COMPLIANCE & ENFORCEMENT

Enforcement is more relevant for regulatory strategies (rules + standards) !

Enforcement ensures “agent compliance” by relying on courts, regulators, and procedural rules to secure the effectiveness of legal norms.

Governance strategies rely upon principals’ initiative!

Governance strategies depend heavily on the principals’ ability to coordinate and act at low cost. When ownership is dispersed, coordination failures significantly reduce the practical effectiveness of governance mechanisms.

TYPES OF ENFORCERS:

Enforcement may operate ex ante (preventing harmful behavior) or ex post (sanctioning misconduct), both of which are necessary for securing compliance.

- **Public** (brought by organs of state)

Public prosecutors, regulatory authorities, stock exchange authorities, etc. Public enforcers include criminal and civil bodies empowered to bring actions on behalf of the state; they also exercise ex ante approval rights over significant corporate decisions. Accordingly public enforcers enhance compliance with rules *ex ante* or impose penalties on for rules violations *ex post*.

TYPES OF ENFORCERS:

Deterrence: threat of intervention of the state

An open issue: public enforcers do not have economic incentives for initiating law suits.

This limitation arises because public officials typically retain none of the financial penalties imposed on corporate defendants. However, in some jurisdictions these distinctions blur when regulators are allowed to keep part of collected penalties, enhancing incentives.

TYPES OF ENFORCERS:

- **Private** (brought by private parties). The efficacy of such private enforcement rely upon solicitors, judges and smooth procedural laws (discovery rights – low legal fees)

The private enforcement's initiatives include class actions and derivative suits.

Private enforcement relies on mechanisms of deterrence: penalties are imposed ex post upon discovery of misconduct. Its effectiveness depends on procedural tools such as discovery rights, low legal fees, and specialized plaintiffs' bars

TYPES OF ENFORCERS:

Deterrence: penalties after assessment of misconduct

Reliable corporate governance is usually guaranteed by public shareholders or institutional investors

Empirical evidence shows significant increases in private enforcement in countries like the U.S., UK, Japan, and Germany, often linked to improvements in judicial infrastructure

Third parties litigation funding (TPLF): a new fashion to boost private enforcement ! TPLF enhances private enforcement by reducing financial barriers for small shareholders, making derivative and class actions more accessible.

Third-party litigation funding (TPLF) is an arrangement where an external entity finances the legal costs of a lawsuit in exchange for a share of the settlement or judgment proceeds if the case is successful. The funder takes on the financial risk, assuming the costs of legal fees, expert witnesses, and other expenses, while the funded party can pursue a case without upfront costs and with non-recourse financing, meaning they don't have to pay the funder back if they lose. This practice is used in both commercial and personal injury cases, often by specialized companies, investment funds, or wealthy individuals.

TYPES OF ENFORCERS:

- **Gatekeepers** (accountants – lawyers- auditors – investment banks – financial advisors, etc.)

They should prevent or react properly in case of misbehavior by directors or shareholders, if they fail to intervene then they can be considered co-responsible for the misbehavior of the agents.

Gatekeepers function as “noncorporate actors conscripted” into enforcement. Their liability arises when they fail to prevent or disclose misbehavior, creating strong incentives for monitoring (gatekeeper control).

TYPES OF ENFORCERS:

Deterrence: corporate activity cannot go ahead without gatekeepers support

Gatekeeper control operates primarily *ex ante*: firms cannot proceed with key corporate transactions (e.g., issuance of an unqualified audit report) unless gatekeepers approve, giving them decisive leverage.

Whistleblowing
- Internal - workers
- External – third parties

Whistleblowing introduces a hybrid form of enforcement, relying on insiders who reveal wrongdoings in specific areas. The EU Directive 2019/1937 strengthens protections for whistleblowers, reducing retaliation risks and increasing detection.

Penalties

The threat of an enforcement must be finely tuned with the selection of an adequate penalty

I. Payment of money. Who is responsible, company or manager?

The D&O insurances policies

II. The annulment of corporate decisions

III. Prison

IV. Loss of licence

V. Loss of reputation

SYSTEMATIC DIFFERENCES

Legal strategies and their enforcement can change across jurisdictions

Much of the difference depends from structure of share ownership.

Where ownership is concentrated in a few hands, principals can coordinate more easily, making governance strategies more effective. Regulatory strategies become comparatively less necessary.

Such differences are narrowing ⇒ convergence in ownership structure

SYSTEMATIC DIFFERENCES

Convergence trends in ownership structures across jurisdictions have reduced—but not eliminated—differences in enforcement systems. Yet regulatory institutions (courts, regulators, accounting professions) still play a decisive role

Efficacy of governance strategies rely upon coordination of principals (effective wherever there is a good concentration of the shares in few hands)

More regulatory strategies the more enforcement institutions

Disclosure supports both enforcement and governance: it reduces information asymmetry not only between firm and market but also among shareholders themselves, preventing selective disclosure and protecting minority investors.