MODELS OF MODERN CORPORATIONS: A COMPARATIVE ANALYSIS OF GERMAN AND U.S. CORPORATE STRUCTURES*

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INTRODUCTION

A comparison of U.S. and German corporate governance systems is significant not only because it exemplifies two quite diverse corporate models, but also because some German commentators are jealously suggesting to “Americanize” German corporate structures. German commentators base their argument on the competitive failures of German corporations and the high German unemployment rate. While German stock markets are booming and generating high profits, the increase in shareholder value does not show other related benefits like increased employment rates. The question commonly raised is whether German mechanisms for monitoring and controlling corporate managers are inferior to those in the United States. This paper will provide a detailed analysis of German and U.S. corporate law.

Part I of this article provides a short description of the historical development of German corporations, the Aktiengesellschaften (stock corporations),¹ and a description of the German banking system. Part II discusses the unique features of German Aktiengesellschaften, including bank involvement, how it was created by German law and practice, and the influence of European Union law. Part III describes the capital structure of German corporations and compares it to that of the U.S. corporations. Finally, Part IV compares corporate governance in the United States to the governance system in Germany.

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¹ The German Aktiengesetz (German Stock Corporation Act) from September 6, 1965, BGBl. I 1089, as amended last December 12, 1998, BGBl. I 3836 (cited below as AktG.), regulates the stock corporation, or Aktiengesellschaft (AG), as well as the Kommanditgesellschaft auf Aktien (KGaA). The Aktiengesellschaft is the German counterpart of the U.S. corporation. The Aktiengesellschaft and the Kommanditgesellschaft auf Aktien are greatly outnumbered by the limited liability company, or Gesellschaft mit beschränkter Haftung (GmbH), a more flexible form suited for closely held and subsidiary companies, governed by a separate act.
I. HISTORY OF THE GERMAN CORPORATION AND THE GERMAN BANKING SYSTEM

A. Developments Before World War I

Historically, the influence of banks in Aktiengesellschaften was closely tied to the development of corporate law in Germany, and vice versa. Aktiengesellschaften were initially intended only for large enterprises. The precursors of Aktiengesellschaften can be found in the Italian banking system of the 15th century like "St. Georgsbank" in Genoa, and "Ambrosiusbank" in Milan.\(^2\) In the 17th century, "Handelskompagnien" developed as companies to tap newly colonized lands. The height of the Aktiengesellschaften began in the 19th century,\(^3\) and can be attributed to the rise of railroads. Their construction, as in the United States, required large amounts of capital. Neither governments nor entrepreneurs alone were able to raise the kind of capital railroads required.\(^4\) At this time, the incorporation of an Aktiengesellschaft depended on governmental review and approval.\(^5\)

In the middle of the 19th century, Germany, a relatively underdeveloped country, tried to keep up with more industrialized countries, especially England.\(^6\) At this time Germany was politically divided into different countries, each with its own domestic markets and currencies. Thus, raising capital across borders was not easy.\(^7\) In addition, there was a deficiency of savings and a lack of a developed capital market. A successful incorporation required leverage.\(^8\) The upturn of the corporate form could only be achieved with the foundation of banks as Aktiengesellschaften themselves. Some of these banks, known as "Grossbanken," are still around today. They offered commercial credit, brokering and investment and other services that were essential to newly formed

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3. See id.
4. See id.
5. This was still the case under the regime of the Allgemeines Deutsches Handelsgesetzbuclh (German Commercial Code) from 1861; now Handelsgesetzbuch from May 10, 1897, RGBI. S. 219, as amended last December 12, 1998, BGBI. I 3836.
6. See Klunzinger, supra note 2, at 150-151.
7. See id.
8. See Enno W. Eckelentz, Jr., Modern German Corporation Law 3 (1979) (Corporate legislation at this time was still confined to the various German countries. The first statute to regulate corporations in Germany was the Prussian Law of 1838 relating solely to railroad companies. Years later, a more general Prussian Law of 1843 was enacted).
Aktiengesellschaft.\(^9\)

In the course of the economic liberalization that occurred during the second half of the 19\(^{th}\) century, changes were made to German corporate law in 1870 that gave the founders of corporations more freedom. The average attendance of shareholders at annual meetings was low; consequently, it was easy for management to control and, in the extreme, to buy votes. By 1884, misuse led to the introduction of a sharp liability for founders and the beginning of "shareholder democracy"\(^10\). As a result, the number and dispersion of small shareholders began to increase. Despite owning the shares, many shareholders did not attend the periodic meetings and, due to several factors, conveyed voting rights to their banks. Thus, proxy voting by banks became an important feature in the governance of Aktiengesellschaften.\(^11\) Representation of the shareholders by banks was thought to assure good attendance at the shareholders' meetings and to assure that decisions made at the meeting would mirror the opinion of all shareholders. This was one reason why quorum requirements, unlike in the United States, were not dictated by law. Besides their financial expertise, and their close relationship with the Aktiengesellschaften, there was (and still is) another reason why banks took the role as a link between shareholders and the corporations: banks deposited the shares in their vaults.\(^12\) With the shares in their possession, it was convenient to let them also exercise the right to vote for the shareholders.\(^13\) Banks took advantage of this attitude and included a blanket authorization to vote for the shareholders as a preprinted term of business in their deposit contracts. At this time, there was no regulation that guided the voting of banks.

Shares were deposited with banks because they were bearer shares. A bearer share does not require an endorsement by its owner to be conveyed; it is simply transferred by contract and delivery of the certificate.\(^14\) Consequently, this kind of paper needed a secure deposit to prevent theft, destruction or loss.\(^15\) Under German law, until 1965, registered shares were deemed the default legal rule,

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10. See Karsten Schmidt, Gesellschaftsrecht 770 (1997) (emphasizing that this reform is one of the most important in the history of stock corporation law in Germany).
11. See Vallentin, supra note 9, at 10.
12. See Hans Wurdinger, German Company Law 30 (1975) (stating that current bank practice is to transfer their holdings to the licensed security holding bank, Deutsche Clearing AG, which credits the banks with the number of securities deposited).
14. See § 929 BGB (The Bürgerliches Gesetzbuch or German Civil Code).
whereas bearer shares had to be provided for explicitly in the articles of incorporations.\textsuperscript{16} German corporations and shareholders, however, preferred shares in bearer form because they wanted to remain anonymous for tax purposes and other reasons.\textsuperscript{17}

B. \textbf{German Corporations After World War I}

In the decades immediately after World War I, inflation and speculation again caused misuse of voting rights.\textsuperscript{18} In reaction to this misuse, a significant reform of the regulations dealing with Aktiengesellschaften occurred. In addition, the regulations dealing with the Aktiengesellschaft were separated from the German Commercial Code, and the Aktiengesetz of January 30, 1937 was created.\textsuperscript{19} This reform, among other things, increased the minimum capital required to incorporate an Aktiengesellschaft to 500,000 Reichsmark. Furthermore, this reform also brought a change to the statutory regulation of depository voting.\textsuperscript{20} However, only the form and duration of the authorization was regulated; it was not until the reform of 1965 that conflict of interest issues were addressed. The goal of the 1965 reform was to make stocks more attractive as a form of capital investment, and to strengthen the position of shareholders. Some of the important changes included:

\begin{itemize}
  \item[(1)] Restrictions on the freedom of contract [A deviation from the regulations of the Aktiengesetz is only possible where explicitly permitted by law.]
  \item[(2)] A decrease of the minimum par value of shares from 1000 to 50 Deutschmarks (DM) [in 1994 decrease to 5 DM; now 1 Euro.]
  \item[(3)] Improvement of the rights of shareholders to information
  \item[(4)] More influence by the shareholders' meeting regarding the distribution of profits
  \item[(5)] More efficient protection for minorities
  \item[(6)] Improvement of disclosure requirements
\end{itemize}

Before these amendments, especially before the decrease of the minimum par value of shares, many people were unwilling or unable to invest in

\textsuperscript{17} See Vagts, \textit{supra} note 13, at 53-56.
\textsuperscript{18} See ERCKLENTZ, \textit{supra} note 8, at 4.
\textsuperscript{19} See KLUNZINGER, \textit{supra} note 2, at 150-151.
\textsuperscript{20} See 1937 Stock Corporation Act (Aktiengesetz) § 114. \textit{See also} VALLENTHIN, \textit{supra} note 9, at 31-35, and Vagts, \textit{supra} note 13, at 54-55.
Aktiengesellschaften.  

C. Recent Changes

Major amendments were made to the Aktiengesetz in 1998. These changes were prompted by the failure of the Aufsichtsrat (supervisory board) and auditors to prevent spectacular collapses, and by discussions about the power of banks in Aktiengesellschaften, due to their participation in many corporations and their depository voting rights. Additionally, the German legislature, aware of the progressing globalization of markets, intended to foster the competitiveness of German companies and to open international capital markets to German Aktiengesellschaften. The 1998 amendments were envisioned as creating transparency and capital market orientation. The changes mostly concern the Vorstand (board of management) and the Aufsichtsrat. They were intended to reduce the size of the boards, allow for greater access to information, strengthen the control of the shareholders’ meetings (with continuing, but further developed depository voting by banks), improve the quality of account audits, and amend the regulations dealing with the acquisition of the corporation’s own stocks.

"Incentives" to amend German corporate law are also coming from the European Communities, now the European Union. The Monetary Union made it necessary to amend regulations that deal with monetary issues so that they now refer to the new common currency, the Euro, instead of the Deutschmark. Although there have been more significant amendments due to EU obligations, it is unnecessary to describe in detail the various EU directives and their implementation in German law out of context.

23. See KLUNZINGER, supra note 2, at 152.
24. See id.
25. See id.
27. EU Directives are binding on the Member States to which they are addressed, but the choice of forms and methods are left to the national authorities. See Article 249 of the Treaty Establishing the European Community from March 25, 1957, in the Consolidated Version with the amendments by the Treaty of Amsterdam from October 2, 1997 (CONF/4005/97 ADD 2). Thus, generally speaking, directives need to be implemented into national law.
D. The German Banking System

As previously mentioned, since the beginnings of Aktiengesellschaften as a corporate form in Germany, banks have played an important role. Unlike their U.S. counterparts, German banks are permitted by law to offer a full range of commercial banking and investment banking services under one roof (universal banking).\(^{28}\) Some of them have even started to engage in the insurance business.\(^{29}\) Furthermore, since the "merger and hostile takeover fever" began in Germany, banks have also acted as initiators, advisers and financiers for acquisitions and mergers.\(^{30}\) Unlike in the U.S., German banks had not previously worked in this area mainly because hostile takeovers had been unknown in Germany.\(^{31}\) German banks have also been reluctant to offer their clients derivatives, swaps, futures and options.\(^{32}\) With the exception of Deutsche Bank, German banks have not extensively participated in the Eurobond market or in other international securities markets.\(^{33}\)

In Germany, all banks have universal banking power, but only a few German banks actually underwrite securities.\(^{34}\) The banking industry is basically divided into three main parts: the public sector banks, which act as saving banks (Sparkassen); the cooperative banks (Genossenschaftsbanken); and the private (commercial) banks (Privatbanken).\(^{35}\) Underwriting syndicates are dominated by the three large private banks: Deutsche Bank, Dresdner Bank and Hypo-Vereinsbank.\(^{36}\) The German banking market is highly segmented, with different banks serving different economic sectors. The private banks have stable, long-

\(^{28}\) See Alan J. Daskin & Jeffrey C. Marquardt, The Separation of Banking from Commerce and Securities Business in the United Kingdom, West Germany and Japan, 7 ISSUES IN BANK REG. 18 (1983).


\(^{31}\) See Kubler, supra note 29, at 102.

\(^{32}\) See James R. Kraus, Solid German Banks May See Profit Slump, 92 AM. BANKER, July 27, 1992, at 8A.

\(^{33}\) See id. at 9A.

\(^{34}\) The most recent available number is around 10 out of 4000 German banks in the late 1980s. See Herman H. Kallfass, The American Corporation and the Institutional Investor: Are There Lessons From Abroad? The German Experience, COLUM.BUS.L.REV. 775, 779 (1988). This number might have changed a little, due to the increased activities and participation in the German stock market. On the other hand, it has to be noticed that a development started where banks try to get away from universal banking, and specialize instead.


\(^{36}\) See Kallfass, supra note 34, at 782. Due to recent growth, Hypo-Vereinsbank now outranks Commerzbank as the third largest bank.
term relationships with corporate customers who tend to obtain most or all of their financial services from their banks.\textsuperscript{37} For large companies, credit relationships may not be exclusive. Publicly held corporations may maintain multiple main-bank relationships.\textsuperscript{38}

German banks have focused on traditional market services, mainly loans and securities placement, in domestic markets. They slowly expanded their vision, recognizing the necessity to participate in international markets. A good example of this is the acquisition of Morgan Grenfell & Co., a London merchant bank, by Deutsche Bank in order to get instant expertise in merger advice and investment management.\textsuperscript{39}

\section*{II. GOVERNANCE OF AKTIENGESELLSCHAFTEN}

In the United States, the corporate actors are the shareholders and the board of directors, which is elected by the shareholders and is responsible for managing and supervising the corporation's business.\textsuperscript{40} In addition, there are the officers of the corporation who run the corporation's day-to-day business.\textsuperscript{41}

In the German Aktiengesellschaft the responsibilities for managing and for supervising the corporation's business are separated and entrusted to the Vorstand (board of management) and the Aufsichtsrat (supervisory board).\textsuperscript{42}

\subsection*{A. Composition of the Aufsichtsrat}

German law requires that the Aufsichtsrat be comprised of at least three members. However, the bylaws can provide for a higher number depending on the stated share capital of the corporation.\textsuperscript{43} A higher number of members are required for corporations that are subject to the various Acts of Codetermination (Mitsbestimmungsgesetzen).\textsuperscript{44} Codetermination is the involvement of the firm's employees in the decision-making process, and is an important underlying concept

\begin{itemize}
\item 37. See Kubler, supra note 29, at 103.
\item 38. See Theodor Baums, Corporate Governance in Germany: The Role of the banks, 40 AM. J.COMPL. L. 503, 508 (1992).
\item 41. See id.
\item 42. See KLINZINGER, supra note 2, at 170.
\item 43. See AktG, supra note 1, § 95.
\item 44. See id.; Uwe Hüffer, Aktiengesetz, Kommentar, § 95 Rn. 6 (1999). See also Mark Roe, German Codetermination and the German Securities Market, 1998 COLUM. L. REV. 167 (1998).
\end{itemize}
in German corporate law. Thus, the composition of the Aufsichtsrat is determined on one hand by the Aktiengesetz and on the other by the Codetermination Acts. These Acts may prescribe different membership requirements for the Aufsichtsrat. However, not all corporations meet the requirements for codetermination, and there are various Codetermination Acts. The applicability of the Codetermination Acts depends on the kind of business a corporation is engaged in, and the number of its employees.

1. Corporations not Engaged in Mining, Iron or Steel

Corporations that are not engaged in the mining, iron, or steel industry, that have less than 500 employees, or that engage in certain special activities like charity, are not required to have employees as representatives in the Aufsichtsrat. In these corporations, the members of the Aufsichtsrat are only representatives of the shareholders. If a corporation has 500 or more employees, one third of the members of the Aufsichtsrat must be their representatives.


46. For a better understanding of the following, it should be noted that the German law distinguishes in the non-governmental area between two kinds of employees: Arbeiter and Angestellte. Simplified, Arbeiter are people who do manual work like mechanics, miners, etc. The closest English translation would be blue-collar worker. Angestellte are people doing administrative work. White-collar workers would be the closest English expression. For the purpose of this paper it is not necessary to go into the details of regulations dealing with the difference regarding codetermination and election of the members of the Aufsichtsrat. Thus, the author will just refer to all of them as employees.

47. See BetrVG, supra note 45, §§ 76, 81. If a corporation was incorporated before August 10, 1994, this exemption only applies in cases of so-called family corporations that is, corporations that have only one natural person as a shareholder or that have only shareholders related to each other. In all other cases, the corporation is treated as one having at least 500 people in its workforce.

48. See id. §§ 76, 77.
2000 or more employees, so-called paritätische Mitbestimmung is required. This means that an equal number of workforce and shareholder representatives must be members of the Aufsichtsrat.\textsuperscript{49} However, two features blur this equality. First, the Chairman of the Aufsichtsrat decides in case of a parity of votes. Second, one representative of the workforce has to be a management executive who has employer-like functions in the corporation.\textsuperscript{50}

2. Mining, Iron and Steel Corporations

For corporations in the mining, iron or steel industry special laws are applicable.\textsuperscript{51} Corporations with more than 1000 people in their workforce are legally required to have an Aufsichtsrat of 11 members.\textsuperscript{52} Out of this number, four must represent the shareholders, while four must represent the employees. The remaining three members should not be employees of the corporation, have economical interest in the corporation, have been a representative for the shareholders in the Aufsichtsrat the year before the election, nor be a representative or an employee of a union or employer association.\textsuperscript{53} Besides this, the regulations contain elaborate rules for nomination and election of the candidates. Aufsichtsrat members who are representatives of the shareholders, plus one of the additional members, are elected by the shareholders’ meeting.\textsuperscript{54} Workforce representatives, plus one additional member, are elected by the employees either through delegates or directly.\textsuperscript{55}

3. General Requirements

Only natural persons of full legal capacity can serve as members of the Aufsichtsrat. A member of the Aufsichtsrat cannot simultaneously serve as a member of the Vorstand. At maximum, a person is only allowed to be a member in ten Aufsichtsräten of various corporations. However, the chairman in an Aufsichtsrat counts as two memberships towards this limit.\textsuperscript{56} In addition, one

\begin{itemize}
\item \textsuperscript{49} See MitbestG., supra note 45, §§ 1, 7.
\item \textsuperscript{50} See KLUNZINGER, supra note 2, at 172.
\item \textsuperscript{51} See generally supra note 45.
\item \textsuperscript{52} See Montan-MitbestG, supra note 45, §§ 1, 4. The Montan-MitBeastErgG, applies to controlling corporations. It contains some minor deviations for the composition of the Aufsichtsrat. Specifically, it prescribes one additional member besides the equal number of representatives of the shareholders and workforce. See id. § 5.
\item \textsuperscript{53} See Montan-MitbestG, supra note 45, §§ 1,4.
\item \textsuperscript{54} See AktG, supra note 1, §§ 101, 119
\item \textsuperscript{55} See id. § 101 The third additional member is nominated by the workforce and elected at the shareholders’ meeting.
\item \textsuperscript{56} See AktG, supra note 1, § 100.
\end{itemize}
cannot be a member of the Aufsichtsrat if he/she is a legal representative of a company controlled by the corporation, or is a legal representative of another corporation in which a member of the Vorstand serves as a member of the Aufsichtsrat. Membership in the Aufsichtsrat is limited to about five years. These restrictions are intended to prevent conflicts of interest.

The Aufsichtsrat elects from among its members a chairman in accordance with the articles of incorporation. The Vorstand has the responsibility to report the elected person to the commercial register (Handelsregister). The Aufsichtsrat has the right to appoint among its members one or more committees for the purposes of preparing its deliberations and resolutions, or for supervising the execution of its resolutions. However, some special duties, listed in § 107 AktG, cannot be referred to a committee.

B. Duties and Rights of the Aufsichtsrat

For a better understanding of the roles banks play in German corporations, it is necessary to examine the powers and responsibilities of the Aufsichtsrat and later of the Vorstand. Representatives of the large banks are usually also members of the Aufsichtsrat. Additionally, German banks are allowed to invest in the stocks of German corporations and they exercise power through their depository voting rights. Furthermore, banks also exercise their traditional influence as lenders.

In the past, power shifted between the institutions of the Aktiengesellschaft. The composition, responsibilities, and powers of the Aktiengesellschaft are heavily regulated by law. For example, the reform of corporate law in 1937 strengthened the position of the Vorstand, and its position remained unchanged by the reform of 1965.

Section 76 AktG states that the Vorstand is responsible for the management of the corporation. The shareholders' meeting is not entitled to decide issues dealing with management, except in cases where the Vorstand asks for shareholder approval. The shareholders have no authority to give instructions to the Vorstand; it is the main task of the Aufsichtsrat to supervise the management activities of the Vorstand. However, it is not possible to confer

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57. See id.
58. See id. § 102. See also Hüffer, supra note 44.
59. See id. § 107.
60. See id.
61. See KLUNZINGER, supra note 2, at 166.
62. See id.
63. See AktG, supra note 1, § 119.
64. See KLUNZINGER, supra note 2, at 166.
management or management related issues on the Aufsichtsrat. The articles of incorporation can provide for the necessity of Aufsichtsrat approval for certain types of transactions.

The formal separation of the Vorstand, the Aufsichtsrat, and the shareholders should be understood against the following backdrop. The Aufsichtsrat appoints the members of the Vorstand, and the Aufsichtsrat (disregarding the codetermination requirements) is elected by the shareholders' meeting. So, the Vorstand determines the details of management, even though the real power lays with the Aufsichtsrat and the shareholders' meeting, especially if both are dominated by majority shareholders. The Aufsichtsrat has the power to remove the Vorstand if the shareholders pass a vote of no confidence against the Vorstand.

The main powers of the Aufsichtsrat are as follows:

1. Appoint and remove members of the Vorstand
2. Supervise the Vorstand [In doing so, the Aufsichtsrat has the right to inspect and examine the books and records as well as the assets of the corporation.]
3. Represent the corporation, both in and out of court, against the members of the Vorstand
4. Examine financial statements, including the annual reports and proposals for the appropriation of distributable profits
5. Approve the annual financial statement
6. Call a shareholders' meeting whenever the interests of the corporation require
7. Approve certain acts of management [if the articles of incorporation provide for this, or if the Aufsichtsrat determines this itself]

The standard for the duty of care and the responsibility of the members of the Aufsichtsrat are the same as for the Vorstand. This standard will be discussed

65. See AktG, supra note 1, § 111.
66. See id.
67. See KLUNZINGER, supra note 2, at 166.
68. See AktG, supra note 1, § 84
69. See id.
70. See id. § 111.
71. See id.
72. See id. § 112.
73. See id. § 171.
74. See id. § 172.
75. See id. § 111.
76. See id.
77. See id. § 116.
C. Composition of the Vorstand

The articles of incorporation of an Aktiengesellschaft determine the number of members on the Vorstand. According to § 76 AktG, the Vorstand may be comprised of one or more members. In practice, especially in large Aktiengesellschaften, the Vorstand has several members, with different responsibilities. Some Codetermination provisions require that an Arbeitsdirektor (labor director) be appointed as a member of the Vorstand. In this case, the Vorstand has to have at least two members. The same is true for corporations with a stated share capital of more than three million Euro.

Only natural persons, not corporations, can serve on the Vorstand. They can be an outsider, not a shareholder, of the Aktiengesellschaft. This is the rule rather than the exception. A person convicted of a criminal offense pursuant to § 283 et seq. of the German Criminal Code (Strafgesetzbuch) dealing with insolvency and bankruptcy, is barred as a member for a period five years. Also, a person who has been prohibited by judicial decision or an enforceable administrative order from engaging in any profession or trade, may also not, during the period of such prohibition, be a member of the Vorstand of a company whose corporate purpose encompasses, in whole or in part, such a profession of trade.

As mentioned above, the members of the Vorstand are appointed by the Aufsichtsrat. They can be appointed for a period not exceeding five years, with the possibility of renewal or extension, provided that the term of each such renewal does not exceed five years. The Aufsichtsrat may appoint one member as a chairman of the Vorstand.

78. For example, the field of responsibilities within the Vorstand of the RWE AG is as follows: Finance; Personnel; External Relations; Energy; Mining and Resources; Oil and Chemistry; Telecommunication; Construction; etc.
79. See e.g. MontanMitbestG, supra note 45, § 13, and MontanMitbestErG, supra note 45, § 13, and MitbestG, supra note 54, § 33 (A labor director represents the workforce).
80. See Hüffer, supra note 44, § 76, Rn. 24.
81. See AktG, supra note 1, § 76.
82. See id.
83. See KLUNZINGER, supra note 2, at 168.
84. See AktG, supra note 1, § 76.
85. See id.
86. See AktG, supra note 1, § 84.
87. See id.
88. See id.
Appointment to the Vorstand should be distinguished from the employment contract between each member of the Vorstand and the Aktiengesellschaft, which determines the rights and duties of the contracting parties (amount of compensation, deadlines for terminations, etc.). Thus, there is a two-fold relationship between the members of the Vorstand and the Aktiengesellschaft: the member-corporation relationship and the employee-employer relationship. If there is an employment dispute between the corporation and a member of the Vorstand, the Aktiengesellschaft is represented by the Aufsichtsrat.89

Corporate law permits profit sharing for the members of the Vorstand as compensation for their work.90 As a consequence of a statutory prohibition of competition, individual members of a particular Vorstand are forbidden to engage in any trade or business, or enter into any transaction, in the company’s line of work unless the Aufsichtsrat consents.91 Without consent of the Aufsichtsrat, members of the Vorstand are also not permitted to be members of a Vorstand or managers in another Aktiengesellschaft, or to be general partners of another commercial enterprise.

The Aktiengesellschaft can extend credit to members of the Vorstand only pursuant to a resolution of the Aufsichtsrat. Such a resolution may only authorize the extension of specific credit transactions for no more than three months in advance.92

An appointment to the Vorstand, or to the chairmanship of the Vorstand, can be revoked by the Aufsichtsrat for cause.93 The Aktiengesetz lists particular reasons for revoking an appointment including a gross breach of duties, the inability to manage the company properly, or a vote of no confidence by the shareholders’ meeting. These provisions exemplify the enormous powers of the Aufsichtsrat within the Aktiengesellschaft.

D. Duties and Rights of the Vorstand

The Vorstand is responsible for the management of the Aktiengesellschaft.94 The authority to manage the Aktiengesellschaft covers the scope of the corporation’s business and is determined by the articles of incorporation. The Vorstand is the legal representative of the Aktiengesellschaft in and out of court.95 As a dispositive statutory rule, the members of the Vorstand represent the

89. See id. § 112.
90. See id. § 86.
91. See id. § 88.
92. See id. § 89.
93. See id. § 84.
94. See id. § 76.
95. See id. § 82.
Aktiengesellschaft jointly, unless the articles provide otherwise, in which case one or more members of the Vorstand cannot decide conflicts against the majority. The articles of incorporation can also provide that one member of the Vorstand, or particular members of the Vorstand, may represent the corporation by acting solely or jointly with the Prokurist (holder of a statutory authority, the so-called Prokura).

The Vorstand’s power of attorney cannot be restricted against third parties. Due to the abstract character of the German agency law, the members of the Vorstand are internally obligated to act only within the limits set out in the articles, by the Aufsichtsrat, or by the shareholders. However, as a general rule of statutory agency, a third party cannot rely on the unlimited power of the Vorstand in cases of collusion or obvious misuse. According to permanent rulings of the courts, misuse occurs when the Vorstand exceeds the limits of its internally restricted powers and thereby consciously acts to the disadvantage of the corporation. Unlike in the United States, German law does not recognize the ultra vires doctrine or the limitation of power by the corporate purpose. Within its management duties, the Vorstand has the obligation to inform the Aufsichtsrat about the intended business policy of the corporation, the profitability of the Aktiengesellschaft, the state of business and condition of the company, and transactions that may have a material impact upon the profitability or liquidity of the company.

E. Liability of the Vorstand

In conducting business, the members of the Vorstand have to employ the care of a diligent and conscientious manager. Besides this general standard, the

96. See id. § 77.
97. See id.
98. See id. § 78. Prokura is the power of attorney granted under the provisions of the German Commercial Code. It confers the authority to act on behalf of the principal (owner of a commercial firm) with respect to all transactions, both in and out of court, within the scope of mercantile trade. The Prokura has to be entered in the Commercial Register (Handelsregister). See Handelsgesetzbuch (German Commercial Code), §§ 49 et seq. RGD 1897, 219, as amended last Dec. 19, 1998, BGBI. I 3836.
99. See id.
100. See id.
101. See KLUNZINGER, supra note 2, at 170.
102. See generally Bundesgerichtshof (German Federal Supreme Court), decision from May 17, 1988—VI ZR 233/87, Neue Juristische Wochenschrift 1989, 26, 27. See also Hüffer, supra note 44, § 82 Rn. 6-9.
103. See Hüffer, supra note 44, § 82 Rn. 6-9.
104. See AktG, supra note 1, § 90.
105. See id. § 93. This is the standard of a manager acting with similar obligations as a fiduciary. See Hüffer, supra note 44, § 90, Rn 4.
Aktiengesetz sets out specific requirements of conduct. Members of the Vorstand shall not disclose confidential information and secrets of the company, in particular trade and business secrets, which have become known to them as a result of their services on the Vorstand. They have special duties relating to insolvency and bankruptcy of the corporation. Section 93 of the Aktiengesetz specifically enumerates instances in which members of the Vorstand themselves may be held joint and severally liable.

In the event of a dispute as to whether or not they have employed the care of a diligent and conscientious manager, the members of the Vorstand bear the burden of proof. Section 93 AktG establishes only the liability in relation to the corporation, but the Bundesgerichtshof (German Federal Supreme Court) has held that creditors also should direct their actions against the Vorstand to claim damages.

In carrying out their corporate responsibilities, members of the Vorstand are not liable if they acted pursuant to a lawful shareholder resolution. Members, however, incur liability if they breached their duties in forcing the shareholders to pass a resolution. Furthermore, consent by the Aufsichtsrat does not release the Vorstand from liability.

The corporation can also waive or settle its claim for damages. In general, this option is only available within three years after the claim has arisen. The shareholders' meeting has to consent to the waiver or settlement. Only a simple majority of the shareholders is necessary to approve a waiver or settlement. Only members of the Vorstand not involved in the transaction at issue are allowed to vote their shares. The shareholders' consent is invalid if a minority whose aggregate holdings equals or exceeds one tenth of the share capital objects.

Although common in the United States, German corporate law generally does not recognize derivative suits by shareholders. Thus, it is important that safeguards exist to protect minority rights especially regarding the waiver or settlement of a corporation's claims.

Under certain circumstances, creditors of the Aktiengesellschaft may assert the claim of the corporation for damages against the Vorstand. In order for this to occur the corporation must be unable to pay the damages to the creditor. If bankruptcy proceedings have been instituted over the company’s assets, the

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106. See id.
107. See id. § 91.
108. See id. § 93.
109. See id.
110. See KLUNZINGER, supra note 2, at 171.
111. See AktG, supra note 1, § 93. See also Hüffer, supra note 44, § 93 Rn. 25.
112. See id.
113. See id.
114. See id.
115. See Hüffer, supra note 44, § 93, Rn 20.
116. See id.
receiver in bankruptcy or trustee shall exercise the rights of the creditors against
the members of the Vorstand. In cases other than those specifically set out in § 93,
members of the Vorstand must have grossly violated their duty of care as a
diligent and conscientious manager.

A waiver of the corporation’s right to sue or a settlement between the
Vorstand and the corporation has no effect on the rights of creditors. Unlike
derivative suits in the United States, the creditor has to ask for the payment of
damages individually, and not to the corporation.

F. Shareholders’ Meeting (Hauptversammlung)

The shareholders’ meeting is considered the highest institution within the
German Aktiengesellschaft.117 It is the shareholders’ meeting that is entrusted with
the fundamental corporate decisions.118 The shareholders exercise their rights
with respect to the corporation at shareholders’ meetings unless the Aktiengesetz
provides otherwise.119

1. Rights

Shareholders’ meeting responsibilities include:120

A. Election of the shareholders’ representative in the Aufsichtsrat
B. Appropriation of distributable profits
C. Ratification of the acts of the members of the Vorstand and
the Aufsichtsrat
D. Appointment of external auditors
E. Amendments of articles of incorporation
F. Measures to increase or reduce the share capital
G. Appointment of auditors for the examination of matters in
connection with the formation or the management of the
company
H. Dissolution of the Aktiengesellschaft
I. Transformation of the corporation (e.g. merger)
J. Consent to agreements between enterprises

117. See V. RECHENBERG, DIE HAUPTVERSAMMLUNG ALS OBERSTES ORGAN 27 et
seq. (1986).
118. See id.
119. See AktG, supra note 1, § 118.
120. See id. § 119.
The shareholders' meeting is not entitled to interfere with the management of the corporation, unless the Vorstand asks for its decision or approval. The Bundesgerichtshof has held that the Vorstand must ask for shareholder approval in instances where the rights or interests of shareholders may be infringed.

2. The Calling of a Shareholders’ Meeting

In addition to the annual meeting, an ordinary shareholders’ meeting has to be called when required by law or by the articles of incorporation. A meeting is required by law if the Aktiengesellschaft suffered a loss equal to half of its stock capital (§ 92 AktG), or whenever an issue is at stake that relates to the duties of the shareholders’ meeting. Furthermore, a meeting is required whenever the interests of the Aktiengesellschaft are at stake. However, a meeting is rarely called for this reason. Usually, the Vorstand calls shareholder meetings. In exceptional circumstances, where it is necessary for the benefit of the corporation, a meeting can be called by the Aufsichtsrat. A meeting will also be held if shareholders whose aggregate stock-holding equals or exceeds one-twentieth of the share capital demand it by written request. This is another example of the extent to which German law protects shareholders’ rights, especially the rights of minority shareholders.

German law provides for broad protection of minority rights. Shareholders have the right to demand that issues be submitted to the shareholders’ meeting for approval if the aggregate shares of these shareholders amounts to not less than one twentieth of the share capital, or the aggregate shares of these shareholders amounts to a sum of 500,000 Euro.

The Vorstand and the Aufsichtsrat must submit their proposals on every issue on the agenda of the meeting. Exceptions to this are the election of representatives to the Aufsichtsrat, and the appointment of auditors, which are solely proposals of the Aufsichtsrat.

121. See id. § 199.
122. See Bundesgerichtshof, decision from February 25, 1982—II ZR 174/80, BGHZ 83, 122. In this case the Vorstand planned to transfer a part of the business to a subsidiary.
123. See AktG, supra note 1, § 120.
124. See id. § 121.
125. See Höffter, supra note 44, § 121, Rn 5.
126. See AktG, supra note 1, § 121.
127. See Höffter, supra note 44, § 121, Rn. 6.
128. See AktG, supra note 1, § 122.
129. See id. at (2). The value of one share of stock for this purpose is determined by dividing the share capital by the number of shares.
130. See id. § 124.
Proxy voting

The Aktiengesetz not only provides for proxy voting, but also acknowledges the importance of banks within this framework. The function of banks within the proxy system starts before the shareholders' meeting. Due to the fact that the majority of shares are bearer shares, the shareholders are mostly unknown to the Aktiengesellschaft. The Vorstand must publish the invitation and the agenda of the meeting, and include it in the Bundesanzeiger (Federal Gazette). The Vorstand, prior to the meeting, is also required by law to send copies of the agenda, proposals and nominations to banks (and associations of shareholders) that exercised rights to vote at the last meeting, or that simply asked for information. In addition, insurgent counter-proposals and nominations for the Aufsichtsrat are submitted. Banks are obliged to forward these materials to those shareholders who deposited their shares with them.

Problems communicating with shareholders are similar to those in the United States, insofar as securities are held by brokers for their clients "in street names." The difference is that difficulties identifying shareholders in the United States creates problems for management or fellow shareholders soliciting proxies. However, under German law, it is assumed that banks, able to identify their clients easily, are exclusively able to exercise the voting rights of the shareholders.

Banks must receive authorization in writing to exercise client’s voting rights. This authorization, revocable at any time, can no longer be just part of the depository contract and may not exceed fifteen months. A bank that intends to vote must inform the client of its own proposals. The bank has to ask for instructions on how to vote and must inform the shareholder that if he or she does not give orders to the contrary, the bank will exercise the vote in accordance with its own suggestions communicated to the client. This process is similar to proxy solicitation in the United States, but lacks the aggressiveness of its American counterpart and is a very formalistic procedure. One of the main reasons for this difference is the lack of competition between banks during the solicitation process. They compete at an earlier stage to win small investors as

131. See id. § 134.
132. See id. § 125(1).
133. See id. §§ 126, 127.
135. See Vagts, supra note 13, at 56-57.
136. See Hermann H. Kalfass, supra note 34, at 782 (These banks are exercising 90% of the voting rights in shareholders’ meetings).
137. See AktG, supra note 1, § 135 (7).
138. See id. § 135 (2).
139. See id. §§ 128 (2), 135 (4).
clients who need bank service in order to buy and sell securities. After this point, it is settled that banks only vote the shares of their clients. Another explanation for the “peacefulness” of this process is that, in general, the clients simply rely on the judgment of the banks.\footnote{140}{See Horst Hammen, Das Vollmachtstimmrecht der Banken in der Aktienrechtsreform, 51 WERTPAPIERMITTEILUNGEN, 1221, 1225 (1997).} In the German proxy system, advertising is not necessary. Furthermore, there is no competition from other entities. The Vorstand, being an agent of the corporation, is not allowed to solicit proxies or act as a proxy holder.\footnote{141}{See Martin Peltzer, Empfehlen sich gesetzliche Einschränkungen des Einflusses der Kreditinstitute auf Aktiengesellschaften?, 51 JURISTENZEITUNG 842, 844 (1996) (Stating that only about 1 % of the shareholders make their own proposals) See also Theodor Baums, Takeovers Versus Institutions in Corporate Governance in Germany, CONTEMPORARY ISSUES IN CORPORATE GOVERNANCE 151, 159 (1993) (Other sources state that in 2-3% of all cases a special instruction occurs).} Even though the proxy rules also apply to associations of shareholders (shareholders’ protection associations), they have not played an important role so far. Fellow shareholders face the obstacles created by the dominance of bearer shares and the resulting anonymity, plus the collective action problems that seem to be intensified, relative to the United States, by the significant presence of banks in corporate decision-making. Since the Vorstand is not elected by the shareholders,\footnote{142}{See Wolfgang Zöllner, Die Ausübung des Stimmrechts für fremde Aktien durch die Aktiengesellschaft auf ihrer eigenen Hauptversammlung, FESTSCHRIFT FÜR HARRY WESTERMANN 603, 603 (1974).} there is no reason for a shareholder to solicit proxies in an attempt to gain control of the corporation.\footnote{143}{See AktG, supra note 1, § 84. A shareholder may make proposals for the appointment of the members of the Aufsichtsrat and the shareholders’ meeting elects their representatives in the Aufsichtsrat. See id., § 127.} One of the consequences of this lack of competition can be seen in the non-existence of standards for proxy statements under German law, which is quite a contrast to SEC rules and filing requirements in the United States.

To prevent banks from only exercising the voting rights of clients who accept their proposal, German law imposes on them the legal obligation to vote in accordance with their clients’ requests, regardless of whether the bank agrees with the recommendation.\footnote{144}{With regards to the Aufsichtsrat, this would simply be the gain of supervision instead of control. One should also keep in mind that the Aufsichtsrat, under Codetermination rules, basically consists of shareholder and workforce representatives.} This does not mean that the bank has to exercise the voting rights of all the shares deposited with it. It is up to the client to ask for proxy voting in order to impose the duty on the bank.\footnote{145}{See AktG, supra note 1, § 135.} The relationship between shareholder/client and bank is the classic principal-agent relationship. Concerns about the imposed duties are intensified when one
considers that banks have some discretion under German law. The Aktiengesetz requires that in drafting its proposal, the bank keeps the best interests of the shareholders in mind.\(^{147}\) The bank is allowed to deviate from a communicated voting exercise in exceptional cases. For example, if a new corporate policy is revealed at the shareholders’ meeting, and the proxy holder can assume that the shareholder would approve a deviation, then the bank is entitled to depart from the otherwise binding proposal.\(^{148}\) If this occurs, the bank is obliged to inform the shareholder and name its reasons for the deviation.\(^{149}\) Otherwise, under § 135 AktG, the bank is liable for damages.

Other issues arise in conflict of interest situations. The law provides two important disclosure requirements when such situations occur. First, a bank has to be clear as to whether it is voting its own shares or exercising the voting right of a shareholder.\(^{150}\) Second, if a member of the Vorstand, or an employee of the bank is also a member of the corporation’s Aufsichtsrat, or if a member of the corporations’ Vorstand or an employee of the corporation is a member of the bank’s Aufsichtsrat, the bank must disclose this in its proxy statement.\(^{151}\)

Not only do banks significantly influence a corporation through the shares they own and the shares they vote, but they also exert influence by the fact that members of the Vorstand, or the Aufsichtsrat, of a bank are often encouraged to become members in the Aufsichtsrat of the corporation. In 1995, this was the case in more than 50 out of the 100 largest publicly held corporations in Germany.\(^{152}\) Furthermore, corporations and banks are tied to each other in that corporations are typically bank clients.\(^{153}\)

The three largest banks in Germany, Deutsche Bank, Dresdner Bank and Hypo-Vereinsbank, play a role in corporate governance similar to the role of management in a corporation in the United States.\(^{154}\) However, no bank seems to hold a majority of depository votes. In addition, the large banks have to share

\(^{147}\) See AktG, supra note 1, § 128. See also George Maier-Reimer, Protection Against Hostile Takeovers in Germany: Banks and Limitations on Voting Rights, EUROPEAN TAKEOVERS: LAW AND PRACTICE 242, 243 (1992) (stating that 'best interest' is commonly defined as that of the company, not that of management).

\(^{148}\) See AktG, supra note 1, § 135.

\(^{149}\) See id.

\(^{150}\) See id.

\(^{151}\) See id. § 128.

\(^{152}\) See Marcus Lutter, Macht der Banken, 34 NEUE JURISTISCHE WOCHENSCHRIFT 2766 (1995).

\(^{153}\) Note that these days German corporations raise capital more and more through stock markets. While publicly held German corporations raised only 826.4 billion Deutschmark in the capital market in 1995, it raised 2794.6 billion Deutschmark in 1999. See J. Fleischhauer, D. Hawranek, A. Jung, M. Muller von Blumencroh Es Regiert Die Gier, SPIEGEL, Nov. 2000, 105.

\(^{154}\) See Mark Roe, German Codetermination and German Securities Market, 1998 COLUM. BUS. L. REV. 167, 170-171.
their influence with small, regional, private banks and municipal saving banks.\footnote{155} It is not unusual to have 50 banks present at a shareholders' meeting.\footnote{156} Nonetheless, it should be kept in mind that small banks tend to defer to the interests of the influential large banks.

Presently, banks face more competition from associations of shareholders, institutional investors, and self-employed persons. In particular, shareholder associations seem to be well suited as proxy holders. These associations are interested, responsive, and do not have any conflicts of interest. Only time will tell if they can really outperform banks. Up until now, shareholder associations have only represented less than one percent of the shareholders in shareholders' meetings.\footnote{157}

III. INCORPORATION AND CAPITAL STRUCTURE OF AKTIENGESELLSCHAFTEN

A. Incorporation

Unlike in the United States, where the incorporators simply file the articles of incorporation with the secretary of state or another designated state agency,\footnote{158} the formation of an Aktiengesellschaft in Germany is a complicated process. It begins with the establishment of articles of incorporation (Satzung) notarized by a notary public,\footnote{159} and ends with the registration of the Aktiengesellschaft in the commercial register (Handelsregister).\footnote{160} The articles of incorporation must contain a number of legally required provisions.\footnote{161} The domicile of the corporation (Sitz), which must be specified in the articles of incorporation, and its

\footnotesize{155. On average the three large banks together exercise 45-47\% of all proxies at an annual meeting.
158. See *SOLOMON, SCHWARTZ, BAUMAN, WEISS*, supra note 40, at 163 et seq.
159. See AktG, supra note 1, § 23.
160. See id. §§ 36-40. Prior to the completion of registration, the Aktiengesellschaft does not exist and may not issue or transfer shares. Persons acting in the name of the Aktiengesellschaft at this stage have personal liability, although with the prior or subsequent consent of the creditors, the Aktiengesellschaft may assume such liability and release such persons. The Aktiengesellschaft may not, however assume obligations arising under agreements regarding special benefits, formation expenses or contributions in kind and acquisition of assets unless they are stipulated in the articles. See also id. §§ 26, 27.
161. See id. § 23.}
place of filing, must be within Germany. The articles of incorporation must also specify the corporate purpose of the Aktiengesellschaft. The articles of an Aktiengesellschaft engaged in industry or trade must specify the kinds of products and goods to be produced and traded. This statement of purpose limits the authority of management, but not its power to act. The Vorstand (management) may bind the Aktiengesellschaft outside the scope of its stated purpose, but may find itself liable for damages resulting from these acts. The articles must also specify the amount of the Aktiengesellschaft's share capital (Grundkapital). The articles have to include the par value, classes, and numbers of shares. Finally, the number of members of the Vorstand, or the rules on how to determine this number, and the journals for corporate announcements must be specified. In addition, the articles can contain optional provisions, like shareholders' meetings or the fiscal year, but cannot change matters that are conclusively dealt with by the Aktiengesetz.

The founders appoint the first Aufsichtsrat and the auditors for the Aktiengesellschaft's first fiscal year. The provisions of Codetermination do not apply to the first Aufsichtsrat. In turn, the first Aufsichtsrat appoints the first Vorstand. The founders must prepare the formation report (Gründungsbericht). The report must list the transactions leading to the formation, acquisition of assets and in-kind capital contributions, special advantages or compensation to members of the Vorstand or the Aufsichtsrat, and earnings' history of acquired enterprises. It also has to contain the extent to which members of the Vorstand or Aufsichtsrat have subscribed for shares on formation or received a promise of any special benefit or compensation. Furthermore, the Aktiengesetz requires that transactions in connection with the formation be audited by the Vorstand and the Aufsichtsrat. A foundation audit by outside auditors, appointed by the court, is necessary with in-kind capital contributions and acquisitions of assets. An audit is also required if any founder is a member of either board, or if members of either board have subscribed to shares, or have requested compensation in connection with the formation of the

162. See id. § 5. The domicile must also be located where the management is situated or where the administration is conducted. See id. Thus, in general there is not a distinction between the place of incorporation and the place of business as in the United States.
163. See id. § 23.
164. See id.
165. See id.
166. See id.
167. See id. § 25.
168. See id. § 30.
169. See id.
170. See id.
171. See id. § 32.
172. See id. § 34.
Aktiengesellschaft. Audits are basically concerned with the accuracy of the formation report and the adequacy of the value of assets acquired or contributed in kind. The report of the formation auditors is available for public inspection at court. The court resolves differences of opinion and sets the level of remuneration for outside auditors.

After all this is done, and all in-kind contributions have been made, the Vorstand and the Aufsichtsrat can apply for registration in the commercial register. However, at least one quarter of the par value must be paid on shares subscribed for cash. The entire premium to be paid, if any, must be paid before application for registration. The application must document the required steps mentioned before, contain governmental authorization where required and prove that capital contributions have been made properly.

While reviewing the application, courts may approve it, reject it, or ask for amendments. If the court approves the application, an entry containing the principal data of the Aktiengesellschaft, e.g., name, domicile, purpose, etc., will be made in the commercial register. Once the application is approved, the registration is announced in the corporation's journals, shares may be issued and transferred, and the Aktiengesellschaft may assume liability, retroactively, for the acts of persons on its behalf during the course of formation. In connection with the formation, all persons taking part — including founders, subscribers, and members of the first Vorstand and Aufsichtsrat as well as formation auditors — may be joint and severally liable to the Aktiengesellschaft for deficiencies in formation and capitalization.

Finally, there are provisions in the Aktiengesetz that deal with post-formation acquisitions. These provisions cover agreements entered into for the acquisition of assets in exchange for consideration exceeding one tenth of the Aktiengesellschaft's capital within two years of registration. Their purpose is to prevent mistreatment of minority shareholders and deception of creditors.

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173. See id.
174. See id.
175. See id.
176. See id. § 35.
177. See id. § 36.
178. See id. § 36a.
179. See id. § 37.
180. See id. § 38.
181. See id. § 39.
182. See id. § 40.
183. See id. § 41.
184. See id. §§ 46-51.
185. See id. §§ 52, 53.
B. Selected Differences of Capital Structures

1. The Stated Share Capital of the Aktiengesellschaft

The Aktiengesetz puts great emphasis on the integrity of the stated share capital. Germany recognizes the concept of stated share capital (Grundkapital).\(^{186}\) Oversimplified, this is the minimum amount of capital that has to be raised at the time of incorporation.\(^{187}\) It has to be denominated in Euro, and the minimum par value of the share capital has to be least 50,000 Euro.\(^{188}\) In comparison, the Aktiengesetz from 1937 required an amount of 500,000 Reichsmark. The reason for the high amount was to prevent small enterprises from incorporating as an Aktiengesellschaft.\(^{189}\) This kept small, potentially insolvent, companies from enjoying the advantages of the corporate form and thus, protected creditors. Although the legally required amount was later reduced to make the Aktiengesellschaft more attractive for a broader range of companies,\(^{190}\) the recent amount is still high enough to function as an obstacle for small enterprises, which are not able to raise enough (50,000 Euro) to incorporate as an Aktiengesellschaft.\(^{191}\) In addition, experience has shown that most of the Aktiengesellschaften have a stated share capital far above the legally required amount.

According to § 1 AktG, the Aktiengesellschaft has to have a stated share capital (Grundkapital) divided into shares. This means that the Grundkapital must be divided into at least two shares. The number of shares it is divided into must be mentioned in the articles of incorporation.\(^{192}\) The requirement of Grundkapital is seen as the necessary foundation for the limited liability of an Aktiengesellschaft. As in U.S. corporations, an Aktiengesellschaft's liability is limited only to its corporate assets.\(^{193}\) Interestingly, U.S. law does not require corporations to have a minimum amount of assets for the purpose of incorporation. One reason for this might be that U.S. corporations are not as heavily dependent on loans as German corporations. Consequently, the protection of creditors is not such a vital issue for U.S. corporations.

The second purpose of the Grundkapital, closely related to the deterrence function for very small companies, is the protection of third parties, especially

\(^{186}\) See id. §§ 1, 6.
\(^{187}\) See KLUNZINGER, supra note 2, at 154.
\(^{188}\) See id. §§ 6, 7. There are different requirements for corporations engaged in the credit or insurance business; especially concerning the required amount of Grundkapital. See Hüffer, supra note 44, § 7, Rn. 9.
\(^{189}\) See KLUNZINGER, supra note 2, at 154.
\(^{190}\) See id.
\(^{191}\) See Hüffer, supra note 44, § 7, Rn. 1.
\(^{192}\) See id. § 1, Rn. 13.
\(^{193}\) See id. § 1, Rn. 10.
creditors, and future shareholders. Third parties are protected by requiring that the Aktiengesellschaft have assets at least equal to the amount of the Grundkapital. The legal nature of the Grundkapital itself is that of a balance sheet number, fixed by the articles of the Aktiengesellschaft. The Grundkapital is not a corporate asset. It has to appear on the liabilities side of the balance sheet.

Even though the Aktiengesellschaft must state at least the legally required Grundkapital at the time of incorporation, it does not sufficiently protect third parties. Also, the Aktiengesellschaft has to provide that assets equal the amount of Grundkapital are in fact raised (principle of capital raising). Additionally, the protection of third parties is accomplished by various provisions of the Aktiengesetz including, a prohibition of an incorporation carried out in phases, a prohibition of the issuance of stocks below par value, a provision that requires an audit of the incorporation process, and a provision that establishes liability of founders who incorporate the Aktiengesellschaft.

The Grundkapital can only function as a guaranty for third parties so long as there are corporate assets that at least equal the amount of the Grundkapital (principle of maintenance of capital). Besides the general accounting rules, there are several provisions in the Aktiengesetz that address this issue.

The reduction of the Grundkapital after incorporation is possible. However, it is not permissible to reduce it below the legally required amount at the time of incorporation. Reductions must be approved by resolution of three-fourths of the Grundkapital represented and will ultimately result in an amendment to the articles of incorporation. The articles of incorporation can provide for a higher majority. Creditors with pre-existing claims have the right to demand security within six months after publication of the reduction. Any distribution to shareholders must be delayed until the six month period has expired and demands for security or claims have been satisfied.

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194. See id.
195. See id.
196. See id.
197. See AktG, supra note 1, §§ 2, 29. This means that the Aktiengesellschaft is considered incorporated only when the founders have subscribed to all shares.
198. See id: § 9.
199. See id. §§ 33, 34.
200. See id. § 46 et seq.
201. See KLUNZINGER, supra note 2, at 155.
202. See AktG, supra note 1, §§ 56, 57 71(a)-(e).
203. See Hüffer, supra note 44, § 7 Rn. 8. An exception to this rule occurs when there is simultaneously a resolution for an increase of cash capital. See AktG, surpra note 1, §§ 228, 229.
204. See AktG, supra note 1, §§ 222-224.
205. See id.
206. See id. § 225.
In a simplified capital reduction, the losses of the Aktiengesellschaft may be restructured without a distribution of assets to shareholders, and without a security provision for creditors.\textsuperscript{207} Prior to this, all free reserves must be used to cover losses.\textsuperscript{208} Released funds may be transferred to statutory reserves only to the extent that the reserves, after the transfer, do not exceed ten percent of the reduced capital.\textsuperscript{209} After the reduction, distributions are limited to four percent of share capital for two years unless the creditors are secured.\textsuperscript{210}

Reductions can be made retroactively with the establishment of annual fiscal statements.\textsuperscript{211} In addition, these reductions may be made simultaneously with retroactive capital increases, if all shares have been fully subscribed, and one-fourth of par value, plus the entire premium, has been paid on each share.\textsuperscript{212} The function of a combined capital reduction and increase is to enable an Aktiengesellschaft, whose capital has been impaired, to raise additional equity capital. An increase without a reduction would deprive the new investors of a return on their equity until the prior capital was replenished with earnings. Redemptions can be made under similar rules.

2. A Comparison with the Capital Structure of U.S. Corporations

Corporate capital comes from issuing securities. "Securities," in this sense, means an array of obligations, including equity obligations or shares of stock and debt obligations or, bonds.\textsuperscript{213} A debt security, e.g. bond, represents a creditor/debtor relationship with the corporation, whereby the corporation borrowed funds from an outside creditor and promises to repay the creditor.\textsuperscript{214} The creditor is not an "owner;" he or she is a lender. An equity security, e.g. share of stock, is an instrument representing an investment in the corporation whereby the holder becomes a part owner of the corporation.\textsuperscript{215} Debt obligations, such as bonds, can be secured or unsecured (a "debenture"). They differ from other liabilities, such as the claims of trade creditors or of financial institutions who lend money with the expectation of short-term repayment. Debt securities are part of the corporation's long-term capital structure, and they reflect an ongoing interest in the corporation's financial fortunes.\textsuperscript{216} Unless the articles of incorporation

\textsuperscript{207} See id. § 229.
\textsuperscript{208} See id. §§ 229, 230.
\textsuperscript{209} See id. § 231.
\textsuperscript{210} See id. § 233.
\textsuperscript{211} See id. § 234.
\textsuperscript{212} See id. § 235.
\textsuperscript{213} See SOLOMON, SCHWARTZ, BAUMAN, WEISS, supra note 40, at 222-223.
\textsuperscript{214} See id.
\textsuperscript{215} See id.
\textsuperscript{216} See id. at 227
provide otherwise, the board of directors are authorized to issue debt securities without shareholder approval.217

The co-existence of debt and equity investors as part of the capital structure gives rise to conflicts of interest, especially due to the fact that holders of equity and debt have different attitudes towards risk.218 Creditors of U.S. corporations enjoy a certain level of protection, but this protection is not as high as it is in Germany. In the United States, a creditor's claim against a corporation's income and assets has priority over claims of equity security holders.219 As in Germany, the claim of a creditor is valuable only if the corporation has received all amounts it claims to have paid in for its equity securities, and if the corporation is not able to distribute the assets needed to satisfy the creditor to the equity security holders. Even though creditors usually protect their claims through contracts, state corporation laws aim to give creditors some protection by regulating the legal capital, which defines the terms and conditions on which a corporation is permitted to sell stock and pay dividends.220

Under U.S. law, contrary to German law, there is no minimum capital requirement to incorporate a corporation. U.S. law does require a corporation to designate some dollar amount on the corporate balance sheet as "capital."221 The board of directors is responsible for making this assessment. The dollar amount stated by the board is the "stated capital" of the corporation.222 The propriety of distributions to shareholders is measured by the "capital," which does not refer to the assets of the corporation, but to an abstract number obtained by multiplying the number of shares of outstanding stock by the par value assigned to each share, itself an arbitrary dollar amount.223 Over time, it became clear that the legal capital rules do not, and maybe never did, protect creditors. Many states revised their statutes to add protection to third parties based on recommendations in the Revised Model Business Corporation Act (RMBCA).224 The RMBCA abolished the traditional approach to legal capital.225 The law no longer requires the designation of "par value" and

217. See id. at 228. Shareholder approval is necessary where the board of directors issues bonds that are convertible into stock and the corporation does not enough stock authorized to satisfy this right. In this case, shareholder approval is necessary for the amendment of the articles of to increase the number of authorized stocks, not for the issuance of the bonds itself. See id.

218. See id.

219. See id. at 242.

220. See id.

221. See id. at 244 (quoting BAYLESS MANNING WITH JAMES J. HANKS, JR, LEGAL CAPITAL 5-40 (1990)).

222. See id.

223. See id.

224. See id.

225. See id. at 251. In many jurisdictions, including Delaware, it is still in force. See id. at 242.
"stated value," but a corporation can, if it wishes, provide for par value in its articles of incorporation. Under § 6.21 there is no minimum price for the issuance of stocks. Shares may be issued for such consideration as the board may authorize. The issuance of shares still requires valid consideration, but the board of directors no longer needs to translate the consideration into dollars, nor must it declare the consideration adequate. The RMBCA also abandons restrictions on the quality of consideration. § 6.21 allows the issuance of shares for promissory notes and for future services. Nevertheless, a corporation has to prepare a financial statement that places a dollar value on the property paid for stock. If those values are inflated, liability may arise under common law fraud or under federal securities laws.

This brief overview demonstrates that the concept of legal capital, whether under the traditional or modern approach, appears similar to the Grundkapital, at first glance. However, a closer look proves this assumption incorrect. The German approach to Grundkapital is a statutorily fixed minimum amount and highly protected. The legal capital approach provides no minimum amount and is protected only through directors' liability.

3. Recent Developments in German Law

The European Community's financial market integration had a significant influence on the German capital market. Not only is the capital market changing, due to national regulations in compliance with Community banking and securities law, but EC directives have impacted corporate governance also. Despite this, the change may be minimal since German corporate law often serves as a model for Community law.

a. Insider Trading

Due to the EC directive on insider trading, Germany is now addressing this problem vigorously. In 1994, Germany enacted a national law to deal with this problem known as the Wertpapierhandelsgesetz (Security Trading Act). Under this act, insider trading is a criminal offense punishable by fines or imprisonment.

228. See id.
229. See RMBCA, supra note 226, § 6.21 Official Comment.
up to five years.\textsuperscript{232} This could be significant for banks in their multi-faceted role as lenders, shareholders, proxy holders, underwriters, and their representation in the Aufsichtsrat of corporations. However, there is no empirical evidence that shows what kind of inside information has been available to banks, whether they even took advantage of it, or whether these regulations will change the relationship between banks and corporations.

b. Banking Directives

The Second Banking Directive, and the directives regarding funds and solvency ratio, will limit German bank's holdings in industrial corporations.\textsuperscript{233} The Second Banking Directive requires banks to meet certain criteria if they wish to acquire or maintain participation in non-banking and non-financial companies. Credit institutions may not maintain non-bank holdings greater than fifteen percent of their own funds in an undertaking\textsuperscript{234} nor may the overall value of such holdings exceed sixty percent of their own funds.\textsuperscript{235} Existing credit institutions with participation exceeding this threshold at the time the directive became effective were given ten years to conform.\textsuperscript{236} These regulations have no impact on the depository voting of banks but do affect bank holdings. One concern regarding the regulations is that the selling of "excessive stock" by the banks, in accordance with the directive, may have an adverse effect on the stock market and could lead to tax charges on capital gains incurred by the transactions.

The draft Investment Services Directive provides that credit institutions holding customers' shares on deposit will no longer be allowed to treat these shares as fungible with their own portfolio.\textsuperscript{237} This could change the present depository voting practice of banks.

\begin{itemize}
\item \textsuperscript{232} See Gesetz über den Wertpapierhandel, as published on September 9, 1998, BGBI. I 2708.
\item \textsuperscript{234} See id. art. 12 (1).
\item \textsuperscript{235} See id. art. 12 (2).
\item \textsuperscript{236} See id. art. 12 (7).
\end{itemize}
c. Market Forces

The globalization of markets, especially open markets within the European Union, has lead to a growing number of acquisitions in Germany. For example, in 1992, there were 546 acquisitions of German companies worth a total of $20.1 billion, 115 of which were acquired by foreign buyers.238 Due to the increasing number of mergers and acquisitions in Germany, German banks are encountering problems, especially conflicts of interest, caused by their memberships in Aufsichtsräten. In a takeover battle between Pirelli and Continental, one member of Deutsche Bank’s board was a chairman in the Aufsichtsrat of Pirelli and one member of the board was a chairman in the Aufsichtsrat of Continental.239 Deutsche Bank voluntarily started to relinquish its chairmanships in Aufsichtsräten of Aktiengesellschaften over which it had exercised control.240 Other banks have or will face similar problems, especially due to the fact that big banks are very active in merging with each other or with foreign banks.241

All this suggests that changes in the law, in conjunction with market forces, might lead to a different conception of German corporate governance in the near future, at least regarding the role of banks.

IV. U.S. CORPORATIONS

A. The Role of Banks and Institutional Investors in U.S. Corporations

Unlike their German counterparts, U.S. banks were restricted, until recently, in their ownership of corporations, and were prohibited from dominating corporate boards by the Glass-Steagall Act.242 The U.S. system of separate

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239. See New Dreams at Deutsche Bank, ECONOMIST June 22, 1991 at 86.

240. See id.

241. For example, the planned merger between Deutsche Bank and Dresdner Bank, spring 2000.

242. The Glass-Steagall Act, 48 Stat. 184 (1933) codified as amended at 12 U.SC. §§ 24 (Seventh), 78, 377, 378 (Supp. II 1990). The act consists of four sections of the Banking Act of 1933 (§ 16, 20, 21 and 32), 48 Stat. 162. It is important to note that since the writing of this article, the Gramm-Leach-Bliley Financial Modernization Act, PL 106-102, 106 Stat. 1338, passed November 12, 1999, has vastly modified the scope of the Glass-Steagall Act. The Gramm-Leach-Bliley Act now permits commercial banks to engage in investment activities. This will, no doubt, result in changes to U.S. corporate structure. This Act also illustrates the point of this paper, namely that corporate law is dynamic, and more changes are likely forthcoming.
ownership and control over corporations is the result of laws passed in response to
the Great Depression. At that time, U.S. banking and securities laws were
permissive, and banks, due to their influence, were able to manipulate certain
companies.\footnote{243 See \textit{Michael T. Jacobs, Short-Term America} 7 (1991).} Congress passed the Glass-Steagall Act in response to the
significant number of bank failures during the Great Depression.\footnote{244 Approximately 5,000 banks failed between 1929 and 1933. See \textit{Frank M. Tavelman, American Banks or the Glass-Steagall Act—Which Will Go First?}, 21 \textit{Sw.U.L.Rev.} 1511 (1992).} This act
banned banks from underwriting corporate securities or owning equity in non-
financial companies. Some of the relevant provisions include § 16, which prevents
a bank from underwriting, distributing, selling, or dealing in investment securities,
director of a commercial bank from managing a company primarily engaged in the
securities business.\footnote{248 See id. § 32, 48 Stat. 162 at 194 (codified as amended at 12 U.S.C. § 78 (1988)).} Efforts of circumvention were followed by Congress’
enactment of the Bank Holding Company Act in 1956, which prohibited bank-
owned companies from engaging in non-banking activities.\footnote{249 See Bank Holding Company Act of 1956, §§ 4 (c)(6)-(7), 12 U.S.C. §§ 1843 (c)(6)(7) (1988).} However, the
Glass-Steagall Act is not a complete barrier. State-chartered banks, which are not
members of the Federal Reserve System, are not subject to the prohibitions of the
Act. Additionally, the act does not apply to bank activities overseas.\footnote{250 See \textit{Financial Institutions Safety and Consumer Choice Act of 1991. H.R.Rep.No.157 (IV), at. 95 (1991).}} Furthermore, banks are not completely prohibited from engaging in investment
activities. Banks can buy and sell securities on behalf of customers as long as
they do so without providing investment advice. Banks are also able to
underwrite debt instruments of the federal government and general obligation
mutual bonds.\footnote{251 See \textit{id.}} Bank affiliates can engage in otherwise prohibited activities so long as they are not “principally engaged” in them.\footnote{252 See \textit{Banking Act of 1933, supra note 244, § 20. The Act prohibits national banks or state member banks of the Federal Reserve System from owning securities affiliates that are “engaged principally in the issuance or underwriting of securities. In \textit{Board of}}
Steagall Act has not created an impenetrable barrier between commercial and investment banks, it strictly prohibits U.S. banks from owning significant amounts of stock in corporations.

Institutional investors own a significant percentage of stock in U.S. corporations, but their influence on corporate governance is limited by collective action problems and legal constraints. Stock ownership by mutual funds is restricted by the Investment Company Act of 1940. This Act provides that a mutual fund cannot advertise itself as diversified if the regulated part of its portfolio owns more than ten percent of the stock of any company. The Act also prohibits a diversified mutual fund from placing more than five percent of its regulated assets in the securities of any issuer. Mutual funds are given incentives to diversify through tax penalties. Stock ownership by insurance companies is restricted by the laws of the state in which the policy is sold. Pension funds are the least regulated institutional investors. However, their stock ownership is restricted by their assets and fragmentation. Each company typically sets up its own fund. Since ERISA (the Employee Retirement Income Security Act of 1974) generally requires each fund to be diversified, there is little room for an influential position in an operating company. ERISA allows deviation from diversification only if "clearly prudent not [to minimize] the risk of large losses." Moreover, pension managers are hired and controlled by the pension operating company, and the pension managers run the risk of upsetting their own company's senior management if they take an active role.

Banks are not only prohibited from directly owning and underwriting any common stock, but the Bank Holding Company Act prevents bank holding companies from owning more than five percent of the voting stock of any operating non-banking company. Bank trust departments are not prohibited

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Governors of Federal Reserve System v. Investment Co. Institute, 450 U.S. 46 (1981), the U.S. Supreme Court stated: "Investment advisers and close-end investment companies are not 'principally engaged' in the issuance or the underwriting of securities within the meaning of the Glass-Steagall Act..." Board of Governors of Federal Reserve System, 450 U.S. at 71.

257. See id at 23.
258. See id.
259. See id.
260. See id at 24 (quoting ERISA § 104(1)(C), 29 U.S.C. § 1104(1)(c) (1988)).
261. See id.
262. See Bank Holding Company Act of 1956, supra note 249 §§ 4(c)(6)-(7).
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from owning stock and may invest up to ten percent of their funds in the stock of any given corporation. Consequently, although national banks may not directly own equity securities for their own benefit, bank holding companies, bank trust companies, and other institutional investors, to a limited extent, may own equity securities for their own benefit.

Due to legal restrictions, banks and other institutional investors do not play an influential role in corporate governance in the United States. Thus, monitoring and control of corporate management is basically left to shareholders and market forces. In addition, U.S. corporations are not as dependent on banks as their German counterparts for capital loans. In the United States, a significant source of capital for large corporations is provided by the well-developed stock market, thus, lessening the possible influence of banks in corporate governance.

B. Corporate Governance in the United States

As mentioned above, there are essentially three players in U.S. corporations: the board of directors, the officers, and the shareholders. As Berle and Means noticed more than 50 years ago, large publicly held entities, which are most commonly thought of as the prototype of the modern corporation, share one feature: the separation of stock ownership and control. The shareholders own the corporation collectively, but in principle, they do not manage it. This is true for German Aktiengesellschaften as well as for corporations in the United States, even though there are significant differences in corporate governance. This separation of ownership and control creates tensions between shareholders and management. Thus, each system has to provide for mechanisms that ensure accountability. Managers do not always act according to their fiduciary duties. German and U.S. law enforce these duties through two underlying suppositions. First, shareholders are supposed to protect their interests by participation in the decision process on fundamental corporate issues. In addition, shareholders or corporate institutions typically have some kind of legal redress for damage to the corporation caused by management.

In the United States, market forces should not be underestimated in their function to keep management in line. The structural rules that govern the allocation of decision-making power between the directors, managers and shareholders must be considered within the market context. Additionally, the

263. See Roe, supra note 256, at 18.
264. See SOLOMON, SCHWARTZ, BAUMAN, WEISS, supra note 40, at 36-37.
character and attitude of the board can vary from corporation to corporation. Some boards efficiently manage the corporation and supervise the corporate officers, other boards simply "rubber stamp" whatever the officers propose.  

Corporate law in the United States, especially regulations dealing with the internal affairs of corporations, is basically state law. Even though there are common features, or at least rules that apply to the majority of states, the reader should always bear in mind that a particular state might handle an issue in a different way than described under the RMBCA. The RMBCA is a product of the Committee on Corporate Laws of the Section of Business Law of the American Bar Association. The RMBCA was adopted in 1984 and has been amended several times since. Thirty-five states have enacted statutes that are modeled on the RMBCA or its predecessor, the Model Business Corporation Act. The other leading body of law in the U.S. is Delaware corporate law; more publicly held corporations are organized in Delaware than in any other state. Consequently, Delaware courts have issued many significant decisions.

1. The Board of Directors

The power to manage the corporation is generally vested in the directors who delegate the day-to-day business to the officers. The duty of the directors is to manage the corporation to the best of their ability. In doing so, they are expected to use good business judgment. They are not, however, considered insurers of success. The courts will not interfere with their decisions nor second-guess them in the absence of fraud, illegal conduct, or an irrational business judgment.

In the majority of jurisdictions, only one director is statutorily required, but some states require at least three directors. A firm’s articles of incorporation or bylaws can provide for a higher number of directors. Directors are elected at each annual shareholders’ meeting unless otherwise provided in the articles of incorporation. Many jurisdictions allow firms to stagger the terms of office for the directors, that assures a continuity of corporate policy by preventing the entire board from being elected at the same time. The articles or bylaws of a corporation may specify qualifications for directors. Unless provided otherwise,

267. See SOLOMON, SCHWARTZ, BAUMAN, WEISS, supra note 40, at 36.
268. See id. at 6.
269. See SOLOMON, SCHWARTZ, BAUMAN, WEISS, supra note 40, at 35.
270. See id.
271. See RMBCA, supra note 226, § 8.0 (b).
272. See SOLOMON, SCHWARTZ, BAUMAN, WEISS, supra note 40, at 658-660.
273. See RMBCA, supra note 226, § 8.0 (a).
274. See id. § 8.05(b).
275. See id § 8.06.
directors commonly do not have to be shareholders of the corporation or a resident of a particular state to serve on the board.\textsuperscript{276}

In most states, vacancies may be filled by shareholders or directors.\textsuperscript{277} If a vacancy is to be filled by shareholders, and the director whose office became vacant was elected by a voting group of shareholders, only shareholders of this group are entitled to vote on the replacement.\textsuperscript{278} Directors can also be removed for cause by shareholders.\textsuperscript{279} Some states, however, provide for removal even without cause.

The board of directors may hold regular or special meetings.\textsuperscript{280} In most jurisdictions regular meetings of the board can be held without notice; however, notice is usually required for special meetings.\textsuperscript{281} A majority of directors constitutes a quorum for a meeting.\textsuperscript{282} The articles or bylaws may establish a requirement for a higher number. Also, unless stated otherwise in the bylaws or the articles, the board of directors acts by majority vote. This means that once a meeting has a quorum, the majority of directors present can pass a resolution.\textsuperscript{283} Directors are not allowed to vote by proxy but the directors can, in lieu of actually meeting, approve measures in writing by unanimous consent, unless otherwise stated in the articles or bylaws.\textsuperscript{284}

Most states allow the board to delegate their duties to officers or to executive committees. Unless provided otherwise in the articles or bylaws, the board can establish committees with one or two members, and appoint members of the board to serve on them.\textsuperscript{285} The board remains responsible for the actions of the committees and has to supervise them.\textsuperscript{286} The board can delegate almost all of its duties to committees. However, the RMBCA prohibits the delegation of certain duties.\textsuperscript{287}

The directors’ management duties are typical fiduciary duties, including the duty of care and the duty of loyalty. The general standards for directors are set out in § 8.30 RMBCA as follows:

(a) A director shall discharge his duties as a director, including his duties as a member of a committee:

1. in good faith;

\textsuperscript{276} See id. § 8.02.
\textsuperscript{277} See id. § 8.1 (a).
\textsuperscript{278} See id. § 8.10(b).
\textsuperscript{279} See id. § 8.08.
\textsuperscript{280} See id. § 8.20(a).
\textsuperscript{281} See id. § 8.22.
\textsuperscript{282} See id. § 8.24.
\textsuperscript{283} See id. § 8.24 (c).
\textsuperscript{284} See id. § 8.21.
\textsuperscript{285} See id. § 8.25(a).
\textsuperscript{286} See id. § 8.25(f).
\textsuperscript{287} See id. § 8.25(e).
(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
(3) in a manner he reasonably believes to be in the best interests of the corporation.\footnote{288}

a. Fiduciary Obligations

Managers are the agents of the corporation. Their relationship with the shareholders is defined by fiduciary duties. These duties can be distinguished into two groups: the duty of care and the duty of loyalty.\footnote{289} Regarding the duty of care, New York's corporate law for example, expressly requires that all managers "shall perform [their] duties in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances."\footnote{290} While it is hard to define what this standard requires, commentators agree that the duty of care places upon management an obligation to exercise reasonable skill and diligence in monitoring corporate affairs and in taking board action.\footnote{291}

In comparison, in German Corporations the members of the Vorstand have to comply with the standard of a diligent and conscientious manager, which includes discretion as an entrepreneur.\footnote{292} The German standard takes into account the characteristics of the particular corporation, but not as under the U.S. standard, the special abilities or experiences of the individual directors.\footnote{293} The German standard does, however, take into account the special abilities of managers.

The second set of managers' duties, namely the duty of loyalty, generally requires managers to maximize investors' wealth rather than their own, and creates a duty of fair dealing in self-interested transactions. When a conflict of interests arises, it is the management's obligation not to enrich themselves at the corporation's expense.\footnote{294} The duty of loyalty is often at issue when a director has a personal interest in a corporate transaction, takes advantage of an opportunity in which his corporation had an interest, enters into a competing business, or uses...
inside information while dealing with securities. Almost every state provides rules about how to "legalize" such transactions through disclosure and approval by disinterested directors or shareholders.

The duty of loyalty is more rigorously enforced than the duty of care. This is evident when one examines courts' different standards of liability and scrutiny in duty of loyalty cases. When sued for a breach of the duty of care, directors and managers are protected by the business judgment rule. The business judgment rule traditionally protects directors and managers from liability for specific business decisions that result in losses to the cooperation.

The Delaware Supreme Court has suggested that the business judgment rule provides procedural as well as substantive due care. Procedural due care means that the officers must use due care during the process of corporate decision-making. Substantive due care deals with the issue of whether "the complaint states a claim of waste of assets," i.e., if "what the corporation has received is so inadequate in value that no person of ordinary, sound business judgment would deem it worth that which the corporation has paid." Thus, in general, directors are shielded from liability for the consequences of their business judgment if they exercised due care, acted in good faith, and had a rational basis for the decision. The business judgment rule intends to preserve risk taking by management. However, the applicability of the business judgment rule is limited to cases where directors are not engaged in illegal conduct or make irrational decisions. One might suggest that, in Germany, the discretion of management is narrower than the U.S. business judgment rule.

A comparison of U.S. and German decisions suggests that the business judgment rule gives the U.S. board of directors broader discretion than their German colleagues. German courts do not hesitate to question whether members of the Vorstand took unreasonable risks or if the Vorstand crossed a borderline drawn by the corporation's benefits. This can lead to second-guessing of decisions made by the Vorstand, which U.S. courts try to avoid. The danger is that courts in Germany apply the supposedly objective standard of care of a diligent and conscientious manager, but it is very likely that this standard is often influenced by judges' own subjective risk attitude. In addition, a court's decision may be influenced by hindsight. A deal may look especially bad because only a board decision with negative consequences will result in litigation. U.S. courts

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295. See Soloman, Schwartz, Bauman, Weiss, supra note 40, at 747 et seq.
296. See id.
299. Id at 184.
300. See Hüffer, supra note 44, at § 93 Rn. 13a.
have recognized this danger as well as their incompetence in business questions to substitute board decisions. Thus, U.S. courts respect the business judgment of directors as long as there is no illegal conduct.301

b. Statutory Liability of Directors and Officers and Federal Securities Laws

State securities laws impose strict rules upon directors and others, especially with respect to their dealings in the stock of their own corporations. Directors may be liable under various state laws, the most important of which are the local corporation code and the securities law (commonly known as blue-sky laws). Nowadays, the law governing the trading of securities is basically federal law developed under § 10(b) of the Securities and Exchange Act of 1934 and SEC Rule 10b-5. However, state law still remains relevant.302

State corporate statutes, like those modeled after the RMBCA, impose on directors additional liabilities. Directors incur liability by voting for or assenting to the declaration of a dividend or other distribution of assets contrary to the provisions of the state statute or the articles of incorporation, the purchase of the corporation’s shares contrary to state statute, or the distribution of assets to shareholders if the corporation is insolvent or would thereby be rendered insolvent.303

All state blue-sky laws contain antifraud provisions that are very similar to the federal securities acts. There are two major federal securities regulations that govern stock transactions: the Securities Act of 1933304 and the Securities Exchange Act of 1934.305 The Securities Act of 1933 regulates the issuance of securities while the Securities Exchange Act of 1934 regulates purchases and sales after initial issuance. The following section will take a closer look at the Act of 1934 in the context of proxy voting under U.S. law. The Securities Acts, especially the one of 1933, are arguably the U.S. substitute for the judicial audit of German Aktiengesellschaften at formation.306 However, the former protect the integrity of the security market, while the latter mainly protect creditors. But if we keep in mind that U.S. corporations raise capital through the

301. As one court has said, “The sound business judgment rule . . . expresses the unanimous decision of American courts to eschew intervention in corporate decision-making if the judgment of directors and officers is uninfluenced by personal considerations and is exercised in good faith. Underlying the rule is the assumption that reasonable diligence has been used in reaching the decision, which the rule is invoked to justify.” Casey v. Woodruff, 49 N.Y.S.2d 625, 643 (Sup.Ct. 1944).
302. See SOLOMON, SCHWARTZ, BAUMAN, WEISS, supra note 40, at 909-910.
303. See RMBCA, supra note 226, §§ 8.33, 6.40.
306. However, as seen above, Germany also has Securities Regulations.
stock market, while German Aktiengesellschaften heavily depend on loans, both kinds of regulations protect the main financiers of the corporations and thus, in return, secure the sources of corporate financing.

(i). The Securities Act of 1933

The Securities Act of 1933 regulates the original distribution of securities. Its goal is to assure that investors have sufficient information on which to make an informed decision. It accomplishes this goal by requiring issuers to register most new issues of securities with the Securities Exchange Commission (SEC), while also requiring that issuers provide a prospectus containing material information regarding the securities to prospective investors. The Act targets primarily sales by issuers (entities whose securities are to be sold), underwriters (entities who undertake to sell issuer’s securities), and dealers (people who sell or trade securities on a full- or part-time basis).

Section 11 imposes liability for any damages caused by a misstatement of material fact in the registration statement. To bring a cause of action under §11, a plaintiff needs to show two things: a material misstatement of fact in a registration statement signed by the defendant and damages. Liability is extended to every person who signed the registration statement, that is every director, every expert who made a statement in the registration statement, and every underwriter.

Section 12(a)(1) imposes liability upon any person who offers or sells a security in violation of the registration provisions. Section 12(a)(2) imposes liability upon any person who offers or sells a security by means of an untrue statement or omission of a material fact in a "prospectus."

There is a so-called safe harbor provision relieving issuers, persons acting on behalf of issuers (like underwriters), and outside reviewers (like attorneys) from liability arising from forward looking statements, e.g. statements that state plans for the future. This provision applies only in a private action for securities fraud based on an untrue statement or omission of material fact. It is not available for statements made in connection with an initial public offering.

308. See id. § 4 (1).
309. See id.§ 11.
310. See id.
311. See id. § 12 Prospectus is used broadly in this section to include almost any written or oral communication.
312. See id. § 27 A.
(ii). The Securities Exchange Act of 1934

Under rule 10b-5 of the 1934 Act, it is unlawful for any person, to:

- Employ any device, scheme, or artifice to defraud;
- Make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statement, in the light of the circumstances under which it was made, not misleading; or
- Engage in any act, practice, or course of business that operates or would operate as a fraud or a deceit upon any person, in connection with the purchase or sale of any security.

A violation of the rule can result in a private suit for damages, an SEC suit for injunctive relief, or criminal prosecution. Rule 10b-5 also covers most instances of insider trading, the trading of securities on the basis of insider information. Courts have developed a rule that certain persons (e.g. directors and officers of a corporation) with inside information must either abstain from trading or disclose the information while trading. Like the Act of 1933, the Securities Exchange Act of 1934 also contains a similar safe harbor provision for forward-looking statements.313

Section 16(b) of the 1934 Act provides that any director, officer, or shareholder owning ten percent or more of the outstanding shares of the corporation, that realized a profit, within six months, in violation of 10b-5, must return the profit to the corporation. The section applies to publicly held corporations whose shares are traded on the national exchange or that have at least 500 shareholders in any outstanding class and at least $ 10 million in assets.

2. Shareholders

The board of directors constitutes the centralized management of the corporation, but the shareholders, the real owners, are responsible for electing directors and for controlling other significant matters in corporate management.314 Shareholders have the opportunity to enter into pooling agreements or engage in trust voting and thus, exercise their rights as a group.315 Their voting rights are usually accompanied with inspection rights, preemptive rights, and cumulative

314. See RMBCA, supra note 226, §§ 8.03, 8.08. In close corporations, shareholders play a more active role, but for the purpose of this paper the focus will be on publicly held corporations.
315. See id. §§ 7.30, 7.31, 7.32.
voting provisions. They may bring derivative actions on behalf of the corporation to enforce management’s duties.

Even though the shareholders have no direct control of the management, several states allow shareholders to dispense with the board of directors and vest management power in shareholders, if certain requirements are met.

Shareholders have indirect control over management through their voting rights on important corporate matters. Typically, shareholders possess a number of powers. They can elect and remove directors. They also have the power to alter, amend, or repeal the initial bylaws if provided for in the articles of incorporation. However, if not provided, the directors retain these powers. In addition, shareholders must approve fundamental changes in the corporate structure. For instance, shareholders have to approve mergers, consolidations, and sale of corporate assets out of ordinary course of business, dissolutions, and other extraordinary corporate matters.

As in Germany, corporations in the United States have to hold one annual shareholders’ meeting. In the United States, the main purpose of this annual meeting is the election of the directors. Special meetings may be called whenever a matter requires shareholder approval. Such a meeting may be called by the board of directors, the president, the holders of one tenth or more of all shares entitled to vote, or other persons authorized by the articles of incorporation or bylaws.

As mentioned above, a shareholder may vote his or her shares in person or by proxy executed in writing by the shareholder. In most jurisdictions, proxies are valid for 11 months, unless a longer period is expressly provided for in the appointment form. An appointment of a proxy is revocable by a shareholder.

a. Proxy Voting under U.S. Law

If German shareholders are reluctant to attend shareholders’ meetings, attendance is even worse in the bigger publicly held corporations in the United States. The high degree of ownership fragmentation reduces the likelihood of
shareholders gathering and efficiently supervising management.\textsuperscript{327} Thus, proxy voting was introduced very early in U.S. corporate history and is still the dominant voting method in all 50 states.\textsuperscript{328} At that time, given that there was no other alternative, management itself was permitted to solicit proxies. There were no powerful intermediaries like banks, insurance companies or other institutional investors who were able to take over the monitoring role. Furthermore, state law did not restrict who could serve as a proxy holder.\textsuperscript{329} Consequently, there was no obstacle for management, who was supposed to be monitored by shareholders, to start soliciting proxies for the shareholders of their own corporation.

To give instructions to the proxy holder on how to vote a proxy, the shareholders need information on affairs of the corporation that must be complete and correct. Management itself, as the proxy holder, has easy access to this information. The fact that shareholders do not have this knowledge, in addition to the very likely self-interest of management as the proxy holders, puts shareholders at the mercy of management. Consequently, it was necessary to regulate this conflict of interests. In the 1930s, during the Great Depression, abuse of proxy voting was rampant.\textsuperscript{330} Congress' reaction was the enactment of the federal securities laws in 1934.\textsuperscript{331} The Securities and Exchange Commission (SEC) was created and given the task of guarding proxy voting through their power to draft detailed regulations. These regulations supplement state law, but do not limit the ability of management to solicit proxies.\textsuperscript{332} The main feature of the federal rules is one of full disclosure. Regulation 14a, together with Schedule 14A, specifies the information that is necessary in a proxy statement. The proxy statement has to be filed with the SEC prior to a solicitation by management or by others. This process ensures that shareholders are given reliable and timely information.

One has to keep in mind that the SEC, while examining the materials filed, only determines whether the proxy rules are satisfied, not if the information provided is true and complete. This latter area is the subject of the federal anti-fraud laws, which bar material misstatements and omissions.\textsuperscript{333} Furthermore, under certain circumstances a shareholder can bring a civil suit if aggrieved by a violation of the disclosure rules.\textsuperscript{334} Lately, courts have narrowed the possibility for this cause of action.

\textsuperscript{327} See BERLE & MEANS, \textit{supra} note 265, at 4-7.
\textsuperscript{329} See WILLIAM C. CARY & MELVIN A. EISENBERG, CORPORATIONS: CASES AND MATERIALS 331 (7th ed. 1995). Proxy voting online is now popular in both Germany and the U.S. In the Spring of 2000, Deutsche Bank became the first German institution to introduce proxy voting online.
\textsuperscript{330} See \textit{id.} at 331.
\textsuperscript{331} See \textit{id.}
\textsuperscript{332} See ALFRED F. CONRAD, CORPORATIONS IN PERSPECTIVE 329 (1976).
\textsuperscript{334} See SOLOMON, SCHWARTZ, BAUMAN, WEISS, \textit{supra} note 40, at 827, for a detailed discussion of corporate disclosure.
Proxy voting is still controlled by management and, in the majority of cases, shareholders seem to follow management’s recommendations.\textsuperscript{335} Due to the fact that the drafting of a proxy statement and survival of a proxy battle are very costly, small and widely scattered shareholders do not tend to contest a proposal by management.\textsuperscript{336} This is true, even though management must include shareholder proposals that conflict with management’s position.\textsuperscript{337} In some cases, however, instead of forwarding these materials, management may give the shareholder a current list of the names and addresses of the security holders that are to be solicited.\textsuperscript{338}

In order to overcome this concentration of power within the management, federal laws have always provided shareholders with the means to contact their fellow shareholders, and consider non-management proposals on corporate matters. An individual shareholder with a minimum stake in the corporation can prepare his or her own resolution and demand that it be included in management’s proxy statement.\textsuperscript{339} The scope of this resolution should be not overstated. First, it cannot relate to the election of directors or to management proposals. Second, it should not pertain to the “ordinary business operations” of the corporation. The law provides that if management believes a shareholder proposal can be excluded from the corporation’s proxy statement under Rule 14a-8, it must submit to the SEC a statement (“no-action-letter”) explaining the reasons why it deems the omission to be proper.\textsuperscript{340}

Because the legal definitions of “solicitation” and “proxy” are set so broadly, shareholders were reluctant to use less formal means of affecting corporate policy. These terms were initially defined so broadly to make it hard for management to circumvent the rules. However, as a side effect, this created an obstacle for communication between shareholders.\textsuperscript{341} As a result, in 1992, the SEC amended these rules. Now, shareholders are permitted to announce in public how they intend to vote and to explain their reasons.\textsuperscript{342} Thus, a shareholder can try to influence other shareholders’ votes through public announcement, but he or she has no proxy statement and cannot vote as a proxy holder. It has been suggested that the new proxy rules and a new awareness of their power by institutional

\begin{footnotes}
338. See Solomon, Schwartz, Bauman, Weiss, supra note 40, at 1169 et seq.
340. See 17 C.F.R. § 240.14a-8(d).
\end{footnotes}
investors, might, in the long run, lead to a development of corporate structures similar to those found in Germany.\textsuperscript{343}

B. Derivative Shareholder Suits under U.S. Law

Standing alone, voting by shareholders in U.S. corporations is not considered sufficient to control management in corporate decision-making. As a result, there are a two other ways shareholders can enforce management's duties under U.S. law. Shareholders can bring either a derivative suit or a class action suit as a direct action, both of which are unknown in Germany. The difference between these causes of action is that in the derivative suit a shareholder sues on behalf of the corporation for losses incurred by the corporation. Thus, if the shareholder succeeds, damages are awarded to the corporation and not to the shareholder.\textsuperscript{344} In the typical derivative suit, a shareholder is allowed to assert the corporation's right on the theory that the board of directors failed to do so.\textsuperscript{345} In a direct action, where a shareholder is suing on his own rights, damages would be awarded to him or to the whole class he is suing for.

The separation between shareholders and management has resulted in an enormous number of shareholder suits in the United States. As a way to align management's interests with the shareholders, American law has permitted shareholders to sue to redress the damages caused by managerial misbehavior.

As already mentioned, in the United States, in general, shareholders are allowed to enforce obligations of management. In doing so, they act only on behalf of the corporation, because the corporate officials owe their duties primarily to the corporation. Because the duties exist in relation to the corporation, only the corporation, acting through its agents, can sue for a breach of these duties.\textsuperscript{346} The agents, usually the management, are predictably hesitant to sue themselves. For this reason, shareholders have the right to take over.\textsuperscript{347}

Due to the fact that the lawsuit primarily belongs to the corporation, the shareholder must first demand that the board of directors initiate a lawsuit, or prove that a lawsuit would be futile.\textsuperscript{348} If the directors decide to bring the case themselves, the derivative suit by the shareholder is usually barred. This does not occur very often. This is why, under certain circumstances, the shareholder may show that a demand for a lawsuit would be futile and may bring the case without

\begin{itemize}
  \item \textsuperscript{343} See Mark J. Roe, Strong Managers, Weak Owners: The Political Roots of American Corporate Finance 230 (1994).
  \item \textsuperscript{344} See Solomon, Schwartz, Bauman, Weiss, supra note 40, at 1014 et seq.
  \item \textsuperscript{345} See id at 1014.
  \item \textsuperscript{346} See Levin v. Smith, 591 A.2d 194, 200 (Del. 1991).
  \item \textsuperscript{348} This is the general rule under Delaware Law. There are slightly different rules under RMBCA and ALI (American Law Institute). See Solomon, Schwartz, Bauman, Weiss, supra note 40, at 1058 et seq.
\end{itemize}
seeking a demand. Generally, a demand is futile when either the board's majority is directly interested in the challenged transaction or the alleged wrongdoers control a majority of the directors, or when the board members did not adequately inform themselves about the transaction in question, or the challenged transaction was so egregious that it could not have been the product of sound business judgment.

The shareholder must present particularized facts that support the alleged misbehavior. Thus, in both cases, whether demand on the board is necessary or not the board still has the opportunity to take control. The board might set up a committee of "disinterested" directors. They investigate the challenged transaction and recommend whether to go forward with the lawsuit. While, in general any recovery will be paid to the corporation, and not to the shareholder who brought the case, the corporation is obliged to pay for the expenses of the shareholder. Insurance and indemnification provisions are an important part of U.S. corporate law. If the plaintiff-shareholder meets all the requirements and succeeds in the lawsuit, there are still indemnification provisions for directors in corporate statutes as well as the articles. They usually cover litigation costs and awarded damages, even through settlement, so long as there is no finding of intentional misbehavior, or self-dealing on the part of the accused directors. If the shareholder is unsuccessful, it is very likely that his or her attorney will bear the cost. Often the attorneys are the driving force behind such a lawsuit. The shareholder serves simply as a nominal plaintiff without any risk.

Many commentators have doubted whether derivative suits really control management, especially in consideration of the procedural and substantive requirements. However, despite substantive limitations on the scope of liability rules and procedural obstacles, shareholder suits in the United States are still considered one of the most striking and threatening ways that shareholders are

349. See id.
350. See id.
351. See N.Y. BUS. CORP. L. § 626 (c) (Mc Kinney 1998).
352. See SOLOMON, SCHWARTZ, BAUMAN, WEISS, supra note 40, at 1070.
353. See Buxbaum, supra note 297, at 204.
354. See KLEIN & COFFEE, supra note 335, at 195. Contrary to the rule in many civil law countries, especially Germany, under the American rule every party to a lawsuit must pay their own expenses.
355. See SOLOMON, SCHWARTZ, BAUMAN, WEISS, supra note 40, at 728 et seq.
357. See KLEIN & COFFEE, supra note 335, at 196.
358. The same is true in class actions under the Securities Laws. In both areas, Congress and the courts try to restrict this and on the same token reduce "strike suits", suits with no merits at all.
This kind of shareholder activity is not common in Germany, even though, as shown above, the duties imposed upon the Vorstand are at least as strict as those imposed upon the board of directors in an U.S. corporation.

C. Enforcing Liability under German Corporate Law

The German Aktiengesetz is very different in the way it addresses managements' obligations. The biggest obstacle to shareholder suits in Germany is the doctrinal framework that embraces the statutes' remedial provisions. Current changes in German laws, like the decrease in capital requirement for minority litigation from ten to five percent, may change the balance of power between shareholders and directors.

The first problem for a shareholder-plaintiff in Germany is the principle that the corporation is a separate entity. Although this principle also applies in the U.S., it is handled in a more pragmatic way. The German interpretation is extremely literal. In Germany, the contractual relationship exists between management and Aktiengesellschaft, and not between management and shareholders. Thus, management owes duties only to the Aktiengesellschaft. Since the procedural side of suing usually mirrors the substantive law, the right to sue on the basis of a breach of duty belongs to the beneficiary of this duty. Accordingly, only the Aktiengesellschaft, as the beneficiary, can sue on the basis of breach of managers' duties. The fact that a breach of duty by management usually has a negative impact on the value of the shares, and with this, on the shareholders, is irrelevant, because as an indirect harm, it is considered to be outside the scope of the pertinent doctrinal concept. Depreciation of equity holdings in a corporation does not constitute a direct damage under German law. However, German courts have established liability when management sells shares with knowledge that the stock price will subsequently fall.


361. See AktG, supra note 1, § 1 (the Aktiengesellschaft constitutes a separate legal entity).


363. See id.

Basically, the pursuit of claims is left to management. As in the United States, it should be obvious that managers are not very eager to take legal action on behalf of the corporation if they themselves are the defendants. Consequently, if a breach of fiduciary duties is alleged, it is up to the Aufsichtsrat to decide whether a suit should be brought, and if so, it is up to them to file it. However, the Aufsichtsrat might hesitate to sue the Vorstand for various reasons. For instance, the Aufsichtsrat itself may be too closely involved in the activities of the Vorstand. Section 147 AktG provides that under these circumstances, the shareholders’ meeting, by majority vote, can decide whether an action should be brought. One should bear in mind that since the Aufsichtsrat is elected by the shareholders, it is unlikely that the shareholders will oppose the decision not to sue. As described above, in case the Aufsichtsrat and the majority of shareholders decide not to sue, minority shareholders still have an opportunity to set these refusals aside. However, there are a number of requirements that must be met, and they have to appoint a special representative (Besonderer Vertreter) for redressing the damage. They are not able to sue in a derivative suit or a class action, which are unknown to German law. In Germany, the Aktiengesellschaft itself will be the plaintiff. In summary, in the United States the focus is on the individual shareholder. He or she is allowed to sue on behalf of the corporation to enforce managements’ duties. In Germany, the Aktiengesellschaft by itself has the authority to enforce these duties.

As mentioned above, there is an additional hurdle for individual lawsuits in Germany, namely the cost of litigation. Like many civil law countries, the German Civil Procedure Code (Zivilprozessordnung) states that the losing party alone bears the cost of litigation. These losses cannot be shared with the lawyer. Contingency fees, common in the United States, are not tolerated under German law. They are considered unethical and against public policy. Consequently, if a private party sues, he or she risks bearing all the litigation costs involved on both sides if unsuccessful, even if the Aktiengesellschaft is the real beneficiary. Under German law the corporation always brings the lawsuit and therefore is the party in the lawsuit. However, if a group of minority shareholders forces the corporation to sue, they, not the corporation, will be liable for the cost the corporation incurs in such an action.

Altogether, German law, lacking a device like the derivative suit, gives shareholders little protection. However, German corporate practice provides two other mechanisms to assure shareholder protection, at least in theory. One of them is the Aufsichtsrat that is designed to control management. The other one is.

365. See Aktg, supra note 1, §§ 78, 112.
366. See id. § 147.
367. See Zivilprozessordnung (ZPO) §§ 91, 92.
368. See AktG, supra note 1, § 147 (stating an exception to the rule that the party of the lawsuit bears the costs).
the still dominant presence of banks in corporate life as shareholders themselves, as creditors, as proxy holders and as members of the Aufsichtsrat.

If the members of the Aufsichtsrat really fulfill their tasks, namely controlling the Vorstand, and if the banks handle their responsibilities properly, there might be less, or maybe no need for a powerful mechanism of judicial enforcement by shareholders. One of the major differences between U.S. and German corporate governance is the fact that a corporation under U.S. law is run under the supervision of one single board, the board of directors, while the German Aktiengesellschaft has the two-tier system. The sole purpose of the Aufsichtsrat is to supervise the Vorstand in managing the Aktiengesellschaft. As a kind of continuous representative of the shareholders between their meetings, the Aufsichtsrat is supposed to be the guardian of their interests. One should not forget that the Aufsichtsrat is not only composed out of representatives of the shareholders, but may also include representatives of the workforce. Their interests are not necessarily identical with the interests of the shareholders. This divergence of interests became apparent during the recent merger negotiations between Deutsche Bank and Dresdner Bank, both incorporated as Aktiengesellschaften. Members of the workforce were afraid that the merger and the subsequently announced closing of some branches would lead to too many lay-offs. The workers were probably more concerned with these layoffs than the shareholders profits. This shows that protecting workplaces in a company often impairs the wealth of the shareholders. Even though the members of the Aufsichtsrat are generally the representatives of the shareholders, not of the workforce, this conflict of interest within the Aufsichtsrat influences or at least slows the decision-making process down.

In the last thirty years the Aufsichtsrat has, in general, complied with its supervisory functions to prevent serious abuses and to react in cases of management's gross negligence. However, the past also reveals serious failures of the Aufsichtsrat. These events raised the question of whether the German two-tier approach should be maintained. According to critics, the system does not function as it is supposed to. These critics have claimed that in some corporations the Aufsichtsrat has become a part of management and thus, lost its ability to objectively monitor the Vorstand. In addition, the Aufsichtsrat has changed into an "organization for business contacts and friendships," where members occasionally work to perpetuate each other's "power and perks." Furthermore,

370. A good example is the decision of the Bundesgerichtshof, Neue Juristische Wochenschrift 1629 (1980), where the members of the Aufsichtsrat were held liable for proposing that the Vorstand give securities to a company with a doubtful credit standing.
371. See Raiser, supra note 369, at 553.
the Aufsichtsrat still effectively exercises supervision, but does not represent shareholders. The traditionally strong position of banks in Aktiengesellschaften and in the Aufsichtsrat of Aktiengesellschaften, has lead to criticism that, by representing themselves and their clients through voting rights, banks pursue their own possibly conflicting interests.\textsuperscript{373} The current system, which enables individuals to be members of the Aufsichtsrat of up to ten corporations brings up conflict of interest issues.\textsuperscript{374} Finally, in some instances, the members of the Aufsichtsrat are so closely connected to the Vorstand that they are not willing to comply with their statutory tasks.\textsuperscript{375}

\section*{VI. CONCLUSION}

The differences between German and U.S. corporate structures, are significant, and it is not practical or desirable to attempt to conclude which system is the better. Both have their advantages and flaws, and both evolved within their own unique cultural, social, and historical circumstances. Given these differences, it is surprising to witness the current "Americanization" of German corporate governance.

Lately, universal banking is considered to be old fashioned. The pressure to stay competitive drives banks to mergers and to specialization. More German companies, like in the United States, are going public as German investors discover stocks as worthwhile investments. With the securities markets prospering, Aktiengesellschaften are becoming less and less dependent on bank financing. It is very likely that the European Union will foster changes in German corporate law, even though German corporate law serves as a model for the European Union. However, important features in U.S. corporate governance that seem to substitute for German bank control and oversight in corporations, like derivative suits, are not available under a long standing German civil procedure tradition. It is very unlikely that this tradition will change. The declining influence of banks as creditors for Aktiengesellschaften might shift bank focus and strengthen bank influence in the other areas of participation in Aktiengesellschaften. But again, their ability to do so depends on how much the EU restrictions of bank participation will hinder them. With all of this said, only one thing can be said for certain—changes are coming in the German corporate structure.

\begin{thebibliography}{99}
\bibitem{373} See Guenther H. Roth, \textit{Supervision of Corporate Management: the "Outside" Director and the German Experience}, 51 N.C. L. REV. 1369, 1378 (1973).
\bibitem{374} See Andre, Jr, supra note 372, at 1822. Cross-membership on the Aufsichtsrat and Vorstand of two or more corporations is prohibited by § 100 AktG.
\bibitem{375} See Norbert Horn, \textit{Die Haftung des Vorstands in der AG nach § 93 AktG und die Pflichten des Aufsichtsrats}, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT 1129, 1130 (1997).
\end{thebibliography}