” *Douglass C. North*, one can perceive that his concept of rationality does not *inherently* differ from modern “neoclassical” views.

Surely, the difference between North’s concept of rationality and the neoclassical concept of rationality is evident. North emphasizes the experimental and cultural dependencies of individual rationality. Again, for North, as for all the NIE, the starting-point is a selfish and self-interest seeking individual. However, what is most interesting, and what Timonen ignores, is the tendency of

individuals acting in *organizations* to seek their own interest; for North, to get a better return on capital invested, on the one hand, by maximizing the individual's own benefit in the existing institutional framework, on the other hand, by improving the individual's standing in the organization by institutional change.

Instead of using these ideas, Timonen leans on (*MHM* pp. 72 f.) his "No. 2 man", *Oliver E. Williamson*, and especially the latter's concept of opportunism, "*self-interest seeking with guile*," typical of individuals. Stressing opportunism in human behaviour, Williamson is narrowing intrinsically the modern neoclassical view of individual rationality. Human choices are admitted to be individual situation-dependent. If opportunism is taken as the starting-point of all human behaviour, individuals must be bound by a regulatory system constructed to restrain stronger individuals' opportunism.

This concept of human rationality is more appropriate than North's for Timonen's own research ideology, emphasizing, as it does, the importance of legislation and regulation generally (*MHM* p. 56), even though Timonen acknowledges the fruitfulness of North's approach (*MHM* p. 57). In principal-agent relationships, this view puts the agent in a strange position: if the managing director of a company is acting opportunistically, he is evidently trying to fraud his principal(s), the shareholders – and to prevent this, more regulation is required to ensure that the agent really does promote the principals' interest.

Back to North; what is even more important for him than his concept of rationality is the dynamic two-way interaction between "institutions" (e.g., legislation, customs and other codes of conduct) and "organizations"

(e.g., firms). Certainly, Timonen is aware of the bidirectional nature of this interaction (*MHM* p. 66), but he rejects too easily the impacts that *organizations* have on *institutions*. The question is not only of interest groups' lobbying, for example, in the Finnish Parliament or the European Commission, but of all institutional change caused by interactions between organizations and institutions, taking place either in judgements given by courts, research undertaken by legal scholars, testimony given by legal and other experts, acts performed by public authorities or norms given by the legislature. What is essential is that organizations, or to be more precise individuals acting in organizations, are forming institutions for their own benefit. This institutional change is examined also by the *public choice* school, but North goes further. Using game theory concepts, North is playing a game with more than one round when theories like *public choice* are satisfied by only one round. In North's game, the players are playing several rounds; they are learning from their mistakes and changing simultaneously the rules of the game.

Another question in which Timonen sees a fundamental difference between "neoclassical" and "neoinstitutional" schools stems from the way *transaction costs* are taken. Timonen claims – if I have understood it right (e.g. *MHM* p. 45) – that the "neoclassical" school does not take transaction costs into consideration. It is not so, but the real question lies in *when* and to what *purpose* reality is *modelled*. When you are talking of the "neoclassical" school, you are talking of operating in a simplified model world.

Timonen admits that modelling is necessary in all economic research (*MHM* p. 38). The *Coase Theorem*, the basis of transaction

cost analysis represented, for example, by Williamson, is an illustrative example of how economics is modelling reality. Although all, including Coase himself, are unanimous that transaction costs *always exist*, it is not pointless to examine the world as if there were no transaction costs. If economics using models is “neoclassical”, Coase is a “neoclassicist” – and that ascription Coase himself wants to avoid. “Schools” are absurd, except for those who want to be a member of one.

Why does Timonen emphasize the differences between the several “schools” of economics and why does he see the legal community as a unified group of people without any “schools”? One explanation might be that Timonen is a lawyer, not an economist. I recently heard from a Finnish economist that there are no schools in economics. If I asked him whether there are schools in legal research, he would answer that the differences between the different schools are great.

Another possible explanation is that Timonen is afraid that he is shaking too much the status quo of the Finnish neo-positivist mainstream legal research. Surely, he *is* shaking it (*MHM* pp. 121 ff.), by emphasizing factual arguments in interpretation. However, an economic analysis of law provides opportunities for contradicting the whole traditional hierarchy of sources of law without abandoning positivism. Timonen, however, does not want to take that path.

The absence of *evolutionary* and *comparative* considerations has already been pointed out by Prof. Reinikainen and Pöyhönen (see *Lakimies* 1998 pp. 149 ff. and pp. 159 ff.). The real strength of the NIE lies in the possibilities it can offer to (historical) comparative law. Good examples of this are North himself (institutional evolution) and Ugo Mattei

(comparative law). It would be interesting to know why Timonen abandons the path down which his methodological concerns are leading him.

Perhaps the most essential phenomena in North’s work are the dynamic element in institutions and organizations in minimizing transaction costs, the efficient definition of property rights, and the costs connected with contracting. It is easy to see how North’s view of economic history combines economics and history, but what benefit does it have for legal research? That benefit can be achieved only in legal history by putting economic history into the toolbox of the legal historian and so of all legal research, in the same manner as Timonen puts (neoinstitutionalist) economics into it (*MHM* p. 47). Without comparative and historical dynamics, his attempt to get rid of “neoclassical” economics is in vain.

At least one reason why Timonen does not want to go further with North’s argumentation *might* be that he sees legal research, in the final resort, as *static* by its nature (*MHM* p. 39). Timonen does not see the dynamics of legal research as a continuous process but as paradigms (cf. Kuhn) that fall in scientific revolutions.

Timonen’s views can be compared with those of another Finnish legal scholar’s, *Kaarlo Tuori’s*, on law as a multi-layered phenomenon and especially on changes at the level of legal culture. The main difference between Timonen’s and Tuori’s views lies in what Tuori calls the critical relationship or generally critical positivism, the way legal theory reconstructs law both at the surface level and at its deeper structures. The reconstruction process is dynamic and continuous though it can be divided *afterwards* into separate phases by founding certain turning points

or “revolutions” (*MHM* p. 40). An economic analysis of law *might* be one way of opening a critical relationship between the surface and the deeper structures of law. Unfortunately, Timonen does not want to use this possibility, as, for example, going deeper in his fairness–efficiency discussions (*MHM* p. 102).

On Corporate Law

Probably the most important contribution made by Timonen is the introduction of the *theory of the firm* and especially of *corporate governance discussion* into Finnish corporate discourse. These themes alone make Timonen’s thesis important in Finnish corporate literature.

The firm in terms of a *nexus of contracts* approach (*MHM* pp. 140 ff., p. 363) shows that company law and securities law cannot be discussed separately. At the same time, it is clear that the third part of the thesis, competition law, remains separate from the other two; it cannot be bound to the theory of the firm and the economic argumentation available is totally different (*MHM* pp. 214 ff., pp. 372 ff.).

Timonen grounds his *corporate governance* arguments on *Adolf Berle’s* and *Gardiner Means’* study of the modern corporation (1932). According to Berle and Means, what is typical of large corporations is the separation of ownership and control, leading the corporate officials inevitably to use corporate assets for their personal gain, in conflict with both the interests of the shareholders and society as a whole. Instead of maximizing (shareholders’) profits, the officials maximize their own remuneration, and, to achieve this, the production and scale of the corporation. The corporation functions less and less efficiently and the profits of the shareholders are

endangered. As a solution to the problem, Berle and Means recommend regulating corporate internal affairs.

Berle and Means’ thesis has been heavily criticized (see, e.g. *George J. Stigler & Claire Friedland*, *J. of L. & Econ.* 1983, pp. 237 ff., not referred to by Timonen). Instead, Chicago-based contractual corporate law has replaced it as a mainstream doctrine at least in the United States (see *Frank H. Easterbrook & Daniel R. Fischel*, ‘The Economic Structure of Corporate Law’ (1991)). This change of a paradigm is not a problem for Timonen, though. He uses in a natural manner material from both contractual and communitarian “schools,” adapting quite easily to “neoclassical” argumentation (*MHM* pp. 159 f.).

Questions of Interpretation

In the sections on practical law, there are some questions of interpretation worth mentioning though Timonen does not discuss them in the Summary. The most important might be the redemption price for the redemption of the minority shares of a company (§ 14:19 of the Finnish Companies Act), a source of several legal disputes, and the right of a public company to lower by provisions in its articles of association the stake of shares creating obligation to redeem other shareholders’ shares from the two-third stake prescribed in § 6:6.1 of the Finnish Securities Markets Act (*MHM* section 6.2).

According to Timonen, the right redemption price is primarily the market value of the share (*MHM* p. 268). In most Finnish publicly quoted companies the stake creating an obligation to redeem the other shares has been lowered by the articles of association from the two-thirds level, usually to one-third (see

MHM p. 282). According to Timonen, (*MHM* p. 304), provisions of this kind in the articles of associations infringe the rule of the free transferability of shares (§ 3:2 of the Companies Act) and are thus invalid unless all shareholders have accepted the provision in a shareholders' meeting or afterwards. This interpretation is in contrast to the interpretation presented by Professor Matti J. Sillanpää in his doctoral dissertation (*Julkisesta ostotarjouksesta* (Zusammenfassung: Übernahmangebote), 1994). Timonen's interpretation is not based on an economic analysis of law but on methods of traditional legal reasoning in Finnish company law, considering first the wording of the law and then the Swedish interpretation of the subject (see *SOU 1990:1*, *SOU 1997:22*). Although Timonen's argumentation fulfils the rules of traditional argumentation, it is not a good example of the *possible* ways of using economics in legal argumentation.

Summary

In the above, I have made some fragmentary remarks on Timonen's thesis. In conclusion, I would say – again – that this is a good-quality thesis, but is a somewhat subjective overview of the NIE. It remains a versatile and doctrine-free attempt to use economics for the resolution of theoretical problems in corporate law. In spite of my critical comments, I shall venture to suggest that Timonen's thesis is one of the most important Finnish monographs in the field of corporate law this century.

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