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Explicit and Implicit System of Corporate Control – A Convergence Theory of Shareholder Rights

Dirk Zetzsche[*]

September 23, 2004

Abstract

This paper categorizes Anglo-American, French and German systems of shareholder rights as either Implicit or Explicit Systems of corporate control. It challenges the orthodox view that inadequate protection of minority stockholders historically accounted for under-developed capital markets by positing that explicit shareholder influence may substitute for market control. Different ethical roots prompted legislature to adopt either a friendly or a hostile attitude towards market forces. This paper further suggests that corporate laws will formally converge through Convergence Cycles towards a middle ground between the Implicit, and the Explicit System. Finally, it posits the need for a close interrelation of comparative and corporate finance research. The author's example of the fertility of such a cooperation results in a dynamic, rather than static theory of ownership convergence. Historical, statutory, and new empirical evidence demonstrates German and American shareholders' different propensity towards shareholder activism, and supports the three propositions.

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Table of Contents

A. Introduction 1
B. The Implicit and Explicit System of Corporate Control 9
I. Traditional Categories 9
1. Common and Civil Law jurisdictions 10
2. Market- and Bank-centered Economies 11
3. Hansmann & Kraakman's Shareholder Primacy 13
II. Thesis 17
1. Proposition 17
2. Elements of Implicit and Explicit Systems 21
3. Caveats 29
4. Provisional Result 30
III. Evidence 31
1. An Ethical Theory of Corporate Governance History 31
a) Christian Ethics and Corporate Law 32
b) From Medieval to Modern Times 34
c) Continuation in 20th Century Politics 36
d) Intermediate result 39
2. Statutory Evidence 40
a) Shareholder Rights 40
b) Directorial deference 51
c) The Functionality of Minority Shareholder Monitoring 53
3. Empirical Evidence 58
a) Attendance Rates? 61
b) Personal Attendance at Shareholder Meetings 68
c) Control Considerations 69
IV. Intermediate Result 73

C. The “Convergence Cycles” 74
I. Formal Convergence on Intermediate Ground 74
II. Potential Counter-Arguments 75
1. Divergenists 76
a) Divergence Forces 76
b) Counter-Arguments 77
2. Functional Convergenists 79
a) The Idea of Functional Adaptability 79
b) Why Formal Convergence Will Nevertheless Occur 80
3. Americanocentric Convergenists 83
a) The Proposition 83
b) A Different View 84
III. The Evidence 87
1. Anglo-America: The Re-Invention of Shareholder Rights 87
a) Trajectory towards the Explicit System 87
b) Statutory Evidence 88
c) Empirical Evidence 92
2. Germany: The Rise of the Market Model 93
a) Statutory Evidence 94
b) Empirical Evidence 97
c) Path Dependency Overcome 99
3. The Cycles are Turning … 99
IV. Intermediate Result 101
D. Convergence of Ownership: An Equilibrium Hypothesis 103
I. Shareholder Monitoring and the Convergence Debate 104
II. The Business Life Cycle Equilibrium 106
1. The BCG Matrix 107
2. Different Level of Endogenous Restraints 108
3. Equilibrium of Ownership Structure 109
4. Caveats 111
III. The Correlation of Ownership Structure and Corporate Law 112
IV. Equilibrium for Cash Cows 113
V. A Tendency 117
1. Concentration and Diffusion 117
2. Legal and Contractual Concentration 118
E. Conclusion 120

A. Introduction

The capital market frenzy of the late 1990s and the following revelations of corporate misconduct have rattled eternal principles of traditional Corporate Governance[1] theory for public corporations. Continuing a scholastic trend of the early 1990s,[2] the tech bubble induced academia to rediscover its examination of the activism of shareholders[3] who have

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[1] This paper uses the term Corporate Governance in a relatively narrow meaning, describing legal issues related to the problem of how equity investors receive a fair return on their investment in public corporations (see Andrei Shleifer & Robert W. Vishny, "A Survey of Corporate Governance", (1997) J. Fin. 52, 737), and dealing with the corporate devices associated with the control of the management (see Joel Seligman, *Corporations: Cases and Materials* (1995), 133 – 230).

[2] Bernard S. Black, "Shareholder Passivity Reexamined" (1990-1991) Mich. L.R.. 89, 520; Bernard S. Black, "Agents Watching Agents: The Promise of Institutional Investor Voice" (1991-1992) UCLA L.R. 39, 811 Bernard S. Black, "The Value of International Investor Monitoring: The Empirical Evidence" (1991-1992) UCLA L.R. 39, 895; Bernard S. Black & John C. Coffee Jr., "Hail Britannia?: Institutional Investor Behavior under Limited Regulation " (1993-1994) Mich. L.R. 92, 1997; C. J. Campbell, Stuart L. Gillan & C. M. Niden, "Current Perspectives on Shareholder Proposals: Lessons from the 1997 Proxy Season" (1999) Financial Management 28, 89; W.T. Carleton, J.M. Nelson & M.S. Weisbach, "The Influence of Institutions on Corporate Governance through private Negotiations: Evidence from TIAA-CREF," (1999) J. of Fin. 53, 1335; John C. Coffee, Jr., "Liquidity versus Control: The Institutional Investor as Corporate Monitor" (1991) Colum. L.R. 91, 1277; Lilli A. Gordon & John J. Pound, "Information, Ownership Structure, and Shareholder Voting: Evidence from Shareholder-Sponsored Corporate Governance Proposals" (1993) J. of Fin. 48, 697; Jonathan M. Karpoff, Paul H. Malatesta & Ralph A. Walkling, "Corporate Governance and Shareholder Initiatives: Empirical Evidence" (1996) J. of Fin. Econ. 42, 365; Jeffrey G. MacIntosh, "The Role of Institutional and Retail Investors in Canadian Capital Markets" (1996) Osgoode Hall L.J. 31, 371; Jeffrey G. MacIntosh, "Institutional Shareholders and Corporate Governance in Canada" (1995-96) Can. Bus. L.J. 26, 145 – 188; Kathryn E. Montgomery "Market Shift – The Role of Institutional Investors in Corporate Governance" (1995-96) Can. Bus. L.J. 26, 189; John J. Pound, "Proxy Voting and the SEC: Investor Protection v. Market Efficiency" (1991) J. Fin. Econ. 29, 241 [Pound, "Proxy Voting"], and "Proxy Contests and the Efficiency of Shareholder Oversight" (1988) J. Fin. Econ. 20, 237 [Pound, "Proxy Contest"]; Edward B. Rock, "The Logic and (Uncertain) Significance of Institutional Shareholder Activism" (1991) Georgetown L.J. 79, 445; Roberta Romano, "Public Pension Fund Activism in Corporate Governance Reconsidered" (1993) Colum. L.R. 93, 795; Stuart L. Gillan & Laura T. Starks, "A Survey of Shareholder Activism: Motivation and Empirical Evidence" (1998) Contemporary Finance Digest 2, 10; Robert Yalden, "Concentrated Control, Institutional Investors and shareholder responsibilities" (1995-96) Can. Bus. L.J. 26, 86, 92 [Canada]. Even before this trend: Melvin Eisenberg, *The Structure of the Corporation: A Legal Analysis* (1976), at 64-65.

[3] Lucian Arye Bebchuck "Empowering Shareholders" (2003) Working Paper (from SSRN), and "The Case for Shareholder Access to the Ballott" (2003) Bus. Lawy. 59, 43 [Bebchuck, "The Case for Shareholder Access"]; Lucian Arye Bebchuck & Allen Ferrell "Federal Intervention to enhance shareholer choice" (2001) Virg. L.R. 87, 993; Lucian Arye Bebchuck & Oliver Hart "Takeover Bids vs. Proxy Fights in Contests for Corporate Control", ECGI Working Paper Series in Finance, Working Paper No. 04/2002; Stuart L. Gillan & Laura T. Starks, "Corporate Governance Proposals and Shareholder Activism: The Role of Institutional Investors" (2000) J. of Fin. Econ. 57, 275; Michael Klausner, "Institutional Shareholders' Split Personality on Corporate Governance: Active in Proxies, Passive in IPOs" (2001) Stanford Law and Economics Olin Working Paper No. 225 (from SSRN); Stewart J. Schwab & Randall Thomas, "Aligning Corporate Governance: Shareholder Activism By Labor Unions" (1998) Mich. L.R. 96, 1018; critical: Roberta Romano, "Less is more: Making institutional investor activism a valuable mechanism for Corporate Governance" (2001) Y. J. on Reg. 18, 174.

traditionally been held to be rationally apathetic and disinterested in the control of their investments.[4] This analysis intends to further the discussion about the role of shareholders in Corporate Governance, by highlighting some differences between present Anglo-American and German and French Corporate Governance systems that have yet to be addressed in academic literature and their impact on the current convergence debate. A hypothesis relating to the likely outcome of legal and factual convergence rounds off the comparative inquiry into shareholder rights.

The study is rooted in three key assumptions: First, the assumption that "**[s]uccess (survival) accompanies relative superiority**." Thus, "[w]henever successful enterprises are observed, the elements common to those observed successes will be associated with success and copied by others in their pursuit of profits or success."[5] This principle also applies to the competition of Corporate Governance systems.[6]

Second, if there is an **ideal Corporate Governance model, this has yet to be unveiled**: while, due to apparently strong minority rights, many (primarily American) scholars assume that the outcome of convergence would be the American model of "shareholder capitalism" in an environment of firms with dispersed ownerships,[7] not all agree on the

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[4] This conception is based on Berle & Means, *The Modern Corporation and Private Property* (1933), at 64-65, and 244 et seq., and has been repeated over and over again, for example by Clark, *Corporate Law* (1986), at 390 et seq.; Earl Latham, "The Commonwealth of the Corporation" (1960) Nw. U.L.R. 55, 25; Clark, *Corporate Law* (1986), at 390; Henry G. Manne, "Some Theoretical Aspects of Share Voting – An Essay in Honour of Adolf A. Berle", (1964) 64 Colum. L.R. 1427, at 1437, at 1438 [Manne, "Some Theoretical Aspects"]; Bayless Manning, "Book Review", (1958) Yale L.J. 67, 1477, 1485-1496; Siems, *Convergence* (2004), at 100 et seq.

[5] Armen Albert Alchian, "Uncertainty, Evolution and Economic Theory," J. Pol. Econ. (1950) v.58, p.211-221, p. 213, 218.

[6] See, for example, the seminal pieces by Harold Demsetz, "The Structure of Ownership and Theory of the Firm" (1983) J.L. & Econ. 26, 375; Robert Clark, *Corporate Law* (1986), at 801 et seq. (Appendix); Roberta S. Karmel, "Is it time for a federal corporation law?" (1991) Brook. L.R. 57, 55, 90, and Easterbrook & Fischel, *Economic Structure* (1991), at 212-218; this view has become almost ubiquitous, see for example David Charny, "The politics of corporate convergence", in Gordon & Roe, *Convergence and Persistence* (2004), at 293, 296.

[7] For example Theodor Baums & Kenneth E. Scott "Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany" (2003) ECGI Law Working Paper No. 17/2003 (From SSRN), at 3 et seq.; John C. Coffee, Jr. "Future As History: The Prospects for Global Convergence in Corporate Governance and Its Implications" (1998-1999) 93 Nw. U. L.R. 641 [Coffee, "Future As History"], at 649, 698; Jeffrey N. Gordon, "An International Relations Perspective on the Convergence of Corporate Governance: German Shareholder Capitalism and the European Union, 1990-2000" (February 2003) European Corporate Governance Institute (ECGI) Law Working Paper No. 06/2003 [Gordon, "An

implicitly stated superiority hypothesis of the American model.[8] Empirical data on the superiority of Anglo-American Corporate Governance is inconclusive.[9]

Finally, Corporate Governance regulation is **responsive to crises**:[10] When recession highlights corporate failures, the impact on the economy and public pressure force legislatures to deal with capital market crises following a plethora of failures. Whenever a crisis occurs, the question of what the right legislative response is to this crisis determines the content of legislation until the crisis is settled or forgotten, and investor confidence has been regained. Academia's responsibility, however, is to deal with the general problem of how to guarantee proper business conduct without restraining entrepreneurial business creativity or otherwise raising social costs. While crises are not necessarily evidence of the

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International Relations Perspective"], p. 43, although Gordon accounts for the German convergence towards the American system with the German commitment to a project of transnational economic and political integration (EU integration) rather than with efficiency consideration; Henry Hansman & Reinier Kraakman, "The End of History for Corporate Law", (2001) 89 Georgetown L.J. 439, 443 et seq. [Hansman & Kraakman, "The End"]; Roberta Romano, "A cautionary Note on Drawing Lessons from Comparative Corporate Law" (1993) 102 Yale L.J. 2021, 2023 et seq. [Romano, "A cautionary Note"]

[8] For example Masahiko Aoki, "Toward an Economic Model of the Japanese Firm" (1990) J. Econ. Lit. 28, 1; Julian Frank & Colin Mayer, "Capital Markets and Corporate Control: A Study of France, Germany and the U.K." (1990) Econ. Policy 10, 189; Klaus J. Hopt & Patrick C. Leyens, "Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy" (2004) ECGI Law Working Paper No. 18/2004 (from SSRN), at 19 et seq. (for Board of Directors). The superiority of German and Japanese banking regulation also posits Mark J Roe, "Some Differences in Corporate Structure in Germany, Japan, and the United States" (1992-1993) Yale L.J. 102, 1927, at 1936, and "A Political Theory of American Corporate Finance" (1991) Colum. L.R. 91, 10.

[9] See - on the hand - the data by Mark Roe, "Corporate Law's Limits", (2002) 21 J. Legal Studies 233, at p. 251 [Roe, "Corporate Law's Limits"]. These data are consistent with the fact that corporate scandals that have shaken the American corporate landscape have not been unveiled to the same extent in Germany. Rather, German shareholders merely associate corporate scandals with young Tech-stocks and the Neuer Markt, see the list of 45 firms that went either bankrupt or were subject to examinations by the Federal Agency for Financial Services, Manager Magazin Online, <www.manager-magazin.de/geld/artikel/0,2828,186368,00.html>. On the other hand, other studies put forth that the fact that capital market pricing positively correlate to a cross-listing in the U.S. should be interpreted as evidence for better American minority rights protection, see, for example, Craig Dodge, "U.S. Cross-listings and the private benefits of control: evidence from dual-class firms" (2004) J. Fin. Econ. 72, 519, citing older studies.

[10] Stuart Banner, "What Causes New Securities Regulation?: 300 years of Evidence", (1997) Wash. U.L.Q. 75, 849, 850; Thomas Clarke, "Cycles of Crisis and Regulation: The Enduring Agency and Stewardship Problems of Corporate Governance" (2004) Corporate Governance: An International Review 12, 153 [Clarke, "Cycles of Crisis and Regulation"]; John C. Coffee, Jr., "The Rise of Dispersed Ownership: The Role of Law and the State in the Separation of Ownership and Control" (2001) Yale L.J. 111, 1 [Coffee, "The Rise"], at 66, speaks of "Crash Then Law" Cycles; Frank Partnoy, "Why Markets Crash and What Law Can Do About It", (2000) U. Pitt. L.R. 61, 741, 743, with detailed citations from the various legislative steps in note 11.

presence of inefficient laws, crises encourage academics to review whether or not the law provides incentives for proper business conduct.

Current comparative Corporate Governance research focuses on the extent of likely convergence between the Anglo-American and the Continental European systems of Corporate Control. Though various nuances hinder overgeneralization,[11] scholastic opinions may best be assigned to one of three strains of thought. (1) The *formal convergenists* suggest that efficiency considerations and increasingly dispersed shareholdings will eventually overcome forces of divergence through democratic devices. These theorists submit that convergence at the level of formal legal rules is ongoing, and even already largely complete.[12] (2) The *divergenists* suggest that political barriers, institutional complementarities, and path dependence will produce trajectories towards convergence. Therefore, at least any short-run tendency towards convergence will be unlikely to materialize, and differences will persist.[13] (3) The intermediate position puts

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[11] Siems, *Convergence* (2004), at 24, counts six subcategories of convergence theory: besides the understanding of formal and functional convergence as described in the following, commentators discuss 1) *contractual* convergence (*Gilson*), referring to similarities resulting from contracting around state-provided rules, 2) *hybrid* convergence (*Rose*), meaning that, in a divergent legal surrounding, firms achieve convergence by changing its state of incorporation to a state with a more convergent regime, 3) *normative* convergence (*Milhaupt*), holding that convergence can be achieved factually despite divergent legal regimes, by changes of ethical and cultural backgrounds of law, and 4) *institutional* convergence (*Charny, Black*), referring to converging institutions in a still partially diverse legal surrounding.

[12] Brian R. Cheffins, "Current Trends in Corporate Governance: Going from London to Milan via Toronto" (1999) Duke J. Comp. & Int'l. L. 10, 5, 6, 39 et seq.; Lawrence A. Cunningham "Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance" (1999) Cornell L.R. 84, 1133, at 1145, 1194 [Cunningham, "Commonalities and Prescriptions"]; Jeffrey N. Gordon, "Pathways to Corporate Convergence? Two Steps on the Road to Shareholder Capitalism in Germany" (1999) Colum. J. Eur. L. 5, 219 [Gordon, "Pathways"], and Gordon, "An International Relations Perspective", *supra* note 7; Hansmann & Kraakman, "The End", *supra* note 7; Edward B. Rock, "America's Shifting Fascination with Comparative Corporate Governance" (1996) Wash. U. L. Q. 74, 367; Siems, *Convergence* (2004), pp. 287 et seq.; Gustavo Visentini, "Compatibility and Competition Between European and American Corporate Governance: Which Model of Capitalism?" (1997-1998) Brook. J. Int'l L. 23, 833, 846 et seq.

[13] Lucian Arye Bebchuck & Mark J. Roe, "A Theory of Path Dependence in Corporate Ownership and Governance" (1999) Stan. L.R. 52, 127, at 132 et seq. [Bebchuck & Roe, "A Theory of Path Dependence"]; Douglas M. Branson, "The Very Uncertain Prospect of "Global" Convergence in Corporate Governance" (2001) Cornell Int'l L.J. 34, 321, at p. 325 et seq. [Branson, "The Very Uncertain Prospect"]; William W. Bratton & Joseph McCahery, "Comparative Corporate Governance and the Theory of the Firm: The Case against Global Cross-Reference" (1999) Columb. J. Tran'l L. 38, 213; David Charny, "The German Corporate Governance System", (1998) Co. Bu. L.R. 145, and "The politics of corporate convergence", in Gordon & Roe, *Convergence and Persistence* (2004), at 293, 297 et seq.; Marry E. Kissane, "Global Gadflies: Applications and Implications of U.S.-Style Corporate Governance Abroad" (1997) N.Y.L. Sch. J. Int'l & Comp. L. 621; Curtis J. Milhaupt, "Property Rights in Firms" in Gordon & Roe, *Convergence and Persistence* (2004), at 210, 243 et seq.; Mark Roe, *Strong Managers, Weak Owners* (1994), at 238-39, 280-81,

forth that different formal rules could produce similar outcomes with respect to the function, rather than the form of the rules [*functional convergenists*].[14]

This analysis focuses particularly on one of the many aspects of the convergence debate, which is shareholders rights. Part B. **compares the basic concepts** of shareholder control in Anglo-America and some states of Continental Europe, and, in particular, those of the United States and Germany, respectively.[15] It shows that three traditional categories of Corporate Governance systems – common vs. civil law countries, market- vs. bank-centered economies, and share- vs. stakeholder models – are inaccurate. It thus introduces a new categorization between Implicit and Explicit Systems of corporate control, which are centered primarily around the concept of shareholder rights. The first category refers to statutes that are enacted and construed with the belief that market forces influence managers, assuming that active competition in the product, stock and managerial labor market has a significant impact on managerial behavior. Shareholder rights to be exercised in direct contact with the corporation are thought to be relatively weak. In contrast, direct shareholder influence through voting and (even minority) shareholder monitoring constitute the fundaments of the Explicit System. The former concept was established in Anglo-America, and the latter is reflective of the Continental European states that this study regards. There is, however, not a bright-line distinction between these two concepts. No

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and *Political Determinants* (2003); Romano, "A cautionary Note", *supra* note 7, at 2036; Reinhard H. Schmidt & Gerald Spindler, "Path dependence and complementarity in Corporate Governance", in Gordon & Roe, *Convergence and Persistence* (2004), at 114, 117 et seq. [Schmidt & Schmidt & Spindler, "Path dependence and complementarity, "Path dependence and complementarity].

[14] Bernard S. Black, "The Legal and Institutional Preconditions for Strong Securities Markets" (2000-2001) 48 UCLA L.R. 781, at p. 846 [Black, "The Legal and Institutional Preconditions"], if the jurisdiction is not caught in a "downsizing, self-reinforcing equilibrium" (see 838 et seq.); Coffee, "Future As History", *supra* note 7, and "The Rise", *supra* note 10, at p. 77; Ronald J. Gilson, "Corporate Governance and Economic Efficiency: When do Institutions Matter?" (1996) Wash.U.L.Q. 74, 327, 332-33 [Gilson, "Economic Efficiency"], and "Globalizing Corporate Governance: Convergence of Form or Function", (2001) 49 Am. J. Comp. Law 329, at p. 333 et seq. [Gilson, "Globalizing"]; Steven N. Kaplan, "Top Executives, Turn Over, and Firm Performance in Germany" (1994) J. L. Econ. & Org. 10, 142, 144; Steven N. Kaplan & Bernadette A. Minton, Appointments of Outsiders to Japanese Boards: Determinants and Implications for Managers (1994) J. Fin. Econ. 36, 225, 256-57; Paul Rose, "EU Company Law Convergence Possibilities after Centros", (2001) Transnat'l L. & Contemp. Probs. 11, 121.

[15] The author is aware of the fact that Germany is not a synonym for Continental Europe, and he does not allege that the laws of other states are modelled after, or similar to, Germany. The German law (and also the French and Swiss law) are two out of more than 40 corporate laws in Continental Europe each of which have with different legal roots and traditions. In order to raise linguistic efficiency, the author uses the term "Continental Europe" merely as a geographical contrast to the United States and England.

jurisdiction has installed a "pure" system that includes implicit or explicit governance tools to the exclusion of the other.

Voting, shareholder monitoring through meetings, shareholder suits revising the decisions of shareholder meetings, and minority protection legislation that enables minority shareholders to survive in the firm, as provided by German *Konzernrecht*, establish the Explicit System of shareholder control. The Implicit System includes public monitoring, takeover bids, the appraisal remedy, as well as protective measures for minorities and shareholder suits aimed at financial compensation. Per se, shareholder influence mediated through the board constitutes neither implicit nor explicit influence within the meaning of the above categories.

Historical, statutory and empirical evidence accounts for this differentiation: The historical analysis reveals the support of market forces that is present in the Calvinistic-Puritan Christian belief that constitutes the ethical basis of the Anglo-American legal system – but also that of Switzerland and the Netherlands. The Catholic and Lutheran-Protestant belief that was predominant in the other states of western Europe favors policies that further the responsibility of those entrusted by God to the economically stronger parts of society for the benefit of overall society, and the balancing of the impact of market power in general. This belief facilitates the emergence of strong states that could hamper market forces where they conflict with the cultural obligation to care for one's dependents.

This philosophy is consistent with historically weak capital markets: if owners can neither sell their stake in the firm nor easily dismiss employees, they are likely to be interested in a long-term healthy business, and a relatively low stress relationship with their employees. Under these conditions, an Anglo-American style of implicit shareholder control through market forces was untenable. Since the need for controlling managers nevertheless existed, Germany and France developed explicit structures of shareholder control. This paper provides statutory evidence from some Continental jurisdictions, esp. Germany, showing that procedural rights preceding shareholder meetings, information rights, and shareholder remedies were enacted as direct and individual measures to control managers explicitly, resulting in a system with significantly less directorial deference than is the norm in the United States.

Empirical figures demonstrate the practical relevance of shareholder control. This paper presents formerly unpublished data showing that German shareholder meetings are huge events with thousands of shareholders present, while those in Anglo-America used to be non-events, relatively speaking. While extraordinary factors render the attendance as measured in votes incomparable, "soft data", such as the website structure of American and German corporations add to the persuasiveness of my theory. It concludes that in Germany, shareholder meetings are part of Corporate Governance, while the Anglo-American corporate world traditionally understood this term to include only inter-board relationships.

Part C. analyses the questions of **whether, how and why Corporate Governance systems converge**. Based on an analysis of major changes in shareholder rights since the early 1990s, this study suggests that Corporate Governance systems are likely to develop in **Convergence Cycles.** This means that in a closely interrelated world Corporate Governance reform draws on foreign experiences with specific Corporate Governance devices. If a legal regime provides a particularly efficient solution to a specific problem, this solution will eventually be adopted by other Corporate Governance systems with an inferior system in respect of such problem. Since no system of shareholder rights is flawless, Convergence Cycles will eventually result in **formal convergence on a middle ground between the Explicit and the Implicit System of corporate control**. Given the current cataclysms in world's economic structure, - negatively speaking – the legislatures' "plagiarism," which is initiated and particularly furthered by comparative academic studies, will finally overcome the three core forces against formal convergence, which are political barriers, complementarities, and path dependence. The proposition of Convergence Cycles draws on historical, as well as new statutory and empirical evidence, collected by the author.

Part D., finally, analyses the likely **impact of convergence on ownership structures**. Based on the hypothesis that the legal environments of Corporate Governance in Anglo-America, France and Germany will converge, it posits that the current discussion has asked the overly simplistic question of whether dispersed or concentrated ownership constitutes the best solution to the problem of how to effectively monitor managers. Instead, this section suggests that asking the more complicated question of which ownership structure is efficient for which type of firm is more likely to yield accurate results. Part D. demonstrates

the fertility of combining comparative and corporate finance research by applying a simplified model of *Jensen*'s free cash flow theory to the debate about ownership structure convergence: Based on this example, it is likely that the answer to the question of which ownership structure is efficient depends on the stage of the business cycle that the firm is at. The specific stage of the firm can be determined by factors such as the firm's growth rate, size, and internal cash flow. Competition will press firms to adopt efficient ownership structures. Thus, firms within the same stage are likely to become more and more similar with respect to their ownership structures, until they reach an **equilibrium** that is set at a specific point for a particular group of firms. Thus, applying corporate finance insights to comparative Corporate Governance adds a dynamic perspective to the static views that presently prevail in the debate upon the convergence of ownership structures.

B. The Implicit and Explicit System of Corporate Control

Convergence theory is unlikely to achieve accurate results with respect to the *future* without understanding the *status quo*. Consequently, a proper categorization of present Corporate Governance systems has constituted a primary concern for convergence scholarship.

I. Traditional Categories

Two types of works utilize the concept of Corporate Governance categories. Some studies focus on systemic issues, examining forces that generally influence tendencies towards convergence and persistence. Another part of comparative literature examines specific elements of Corporate Governance, such as the presence of different types of shareholders, the degree of capital market development, and the degree of minority shareholder protection in order to account for differences between American and European Corporate Governance systems. I admit that every categorization requires a minimum degree of flexibility in order to stay adaptable to different circumstances, e.g. to more than a limited number of countries, or to transition periods. However, most of the categorizations current scholarship provides can be criticized from a methodological perspective for exhibiting deficiencies with respect to their doctrinal and statutory basis.

Due to the inflation in comparative Corporate Governance literature in recent years, this paper cannot analyse *all* categorizations that commentators have used. It merely endeavours to elucidate some of the most glaring, though most prominently argued, misconceptions in drawing wedges between closely interrelated (both culturally and economically) economies. In the belief that, as *Hayek* suggested in another context, grave consequences have followed from these "seemingly simple but false" categories,[16] the adjustment of three biases is particularly essential for the purposes of further discussion. These are the distinction between **common and civil law jurisdictions**,[17] the distinction between **market**

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[16] Friedrich Hayek, "The Pretense of Knowledge", in Nishijama & Leube, *The Essence of Hayek* (1984), 266, at 272.

[17] Primarily established by Rafael La Porta, Florencio Lopez-De-Silanes, Andrei Shleifer, "Corporate Ownership around the World" (1999) J. Fin. 54, 471, at 473 [La Porta, Lopez-De-Silanes, Shleifer, "Corporate Ownership"], and together with Robert Vishny: "Legal Determinants of External Finance", (1997) J. Fin. 52, 1131; "Law and Finance " (1998) J. Pol. Econ. 106, 1113, at 1116; "Investor Protection and

and bank-driven economies,[18] and *Hansmann & Kraakman*'s bold assertion that only the present American corporate world would be **shareholder driven**, while in France the state would regularly intervene in corporate matters, and in Germany labor interests would influence corporate decision making (at least) as much as would shareholder interests.

1. Common and Civil Law jurisdictions

Relying on a distinction between civil and common law countries raises three serious concerns. First, in many cases it is unclear what qualifies which each country for membership in a specific category. For example, Japan is usually considered to be a civil law country. While the roots of the Japanese legal system are German, and thus based in civil law, the categorization neglects that Japanese law after the second world war has been fundamentally reformed under strong influence from the American state law of Illinois.[19] Second, a bright-line distinction between European common and civil law countries is not consistent with traditional cultural ties, or antagonism, which can be assumed to impact law development as well. For example, traditionally strong ties existed between the Netherlands, a civil law country, and England, a common law country.[20] Third, common law traditionally describes a specific kind of law exercised and developed by courts in medieval England.[21] Despite the fact that some legal traditions might be traced back to these times,[22] the Stuart Kings removed parts of the traditional law when it conflicted with

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Corporate Governance" (2000) J. Fin. Econ. 58, 3; reconsidered, e.g., by Coffee, "The Rise", *supra* note 10, at 45 and 60 et seq.

[18] For example, Black, "The Legal and Institutional Preconditions", *supra* note 14, at 842 et seq.; Visentini, "Compatibility and Competition", *supra* note 12; La Porta, Lopez-De-Silanes, Shleifer, "Corporate Ownership", id., at 508.

[19] For Japan's hybrid law background see Curtis Milhaupt, "Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance" (2001) U. Pa. L.R. 149, 2083, 2123 Fn. 131; Siems, *Convergence*, at 8, 21.

[20] After the ousting of the last Stuarts, the Dutch king (Wilhelm of Oranje) became English king, which was due to the strong religious, cultural, and commercial ties between both nations, see Bowl, *The Unity of European History* (1970), at 229-231.

[21] See on early corporate law Paul G. Mahoney, "Contract or Concession" (2000) Ga. L.R. 34, 873, at 878.

[22] For example, the emphasis on precedent over codification in common law countries.

the King's power to charter corporations.[23] Commentators need to pay more attention to these little, but significant details when categorizing corporate law, as they have done.

2. Market- and Bank-centered Economies

Another distinction refers to different legal regimes governing financial institutions. Until 1999,[24] the Glass-Steagall Act of 1933 prohibited American credit banks from engaging in investment banking and the mutual funds industry, and from making equity investments in nonfinancial firms for their own account, while German and Japanese institutions were not restricted in the same way.[25] A categorization of Corporate Governance systems relying on this bank-influence is, however, not convincing.

Despite the fact that until 1998[26] German banks influenced their clients through the triad of memberships in supervisory boards, proxy voting and creditor rights, a bank could not effectively exercise this power without risking a backlash by its own supervisory board and shareholder body, since German corporations were traditionally organized in interlocking shareholdings and directorates.[27] In addition, banks' influence was weakened because relatively low dividend pressure resulting from underdeveloped capital markets enabled firms to use extensive internal financing, and forego external finance through credit and share issues. In addition, share ownership of banks was not extraordinary high, as one would suggest in a bank-centered economy. Share ownerships held by German retail

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[23] Paul G. Mahoney, "Contract or Concession" (2000) Ga. L.R. 34, 873, at 881-886: common law would have enabled free incorporation through contracts, while the king's prime source of income in times of colonization was fees for chartering corporations; Detlef Vagts, "Comparative Company Law – The New Wave" (2002) Festschrift Druey, 598.

[24] Through Gramm-Leach-Biley Financial Modernization Act of 1999, see Art Alcausin Hall, "International Banking Regulation into the 21st Century: Flirting With Revolution" (2001) N.Y.L.Sch. J. Int'l & Comp. L. 21 (2001) 41; Aigbe Akhigbe & Ann Marie Whyte, "The Gramm-Leach-Bliley Act of 1999: Risk Implications for the Financial Services Industry" (2004), Journal of Financial Research, forthcoming (from SSRN).

[25] Mark Roe, "Some Differences in Corporate Structure in Germany, Japan, and the United States" (1992-1993) Yale L.J. 102, 1927, at 1948-49 (with details); a comparative overview over banking regulation provides Siems, *Convergence* (2004), at 318 et seq.

[26] In 1998, the legislature enacted the KonTraG-Reform (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG) v. 27.4.1998, BGBl. I (1998), S. 786), which reduced bank-influence by imposing stricter formal conditions on banks organizing proxy voting, as well as by stricter limits and higher transparency of supervisory board memberships and meetings.

[27] Which caused the legislature to enact in 1965 s. 19 Aktiengesetz (transl.: German Stock Corporation Act) [GSCA], according to which ownership rights in cross-ownerhips exceeding 25% must not be exercised.

investors usually exceeded bank shareholdings, while non-financial corporations held the bulk of the shares in public corporations.[28] This data is consistent with *concentrated ownership*, but not with the theory of a bank-*centered* economy. Banks were part of what has been called "Germany Inc." – a company network that closely tied its members to national economic development, and mitigated competition among themselves.[29] In this network, banks were important and influential, but were neither the *center*[30] nor the *controlling part*.[31] The same aspect – that banks are involved, but do not control the economy – is true with respect to Japan, where banks belong to, rather than control *keiretsu*-conglomerates.[32] Finally, there is some evidence that American banks control important voting stakes of nonfinancial firms through their trust business, and that American bankers are more likely to join the board of nonfinancial firms of which their bank controls a large voting stake through its trust business.[33] These characteristics used to be associated with bank-centered economies.

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[28] *Appendix A* provides a table of share ownership in German corporations. The data is taken with kind permission from DAI, *Factbook* (2003).

[29] Martin Hoepner & Lothar Krempel, "The Politics of the German Company Network" (Nov 2003), MPIfG Working Paper No. 2003-9 (from SSRN), at 3 [Hoepner & Krempel, "The Politics"].

[30] Rather, *insurance companies* (Allianz AG, Munich Re), which neither provided credit nor exercised voting rights, and *industrial conglomerates* (Daimler Benz AG, Veba/Viag, RWE/VEW) also held also wide-spread shareholdings. The fourth element of the Germany Corp. were the estates of the founder families (Thyssen, Krupp, Bosch, Siemens, Quandt, etc.). In this structure, bank-plans could indeed falter, for example the plan of forming a car-conglomerate of Daimler Benz AG and BMW AG in 1966. Though the legal details lack precision, see for an instructive overview Hoepner & Krempel, "The Politics", id.; John W. Cioffi, "Restructuring "Germany Inc.": The Politics of Company and Takeover Law Reform in Germany and the European Union," (2002) Institute of European Studies, University of Berkeley, California, online: <repositories.cdlib.org/cgi/viewcontent.cgi?article=1002&context=ies> [Cioffi, "Restructuring "Germany Inc."].

[31] Ralf Elsas & Jan Pieter Krahnen, "Universal Banks and Relationships with Firms" (February 2004) CEPR Discussion Paper No. 4224 (from SSRN) show that with respect to the role of banks as monitoring investors, the evidence does not unanimously support a special role of banks for large firms. This is consistent with Mark Roe, "Some Differences in Corporate Structure in Germany, Japan, and the United States" (1992-1993) Yale L.J. 102, 1927, at 1945. Recently, similar structures were shown for the U.S., see Joao A.C. Santos & Adrienne S. Rumble, "The American Keiretsu and Universal Banks: Investing, Voting and Sitting on Nonfinancials' Corporate Boards" (2003) Working Paper (from SSRN) [Santos & Rumble, "The American Keiretsu"].

[32] Id.; specifically on the role of *keiretsu*-banks J. Mark Ramseyer, "Cross-shareholding in the Japanese keiretsu", in Gordon & Roe, *Convergence and Persistence* (2004), at 348; Siems, *Convergence* (2004), at 324, 327.

[33] Santos & Rumble, "The American Keiretsu", *supra* note 31, at 11 et seq. show that, in 2000, American banks control on average 10% of the votinmg rights of S&P 500 nonfinancial firms, including several firms in which banks exercise 20% to 60% of the voting rights through their trust business. This evidence is consistent

3. *Hansmann & Kraakman*'s Shareholder Primacy

Hansmann & Kraakman predicate categories of Corporate Governance models on conflicts between stakeholder interests. Economic studies have shown that the interests of different stakeholder groups conflict in particular circumstances.[34] These studies demand that the law determines whose interest management should primarily pursue. Probably due to the legislatures' reluctance to articulate clear statements on this politically explosive issue,[35] and the paucity of case law,[36] the legal literature responded in a fragmented way to the economists' demand.[37] *Hansmann & Kraakman* nevertheless confined their categories by

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with that provided by R.M. Soldofsky "Institutional Holdings of Common Stock, 1990-2000: History, Projection, and Interpretation," (1991) Bureau of Business Research, Graduate School of business Administration of the University of Michigan. It counters Mark J. Roe, "Political and Legal Restraints on Ownership and Control of Public Companies," (1990) J. of Fin. Econ. 27, 7, who posited that banks could not have significant equity stakes in firms through their trust department. S.D. Prowse, "Institutional Investment Patterns and Corporate Financial Behavior in the United States and Japan," (1990) J. of Fin. Econ. 27, 43, argues that American banks would be required by law to vote in the interest of the beneficial owners. This, however, is also the position under German law.

[34] Michael C. Jensen & William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) J. Fin. Econ. 3, 305, at 310 et seq. [Jensen & Meckling, "Theory of the Firm"]; Alfred Rappaport, *Creating shareholder value: the new standard for business performance* (Free Press, New York: 1986). These conflicts include 1. insolvency: shareholders – creditors; 2. reduction of production: shareholders – workers; 3. geographical investment strategy: shareholders – state; 4. environmental aspects of production: shareholders – public; etc.

[35] The German legislature in its "official interpretation" of the German Stock Act Reform of 1965 mentioned that corporations should not oppose interests of overall economy and the interests of society, while they should, among other interests, also regard interests of employees, see Bruno Kropff, *Aktiengesetz* (1965), at 97-98. However, this statement needs to be considered in the light of the "social welfare" clause of s. 70 of the German Stock Act of 1937, which bound corporations to merely pursue social welfare projects. The German majority opinion holds that corporations may and shall pursue shareholder interests, as long as management balances these interests with diverse interests of other stakeholders, see Mülbert, "Shareholder value from a legal perspective", ZGR 1997, 129, 156 ff.

[36] For the United States, see *Dodge v. Ford Motor Co.*, 204 Mich. 459 (1919), implicating shareholder primacy. The German Federal Supreme Court in BGHZ 64, 325, 329 has used the expression "interests of the enterprise," which commentators have interpreted as abbreviation for a behavior whose guidelines are the existence and long-term rentability of the firm, see Hüffer, AktG, § 76 Rn. 13, also Higher Regional Court of Hamm, DIE AKTIENGESELLSCHAFT 1995, 512, 514 – Harpener/Omni -.

[37] The vast majority of American scholarship posits shareholder primacy models, purporting that the primary goal of the public corporation ought to be maximizing shareholders' wealth, and that the reduction of agency costs as central economic problem should be addressed by imposing duties of loyalty and care owed by directors and managers to shareholders, see, for example Lucian Arye Bebchuck, "Federalism and the Corporation" (1992) Harv L.R. 105, 1435, at 1451 (implicitly); Bernard S. Black, "Shareholder Passivity Reexamined" (1990) Mich. L.R. 89, 520; Victor Brudney, "Corporate Governance, Agency Costs, and the Rhetoric of Contract" (1985) Colum. L.R. 85, 1403; Easterbrook & Fischel, *Economic Structure* (1991), at 35; Ronald J. Gilson & Reinier Kraakman, "Reinventing the Outside Director: An Agenda for Institutional Investors" (1991) Stan. L.R. 43, 863, 879 et seq.; Henry G. Manne, "Mergers and the Market for Corporate Control" (1965) J. Pol. Econ. 73, 110. In contrast, stakeholder models assume management should take into

contrasting American shareholder primacy with what they perceive to be the leading principle of other Corporate Governance models. These apparent leading principles include the strong influence or primacy of managers (historically in the United States), workers (Germany), or the state (France and Japan) in the firm. *Hansmann & Kraakman*'s category achieves dubious results, as a closer look at France and Germany illustrates.[38]

The authors categorize the French economy as state driven due to the French state's involvement in corporate affairs, and the replacement of shareholder suits with criminal sanctions for directors' malfeasance.[39] While the creation of "national champions" by the French Government indeed happens,[40] *Hansmann & Kraakman* focus exclusively on a tiny excerpt from French Corporate Governance. The distinction becomes even more hapless when one considers that the French state only interferes with strategic decisions of national impact, rather than with day-to-day business. Consequently, it is very likely that a mechanism for day-to-day control of the firm exists which *Hansmann & Kraakman* do not examine. Eventually, in the aftermath of the bubble, the American public could hardly miss the pictures of American corporate managers having been jailed for (apparent) corporate misconduct. Thus, criminal sanctions are not exclusively a French characteristic.

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account interests of various stakeholder groups, see for example Blair & Stout, " A Team Production Theory of Corporate Law" (1999) Va. L.R. 85, 247; Marleen A. O'Connor, "Organized Labor as Shareholder Activist: Building Coalitions to Promote Worker Capitalism" (1997) U. Rich. L.R. 31, 1345, and "The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation" (1993) Cornell L.R. 78, 899; Duncan McLaren, "Global Stakeholders: Corporate Accountability and Investor Engagement" (2004) Corporate Governance: An International Review 12, 191; Kent Greenfield, "The Place of Workers in Corporate Law" (1998) B.C. L.R. 39, 283; David Millon, "Default Rules, Wealth Distribution, and Corporate Law Reform: Employment at Will versus Job Security" (1998) U. Pa. L.R. 146, 975, and "New directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law" (1993) Wash. & Lee L.R. 50, 1373, and "Theories of the Corporation" (1990) Duke L.J. 201, and the essays in Lawrence E. Mitchell (ed.), *Progressive Corporate Law* (1995). This discussion goes back to the 1930ies, see E.M. Dodd, "For Whom Are Corporate Managers Trustees?" (1932) 45 Harv. L.R. 1145; A. Berle, "For Whom Corporate Managers are Trustees: A Note", (1932) 45 Harv. L.R. 1365.

[38] Hansman & Kraakman, "The End", *supra* note 7, at 449 et seq.; the authors borrow heavily from Cunningham, "Commonalities and Prescriptions", *supra* note 12, at 1136 et seq.

[39] Hansmann & Kraakman, "The End", *supra* note 7, at 446-447.

[40] And has recently happened again with the merger of Sanofi-Synthelabo and Aventis (see online: <www.pwcglobal.com/extweb/newcoatwork.nsf/docid/225FBBBA606F152185256E9400738D9E>; French policy understands its measures as anti-takeover regulation by creating size against imperialistic American firms, most of which have strong anti-takeover devices which cannot be exercised in mandatory Continental European corporate law.

With respect to Germany, *Hansmann & Kraakman* consider worker co-determination to be the prime characteristic. Their emphasis on German worker co-determination, however, is methodologically flawed. If co-determination is the central criterion of a categorization of Germany as labor-oriented, it will require a thorough analysis of the mechanisms of co-determination: what influence do the workers have, in law and in practice? German corporate law provides for three relevant types of co-determination regimes. Pursuant to the most relevant co-determination regime for large public corporations,[41] shareholders and workers elect an equal number of supervisory board members. Since under German constitutional law the final decision of the supervisory board must eventually lay in the hands of shareholders as property owners (or their representatives),[42] if there is a tie in the first vote on a proposal, the chairman of the board (who is a shareholder representative) will have two votes in a second vote, thereby tipping the balance in favor of the owners. Furthermore, one of the worker representatives is an officer of the firm, and will typically represent management's interests in practice. Since worker representatives are aware of this mechanism, they tend to avoid contentious votes. Rather, workers try to gain influence through (sometimes tainted) information about the workers' views and discussions in the board committees. Given these implications, co-determination does not necessarily result in pro-labor decisions of the board. This does not mean that German co-determination will always result in an owner-favored decision.[43] It does, however, suggest that despite the

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[41] The oldest and most extensive, though the least relevant today (with approximately 20 firms, including ThyssenKrupp AG) is the co-determination pursuant to Montan-Mitbestimmungsgesetz of 1951 (and Mitbestimmungsergänzungsgesetz of 1956) merely regards corporations in mining industries and steal production. Supervisory Boards under this regime have 11, 15, or 21 members, of which shareholders and workers elect both the same number. One member of the employees' bench is an officer of the corporation. The eleventh, fifteenth, or twenty-first member will be elected by shareholders on a proposal by the whole supervisory board (in which shareholder and workers are equally represented), for details see s. 8 MonMitbestG.

Furthermore, under the Co-determination pursuant to Mitbestimmungsgesetz of 1976 for corporate groups with more than 2000 workers, workers elect the half of 12, 16, or 20 supervisory board members. See, in particular, ss. 27, 29 (2) MitbestG 1976.

Finally, the Co-determination pursuant to Drittelbeteiligungsgesetz of 2004, the successor of the former Betriebsverfassungsgesetz of 1952, regards corporate groups with more than 500 and up to 2000 workers. Under this regime, a third of the supervisory members will be elected by workers.

[42] BVerfG of 01.03.1979 – 1 BvR 532, 533/77, BVerfGE 50, 290, 337 et seq. – Mitbestimmung -.

[43] Nor does it mean that the German supervisory board system is without weaknesses. For example, German supervisory boards are too large (24 members) and thus inefficient. Labor Unions lobby against a reduction of board sizes since they receive some of the worker members' compensations.

proportional worker representation on supervisory boards, shareholder interests will often be paramount, a suggestion which is disregarded by *Hansmann & Kraakman*'s lopsided analysis.[44]

This does not ignore the fact that the collective bargaining processes mitigating the impact of market forces are deeply rooted in German culture or economy, as *Hansmann & Kraakman* point out. But terming the German economy a "labor-oriented model" is apt to miss other important aspects of Corporate Governance. Some of these aspects are the important questions which ask why shareholders invest in structures with concentrated ownership, and why dispersed shareholders, holding 45% of all shares by then, did not resist structures of worker co-determination by democratic devices when they were first enacted.[45]

Remarkably, *Hansmann & Kraakman* state that the present American model would be the most efficient "standard model".[46] This bold assertion gives us a riddle: why should the present American model be the most efficient – the "End of History"-, while its predecessors have not been? Since legislatures strive for "local optima" through the development of complementarities,[47] and the legislatures of advanced countries also have the intellectual and academic capacities to achieve it, why should the present American system be the most efficient for the *whole world*? References to relatively short periods of economic superiority[48] are not persuasive: the fact that the German system was successful in the 1970s, the Japanese in the 1980s, the American in the 1990s, and probably the

[44] Siemens' and DaimlerChrysler's recent agreement with worker representatives on increasing weekly average labor hours from 35 to 40 per week (which was sacrosanct for many years) as a precondition for building new factories in Germany shows that management can pursue shareholder interests, The Economist Online 29 July 2004 (online: <www.economist.com/business/displayStory.cfm?story_id=2967451>).

[45] Co-determination was enacted in 1950 –52. *Appendix A*, relying on data taken from DAI, *Factbook*, *supra* note 28, shows that in these years German households held approximately 45% of all shares in public corporations. This figure has never been reached since. Data of 2001: 14,8% German households, and 13,2% investment funds (which can be considered to reflect household investments, too). This is also true with respect to actions: these were merely filed against the *extension* of codetermination in the 1970s.

[46] Hansman & Kraakman, "The End", *supra* note 7, at 440-443.

[47] Bebchuck & Roe, "A Theory of Path Dependence", *supra* note 13, at 139 et seq., referring to Mark Roe, "Chaos and Evolution in Law and Economics" (1996) Harv. L.R. 109, 641-643; Schmidt & Spindler, "Path dependence and complementarity, *supra* note 13, at 114, 117 et seq.

[48] Hansman & Kraakman, "The End", *supra* note 7, at 449 et seq.; also, for example, though much more cautious, Romano, "A cautionary Note", *supra* note 7, 2023 et seq., and *The Genius* (1993), at 128 et seq.

Chinese system will be successful in the 2000s, does not establish bullet-proof evidence for the efficiency of *Corporate Governance* systems, but for the periodical supremacy of overall economic conditions. To the same extent that current Chinese enticement of international investment (which is probably due to advantageous labor prices and a state-directed monetary policy) does not necessarily prove that American-style *Corporate Governance* is inherently flawed, American-style Corporate Governance was not necessarily superior to Japanese and German-style Corporate Governance in the 1990s, and so on.[49]

Given that the ability of convergence analysis in predicting future development is conditioned upon a felicitous categorization of present Corporate Governance systems, one can reasonably assume that the above shortcomings in categorizing Corporate Governance models have impacted the quality of predictions based on traditional categorizations. Though, as indicated above, some leeway is inherent in every categorization, a more accurate distinguishing criterion regarding shareholder rights is likely to result in a more sound and stable premise from which to predict future events.

II. Thesis

1. Proposition

A new categorization does not need to reinvent the wheel. Rather, it may draw on three key findings of comparative Corporate Governance analysis in asserting itself.

First, **concentrated ownership** has traditionally been higher in Germany than in the United States. These large shareholders are presumed to control management, which might result in greater management efficiency, but which also increases the danger of minority

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[49] In particular, in the case of Germany, three other reasons than Corporate Governance resulted in a weaker overall position: first, the high government debt load caused by the re-unification of Germany, reducing Government's freedom in entering into a tax-competition; second, insufficient reforms of the labor laws, the pension system, and the health care system in the eighties, which under German Law increases the costs of labor for the employer; third, insufficient financing for entrepreneurs and legal restraints to biotech-innovation, which together prevented the development of a "young" high-tech industry.

shareholder exploitation.[50] From an American perspective, this division of functions provokes an inquiry into why a controlling shareholder would ever refrain from taking over all shares, and why minority shareholders would invest in firms, knowing that they might be deceived by the controlling owner. The logical explanation may be derived from the legislatures' aforementioned tendency to strive for local optima through complementarities:[51] in advanced corporate laws, the consequence of higher concentrated ownership will not be higher exploitation of minorities by majorities, but some kind of minority protection legislation. If protective legislation (or complementarities) guarantees minority shareholders a comfortable existence in a majority controlled firm, minority shareholders will appreciate that they can free-ride on the majority's monitoring expenses.[52]

Second, there is evidence for (formerly) underdeveloped **external capital market laws and institutions** in Germany and France, as compared to the United States and the United Kingdom.[53] Consequently, the market prices in Germany are less likely to reflect management's achievements, and are thus less likely to be effective control devices. Additionally, the network structure between companies presumes that there is a relatively lower level of competitive pressure from the product markets.

Third, although they do not constitute the majority of firms, competitors with dispersed shareholders have also existed in countries associated with less well-developed capital markets.[54] Given that managers are subject to a permanent conflict of interest,[55] if market

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[50] Bebchuck & Roe, "A Theory of Path Dependence", *supra* note 13, at 133-134; Roe, "Corporate Law's Limits", *supra* note 9, 239 et seq., and *Political Determinants* (2003), at 169 et seq.; Andrei Shleifer & Robert W. Vishny, "Large Shareholders and Corporate Control" (1986) J. Pol. Econ. 94, 461 [Shleifer & Vishny, "Large Shareholders"], at 465; Jeremy C. Stein, "Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior" (1989) Q.J.Econ. 104, 655.

[51] Supra, B.I.3.

[52] This observation is consistent with *Roe*'s data, showing comparable degrees of minority protection, despite an apparent lack of Anglo-American-style devices for shareholder protection in Germany and the United Kingdom, and in Sweden and the United States, see Roe, *Political Determinants* (2003), at 189; Ronald J. Gilson, "Complicating the Controlling Shareholder Taxonomy" (Working Paper, March 2003), online: <www.uni-bocconi.it/doc_mime_view.php?doc_id=24692&doc_seg_id=1> [Gilson, "Complicating"], at III. (distinguishing between efficient and inefficient controlling shareholders); the American position analyse Ronald J. Gilson & Jeffrey N. Gordon, "Controlling Controlling Shareholders" (2003) U. Penn. L. Rev. 785 [Gilson & Gordon, Controlling Controlling Shareholders"].

[53] E.g. Coffee, "The Rise", *supra* note 10, at 45 et seq.; Roe, *Strong Managers, Weak Owners* (2004), at 147 et seq.

[54] For example, the German Continental AG.

forces fail to provide control, how could systems with less well-developed market institutions exist, and – in the case of Germany – become a symbol of economic success in the 1970s? Furthermore, since the number of voting shareholders is particularly high in widely held firms, governments can hardly afford scandals in these companies. It is thus logical to suggest that **complementarities to market control** exist.

In light of these three considerations, this paper puts forth that, while the foundation of the French and German system is an **Explicit System of corporate control, an Implicit System of corporate control** prevails in the Anglo-American countries. The Explicit System of corporate control is based on direct influence of present shareholders - majority shareholders through board control, and minority shareholders by providing monitoring functions through shareholder meetings. In contrast, the Implicit System of corporate control is predicated on the efficiency of the capital, product and labor markets.

Three characteristics mark this Implicit System:

(1) Implicit corporate control requires **action beyond** the circumscribed enclave of **present shareholders** and proxies immediately instructed by them. For example, capital market pricing requires activity of present *and* future shareholders. If there were either no present shareholders selling, or no future shareholders buying, a price could not be set.[56] Thus, the exit right of shareholders over capital markets is an implicit device.

(2) The Implicit System does **not** require **direct contact between shareholders and the company**. Rather, if shareholders influence managers, they will do it indirectly,

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[55] Adam Smith, *The Wealth of Nations* [1776], Cannon Edition (New York: Modern Library, 1937), p. 700: "Like the stewards of a rich man, [directors] are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company." [as quoted as Introduction to Jensen & Meckling, "Theory of the Firm", *supra* note 34. For further "agency theory" literature see Eugene Fama, "Agency Problems and the Theory of the Firm" (1980) J. Pol. Econ. 88, 288 [Fama, "Agency Problems"]; Eugene Fama & Michael C. Jensen, "Separation of Ownership and Control" (1983) J.L. & Econ. 26, 301.

[56] Financial Intermediaries merely balance a short-term deficiency of sell / buy orders in a stock.

without contacting the firm, talking to management, or otherwise trying to influence its behavior. Voice is an explicit, rather than an implicit, device.

(3) In the Implicit System, **shares** are **commercialized**, and can be wholly replaced by monetary compensation. In contrast, an Explicit System relies on the assumption that shares represent not only monetary value, but also – positively speaking – possibilities, or – negatively speaking – a responsibility to influence managers.

Thus, while both control systems are based on shareholder decisions and shareholder primacy, the degree of directorial deference that corporate law provides varies significantly. Corporate law in Explicit Systems presumes that directors and shareholders share the power in the corporation. In contrast, corporate law in Implicit Systems allots ultimate power to directors, while explicit shareholder rights are considered to be a side issue. This is due to the presumption that direct shareholder influence is merely part of a "rich array of constraints on directors that also includes markets, private ordering and norms."[57]

The above proposition challenges the orthodox American explanation for why Continental Europe lacks developed capital markets, which is that Continental jurisdictions have failed in providing adequate protection to minority stockholders from expropriation either by management or by majority owners and, thus, strong securities markets could not develop.[58] My theory assumes that commentators have overlooked the key complementarity to implicit shareholder control through security markets, which is the explicit influence

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[57] Robert B. Thompson & Randall S. Thomas, "The Public and Private Faces of Derivative Lawsuits" (2004) Vand. L.R. 57 (forthcoming), (from SSRN), at 6 [Thompson & Thomas, "The Public and Private Faces"].

[58] See, for example, *supra* note 7, and Black, "The Legal and Institutional Preconditions", *supra* note 14, at 804; John C. Coffee, Jr., "Privatization and Corporate Governance: The Lessons from Securities Market Failure (1999), 25 J. Corp. Law 1; "Do Norms Matter--A Cross-Country Evaluation" (2000-2001) 149 U. Pa. L.R. 2151; "Future As History", *supra* note 7, at 644; "The Rise", *supra* note 10, at 59 et seq.; Charles P. Himmelberg, R. Glenn Hubbard & Insessa Love, "Investor Protection, Ownership, and the Cost of Capital" (2000) Col. Bus. Sch. WP (Feb 2000), (from SSRN); La Porta, Lopez-De-Silanes, Shleifer, "Corporate Ownership", *supra* note 17, at 511; together with Robert Vishny, "Legal Determinants of External Finance", (1997) J. Fin. 52, 1131; "Law and Finance " (1998) J. Pol. Econ. 106, 1113; "Investor Protection and Corporate Governance" (2000) J. Fin. Econ. 58, 3; Andrei Shleifer & Robert W. Vishny, "A Survey of Corporate Governance", (1997) 52 J. Fin. 737, at 750 (though more cautious with respect to Germany). Mark Roe, *Strong Managers, Weak Owners* (1994) provides a different explanation, holding that American populist politics are responsible for dispersed ownership. For further counter-positions, see supra, note 52.

exerted by minority shareholders. This study holds that this is at least true with respect to Continental Europe's largest economies, namely France and Germany.

If there is significant evidence to support this proposition, its scope might exceed the countries on which the study focuses. It might provide some interesting insights into the functionality of systems in which companies with concentrated ownership and dispersed minority shareholding coexist without significant minority expropriation.[59]

2. Elements of Implicit and Explicit Systems

How could corporate law protect minority shareholders from expropriation? One would assume that minority shareholders can hardly influence managers through voice: either, a controlling shareholder decrees which decision should result from voting; or, in the absence of a controlling owner, adverse economic incentives would prevent minority shareholders from co-ordinating and exercising voice.[60] According to this logic, the only efficient minority right is the right to sell, which implicates an implicit, rather than an explicit influence on managers.

From today's point of view, however, this logic is contestable, even beyond the point achieved by American corporate lawyers in their encouragement of institutional investor activism.[61] In line with *Hirschmann*'s attack on economic strongholds regarding the incapability of voice,[62] the challenge is twofold. The first strain of argument questions the efficiency of implicit control. Both the Tech Bubble of the years 1998-2000, and the bust period following, have shown that market prices can dissolve from the fundamental data of the underlying business. If market prices do not reflect the business fundamentals, market control becomes partially inefficient.[63] Direct shareholder influence may then substitute for

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[59] Gilson & Gordon, "Controlling Controlling Shareholders", *supra* note 52, analyse this systemic issue for the Delaware Corporate Law in the United States.

[60] Supra, note 4.

[61] Supra, notes 2 and 3.

[62] Hirschmann, *Exit, Voice and Loyalty* (1970), at 4.

[63] See Ronald J. Gilson & Reinier Kraakman, "The Mechanisms of Market Efficiency" (1984) Va. L.R. 70, 549 [Gilson & Kraakman, "MEMO"]; reviewed in a recent set of articles in the J. of Corp. Law, see Ronald J. Gilson & Reinier Kraakman, "The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias" (2003) J. Corp. L. 28, 715 [Gilson & Kraakman, "MEMO – the Hindsight Bias"]; Howell E.

capital market efficiency.[64] Additionally, shareholders might have invested when stock prices were high. While low stock prices include the “option value” of high stock prices, selling at low prices would also amount to a sale of this option: staying in the firm might be profitable in the long run. Explicit shareholder influence might contribute to this profit. The market cannot evaluate the turn-around influence of shareholders, since the “option value” of minority shareholder action, as long as it is not imminent, is beyond the scope of market information and market scrutiny. Finally, medium to large shareholders, on the one hand, do not fully control the investment. On the other hand, sales of medium to large stakes (>0.5%) are rarely possible in the capital markets without price discounts.[65] From the specific perspective of medium to large shareholders, capital markets are inefficient. Explicit shareholder influence might provide a partial solution to this dilemma.

The second strain of arguments focuses on the ongoing improvement and refinement of corporate law by the legislatures. Since *Hirschmann*’s analysis, legal systems have developed a plethora of different mechanisms of exit and voice as archetypes of shareholder rights. A theory holding that explicit shareholder influence may substitute for indirect influence through market pressures thus requires an allocation of shareholder rights to either the Explicit or the Implicit System of corporate control.

Jackson, “To What Extent Should Individual Investors Rely on the Mechanisms of Market Efficiency: A Preliminary Investigation of Dispersion in Investor Returns” (2003) J. Corp. L. 28, 671; Lynn A Stout, “The Mechanisms of Market Inefficiency: An Introduction to the New Finance” (2003) J. Corp. L. 28, 635. See, furthermore, Joseph E. Stiglitz, “Symposium on Bubbles” (1990) J. Econ. Persp. 4, 13-18, including Peter Garber, “Famous First Bubbles” (pp. 35-54); Robert P. Flood & Robert J. Hodrick, “On Testing for Speculative Bubbles” (pp. 85-101); Robert J. Shiller “Speculative Prices and Popular Models” (pp. 55-65); Andrei Shleifer & Lawrence H. Summers, “The Noise Trader Approach to Finance” (pp. 19-33) [Shleifer & Summers, “Noise Trader Approach”]; Eugene N. White, “The Stock Market Boom and Crash of 1929 Revisited” (pp. 67-83), and Andrei Shleifer, *Inefficient Markets* (2000).

[64] With respect to the efficient capital market hypothesis, see Eugene F. Fama, “The behavior of stock market prices” (1965) J. of Business 38, 34; “Efficient Capital Markets: A review of theory and empirical work” (1970) J. of Finance 25, 383; “Efficient capital markets: II” (1991) J. of Finance 46, 1575; Michael C. Jensen, “Some Anomalous Evidence Regarding Market Efficiency” (1978) J. Fin. Econ. 95, 95; Brealey & Myers, *Principles of Corporate Finance* (2000), at 13.2, pp. 354 –376; Ross, Westerfield, Jaffe, *Corporate Finance* (1999), at 13.2, pp. 319 et seq.

[65] Price-Pressure Effects were first denied by M. Scholes, “The Market for Securities: Substitution versus Price Pressure and the Effects of Information on Share Prices (1972) J. of Business 45, 179. Later studies, e.g. D. Keim & A. Madhavan, “The Upstairs Market for Block Transactions: Analysis and Measurement of Price Effects” (1996) Review of Financial Studies 9, 1 (citing further studies at 1-2), at 21, however, demonstrate a rebound effect caused by distressed sale of approximately 1,86% for large block trades. There are a few exceptions with respect to small insider sales, see James Scott and Peter Xu, "Some Insider Sales Are Positive Signals", (2004) Financial Analysts Journal 60, 44 et seq.

Eight mechanisms[66] operate to induce corporate managers to fulfil their duties: (1) voting, (2) public monitoring, (3) takeover bids, (4) the appraisal remedy, (5) shareholder suits, (6) shareholder monitoring through shareholder meetings, (7) minority shareholder protection from abuse of majority shareholders, (8) finally the ongoing supervision of the managers by the supervisory board or the board of directors.

The fundamental elements of explicit shareholder influence are voting and shareholder monitoring through shareholder meetings – for example, by initiating meetings, co-ordinating behavior, and exercising information rights both prior to and during meetings. In the traditional understanding of American corporate law, monitoring by private or public watchdogs aims to ensure a steady flow of topical, correct and material information, which will be evaluated by market institutions. It is not primarily designed to initiate direct shareholder action. Instead, shareholders should be protected by guaranteeing that stock prices accurately reflect the value of the firm at all times.[67] Thus, public monitoring facilitates implicit shareholder influence.

Assigning takeover bids, the appraisal remedy, shareholder suits, minority shareholder protection, and management control through a board to a particular category requires more consideration.

Takeover bids are the hinge between the Implicit and the Explicit System, since they transform market driven control in widely held companies into shareholder driven, direct control of majority stockholders. While the current shareholder's exit-decision after a takeover bid is a reaction to market forces, the bidder's intent to own a majority stake in a

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[66] Literature on this issue is not uniform. For example, Klein & Coffee, *Business Organization and Finance* (2002), at 178, merely mention (1) to (5); Cunningham, "Commonalities and Prescriptions", *supra* note 12, at 1171 et seq. considers (1) through (6), and in addition executive compensation, capital allocation and dividend policy.

[67] Brandeis, *Other People`s Money* (1914), at 92 cites an older proverb by stating "Sunlight is said the best of all disinfectants," and augments it with the sentence "(…) and electric light (is) the most effective policeman." The discovery of preventive effects of disclosure, however, is much older. See, e.g. in 1837 (!) Hansemann, *Railroads* (1837), at p. 104: „Zu den Mitteln, die Verwaltung einer großen Aktien-Gesellschaft rechtlich und tüchtig zu erhalten, gehört, daß sie in gewissem Maße der Oeffentlichkeit anheim gegeben werde. Es ist dies eine wirksame Kontrole." (Translation: "One of the devices through which one will achieve legally and economically proper conduct is that a corporation should be subject to public scrutiny. This will result in effective control.") The disclosure philosophy was adopted at the peak of the great depression, see Seligman, *Transformation of Wall Street* (2003), at 39 et seq.

business is driven by the fact that a majority stake carries direct control rights. Hence, depending on which perspective one takes, the takeover bid could either belong to the Explicit or the Implicit System. Given the definition of explicit and implicit from the perspective of the present rather than the to-be shareholder,[68] takeover bids are regarded as part of the Implicit System. The following consideration supports this supposition. The market evaluates shares as combinations of expected future cash flow and control.[69] Since a takeover bid does not change the cash flow prospects of the firm, as it actually exists, the rise in stock-prices, which occurs whenever there is a takeover bid, is likely to reflect the price for control.[70] If a *potential* controlling shareholder separately evaluates control over that specific firm and announces her intent to the public, a *market for control* begins to develop. Takeover bids are thus part of a market-driven, i.e. Implicit System.[71]

The **appraisal remedy** entitles shareholders to have a court determine and award the "fair value" of their shares in specific circumstances, esp. when the majority shareholder intends to "squeeze out" the minority in the aftermath of a merger or consolidation. While only mergers merit appraisal rights in Delaware,[72] most American states, the United Kingdom and Canada also provide appraisal rights for some asset sales, fundamental changes in the business of the corporation, and some charter amendments that materially affect the rights of dissenting shareholders, such as altering preferential rights, limiting voting rights, or establishing cumulative voting.[73] In contrast, German law has traditionally refrained from utilizing appraisal rights as protection devices of minorities.[74] In France, minority

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[68] *Supra*, B.II.1.

[69] See on merger gains and costs Brealey & Myers, *Principles of Corporate Finance* (2000), at 950 et seq.

[70] See, for example, the international statistics for the control block(!) premium at Roe, "Corporate Law's Limits", *supra* note 9, at 253 et seq.; there might also exist other reasons for the merger gain, esp. asymmetric information signals in a Management Buy Out (MBO).

[71] The fact that, until 2002, Germany did not offer a legal regime for takeover bids is likely to have significantly influenced the development of inner-corporate control mechanisms.

[72] S. 262 *Delaware General Corporate Law* [*Del GCL*].

[73] Ss. 13.01 through 13.31 of the MBCA (2002) grant appraisal rights in the case of mergers, sales of substantially all assets, and amendments of the articles of organization that adversely affect shareholder rights of certain sorts (preferential rights, redemption right, preemptive rights, or voting rights). See also ss. 430A, B of the British *Company Act of 1985*, and s. 184 *CBCA*. Further, see Jeff Macintosh, "The Shareholders' Appraisal Right in Canada: A Critical Reappraisal" (1988) Can.-U.S. L.J. 13, 299.

[74] German corporate law merely assigns appraisal rights in ss. 305, 306 GSCA (*Konzernrecht*, see *infra*) and ss. 29, 34 *Umwandlungsgesetz* of 1994. Furthermore, the Federal Supreme Court in its spectacular

shareholders only have statutory appraisal rights when a majority holds 95% of the shares. Whether fundamental changes result in an appraisal right under French law, is unclear.[75] The appraisal remedy constitutes an implicit tool of corporate control, for two reasons: first, the appraisal remedy is a consequence of a takeover market, which has been found to influence managerial behavior implicitly, and second, the appraisal remedy merely protects the minority shareholders' *exit* rights, but not their *voice* rights, once a shareholder has assembled controlling influence.

Minority shareholding may also result from events other than mergers and consolidations.[76] In this case, devices other than those securing the right to sell at adequate terms may provide minority protection. American case law has decided the outcome of minority and majority conflicts either by applying principles developed in the context of closely held corporations to the few cases regarding public corporations,[77] or these cases were held to be subject to the business judgement rule.[78] Despite the fact that managers are influenced by majority shareholders, the business judgment rule protects managers from liability unless the manager's conduct is so blatant a circumvention of appraisal rights that courts applied the *de facto merger doctrine*, which eventually also resulted in appraisal rights.[79] In short, American law provides either for no specific protection, or for the right to sell, which is an implicit mechanism.

In contrast, German corporate law consists of a complicated system of provisions that are designed to protect minorities from expropriation by the majority, while allowing

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Macrotron-decision (BGHZ 153, 57) has held that a majority shareholder might be mandated to buy the outstanding minority shares, for details see *infra*, C.III.2.a). Finally, one might understand the mandatory bid that follows the acquisition of control (30% of the shares) under the new takeover law of 2000 as indirect appraisal right.

[75] See Siems, *Convergence* (2004), at 237.

[76] For example, secondary offerings initiated by former large shareholders, or from tender offers that did not achieve, or that were not aimed at achieving tenders to the extent necessary for amalgamation mergers in the aftermath of tender offers.

[77] With respect to corporate opportunities, see Clark, *Corporate Law*, at § 7.8, pp. 256, referring to pp. 239-240.

[78] *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971).

[79] *Marks v. Minnesota Mining and Manufacturing Co.*, 232 Cal. Rptr. 594 (Cal. Ct. App. 1986); *Keller v. Clark Euqipment Co.*, 715 F.2d 1280 (8th Cir. 1983); *Pratt v. Ballman.Cummungs Furniture Co.*, 549 S.W.2d 270 (Ark. 1977); *Applestein v. United Board and Carton Co.*, 159 A.2d 146 (N.J. Super. Ct. Ch. Div.), aff'd, 161 A.2d 474 (N.J. 1960); *Farris v. Glen Alden Corporation*, 143 A.2d 25 (Pa. 1958).

concentrated ownership to remain a viable alternative to dispersed ownership [*Konzernrecht*].[80] Controlling shareholders have the choice between formally entering into a control agreement with the minority shareholders, or taking control of the firm without an agreement. If the majority decides in favor of an agreement, it needs to offer to the minority adequate compensation for the loss of economic chances and potential expropriation of the firm's assets by the majority. This offer must induce a dividend guarantee and an offer to buy the outstanding shares. In advance of the separate meeting of minority owners who must also decide upon the agreement, public accountants will review and report about the mandatory compensation, which may also be subject to judicial review ex post.[81] After the agreement has been entered into, the majority owner is relieved from various burdensome formalities in directing the firm, while the control agreement essentially transforms the minority's investment into a debt-like security issued by the majority shareholder, though the corporation still needs to hold annual meetings. If the majority owner decides against entering into an agreement, it must not influence the dependent firm to its advantage without immediate financial compensation to the firm. Some of the specific means of protection include mandatory disclosure by the board of management, and a review of the management's conduct regarding corporate opportunities and asset diversion by public accountants, as well as liability in cases of misconduct.[82]

The difference between German *Konzernrecht* and American law lies primarily in the American emphasis on the *exit*-right that solves majority-minority conflicts through an outright sell-out. If minority shareholders do not sell, American law provides for no other protection but shareholder suits based on a breach of fiduciary duties.[83] Consequently, in order to prevent minorities from suing, American acquirers generally intend to gain total

[80] The literal translation of *Konzernrecht* is "group law." It refers to the fact that controlling shareholders can constitute a "group" of firms under their guidance. It is codified in ss. 15 – 18, and 293 et seq. GSCA.

[81] Ss. 293 – 310 GSCA.

[82] SS. 311 –312 GSCA.

[83] In the case of a sale of (substantially) all the assets, s. 271 (a) Del GCL expropriates even the formal right to vote itself by stating that all of a corporation's property and assets, including its goodwill and its corporate franchises, when and as authorized by a resolution adopted by the *holders of a majority* of the outstanding stock of the corporation entitled to vote thereon. Rights to sue for breach of fiduciary duties, however, still exist, see for details Gilson & Gordon, "Controlling Controlling Shareholders", *supra* note 52, at 791 et seq.

control over the firm, which American corporate law facilitates by devices enabling the acquirer to expropriate minorities if they are properly financially compensated.[84] Equivalent provisions did not exist in Germany until 2002: since German law had originally considered control to be an element of property distinct from financial value,[85] financial compensation was regarded as insufficient for counter-balancing the shareholders' loss in property. Thus, *Konzernrecht* was developed as a functional substitute for takeover regulation. *Konzernrecht* is, hence, the opposite solution to the same problem addressed by takeover regulation. While American law structured and secured the path of Exit, German law ensures minority influence through Voice in a situation where Voice has practically become irrelevant. Thus, *Konzernrecht* belongs to the Explicit System.

The categorization of shareholder suits and day-to-day supervision of management by a supervisory board or a board of directors requires differentiation.

One could suggest that **shareholder suits** are part of the explicit model since they require direct contact between suing shareholders and the company, rather than the use of intermediaries, as one would expect in the market model. However, such an argument would be flawed: from a rational actor model shareholder suits are unlikely to occur, due to collective action problems and free rider phenomena.[86] Capital market, corporate, and civil laws mitigate these problems by providing for solutions[87] that eventually result in lawyer activism, rather than shareholder activism.[88] If shareholder suits are in fact initiated by the entrepreneurial drive of lawyers – hence intermediaries -, rather than the control interests of shareholders on behalf of the corporation, one can reasonably regard shareholder suits as part of the Implicit System. Such a categorization, however, would neglect the fact that

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[84] E.g. American law enables freeze-outs through tender offers, and through amalgamation-mergers, see in detail for Delaware Corporate Law Gilson & Gordon, "Controlling Controlling Shareholders", *supra* note 52.

[85] For the main part, this was due to constitutional reasons, an emphasize of direct control, and illiquid capital markets, see *infra* B.III.2.a) & C.III.2.a).

[86] Edward M. Iacobucci & Kevin E. Davis, "Reconciling Derivative Claims and the Oppression Remedy" (2000) S.C.L.R. 12 (2d), 87, at 114 et seq.

[87] By allowing class-actions, advantageous success related contracts with lawyers, etc. For details, see citations in next note.

[88] Roberta Romano, "The Shareholder Suit: Litigation without Foundation?" (1991) J.L. Econ. & Org. 7, 55, at 84 (1991) [Romano, "The Shareholder Suit"]; Robert B. Thompson & Randall S. Thomas, "The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions", (2004) Vand. L.R. 57, forthcoming, (from SSRN) [Thompson & Thomas, "Acquisition-Oriented Class Actions"].

shareholder suits require a proxy of attorney from a *present* shareholder, while public monitoring and takeover bids require interplay between present *and* future shareholders.

In light of these considerations, a differentiation with respect to the intention of the shareholder bringing the suit guides the way. Some shareholder suits, esp. securities fraud and civil class actions, aim at cash-payments, while other suits are intended to have an immediate impact on firm behavior by challenging shareholder meeting decisions, or requiring a temporary or permanent revision of specific kinds of conduct.[89] While the latter constitutes direct shareholder control – an enforced variant of voice -, the former establishes a variant of the “appraisal remedy“: the shareholder will receive payment for the reduced value of all or a part of her shares as a consequence of directorial misconduct. By paying compensation, the firm or a controlling shareholder essentially buys a part of the share (value) from the present shareholder. Like a sale, monetary compensation substitutes for the share itself. Thus, shareholder suits aiming at judgements directly correcting corporate conduct are part of the Explicit System, while suits initiated to result in financial compensation are part of the Implicit System.

The **ongoing supervision of management by a supervisory board or the board of directors** carries, at first glance, characteristics of explicit shareholder influence: assuming that the board members should supervise the managers’ day-to-day work on behalf of shareholders – metaphorically speaking as proxies of shareholders -, board members would explicitly influence managers through direct contact. A second look reveals that board members neither economically nor legally depend on shareholders, since they receive their payment from the firm (which is represented by directors themselves), rather than directly from the shareholders,[90] and shareholders cannot generally bind directors through their decisions. Consequently, shareholders have, in fact, no direct influence on board members’ conduct, which renders a categorization as explicit inaccurate. However, at the level of who

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[89] See *infra*, B.III.2.a).

[90] This is the American model. Pursuant to s. 85, 86 GSCA, the supervisory board determines the salary of the board of management. The salary of the supervisory board is determined in the Articles of Associations or by a shareholder meeting decision, see s. 113 (1) GSCA. Though both require shareholders’ consent, supervisory board members do not practically depend on their gratuity, since supervisory board membership in Germany tends to be a side job of successful manager-retirees.

pre-selects candidates for election by shareholders, the distinction between Explicit and Implicit Systems may be applied.[91]

3. Caveats

The categorization of shareholder rights as either Implicit or Explicit devices of corporate control requires two caveats.

First: the categorization combines factual and legal factors and, as such, transcends a merely legal differentiation. Categorization thus also becomes a matter of degree. In Continental Europe, as in Anglo-America exist elements of both the Explicit and the Implicit System. For example, though voting rights exist, American Corporate Governance theory and the legislature have long denied their relevance, preferring corporate control through market reactions. The opposite was true in Germany, both due to the under-development of capital markets and the oligopolistic behavior of the corporate aristocracy, which I have referred to as "Germany Inc."[92]

In stating that categorization becomes a matter of degree, one might argue that the author's criteria exhibit equivalent weaknesses to the traditional - and herein criticized - categorizations. However, the categorization posited herein regards a narrow scope – shareholder rights – and inherently relies on specific corporate law devices, while the other categorizations draw on general cultural (civil vs. common law), economical (market vs. bank-centered) or political (liberal vs. interventionist policy) factors whose relationship to corporate law is not always clear. While generality reduces the risk of rebuttal of the categorization, it also reduces precision pertaining to its results. With respect to shareholder rights, the categorization presented herein is, despite its flexibility, likely to achieve more accurate results than its competitors.

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[91] While in Anglo-America market pressures might influence the selection of candidates, which the board suggests for election by shareholders, in Continental Europe concentrated ownership facilitates direct shareholder influence on the selection of candidates. Since the study focuses on shareholder rights, rather than the board of directors, the problems in categorizing the board should not concern for the further examination.

[92] See *supra* B.I.2.

Second: the distinction between implicit and explicit is not doctrinaire selective. Some rights can be interpreted as part of the Implicit, as well as the Explicit System of corporate control. This is particularly true with respect to information rights and mandatory disclosure under securities or corporate law, since information is the pre-condition to both the buy/sell decision, and the exercise of voting rights.[93] Hence, with respect to the above characterization, one can understand the effect of information rights as "**hybrid**." This does not exclude the possibility that systemic differences exist with respect to the specific characteristics of disclosure, which might signal whether information is primarily designed for the exercise of voting rights or market control.

4. Provisional Result

This section posited a new categorization between Explicit and Implicit Systems of corporate control. Both systems rely on shareholder influence, and are thus shareholder primacy models. However, the means of shareholder influence differ: voting, shareholder monitoring through shareholder meetings, *Konzernrecht*, and shareholder suits aimed at the revision of corporate conduct belong to the Explicit System. In contrast, monitoring by private or public watchdogs, takeover regulation, the appraisal remedy, and shareholder suits aimed at financial compensation are part of the Implicit System.

Two caveats frame this categorization. First, "pure" systems do not exist. In some respects, the categorization is a matter of degree. Second, information rights can facilitate both implicit and explicit shareholder influence, and are to be considered as hybrid, while their specific design might hint at either an Implicit or an Explicit System.

[93] Zetzsche, *Shareholder Information* (2004), § 12 III, at 289 et seq.

III. Evidence

Historical, statutory, and empirical evidence support the categorization, as follows.

1. An Ethical Theory of Corporate Governance History

The present Anglo-American system of corporate control is said to be a random result of market forces, the strong influence of which resulted from a **weak state**, and undefined principles in the state's economic policy until the 1930s.[94] In contrast, in Continental Europe, **strong states with a tendency to interfere with market forces** were established.[95] The events resulting in these two divergent systems must be analysed in order to understand what predominant factors catalyzed the development of the current Corporate Governance structures. Though values other than religious principles are likely to prevail in today's business world, this paper argues that religious foundations provide a sound explanation for the *developmental path* of either the Implicit or the Explicit System of corporate control.

Historians recognize three pillars of Western (European) culture. First: the ideal of free and rational thought, a development which is owed to the Ancient Greeks. Second: a neutral state administration designed to pursue the goal of its citizens' "good life," rather than the individual interests of its kings, queens or oligarchs. This ideal was first developed in the Roman res publica, and analysed in Ciceros's *de legibus*. Third: Christianity.[96] The impact of rational thinking of policy makers and corporate stakeholders on corporate law development[97] and the impact of an efficient administration on corporate law has been

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[94] Coffee, "The Rise", *supra* note 10, at 24 et seq. Later, however, the American legislature interfered with a free development of banking structures, see Roe, *Strong Managers, Weak Owners* (1994), at 26 et seq.

[95] Id.

[96] Bowle, *The Unity of European History* (1970), at p. 85.

[97] This is essentially what historical corporate law scholarship is about; see, in particular, Margaret M. Blair "Reforming Corporate Governance: What History Can Teach Us" (2003) Georgetown Law and Economics Research Paper No. 485663 (from SSRN), at 9 et seq. [Blair, "Reforming Corporate Governance"]; Margaret M. Blair, "Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century", (2003) UCLA Law Review 51, 387, at 423 et seq.; "Why Markets Chose the Corporate Form: Entity Status and the Separation of Asset Ownership from Control" (2003) Georgetown Law and Economics Research Paper No. 429300 (from SSRN), at 4 et seq.; Coffee, "The Rise", *supra* note 10; Coffee, "Future As History", *supra* note 7.

sufficiently considered in the current body of literature.[98] Despite *Branson*'s thoughtful comprehension,[99] modern corporate law scholarship[100] has neglected to recognize Christianity as the third cultural root of the Western hemisphere.[101] This is particularly unfortunate since "broad similarities are obvious in terms of the relative development and maturity of legal institutions across Europe and the United States."[102] These institutions impact the application or enforcement of, law and thus deserve more attention.

a) Christian Ethics and Corporate Law

The Christian belief is rooted in the (Jewish-based) Pauline doctrine, combining the ideas of human guilt, asceticism, punishment, election, and – finally – redemption.[103] However, with respect to their attitude towards economic activity, the major Christian strands of belief vary significantly. From an economic point of view, the most important difference between Catholicism and Protestantism is *Martin Luther*'s ethical qualification of a believer's occupation. While from a Catholic's point of view one's occupation is ethically neutral, Protestants understand the occupation as a "calling", and associate the highest value with the fulfilment of one's day-to-day duties. Regardless of whether one works as

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[98] See, for example, the work by James M. Landis (instructive McCraw, *Prophets of Regulation* (1984), 153 et seq.), and Seligman & Loss, *Securities Regulation* (1992).

[99] Douglas M. Branson, "Teaching Comparative Corporate Governance: The Significance of "Soft Law" and International Institutions", (2000) Ga. L.R. 34, 669, at 691: "The teaching of years of comparative study is that it is the culture beneath the law and behind economic and other institutions that is as or more important than law itself, legal structures, and good governance practices."

[100] Other social scientists, such as Max Weber and Friedrich A. Hayek, and 19th century legal scholarship have recognized the impact of ethics on law, for example, Fick, "History of Corporations" (1862), 1.

[101] This might be due to a misunderstanding of the term rationality, which sees religion and culture as its anti-thesis. Religion and culture is then merely a historical pre-condition to the dominance of rationality. However, considering ethical roots such as Christianity provides better help in understanding the present state of the law than applying principles of rationality to periods in which rationality did not supersede other influences on rule makers, such as ethics (if it ever does.) Max Weber, *Protestant Ethics* (1920), I.2., at [62], demonstrated with respect to capitalistic beliefs that a rationalistic approach cannot explain, why policy makers pursue some aspects of a generally accepted value, while others are not pursued. Consequently, an ethical analysis of corporate law development might provide insights into the *irrational elements* of policy making.

[102] Coffee, "Future As History", *supra* note 7, at 645.

[103] Bowle, *The Unity of European History* (1970), at p. 79-80.

master or servant, all religiously acceptable jobs have the same positive ethical qualification, while being lazy or wasting time, in general, are considered to be sins.[104]

While this religious duty might explain greater economic activity in Protestant, as compared to Catholic, societies,[105] it cannot explain the different economic development among Protestant societies, such as between parts of Germany and Scandinavia, on the one hand, and parts of Switzerland, the Netherlands, the United Kingdom and the United States, on the other hand. A closer look at the strands of Protestantism that prevail in these countries reveals that **Lutheran-Protestantism** prevailed in the former, while **Calvinistic-Puritanism** dominated the culture of the latter.[106]

While both convictions accept the idea of a calling, they qualify the pursuit of profit differently. Being traditionalistic and dogmatically very similar to Catholicism,[107] *Martin Luther* holds that, since the pursuit of profit can only be achieved at others' costs, it is sinful and should thus be left to the heathens. A believer should concentrate on her God-given occupation, which she must not challenge or change by, for example, improving the tools of production, etc.[108] Calvinistic-Puritanism, though far from being *focused* on financial affairs, took a much more world-directed stance. Based on the doctrine of predestination, the distribution of any characteristic, personal good, or idea, is assumed to be God-given.[109] Consequently, neither wealth, nor its maximization through the pursuit of profit-maximizing opportunities or inventions, is assumed to be sinful. Though riches for the believer's fleshy ends must not ultimately be intended, profitability of the occupation will

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[104] Max Weber, *Protestant Ethics* (1920), I.3., at [64-71] and [169-175]

[105] The Roman-Catholic belief was predominant throughout the 19th century in all of south, and most of west Continental Europe, besides the Netherlands, the German parts of Switzerland and the North and East of Germany.

[106] Though in England Calvinism did not become the established religion, Calivinism became influential through a compromise in the Anglican church under which "the bulk of Church property, as well as much preferment" went into lay hands (Bowle, *The Unity of European History* (1970), at 192) – hence, in the hands of the Calvinistic bourgeoisie. In the United States, there is a rich religious diversity. Nevertheless, the WASP elite – White Anglo-Saxon Protestants – long controlled American polity.

[107] And – since this is derived from the Old Testament - also to the Jewish belief, before the Talmud, see Max Weber, *Protestant Ethics* (1920) , at I.3., at [74].

[108] Id., at I.3., at [75-79].

[109] Id., at I.3., at [92-93].

accrue to God's honour[110] - unless it results in laziness, since enjoying one's wealth and refraining from work means denying God his dignity and honour, which results in the foreclosure of one's access to paradise.[111] The true believer thus worships by pursuing her calling. Consequently, in contrast to Lutheran and Catholic societies, wealth maximization by trade or industrial activity is a generally accepted goal in Calvinistic societies.[112] Thus, Calvinistic ethics strongly encouraged the development of market institutions that were not interfered with by the state. The different attitude towards the impact of (capital) markets on society is consistent with the different religious backgrounds of societies.[113]

As a cautionary note, however, one needs to consider that the question of which religion was adopted for society in the aftermath of reformation depended on *which parts* of society *decided upon* the adoption of a belief. In Calvinistic societies, wealthy citizens of a merchant background were influential, while in the rest of Europe feudal structures (still) prevailed. It is thus possible that the choice of religion is merely a proxy for the ruling class itself. Even then, though, the specific religious belief has at least petrified the prevailing attitude of the ruling class at a particular point in time.

b) From Medieval to Modern Times

These ethical differences can be traced through philosophical and political literature.[114] A brief look at three events further untangles the ways in which religion has influenced corporate law development: the diverse fates of colonial undertakings, the policy regarding

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[110] Id., at I.3., at [176-177].

[111] Id., at I.3., at [166-172].

[112] Bowle, *The Unity of European History* (1970), at p. 192. This must not be misunderstood as legalization of exploitation. The impact of "capitalistic" beliefs is balanced by the ideal of charity, which imposed duties on the wealthy to share its wealth with the poor, rather than to forego opportunities on religious grounds, as Martin Luther suggested.

[113] Though one can argue against the proposition of ethical influence that there have been national differences in terms of societal characteristics, as well, Max Weber, *Protestant Ethics* (1920), at [81], argues that such differences did not exist. What is perceived as such today is rooted in the "might of religions."

[114] See, for example, John Locke, John Stuart Mill, as well as Benjamin Franklin, *Necessary hints to those that would be rich*, 1736, and *Advice to a young tradesman* (1748), Works ed. Sparks Vol. II p. 87, against Jean Jaques Rousseau's *Contract Social* (1762), at I. 6. (emphasizing the "*supreme direction of the general will"*), online: < www.constitution.org/jjr/socon.htm >.

speculative bubbles in corporate stocks in the years of 1719/1720, and the regulatory approach to freedom of incorporation in the 19th century.

First: the theory of a pro-business attitude in the Calvinistic belief is consistent with the success of colonial undertakings in the Netherlands and England.[115] While the Dutch and English East-India companies flourished for almost 200 years[116] and laid the foundations of British and Dutch colonial empires, colonial companies from Catholic and Lutheran countries were all but successful. For example, the French East-India company, set up in 1624 and re-named as such in 1664, quickly faltered because French Kings focused on Catholic missionary works, rather than on economic development and trade.[117]

Second: in the first quarter of the 18th century, a frenzy in corporate stocks developed. Starting in France, the *Compagnie des Indes*, magnetizing money from all over the continent, promised to invest in, and economically exploit, the area of New Orleans, which was a French colony in North-America.[118] At about the same time, the English South Sea Corporation, trying to mimic the amazing success of the *Compagnie des Indes*, promised to exploit territories in the South Sea area. When both bubbles eventually burst, the French and English legislatures dealt with the speculation problem in different ways. The French tried to stabilize the precipitating stock prices by prohibiting trade in the stocks by various means.[119] All of these measures were (futile) means of reducing the impact of market forces on investors and preventing them from experiencing financial catastrophe. In contrast, in

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[115] These undertaking were organized in a structure considered to be the first stock corporations.

[116] The former was founded March 20th 1602, received the right of perpetual existence in 1623, and existed until struggles in the aftermath of the French revolution caused its end in 1795. The later dated back to 1613 (Blair, "Reforming Corporate Governance", *supra* note 97, holds it was founded in 1600), was perpetually incorporated in 1654, and was liquidated in 1858.

[117] See, for example, Fick, "History of Corporations" (1862), at 45 (translated): „Rather than building fortresses, the company built Catholic churches; instead of farmers and merchants priests were sent to the colonies. In fact, trade with pagans, living in the new territories, were prohibited. Thus, it did not surprise that the French East-India company … became insolvent in 1684, and creditors as well as shareholders were at the mercy of the majestic exchequer."

[118] The details of the Mississippi-Bubble cannot be given here. The following abstract of events is taken from Fick, "History of Corporations" (1862), at 46 et seq.; Peter Garber, "Famous First Bubbles" (1990) J. Econ. Persp. 4, pp. 35 [Garber, "First Bubbles"], as well as the other articles in Joseph E. Stiglitz, "Symposium on Bubbles" (1990) J. Econ. Persp. 4, see *supra* note 63.

[119] They included hindrance of exchange of stocks in real value assets, such as gold, restrictions of monetary export, as well as a mandatory amalgamation of *Compagnie des Indes* with the partially Crown-owned and financial stabile company *Banque Royal*.

accordance with the idea of predestination, English regulators strictly applied the caveat emptor principle, resulting in spectacular scenes in the London financial district, involving bankruptcy and the suicides of many investors.[120]

Third: Aristocratic state laws had traditionally required an official state act for incorporation [concession system]. Given the enormous amounts of capital needed for industrialization, state bureaucracies faced the impossible task of estimating whether the prospective business was viable, dangerous, or potentially fraudulent, on the basis of papers that entrepreneurs presented when applying for concession. The United Kingdom replaced the concession system in 1844.[121] The early departure from concession to the contractual approach has been held to be an expression of the English sense of personal and economic liberalism,[122] since – despite the prohibition of bearer shares – few restrictions applied. By 1860, most American states, following England's liberal approach, had passed general incorporation statutes.[123] When France (1867) and the Northern German states (1870) eventually receded from incorporation control,[124] it was soon replaced by a strict mandatory scheme, rather than by a reliance on freedom of contract. This is consistent with an ethical bias against the impact of market forces.

c) Continuation in 20th Century Politics

In the 20th century, the constitution of the Federal Republic of Germany from 1949, the political roots of co-determination after World War II, and the refusal to implement the suggestions contained in the Segrè-Report by the French and German governments, are milestones in a chain of events that show the significant impact of ethics on corporate law development.

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[120] The fiscus and the non-invested public, though, benefited from the burst of the bubble proportionally more than in France.

[121] The *Joint Stock Companies Registration, Incorporation and Regulation Act* of 1844 was upgraded in four legislative steps in the years of 1855 through 1858, and resulted in a system that forced business entities to disclose its limited liability by adding a "limited" to its name. See Paul G. Mahoney, "Contract or Concession" (2000) Ga. L.R. 34, 873, 886-892.

[122] Fick, "History of Corporations" (1862), at 55-56.

[123] Blair, "Reforming Corporate Governance", *supra* note 97, at 27.

[124] Werner Schubert, "Stock Corporation Law Reform of 1970", ZGR 1981, 285, 292 ff.; Siems, *Convergence* (2004), at 19.

First: Article 14 of the constitution of the Federal Republic of Germany [*Grundgesetz*] provides constitutional protection for property rights to which the rights of share owners belong.[125] Articles 14 (1) and (2) hold:

> (1) Property and the right of inheritance shall be guaranteed. Their content and limits shall be defined by the laws.
>
> (2) **Property entails obligations. Its use shall also serve the public good.** [emphasis by author]

Furthermore, according to Article 20 (1) of the *Grundgesetz*, Germany is a democratic and *social* federal republic. Articles 14 and 20 are the result of a consensus of the constitutional convent at Herrenchiemsee in 1948. A lay public would assume that this provision is derived from socialist ideas. This is not, in fact, the case. After the breakdown of the Third Reich, all democratic groups assembled in order to negotiate the provisions of the *Grundgesetz*. The most influential group was the Catholic Christian group[126] centered around the later chancellor *Konrad Adenauer*. *Adenauer*'s belief was rooted in the Catholic social ethics of the 19th century, developed by *Steguweit*, *Wilhelm Marx*, and *Windhorst*.[127] The main achievement of Catholic social ethics was to develop from the Christian ideal of charity [clemencia] an obligation of the state and its members to support the weaker parts of society, which - in times of industrialization - meant to protect them from the impact of market forces. This approach was consistent with Lutheran beliefs and Germanic traditions,[128] and also found support in left-wing groups, such as the social democrats.

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[125] This is constant judicature of the German Constitutional Court, see BVerfG, BVerfGE 4, 7, 30 – Investitionshilfe -; BVerfGE 13, 363 – Feldmühle -; BVerfGE 25, 371 – Rheinstahl -; BVerfGE 50, 290 – Mitbestimmung.

[126] The German Catholics were traditionally organized the "Zentrums-Partei", which was renamed the Christian Democratic Union [CDU].

[127] For an introductory overview in English see Mary Fullbrook, *A Concise History of Germany*, second ed. (Cambridge University Press, Cambridge, UK, 2004), at 131, and 205 – 219 (this specific strain of belief is called "Rheinischer Katholizismus" [Catholicism of the Rhine area, referring to a predominantly Catholic, and traditionally wealthy, part of Western Germany.]

[128] *Martin Luther* admonishes in his letter "An den christlichen Adel deutscher Nation" [translated: "To the Christian Nobility of German Nation"] aristocracy to take on its responsibilities for their dependents, drawing on Jesus' Sermon on the Mount. *Fürst von Bismarck*'s diaries show that his social insurance laws of 1884 was on the one hand a strategic strike against social democracy, which gained more and more support in the second half of the 19th century. On the other hand, he held that – to the same extent that aristocracy had traditionally provided food and shelter on their grounds to the old and weak of its dependents – industrialists

Thus, Christian roots underpin the ideological fundament of the German "social economy." The Ahlen-Program of the Christian Democratic Union of 1947 reflects this fundament:

> Capitalist striving for profit and power can no longer constitute the essence and objective of this social and economic renewal; it will have to be the well-being of our nation. By adopting a cooperative economic order, the German people shall obtain an economic and social constitution which is commensurate with the rights and dignity of man, serves the spiritual and material reconstruction of our nation and secures peace at home and abroad.[129]

Second: In the years 1951 through 1956, the CDU under *Konrad Adenauer*, *Ludwig Erhardt* and *Alfred Müller-Armack* implemented (in coalition with the Liberals) co-determination regimes.[130] While co-determination was partially intended to be a device used to control industrialists, who had supported the Third-Reich Nazi-regime,[131] it was also well aligned with the doctrine of ensuring corporate social responsibility (Property entails obligations!). German Social-democrats, who first participated in government in the late 1960s, did not create the co-determination regimes in the Federal Republic of Germany, but rather expanded them in the 1970s.[132]

Finally,

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were to take on responsibility for those who had sacrificed their life and health to the personal profits of the industrialist.

[129] Translation from Yonathan Reshef, "Germany", online: <courses.bus.ualberta.ca/orga417-reshef/germany.htm#republic > [Reshef, "Germany"].

[130] For details pertaining to co-determination see supra, B.I.3.

[131] Reshef, "Germany", *supra* note 129, at IV., describes the deconcentration policy regarding "heavy industries"; Thomas Raiser, "The theory of enterprise law in the Federal Republic of Germany", (1988) Am. J. Comp. L. 36, 111, at 118 [Raiser, "The theory of enterprise law"] emphasises the team work effect of codetermination.

[132] The common interpretation of various authors, for example Hansman & Kraakman, "The End", *supra* note 7, that workers' codetermination was an achievement of social democrats or the political left is inaccurate. The fact that a political precursor was enacted in the 1920s in efforts to co-opt revolutionary forces (by social democrats) [see Raiser, "The theory of enterprise law", id., at 117] does not explain why a conservative party enacted a co-determination regime in the 1950s. More accurate Mark Roe, *Strong Managers, Weak Owners* (1994), at 214: "Germany had an ideological tradition of codetermination, dating from the nineteenth century, when religious groups championed it to soften capitalism, to foster a workplace community without socialism." Confusing, however, his categorization in Roe, *Political Determinants* (2003), at 92, 151.

> Christian democratic parties … with powerful Catholic influence behind them, promoted [a] closer European Union: the existing social order was to be saved by a reaffirmation of Christian values in social welfare and rationalized by cosmopolitan big business.[133]

The reaction of European states to the **Segrè-report**[134] in the 1960s, that guided the trajectory of Continental European Corporate Governance, is consistent with *John Bowle*'s above statement. The Segrè-report strongly recommended the development of capital market law, in order to strengthen economic development and competition in the (then) European Economic Community [EEC]. The governments of Continental European nations, however, decided to harmonize and strengthen corporate law by strengthening explicit shareholder rights, rather than by establishing a uniform capital market law. This decision is consistent with the doctrine of the German *Stock Corporation Reform Act of 1965*, which enhanced the information that was required to be provided to shareholders through a variety of mandatory regulatory devices, and reduced directorial deference, which the leadership-oriented *Stock Corporation Act of 1937*, tainted by Nazi-ideology, had embedded within the Act.[135] This decision was not revised until the United Kingdom entered into the EEC in 1973.[136]

d) Intermediate result

This section has shown that a weak state coupled with strong market forces is consistent with Calvinism-Puritanism, which prevailed in Anglo-America, while a strong state that aims at balancing and directing the influence of economic power on society is consistent with the Roman-Catholic and Lutheran-Protestant belief. It traced the impact of these different ethical backgrounds throughout the centuries until the second half of the 20th century. The observation that different "market" ethics prevailed in Anglo-America and in

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[133] Bowle, *The Unity of European History* (1970), at p. 337.

[134] EEC-Commission (Ed.), "*Building a European Capital Market – Report of an Expert Group of the EEC Commission*" [Segrè-Report], Brussels 1966.

[135] Raiser, "The theory of enterprise law", *supra* note 131, at 117, refers esp. to s. 70 GSCA of 1937.

[136] Roosevelt's New Deal does not constitute a convincing counter-example for the distinction argued herein, for three reasons. First, the New Deal policy did not necessarily interfere with market forces. E.g. the Securities Regulation was to provide a "fair market." Second, it is noteworthy that the American churches strongly supported the New Deal, see Mark A. Sargent, "Competing Visions of the Corporation in Catholic Social Thought" (2004) Journal of Catholic Social Thought, forthcoming (from SSRN), at IV., with further citations. Third, the policy of the New Deal could not resist opposing political forces, since it was not based on a social consensus as in Germany.

France and Germany, is consistent with a *Friedrich A. Hayek* study, which underscores the difference between an understanding of individualism that is bound by the limits that society provides, and the "true" individualism.[137] While French and German authors have typically endorsed the former, Anglo-American authors have generally hailed the latter. It is likely that this differential understanding of individualism has impacted modern corporate law. Thus, the different ethical backgrounds might explain the differences between countries with an Explicit and those with an Implicit System of corporate control.

2. Statutory Evidence

If these cultural roots have indeed impacted modern corporate law, one would anticipate that the statutes will provide further evidence to support such contention. I have suggested that more explicit devices traditionally serve as a substitute for market control in France and Germany. Less efficient external institutions have been balanced by more efficient internal institutions.[138] In light of this proposition, those shareholder rights which enable explicit influence on the corporation and its management should be more strongly developed in Continental Europe than in Anglo-America. At the same time, a market based economy could accommodate more directorial deference, since the proliferation of other control institutions balance the lower incidence of explicit shareholder influence. The following section extracts evidence from statutory shareholder rights, and the degree of directorial deference permitted. It ends with a hypothesis concerning the practical workings of shareholder monitoring.

a) Shareholder Rights

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[137] Friedrich A. Hayek, "Individualism: *True and False*" (1946), in: *Individualism and Economic Order* (The University of Chicago Press, Chicago and London 1948), at 8-9. *Hayek* tracks this strain of thought through Anglo-American philosophy, including John Locke, Bernard Mandeville, David Hume, Josiah Tucker, Adam Ferguson, Adam Smith, and Edmund Burke.

[138] Supra, B.II.

Procedural rights in shareholder meetings

I have shown elsewhere[139] that mandatory rules with respect to procedural rights pertaining to communication and co-ordination among shareholders in advance of shareholder meetings differ between the jurisdictions. France and Germany provide for relatively strong and direct shareholder influence, while Canadian law, as well as American Securities Regulation in connection with the Delaware corporate law, represent the flipside of the coin.[140] The French and German regimes are spawned from the ideal of giving minority shareholders the power to monitor both managers and large shareholders. Conversely, the Canadian and American systems seem to be rooted in the ideal of, and better suited to, providing a level playing field, for those participating in control contests.[141]

In particular, by providing extensive information to the market about the consequences that might occur from voting in shareholder meetings, American rules on proxy solicitation enable markets to estimate the impact of either success or defeat of insurgents on the firm's future. From the American stance, since through active opposition to a merger "shareholders will receive additional gain for their vote, even though they may not be

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[139] Dirk Zetzsche, "Shareholder Procedural Rights Preceding Shareholder Meetings of Public Corporations – A Six Country Comparison", online: < www.jura.uni-duesseldorf.de/dozenten/noack/team/details_zetzsche.asp> [Zetzsche, "Shareholder Procedural Rights"].

[140] The following nine aspects mitigated the efficacy of Delaware corporate law and American federal securities regulation for shareholder monitoring: 1. The terms for shareholder proposals facilitate director control; 2. There is limited space for shareholder proposals; 3. due to very high costs of proxy contests, public good problems are increased; 4. Court discretion may interfere with bringing a shareholder proposal to knowledge of all shareholders, resulting in a controversial discussion in the meeting; 5. Communication among shareholders is restricted; 6. American law provides for relatively extensive exclusionary reasons regarding shareholder proposals; 7. Management receives a long-term warning, due to a deadline for shareholder proposals of 120+ days before the proxy statement; 8. Non-voting shares cannot make shareholder proposals; 9. Some meeting decisions do not bind directors. A different opinion on this issue provides Cunningham, "Commonalities and Prescriptions", *supra* note 12, at 1187 et seq. However, he does not consider some devices German corporate law provides to shareholders, esp. the right of counter-motion, and the 500.000 € nominal share capital threshold for proposals.

[141] French and German law provides insufficient information about the shareholder group that attempts to gain control, and surprise attempts are possible. Furthermore, German law requires super-majority for early dismissal of supervisory board members, which is in practice almost never achievable. In contrast, while American and Canadian law provide adequate information, long deadlines and high thresholds for proposals, aiming at replacing directors, require relatively strong support of the insurgents among shareholders. The relatively high fixed costs American law imposes might be an obstacle for change in controls in shareholder meetings of small companies.

conscious that this is occurring,"[142] the active opposition to a merger is the archetype of proxy solicitation. At the same time, the costs for insurgent shareholders organizing an opposition are rising, shareholder co-ordination is less likely, and shareholder monitoring is crippled.[143]

In contrast, German law encourages shareholder activity by providing for three institutions, designed to overcome shareholders' rational apathy. First: every shareholder of a German company can require that the company publishes a shareholder's opposing or dissenting statement on an agenda item after the Notice of the shareholder meeting, and up to two weeks before the meeting. This may include a Draft Resolution.[144] Management must publish the opposing statement of up to 5000 characters at an easy to find, clearly marked place on the company's website.[145] In its particularity as an individual shareholder right, this right to oppose management is unique. Second: German corporate law encourages shareholders to organize themselves in associations of interest.[146] These associations can sue the management on behalf of their members, a right which is exercised on a regular basis against – allegedly - negligent or criminal management.[147] Third: In order to further facilitate shareholder co-ordination, the German legislature is planning to implement a specific section for shareholder co-ordination in the German Federal Electronic Bulletin.[148]

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[142] Manne, "Some Theoretical Aspects", *supra* note 4, at 1438.

[143] See, for example, the considerations by Manne, id., at 1439 et seq.: "The most complex takeover technique is undoubtedly the proxy fight.", and 1442: "In the absence of party loyalty, moral suasion or high "entertainment" value, small shareholders have little incentive to incur any costs to aid in the election if corporate management."

[144] Until 2002, the management needed to print the opposing statement and send it to all shareholders. S. 126 (1) GSCA (old version).

[145] § 126 (1) GSCA, see on details Noack, "The New Rules on Counter Motions", BB 2003, 1393, 1395 ff.; Zetzsche, "Virtual Shareholder Meeting", BKR 2003, 736, at 738.

[146] S. 135 (9) GSCA; on shareholder associations from the German perspective, see Noack, in: FS Lutter (2000), at 1480. The German shareholder associations, though, does not have the privileges of lower thresholds for proposals, and one-time registration, as the French Association of Interests.

[147] Two established German "Shareholder Associations" function traditionally as watchdogs of minority shareholders in German shareholder meetings. The "Deutsche Schutzvereinigung für Wertpapierbesitz" (German Association for the Protection of Securities Holders), online:<www.dsw-info.de> and the "Schutzvereinigung der Kleinaktionäre" (Association for the Protection of Retail Shareholders).

[148] See "Draft Rules on raising the integrity of corporations and to modernise the court procedures declaring shareholder meeting decisions void" (translated by the author) [UMAG] by the German Federal Secretary of Justice, which is likely to come into force per 1 Jan 2005, online: <www.bmj.bund.de/images/11742.pdf>, Art. 1 No. 6, introducing S. 127a of the GSCA.

Many minority rights currently require shareholders to meet a threshold before they can be exercised. Under the legislative proposal, a shareholder can send her issue and a contact address to the editor of the Federal Bulletin who will publish it in the special section. Other shareholders can access the special section by electronic means, and thereby associate with the opposition, free of costs.

Information Rights

Neither direct nor indirect control can be exercised without proper information. Advanced Corporate Governance systems thus facilitate the flow of information to the controlling institutions. The proposition developed in this paper suggests that Anglo-America's prime concern is market information, while Continental Europe focuses on shareholder information. With respect to information, it is therefore reasonable to distinguish between market information, which securities law mandates, and information that is provided under state[149] or federal[150] corporate legislation (merely) to shareholders.

Since the enactment of the 1933 and 1934 federal **securities laws**, American securities regulation has pursued a disclosure philosophy,[151] which the Securities and Exchange Commission [SEC] actualised by enacting rules which demand mandatory corporate disclosure.[152] The more material information there is available, the better the share prices. Thus, "[a]t its core, the primary policy of [American] federal securities laws … involves the remediation of information asymmetries."[153] Consequently, the American legal regime strives for the access of market participants to all material information on each company, requiring the registrant to report to security holders periodically in Annual and Quarterly Reports.[154] According to the SEC, the Annual Report is "the most effective means of

[149] Esp. in the United States, but also in Canada.

[150] France, Germany, United Kingdom, Switzerland, but also the Canadian CBCA.

[151] Loss & Seligman, *Fundamentals of Securities Regulation* (2001), at 31.

[152] This would later constitute a precondition of the semi-strong form of the efficient market hypothesis, purporting, that all publicly available information is considered in the stock prices at within the markets. On the efficient capital market hypothesis, see *supra* note 64.

[153] Seligman, *Transformation of Wall Street* (2003), at 604.

[154] Pursuant to Section 13 (a) Nr. 2 the Securities Exchange Act of 1934, the SEC enacted Rule 13a, which requires the issuer to file an Annual Report on Form 10-K (Rule 13a-1), and a Quarterly Report on Form 10-Q (Rule 13a-13), available online:<www.law.uc.edu/CCL/34ActRls/reg13A.html>.

communication between management and security holders."[155] The rules on proxy voting have gradually tightened and now require the issuer to include all information contained in its Annual Report in its proxy statement as well. Since 1987, the SEC has allowed issuers to include the information required in Form 10-K only in its proxy statements. In the absence of a violation of the antifraud provisions, companies can draft and format the Annual Report as they see fit.[156] In addition, registrants have to disclose in Form 8-K such information as the SEC may by rule require "to keep [the previously filed information] reasonably current". Form 8-K contains an exclusive catalogue of events, which are presumed to generate "material information."[157] If one of these events occurs, an issuer needs to file a current change report. Periodical and current change reports together establish the SEC's "integrated disclosure system," which should operate so that the public files contain, at any given time, information substantially equivalent to that published in a current prospectus.[158]

Four aspects of American Securities Regulation support the proposition expounded herein, according to which the American system of corporate control is implicit, meaning that it impacts corporations through the forces of capital markets, rather than through direct shareholder activity: (1) the early creation of the SEC itself under President Roosevelt in 1933 - 1934,[159] (2) its Brandeis-style[160] disclosure philosophy, which both facilitated market forces – in contrast to direct market regulation, as demanded by some high-profile contemporaries -,[161] (3) the early development[162] of a centralized filing system of all issuer-

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[155] Sec. Ex. Act Rel. 11,079,5 SEC Dock. 356, 357 (1974).

[156] Loss & Seligman, *Fundamentals of Securities Regulation* (2001), at 473-474.

[157] See s . 13 (a) No. 1 of the Securities Exchange Act of 1934 and SEC Rule 13a-11.

[158] See Milton H. Cohen, "Truth in Securities' Revisited" (1966) Harv. L. Rev. 79, 1340.

[159] See Seligman, *Transformation of Wall Street* (2003), at 101 et seq.

[160] See *supra* note 67, McCraw, *Prophets of Regulation* (1984), at 84, 151-152, and Seligman, *Transformation of Wall Street* (2003), at 53, 79. Brandeis's philosophy was so influential on the concept of the Securities Act and the Securities Exchange Acts of 1933/1934, since James M. Landis, the drafter of the acts and first chairman of the SEC, had worked for Brandeis as law clerk, and President Roosevelt personally admired Brandeis' texts.

[161] On the one side, Wall Street resisted against any regulation. On the other side, more progressive political forces demanded interfering with market forces, Seligman, *Transformation of Wall Street* (2003), at 51 et seq.

[162] First established in 1984, the SEC database Electronic Data Gathering, Analysis, Retrieval System - EDGAR (since 1993 available online: <www.sec.gov/edgar/searchedgar/webusers.htm>), were the first

related material information, which, practically speaking, imposes “on issuers … a genuinely continuous duty to update”[163] of the information available, and (4) the unlimited access of the public, including present and potential shareholders, as well as other interested parties, to the data.

In contrast, other than a basic prospectus obligation for share issues, none of these four elements existed in Germany until the early 1990s.[164] A federal security trading agency was established in 1994. Supervision of managerial conduct was traditionally considered to be a private concern of shareholders. Laws imposing mandatory disclosure, such as the Annual Report, which has been federally regulated since the 19th century, had primarily been understood as tools to provide information to shareholders and to protect creditors.[165] Until 1994/1995, potential shareholders could not acquire topical[166] company information without management’s consent. Thus, a (hostile) takeover market was already crippled at the level of adequate information.[167]

Corporate law provides a laterally reversed image. S. 131 of the GSCA grants shareholders of German companies a far-reaching investigative information right that is to be exercised in shareholder meetings. Its scope is wide. If the company has not published the information required, management can only deny information when the publication of the information will cause damage to the corporation. Courts have rarely held that this is the case. The information right, however, will be unlimited if shareholders require

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centralized electronic filing system of all company related information worldwide, see Loss & Seligman, *Fundamentals of Securities Regulation* (2001), at 136-138.

[163] Donald C. Langevoort, “Information Technology and the Structure of Securities Regulation,” (1985) Harv. L.R. 98, 747, 786.

[164] Since the early 1990s German legislature enacted up-to-date capital market regulation, including various report obligations and a wide definition of the group of legally recognized receivers of company information. A centralized electronic company database exists under www.bafin.de, though some information is merely available at other public-run databases. For details on the centralized database, see Noack, *Database for Corporate Information* (2003); with respect to the development of information-related capital market laws see Zetzsche, *Shareholder Information* (2004), § 8, at 193 et seq., and *infra*, sub C.III.2.a).

[165] For example, Baumbach/Hopt, Commentary on German Commercial Code, Einl vor § 238 Rn. 15.

[166] Some information could be achieved through the Annual Reports, and the collection of basic company data in commercial registrars. The impact on actual events, however, was low, since these data were usually outdated, before the companies even sent them to the registrars.

[167] Pirelli tried in 1990-1991 the first hostile takeover bid in Germany that, given the combined white knight efforts of almost all German banks and insurers, finally faltered. There was no hostile takeover bid on German ground until 2000, when Vodafone took over Mannesmann AG.

information that has been given to any other shareholder before,[168] besides the controlling shareholder who is compensating the minority as defined in the control agreement under German *Konzernrecht*.[169] If information is given to shareholders who also are supervisory board members, these shareholders must not use information that they achieve for other purposes than for exercising their function as supervisory board members.[170] Whether management has lawfully denied information may be reviewed in a specific judicial procedure,[171] and, in addition, may be a reason for declaring the decisions reached at shareholder meetings to be void. Though French corporate law does not contain codified rights allowing individual shareholders to spontaneously ask questions in shareholder meetings, French literature interprets such spontaneous rights to be an inherent part of shareholder meetings.[172] In addition, French shareholders have inspection rights in respect of specific company information,[173] which are enhanced during the period preceding the meeting.[174]

Neither American nor British corporate laws provide for an individual shareholder right to speak, or to ask questions in shareholder meetings of public corporations.[175] Shareholders may propose that the management shall report on certain issues. This proposal right,

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[168] S. 131 (4) GSCA.

[169] German commentators discuss contentiously whether controlling shareholders that have not entered into a formal control agreement are exempted from s. 131 (4) GSCA. See the citations in favor and against an exemption at *Hüffer*, *AktG* (2003), § 131 Rn.38; in Zetzsche, *Shareholder Information* (2004), § 17 II 3, at 469 et seq. I hold that the *Securities Purchase and Takeover Law* of 2001 adds important arguments in favor of an exemption.

[170] *Hüffer*, *AktG* (2003), § 131 Rn. 38.

[171] S. 132 GSCA.

[172] According to Art. L. 225-108 French Code de Commerce [FrCC], French shareholders may hand in their questions to the corporation in writing until a specific time before the meeting. Associations of shareholders, and shareholders representing a quorum of shares may ask twice a year questions, which must be handed in in writing, Art. L 225-232 Code de Commerce. See Siems, *Convergence* (2004), at 142.

[173] Art. L225-115, L225-117 FrCC, Art. 142, 152 Decret to FrCC.

[174] Art. 135, 138 Decret to FrCC.

[175] In *Loudon v. Archer-Daniels-Midland Co.*, No 14638, 1996 Del. Ch. LEXIS 12, aff'd, 700 A.2d 135 (Del. 1997), at 25, the court held that there was no "specific legal duty to answer every question put to them by shareholder at an annual meeting," though "courtesy and prudence indicate that [the directors] should do [so] where possible." ABA, Shareholders' Meetings (2000), at 8, recommends to hold a question and answer session *after* the vote, notwithstanding that this recommendation is not intended "to limit … questions ord disccussion about the issues that require shareholder action." For the U.K., see Davies, *Principles* (2003), at p. 360: such a right merely exists in private companies. According to Siems, *Convergence* (2004), at 142, the reform proposal, which *Davies* cites in note 38, will not be enacted.

however, is subject to a vote of stockholders at the Annual Meeting, and, due to the proxy process[176] and the "Wall-Street-Rule,"[177] chances are slim that the stockholder will succeed. The chances are effectively zero when requiring information spontaneously in the meeting. On a customary basis and under the principles of fairness and good faith, corporations practice discussions including question and answer periods. The length of these sessions, the number and the content of questions being asked, as well as the complexity of the answers given by management are entirely voluntary. Sanctions do not exist. Management cannot be forced to answer. One might suggest that inspection rights[178] provide for complementarities. Inspection rights, however, have different characteristics regarding coverage, initiative, and costs of exercising the right.[179] With respect to *coverage*, books and records of the company usually contain merely objective facts. Notes from meetings are typically short and merely state the result of deliberations, for the simple reason that there are inspection rights, or that the protocols may be subject to subpoenas as evidence in shareholder actions. In contrast, information provided by the company in a shareholder meeting may also include subjective facts, such as opinions, emotions, and arguments in favor of or against yet undecided issues. Regarding the *initiative*, an inspection right is a one-sided process entailing a lengthy session of digging through folders and data. A spontaneous information right, in contrast, facilitates communication between the corporation and its shareholders, which may provide new insights to both sides. Finally, an

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[176] This is particularly due to the broker non-votes resulting from the proxy procedure (see more in detail *infra* B.III.3.).

[177] Easterbrook & Fischel, *Economic Structure* (1991), at 83, n.33: "Given the combination of collective action problem and easy exit through the stock market, the rational strategy for most dissatisfied shareholders is to sell rather than incur costs in attempting to bring about change through votes. .. The greater the availability of the sale or exit option, the less desirable is the voting or voice option."

[178] S. 220 DelCL, and § 16.02, 03 MBCA (2002). For long, inspection rights were merely vested in shareholders representing a 5% Quorum. This has relatively recently changed. Individual shareholders of Delaware corporations may inspect the corporation's books and records, as well as the corporations subsidiaries' books and records over which the corporation has control, provided that the inspection such stockholder seeks is for a "proper purpose." The chancery court supervises that the shareholder indeed achieves access to the books. Jurisprudence understands "proper purpose" to include the desire to evaluate the shareholders investement, and to deal with other shareholders, qua investors, but excludes the desire to obtain noninvestment-related personal benefits, or to promote social responsibility goals, see Clark, *Corporate Law* (1986), at 100, and *State ex rel. Pillsbury v. Honeywell, Inc.*, 191 N.W.2d 406 (Minn. 1971). British shareholders' inspection rights are limited to specific, primarily publicly available information, see ss. 288, 318, 380 of the British *Company Act of 1985*.

[179] For details, see Zetzsche, *Shareholder Information* (2004), at § 13, pp. 300 et seq.

essential difference is who bears the *costs*. While shareholders bear the costs of inspection rights, the costs associated with spontaneous information rights can be attributed to the corporation. Given the large amount of data that company books may contain, the costs associated with inspection rights may be significant.[180] Given that both types of information rights may be exercised on behalf of all shareholders as corporate control instruments, an inspection right encourages "free-rider phenomena" among other shareholders, while spontaneous information rights mitigate adverse incentives.

Since it can be safely assumed that majority shareholders receive information through supervisory board meetings, the individual, investigative-like information right primarily symbolizes the Continental management's direct accountability towards minority shareholders. In contrast, Anglo-American law increases the barriers for individual shareholder participation in corporate control. This is consistent with the Implicit System: if rules force companies to disclose all material information, markets control managers, and market prices reflect all available information, shareholders who are presumed to be merely financially interested have no reason to ask questions.

Remedies

Finally, shareholder remedies are reflective of the different control approaches. As has been demonstrated, shareholder suits can be aimed at financial compensation [compensation-directed suit], or at a revision of the shareholder meeting's decision [revision-directed suit].[181]

The compensation-directed suit prevails in **American corporate** law practice. While the traditional form of the compensation-directed suit was the derivative suit, which was succeeded by fraud claims under federal securities law,[182] the vast majority of

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[180] This fact explains that many shareholder proposals in the U.S. aim at demanding the directors to report on some kind of issues, see the data collected by the author in *Appendix E*.

[181] Supra, B.II.2.

[182] Both were supposed to be "a weak, if not ineffective instrument of Corporate Governance," see Romano, "The Shareholder Suit", *supra* note 88, at 84; ditto Snjai Baghat & Roberta Romano, "Event Studies and the Law: Empirical Studies of Corporate Law" (2002) Am. L. & Econ. Rev. 4, 380, 407. This judgement initiated a downsizing of shareholder rights to sue, see citations at Branson, "The Very Uncertain Prospect", *supra* note 13, 330.

representative litigation in Delaware courts today (after the Securities Litigation Reform Act of 1995) consists of class actions launched against public companies by shareholders who challenge directorial action in an acquisition, the terms of which were influenced by a majority shareholder.[183] Though s. 225 (b) of the Delaware General Corporate Law provides for a revision-directed suit in the case of a contested election of directors and courts may grant revision-based remedies by means of interim injunctions, shareholders rarely initiate these type of actions, and courts rarely set aside a decision of a shareholder meeting.[184]

In contrast, the revision-directed suits prevail by a significant margin in Germany.[185] This might be due to the strict **German corporate law,** which states that every shareholder who was represented in the meeting can challenge a shareholder meeting decision that is held to violate the law or the Articles of Association, or to benefit a specific shareholder.[186] Remarkably, if shareholders sue on the grounds that they were denied access to information by management, it does not legally matter that the majority of shareholders decided against providing the requested information. The judiciary's discretion (yet)[187] merely extends to answering the question of whether the company's conduct was unlawful or not, but not the legal consequences of the suit. At the same time, the law does not (yet) enable the court to

[183] Thompson & Thomas, "Acquisition-Oriented Class Actions", *supra* note 88, at 6-8, present data showing that these claims represent approximately 80% of breach of fiduciary duty claims. Most settlements happen to exist in cases where a majority shareholder squeezes out minority (public) shareholders. Weakness, however, seem to persist: Elliott J. Weiss & Lawrence J. White, "File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions" (2004), (from SSRN). To the effect of the Securities Litigation Reform Act of 1995 see Stephen J. Choi, **"**Do the Merits Matter Less After the Private Securities Litigation Reform Act?" (2004), (from SSRN).

[184] According to the Delaware Supreme Court in *Mills v. Electric Auto-Lite Co*, 396 U.S. 375 (1970), regarding a shareholder decision with respect to a merger proposal that violated proxy rules, the lower courts should exercise their discretion to achieve the most equitable reconciliation between the public interest and private needs as well as between competing private claims. A major American company being asked by the author whether shareholder suits directed at declaring the decision of shareholder meetings void have any meaning in American corporate law, answered: "In our [more than 100] year history as a company shareholders have never litigated against decisions and we do not know of any such suits litigated by shareholders of other corporations." This is consistent with the empirical data available on shareholder suits, which merely mention financial suits, see for example Thompson & Thomas, "Acquisition-Oriented Class Actions," id., and "The Public and Private Faces", *supra* note 57.

[185] Based on data of my survey, I estimate that 8 of the DAX30 corporations were subject to revision-directed shareholder suits twice or more since the year 1998. One firm was subject to 12 suits in 7 meetings, with shareholders challenging decisions of all but 1 meeting.

[186] S. 243 (1) and (2) GSCA.

[187] For recent trends, see *infra* C.III.2.

grant preliminary injunctions. The statutory derivative shareholder suit, aimed at financial compensation for the company on the basis of managerial misconduct, (yet) presents rather high procedual hurdles.[188] This is due to the statutory concept that the supervisory board, and not the shareholders, should take action against managers. In addition, the German Federal Supreme Court traditionally allowed shareholder suits for enforcing shareholder participation rights in shareholder meetings,[189] but did not allow for compensation-directed claims. Securities fraud claims for being wrong given information were ineffective, as well, until the securities law reform in the year 2002 facilitated financial compensation in glaring fraud cases.[190]

A look at other European Countries paints a mixed picture: While Swiss law is similar to German law,[191] French Corporate law contains an exhaustive list of revision-directed shareholder suits.[192] Instead, compensation-directed litigation is more strongly developed, though not to the same extent as in American law.[193] Despite the fact that the derivative suit originated in English law, modern English law is much more cautious in providing derivative actions. The claim of unfair prejudice may result in a revision-directed remedy, though this is rarely the case,[194] given that the judge may order financial compensation

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[188] For details, see ss. 117 and 147 GSCA.

[189] German Federal Supreme Court, in BGHZ 83, 122, 126 - Holzmüller-; BGHZ 136, 133, 140 – Siemens/Nold -.

[190] Amended by the Fourth Financial Markets Promotion Law, see Zetzsche, *Shareholder Information* (2004), at 100 et seq.

[191] Artt. 706 and 706b Swiss *Code of Obligations* [CO] provide for revision-directed suits. While Art. 752 *CO* also provides a general action for civil liability against officers and directors, it is controversial whether challenging a resolution excludes the possibility of claiming civil liability, see Forstmoser, Meier-Hayoz, Noack, *Schweizerisches Aktienrecht,* (1996) at § 25 N 7.

[192] See Art. 225-104, 225-121, and 235-1 et seq. of the French *Code de Commerce*.

[193] Siems, *Convergence*, at 247-248.

[194] Witt, “Informationrrights,” AG 2000, 257, 263; Siems, *Convergence* (2004), at 246-247, and Hans-Christoph Hirt, “In what circumstances should breaches of directors’ duties give rise to a remedy under s. 459-461 of the Companies Act 1985?” (2004) The Company Lawyer 24, 100. Davies, *Principles* (2003), at 522 cites *McGuiness v Bremner Plc*, [1986] BCLC 382, in which the judge decided whether delay on the part of the directors in convening a meeting requisitioned by the petitioner was unfairly prejudicial.

under the same claim.[195] Though Canadian law does not explicitly contain a sanction of revision-directed actions, the oppression remedy[196] can be utilized for this purpose.

The observation that American shareholders can substitute financial compensation for the power to directly influence corporate decision making, while German legislature traditionally required shareholders to enforce their interests through revision-directed suits is consistent with the distinction between an Explicit and an Implicit System of corporate control. The diminished existence of derivative actions in the United Kingdom, in respect of that of revision-directed suits in France weakens the argument, though not significantly. The fact that the English and the American system are rooted in the same philosophy does not mean that some elements cannot develop differently, which is likely be due to idiosyncracies of each country.[197] This is also true with respect to France and Germany. Additionally, the fact that French law comprises several provisions dealing with revision-directed suits reveals that the *legislature* has assigned some level of importance to revision-directed suits. Eventually, the existence of extensive codification of – and, thus, clear laws on - revision-directed suits, though rarely exercised, might nevertheless have the effect of stiffening the directors' backbone when opportunistic incentives lure them towards the path of illegality. Despite the allure of this explanation, it does not lend itself to empirical support.

b) Directorial deference

The evidence presented thus far lends support to the hypothesis that the degree of directorial deference afforded to directors is higher in Anglo-American statutes than it is in Continental European statutes, which is consistent with the Explicit / Implicit categorization. Further statutory evidence strengthens this impression, as follows.

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[195] Ss. 459 (1) and (2), 461 (2) *Companies Act of 1985* determines that the petitioner's shares may be purchased by the controllers or the company. Davies, *Principles* (2003), at 525 holds that this remedy is "undpubtedly the most commonly used."

[196] Under s. 241 *Canadian Business Corporations Act [CBCA].*

[197] The meaning of shareholder meetings in British law is stronger than in the United States (but weaker than in France and Germany). I have hypothesized that this is due to the small size of the country, as compared to the U.S., and a traditionally concentrated investment community in London, see Zetzsche, "Shareholder Procedural Rights", *supra* note 139, at D.II.3.

American corporate statutes start from a foundational statement that *all* corporate power ultimately resides in the board,[198] while shareholders essentially have no power apart from voting, esp. in director elections,[199] suing and selling.[200] German corporate law traditionally referred to shareholder meetings as the "highest body of the corporation"[201] - as Swiss corporate statutes still do[202] - in which shareholders demand and receive information, communicate among each other, and make decisions.[203]

Under Delaware law, if a majority that is required by law to support the decision supports the proposal, for example in a written comment, management can dispense with the meeting altogether.[204] In addition, s. 211 Del. GCL determines that a failure to hold a meeting does not affect otherwise valid corporate acts.[205] Thus, Delaware law understands shareholder meetings merely as voting devices. In contrast, a shareholder vote in German corporations by means other than a meeting can only substitute for a meeting if all shareholders, including holders of preference shares who are not entitled to vote, have agreed on substituting the vote for the meeting.[206] Decisions lacking the legally required consent of the shareholders are considered to be void, or voidable.

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[198] See Section 8.01 of the MBCA (2002), and s. 141 of Del GCL; Thompson & Thomas, "The Public and Private Faces", *supra* note 57, term this concept "anachronistic", since directors share their governance functions with officers, shareholders and various gatekeepers. To the origins of the board concept, see Franklin A. Gevurtz, "The Historical and Political Origins of the Corporate Board of Directors", (2004) Working Paper (from SSRN)

[199] *Foss v. Harbottle* (1843), 2 Hare 461, 67 E.R. 189.

[200] See Chapter 7 of MBCA (2002), and ss. 211 et seq. of the Del GCL, as augmented by case law.

[201] See the "General Motives" of the German Stock Act of 1884, in: Hommelhoff/Schubert, *Hundert Jahre modernes Aktienrecht* (1985), at 407, 464. The concept of shareholder meeting primacy was changed by the German Stock Act of 1937 to the favor of a trias of supervisory board, board of management, and shareholder meeting.

[202] Art. 698 (1) of Swiss Law of Obligations.

[203] Noack, *Information, Communication, Decision* (2003).

[204] S. 228 of the Del GCL

[205] See S. 211 (c) *Del. GCL:* "A failure to hold the annual meeting at the designated time or to elect a sufficient number of directors to conduct the business of the corporation shall not affect otherwise valid corporate acts or work a forfeiture or dissolution of the corporation except as may be otherwise specifically provided in this chapter."

[206] This is the majority opinion, derived from s. 121 (6) of the GSCA, which states the requirement of all shareholders' consent for the abandonment of procedural provisions on shareholder meetings, see Hüffer, *AktG* (2003), § 121, at [23].

Finally, in American corporations, some submissions to shareholder meetings require directorial approval before shareholders can vote on the issue,[207] and some shareholder meeting decisions do not bind directors.[208] Besides the general limit that shareholder meetings may only decide upon matters of day-to-day management, if the board of management makes a proposal pertaining to day-to-day issues,[209] both restrictions are unknown to German shareholders.[210]

c) The Functionality of Minority Shareholder Monitoring

For companies with dispersed ownership, commentators have associated a *disciplining*[211] and an *advisory*[212] effect with proxy votes and shareholder meetings. But how does shareholder monitoring work in corporations with concentrated ownership where – in spite of stronger shareholder rights and lower directorial deference - majorities can easily curtail minority influence through their voting power? The efficiency of minority shareholder monitoring depends on two factors: first, a **legal regime** that enforces minority rights and, thus, reduces the adverse incentives that the aforementioned economic considerations[213]

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[207] For example, pursuant to s. 2.02(3)(d) MBCA (2002), the board of directors of a corporation must approve a merger before it is submitted to shareholders for a vote. This means that ordinarily there is no way for an outsider to reach the shareholders directly as they can with tender bids or proxy fights, see Manne, "Some Theoretical Aspects", *supra* note 4, at 1437.

[208] See SEC Rule 14a-8, Question 1 (§240.14a-8), online www.sec.gov/about/forms/reg14a.pdf: A shareholder proposal is your *recommendation or requirement* that the company and/or its board of directors take action.

[209] S. 119 (2) GSCA. Further, some commentators hold that the shareholder approval of management's actions beside disapproval of the supervisory board pursuant to s. 111 IV 3 GSCA is a recommendation.

[210] S. 83 (2) GSCA. Though specific items require proposals by the board of management or the supervisory board, the shareholder meeting may require the boards to propose this matters, s. 83 GSCA.

[211] Easterbrook & Fischel, "Voting in Corporate Law" (1983), 26 J. Law & Economics 395; Randall S. Thomas & Kenneth J. Martin, "The Effect of Shareholder Proposals on Executive Compensation" (1999) University of Cincinnati Law Review 67, 1021; Pound, "Proxy Voting", and "Proxy Contests", both *supra* note 2. However, empirical studies achieved mixed results. An overview of empirical studies on the effect of shareholder activism provide Stuart L. Gillan & Laura T. Starks, "A Survey of Shareholder Activism: Motivation and Empirical Evidence" (1998) Contemporary Finance Digest 2, 10, at V; more positive Deon Strickland, Kenneth W. Wiles & Marc Zenner," A requiem for the USA: Is small shareholder monitoring effective?" (1996) J. Fin. Econ. 40, 319.

[212] Joseph A. Grundfest, "Advice and Consent: An Alternative Mechanism for Shareholder Participation in the Nomination and Election of Corporate Directors" (November 2003) Stanford Law and Economics Olin Working Paper No. 274 (from SSRN) [Grundfest, "Advice and Consent"]; Ernst G. Maug & Kristian Rydquist, "Do Shareholders Vote Strategically? Evidence on the Advisory Role of Annual General Meetings" (January 2004) CEPR Discussion Paper No. 4192 (from SSRN).

[213] *Supra* note 4, and B.III.2.a).

have revealed. This first element has been examined above. Second, **shareholders** must overcome the (nevertheless) remaining adverse incentives. The ethical, rather than legal, obligation of shareholders to take on responsibility for their property - property entails obligations -, may have strengthened shareholders' propensity to monitor.

I hypothesize, however, that this ethical tendency was furthered by the fact that France and Germany traditionally had poorly functioning capital markets, which catalysed the need for exercising *explicit* rights. The efficiency of capital markets correlates with the incentives to participate in shareholder monitoring. In *semi-strong* efficient capital markets, all publicly available information is taken into account within the stock prices.[214] This is not true in inefficient capital markets: If shareholders cannot rely on the informational content of stock prices, they will need to gather and evaluate information before they can sell. Even then, in the state of asymmetric information, they might not find a buyer who trusts in the shareholder's (private) evaluation, or the buyer might require a discount for the risk of non-liquidity of the stock. Altogether, selling might be more expensive to the shareholder than monitoring the investment and making sure that it yields adequate returns.

Some empirical evidence supports this proposition: for deep and liquid capital markets, economists have found that increased liquidity reduces the incentives for large shareholders to fulfil their monitoring role.[215] Conversely, more illiquid, poorly-functioning equity-capital markets increase the incentives for large shareholders to monitor. The poorer that capital markets function, the smaller the investor that is affected by deficiencies of liquidity. Since minority shareholder monitoring through shareholder meetings usually requires preparation and expenses merely once a year, and – in Explicit Systems - does not impose costs for inspecting the firm's books and records, monitoring costs are sustainable. Active shareholder monitoring is therefore a logical phenomenon when one considers the historical state of the German and French world as being characterised by weak capital markets.

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[214] Supra, B.II.1.

[215] Amar Bhide, "The hidden costs of stock market liquidity" (1993) J. Fin. Econ. 34, 31; Philippe Aghion, Patrick Bolton & Jean Tirole, "Exit options in corporate finance: liquidity versus incentives" (2004) European Finance Review 8, 1.

Having regarded the legal side and the minority shareholders' incentive, the last unsolved, though particularly important, factor is whether and how shareholder monitoring, which is exercised only once a year in a shareholder meeting, may influence **management and controlling shareholders**. Three potential threats drive the efficiency of (minority) shareholder monitoring: negative publicity, (ad-hoc) shareholder co-ordination, and legal enforcement.

Probably the most commonly used threat of minority shareholder monitoring is **negative publicity**, having a direct impact on the company's share prices, disgruntling the controlling shareholder, and damaging the controlling shareholder's and the manager's personal reputation. If managers' compensation depends on stock prices, it may also directly affect managers' wealth. Wealth and reputational effects may come hand in hand, in particular, if the controlling shareholder is one of the executive managers.[216]

As between wealth and reputational restraints, the potential reputational loss is likely to restrain the controlling shareholder most effectively: First, it is likely that negative publicity related to minority expropriation would permanently increase the firm's cost of capital through an "expropriation discount" on the shares issued to minority shareholders. Second, controlling shareholders of large corporations can be assumed to be very wealthy. The size of wealth itself makes it likely that decreasing marginal returns to wealth have set in.[217] Values other than pecuniary values, such as social standing and reputation, are likely to become the core of the controlling shareholder's utility function. This *individual* characteristic is augmented by a *societal* characteristic: in societies that are rooted in the belief that minority expropriation is particularly unethical, the reputational loss resulting from minority expropriation can be assumed to be much higher than in a society that furthers the ideal of individualism. Consequently, minority expropriation would have an extraordinary negative impact on the controlling shareholder's non-pecuniary benefits of

[216] Controlling shareholders in Germany used to control the management through the supervisory board. The controlling shareholder is rarely an executive manager.

[217] Gilson, "Complicating", *supra* note 52, at IV., ask the hypothetical question: "Is the role of leading industrialists in a country … worth more than additional wealth at a point where decreasing marginal returns to wealth must surely have set in?"

control, such as social standing and the political weight of the controlling shareholder's opinion, and might also impact relationships with pecuniary impact.[218]

In light of these considerations, the chairmen of the boards, who in practice do the talking, need to have - at least at first glance - convincing answers to pressing issues. Otherwise, despite a theoretically low impact on the voting results, negative emotions will be transferred by the press to the public. The press would not be present if shareholder questions would not reveal interesting, though rarely "material", facts. Thus, publicity and information rights are closely interrelated.

Another possible effect of unconvincing answers and arrogance towards shareholders is a **spontaneous resistance by, and co-ordination among,** shareholders against the management's proposal. Even more burdensome to management are displeased shareholders' proposals for additional shareholder meetings,[219] or the initiation of special reviews by minorities[220] (which may augment the protective devices under *Konzernrecht*). It is possible that, in shareholder meetings with many shareholders attending in person, there will be sufficient support for meeting the threshold-requirements. Shareholders' exercise of these procedural rights would consume management's time, and – under German corporate law - are costly to the corporation (while shareholders bear merely a small fraction of the overall costs).[221] Since the costs imposed on the corporation will annoy the controlling shareholder, managers will strive to avoid giving shareholders a reason to exercising these procedural rights in the first place. Furthermore, these procedural rights fulfil an important function in augmenting other cost- and reputation-related incentives. If

[218] In fact, pertaining to the large and established German corporations, minority expropriation is rarely reported. Instead, the famous controlling shareholder families – for example, the Quandts (BMW, Altana), Krupps, Thyssens (ThyssenKrupp), Siemens – strategically built a reputation for sharing the benefits of control with the minority shareholders in "their" firm.

[219] S. 122 GSCA provides for calling rights in specific circumstances. For details, see Zetzsche, "Shareholder Procedural Rights", *supra* note 139, at C.I.

[220] Pursuant to s. 142 GSCA, a majority can initiate special reviews of specific issues by certified accountants through a shareholder meeting decision. Minorities, representing 10% of the shares or – more relevant - 1 Mio € of the share capital, can apply to court. Court approval then replaces the shareholder meeting decision. The provision will be changed through the UMAG, see *supra* note 148. According to the UMAG-draft, the court application will require a threshold of merely 1% of the votes, or a share of 100.000 € of the nominal capital.

[221] This will be also true, if, as in most cases, the substantive issue at stake is eventually unsuccessfully pursued.

the gain of asset diversion outweighs the direct costs of minority opposition and the loss of reputational costs, these restraints alone may become ineffective. Given this situation, the aforementioned legal devices put management and the majority shareholder under the permanent threat that additional minority shareholder scrutiny, esp. through the individual information right and the minority's power to initiate a special review, results in sufficient evidence for criminal and civil liability of the controlling shareholder and managers.

Thus, a combination of the *negative publicity threat* and the *nuisance value* of dealing with the exercise of minority rights prompts management to prepare properly for shareholder meetings as a means of avoiding the occurrence of these consequences in the first place. **Legal enforcement** of information rights constitutes the fulcrum of both the publicity- and the nuisance value-threat: since the procedure itself is costly and risky to managers and controlling shareholders, a legal obligation to provide information and to enter into a discussion – and severe enforcement of such obligation – helps to overcome adverse incentives. In the absence of law, management and controlling shareholders may be less inclined to answer shareholders' questions. At least, legal enforcement of information rights makes lying and withholding of information more costly since 1) it increases the risk that the lie will be revealed, and 2) it imposes sanctions.[222] Without information and discussion, the press would not report about the meeting - since the voting results in countries with concentrated ownership are far from being spectacular -, and less shareholders would be aware of, and come to, meetings, thereby reducing the threat of spontaneous co-ordination.

[222] Though he did not deal with a right to ask questions, we are facing here a variant of Akerlof's lemons-problem. George A. Akerlof, "The Market for "Lemons": Quality Uncertainty and the Market Mechanism", (1970) 84 Quarterly Journal of Economics 488, has held that in perfectly efficient markets and under a regime that renders lying costly, one would assume that investors would discount goods (here: shares) of firms that do not provide sufficient and timely information pertaining to the quality of their product (here the company). Thus, share prices would be depressed. Since managers know how investors think, one would assume that they disclose information voluntarily. Transferring the model to the real world faces difficulties: First, history and empirical data have shown – (even) for traditionally strong capital markets – that managers tend to withhold bad news, despite the discount that theoretically follows. Because of this behavior, mandatory disclosure rules have been enacted in the first place (Seligman, *Transformation of Wall Street* (2003), at 39; for a different view, see, e.g. Marcel Kahan, "The Limited Significance of Norms for Corporate Governance", (2000-2001) 149 U. Pa. L. Rev. 1869, and the literature by Kahan & Klausner cited in the bibliography). Second, regarding to the flow of information, the historic state of German capital markets was likely one in which capital markets were inefficient. Thus, they did not fulfil (or were close to) the preconditions of Akerlof's model. The assumption of poorly-functioning capital markets is consistent with the traditional very low numbers of initial public offerings (see *infra*, sub B.III.3.), of public corporations and of shareholders (see Table 8 and 9 *infra* sub C.III.2.b) in German capital markets. For recent changes, see *infra*, sub C.

Finally, the severe sanction of suits challenging a meeting's decision[223] often prevents directors from withholding information altogether.

Admittedly, one might regard the risk to a manager of being exposed to negative publicity, or majority owners' furor insignificant. However, two aspects improve the minority shareholders' position. First: the controlling shareholder is likely to examine "regular" asset diversions, hence, the minority shareholders can free-ride on the controlling shareholder's actions. Thus, based on the control report by the auditors, minority shareholders can focus their attention on transactions between the corporation and the controlling shareholder. This is a relatively narrow scope and would not often be beyond the capacity of minority shareholders.[224] Second: since reputation is the primary concern of managers[225] - and reputation is what they can easily lose as a consequence of poorly organized shareholder meetings - managerial stakes are relatively high. Managerial propensity to thoroughly review corporate policy and present a viable long-term strategy is facilitated by the fact that shareholders bear the costs of any conduct engaged in by managers to avoid risking their reputations. Pointing at the severe sanctions helps to overcome the resistance of controlling shareholders against wasting corporate resources. Thus, managers have few incentives to forego these expenses. Consequently, shareholder meetings exert permanent pressure on managers to keep the possibility in mind that shareholders can and will use their strong information rights in shareholder meetings to question the details of managerial conduct.[226]

3. Empirical Evidence

If there were – for whatever reason – a greater level of explicit shareholder influence in France and Germany, and a greater level of implicit shareholder influence in Anglo-America, one would assume that current corporate practice should provide some empirical evidence. In particular, this regards two key assumptions of the proposition.

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[223] For example, a decision whose validity is required for selling a significant part of the firm's assets.

[224] If minority shareholders nevertheless reveal regarding "regular" asset diversion, they can assume that the controlling shareholder will undertake appropriate measures in the aftermath of the meeting.

[225] Fama, "Agency Problems", *supra* note 55, at 293 et seq.

[226] The Implicit System achieves the same effect through analyst conferences, and conference calls with institutional investors. However, this information is, at its core, voluntarily, and not enforceable.

First: if capital market control constitutes the core component of Anglo-American shareholder influence, there is likely some proof that capital markets are more strongly developed in the United States than in Continental Europe. This first point has been sufficiently examined in former studies to which I refer.[227]

Theoretically, though, one might assume that the Explicit System could lead to a sizable capital market that relies on Explicit Control, rather than Implicit control. However, a system that does not rely on capital markets for control and financing purposes is unlikely to develop the institutions that are required for a highly sophisticated capital market, either. This particularly pertains to institutions that guarantee equal access to information - in between the shareholder meetings! - (securities law), institutions that evaluate information on a day-to-day basis (analysts), and institutions that strive to exploit the liquidity of capital markets by developing and bringing new firms to the market (venture capitalists). All of these institutions require direct or indirect funding by the corporations and their shareholders. If the shareholders do not regularly use these institutions, it is unlikely that they will generously pay for their existence. Hence, institutions which drive efficient capital markets are less likely to develop in countries which have traditionally relied on the Explicit, rather than the Implicit System of corporate control.

The empirical evidence is consistent with this observation: The thesis of poorly-functioning French and German capital markets is consistent with historically very low numbers of initial public offerings: Between 1986 and 1996, 200 German and 281 French firms were newly listed at official capital markets, as compared to 1,955 in the United Kingdom (which has approximately as many inhabitants as France, and as Germany had before 1990), 7,538 in the United States – which has four times the inhabitants of Germany, but 38 times its IPO numbers -, and 253 in Switzerland (with less than 10 million people!). The figures for the five year period of 1997-2002 signal improvement: 398 German and 452 French (only 1997-2000) registrations, as compared to 1,342 British, 3,268 American, and 89 new Swiss listings.[228]

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[227] E.g., Coffee, "The Rise", *supra* note 10, at 15, whose data slightly differ from the data presented here.
[228] Source: DAI, *Factbook*, *supra* note 28.

Table 1: Market Capitalization as a percentage of the Gross Domestic Product[229]

	1989	+/-	1994	+/-	1997	+/-	2000	+/-	2003	1989/2003	+/-
France	37.80%	-10.05%	34.00%	41.47%	48.10%	130.35%	110.80%	n.a.	n.a.	n.a.	n.a.
Germany	30.90%	-21.36%	24.30%	60.49%	39.00%	74.10%	67.90%	-33.43%	45.20%	14.30%	46.28%
Switzerland	251.20%	-56.61%	109.00%	106.24%	224.80%	46.80%	330.00%	-29.82%	231.60%	-19.60%	-7.80%
U.K.	98.50%	14.01%	112.30%	34.82%	151.40%	20.01%	181.70%	-24.77%	136.70%	38.20%	38.78%
U.S.	55.10%	31.40%	72.40%	79.56%	130.00%	19.92%	155.90%	-15.72%	131.40%	76.30%	138.48%

Further, Table 1 replenishes existing data on Market Capitalization as a percentage of the Gross Domestic Product. The data support the general view that French and German capital markets were weak, but increased their strength to a greater extent than European countries with a stronger capital market tradition, as for example, the United Kingdom and Switzerland. The data, however, also provide an insight into the decline in capital market strength after the "tech bubble" of the years 1998 to 2000. The extent of the decline is greater in Germany[230] than in countries with a capital market tradition.[231] The greater decline might be understood as a proxy for a deficiency in investor maturity. Inexperienced investors may be more inclined to sell on the basis of noisy signals when the market turns, as compared to their experienced Anglo-American counter-parts.

Second: since, according to the foregoing, shareholder meetings constitute the center of the Explicit System, one would assume that there exists some empirical evidence that French and German shareholders are more active through shareholder meetings than are Anglo-American investors.

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[229] Data taken from DAI, Factbook (2003).

[230] Decline of 50,22% from peak in 2000 to 2003.

[231] Switzerland: decline of 42,49%; United Kingdom: peak in 1999: 195,5% of GDP, decline of 43,01%; United States: peak in 1999: 181,1% of GDP (according to Coffee, "The Rise", *supra* note 10, at 18), decline of 37,82%.

To my knowledge, data on this second point have not been systematically collected and evaluated. This paper thus presents new data on shareholder activity in shareholder meetings, based on a survey including the thirty largest German public corporations, which are listed in the DAX30.[232] This data has been compared to data taken from the EDGAR-files of a random sample of thirty-two of the largest American public corporations with dispersed ownership, which are listed in the N.Y.S.E. U.S. Top 100 index.[233] Tech-stocks listed on the NASDAQ and on the German Tec-DAX were excluded for two reasons: (1) concentrated ownership is more likely to occur in young tech firms, due to their relatively recent history as public corporations and, hence, there will be less dilution of shares held by entrepreneurs. These shares would disproportionately influence the outcome of the statistics; (2) traditional, old firms are the firms that need active shareholders the most, since corporate finance theory predicts a concentration of managerial slack in these firms,[234] which particularly necessitates either implicitly or explicitly exercised shareholder control. The data presented in this section is extracted from *Appendixes B and C*, regarding attendance rates, as measured by votes, and *Appendix D*, showing the personal attendance at shareholder meetings in German companies.

a) Attendance Rates?

Table 2: American sample: average attendance, measured in votes

% (votes)	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	1994-2004
Average	83.26%	85.05%	85.99%	85.96%	84.88%	84.33%	84.26%	84.26%	85.01%	84.88%	86.34%	84.93%

In the years 1994 – 2004, the average attendance, as measured in votes, of the American sample varies between approximately 83% and 86%. Given that the period of time that the

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[232] The data presented is rooted in various sources. In addition to those mentioned in the first note the author is heavily indebted to all corporations listed in the DAX30 for answering on his questionary.

[233] According to the New York Stock Exchange, this index tracks "the top 100 NYSE-listed U.S. stocks." New York Stock Exchange, online:<www.nyse.com/marketinfo/p1020656068262.html.> .

[234] Michael C. Jensen, "Agency Costs of Free Cash Flow, Corporate Finance and Takeovers" (1986) Am. Economic Review 76, 323, at 326 [Jensen, "Agency Costs"]; See Harold Demsetz & Kenneth Lehn, "The Structure of Ownership: Causes and Consequences" (1985) J. Pol. Econ. 93, 1155, at 1158 et seq. [Demsetz & Lehn, "The Structure of Onwership"]; Harold Demsetz, The Structure of Ownership and Theory of the Firm (1983) J.L. & Econ. 26, 375.

data covers includes a boom and two bust periods, which can be assumed to influence shareholder activism, this is a relatively narrow corridor. Further inquiry illuminates the fact that in the years following the tech-bubble (in which American shareholders were to suffer due to a range of corporate scandals), average attendance hardly varied from previous years. In light of these scandals, one would anticipate a shareholder response of either higher attendance (stemming from a desire to exercise more control over managers) or of diminished attendance rates (due to shareholder frustration). The data, however, show the only unlikely result, which is stability.

An inquiry into the institutional and regulatory environment in which proxy voting occurred reveals that, while originally designed as a means of ensuring that companies could meet quorum requirements, American stock exchange rules permit brokers to vote uninstructed shares held in street names for routine, rather than classified, proposals.[235] The impact of these uninstructed shares for the year 1998 is estimated to account for approximately 15% of the overall turnout at the meeting.[236]

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[235] NYSE Rule 451,452, Amex Rule 576, 577, and NASD proposal for Rule 2260, pending with the SEC (see <www.nasdr.com/filings/rf99_63.asp>). Pursuant to NYSE Rule 452, "[a] member organization which has transmitted proxy soliciting material to the beneficial owner of stock … and solicited voting instructions in accordance with the provisions of Rule 451, and which has not received instructions from the beneficial owner … by the date specified in the statement accompanying such material, may give or authorize the giving of a proxy to vote such stock, provided the person in the member organization giving or authorizing the giving of the proxy has no knowledge of any contest as to the action to be taken at the meeting and provided such action is adequately disclosed to stockholders and does not include authorization for a merger, consolidation or any other matter which *may affect substantially the rights or privileges of such stock*." Rule 402.08 of the NYSE Listed Company Manual defines which proposals may affect substantially these rights (online: <www.nyse.com/listed/p1020656067970.html?displayPage=%2Flisted%2F1020656067970.html>).

[236] Jennifer E. Bethel & Stuart L. Gillan," The Impact of the Institutional and Regulatory Environment on Shareholder Voting" (2002) Financial Management 31, 29, at 30.

Table 3: Turnout at special meetings of American Sample

Corporation	Year	Turnout in votes	Average Turnout 1994-2004	+/-
Bank of America	2004	68.13%	85.00%	-16.87%
Hewlett & Packard	2001	84.69%	84.30%	0.39%
JP Morgan Chase	2004	84.09%	86.78%	-2.69%
Pepsi & Co	2001	66.37%	83.47%	-17.10%
Procter & Gamble	1998	88.57%	89.92%	-1.35%
SBC Communications	1996	73.56%	82.18%	-8.62%
Time Warner	2000	83.29%	87.59%	-4.30%
Tyco	1999	62.65%	84.10%	-21.45%
Wachovia Corp.	1998	74.90%	84.16%	-9.26%
Walt Disney	1996	77.08%	85.19%	-8.11%
Average Difference				*-8.95%*

Table 3, showing the turnout at the special meetings (with classified proposals only) of the American sample, suggests that broker votes impacted the overall turnout in the sample in the range of approximately 9%. This estimate, however, might be a bit too low since special meetings might extraordinarily encourage shareholder attendance, due to the importance of the issue at stake. Further, special meetings with strong attendance rates were held at the same day as the Annual Meeting. Hence, these data are likely to be too low. In 2004, the reported non-broker votes in the American sample accounted for 15.10%.[237] These data, on the other hand, might be a bit too high, since some shareholders will wilfully rely on the non-broker voting mechanism if unimportant issues are at stake. The truth is likely to be somewhere in between. In light of these data, one can reasonably assume that American active shareholders account for a turnout of approximately 70-75% of the votes.

Table 4: Average attendance of German DAX 30 firms, 1998 - 2004.

% (votes)	1998	1999	2000	2001	2002	2003	2004	1998-2004
Average	58.26%	57.20%	53.39%	52.29%	50.80%	48.88%	47.21%	48.97%

[237] See *Appendix G*.

Measured by the percentage of overall votes, the data of the German sample show a continuous decline between 1998 and 2004, from 58.26% to 47.07% of the votes. Four factors influence the statistics: (1) the increase of foreign (non-German) investors in German corporations, (2) a reduction in concentrated ownership, (3) a change in the structure of German proxy voting rules, and, (4) finally, a different disclosure policy regarding share buybacks.

First: Germany animated its capital markets in the 1990s.[238] In the aftermath, international investors have increasingly invested in large German corporations. International investors are primarily institutional investors who do not participate in German shareholder meetings. This is due to the fact that foreign financial intermediaries, which administer the deposits of foreign investors, do not forward the company information regarding meetings, and the registration procedure requires co-ordinated behavior of several financial intermediaries, which is costly and may require more time than is available before the meeting. Further, institutional investors fear that their shares will be blocked for the purpose of exercising votes[239] - a fear that is not justified with respect to German company law.[240] Given these problems and the absence of extraordinary circumstances for the purpose of these statistics, one can assume that foreign shareholders are non-voting shareholders. Empirical data support this assumption.[241]

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[238] For details, see C.II. and III.

[239] Editorial, "Institutional Investors and Cross Border Voting" (2003) Corporate Governance: an International Review 11, 89.

[240] See Noack & Zetzsche, "The Identification of Shareholders of Companies Issuing Bearer Shares", WM 2004, 1, and Noack & Zetzsche, "Identification of Shareholders", AG 2002, 651, at 663; Expert Group on Cross-Border Voting, "REPORT ON CROSS-BORDER VOTING BY SHAREHOLDERS" (Sept 2002), online: <www.jura.uni-duesseldorf.de/dozenten/noack/texte/normen/amsterdam/ >.

[241] Of the ten companies with the lowest three-year attendance rate average seven are owned by more than 40% by foreign investors, while three of these companies refrained from publishing a shareholder structure that distinguishes between countries (though Volkswagen-data are likely to be inconsistent with the foreign shareholder theory, since the Volkswagen law discourages proxy voting). The company with the lowest three-year average, adidas-salomon with 27,65%, is 66% foreign-owned, with 34% American investors. Between 2001 and 2003, the international shareholdings of Deutsche Bank are waving between 53% (2001) to 46% (2002) and 53% (2003). The attendance rate waves as well.

Table 5: impact of foreign investment.

Corporation	Foreign Shs	Turnout 2004	"German Only"
Infineon Technologies	n.a.	17.59%	n.a.
adidas-Salomon	66%	28.25%	83.09%
Deutsche Börse	59%	31.55%	76.95%
Deutsche Bank	53%	31.98%	68.04%
Bayer	42%	32.50%	56.03%
Siemens	56.30%	32.67%	74.76%
Schering	52%	33%	68.75%
Continental	n.a.	34.44%	n.a.
BASF	52.40%	34.99%	73.51%
E.ON	43%	35%	61.40%
Allianz	33.90%	37.15%	56.20%
Volkswagen	n.a.	37.21%	n.a.
Deutsche Lufthansa	23.90%	41.09%	53.99%
DaimlerChrysler	45%	43.69%	79.44%
Munich Re	36.70%	44.89%	70.92%
Average (without n.a.)			*68.59%*

Table 5 demonstrates that, in a hypothetical "German only turnout", the average attendance is relatively close to the adjusted American figures. One might suggest that the same adjustment to international investments is required with respect to American turnout rates. However, the size of the American capital market is disproportionately larger than the German market, while the proportion of foreign investors is lower in American capital markets, as compared to Germany.[242] Further, several European firms are second-listed at American stock exchanges, while American firms rarely strive for a second listing at

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[242] In 1995, foreign investors held 8,7% of German stocks, as compared to 4,2% of American stocks. (Further data: France: 11,2%, United Kingdom: 13,7%; the large stake of foreign shareholdings in U.K. is probably due to the similarity to the American system, which lures American institutional investors to invest in British capital markets). The data are taken from DAI, Factbook (2003). These data reflect the level of foreign investment before the adoption of advanced securities regulation in Germany. The data presented in Appendix F suggest a much higher foreign shareholding in the DAX30 (app. 35%) in 2004.

European stock exchanges. At the same time, institutional investment through pension and mutual funds, which undertake the majority of cross-border investments, is traditionally more strongly developed in Anglo-America than in France and Germany.[243] Thus, one can assume that Anglo-American investors (still) invest more money in French and German firms than vice versa, hence foreign investors do not have as much of an impact on American turnouts. Finally, many international investors act through their American subsidiaries. With respect to these subsidiaries, American proxy rules (esp. the broker non-voting rules for shares hold in broker-accounts, rather than directly) may apply, ensuring that these shares are represented in the meeting. Though the above considerations suggest that foreign investment in American firms does not significantly impact the turnouts, it nevertheless constitutes a potential source of error, which – given the published data – could not be extinguished.[244]

Table 6: impact of concentrated ownership[245]

Corporation	Conc. Os.	3-year average
Henkel	57.75%	81.11%
Deutsche Post World Net	62.60%	76.48%
Metro	55.58%	65.84%
BMW	46.60%	65.37%
Altana	50.10%	64.74%
Fresenius Medical Care	50.76%	64.19%
Deutsche Telekom	42.77%	59.82%
ThyssenKrupp	*23.50%*	59.30%
SAP	35.50%	57.65%
RWE	27.68%	55.05%

[243] The data of DAI, *Factbook* (2003), show that in 1995 domestic investment and pension funds and insurance companies in Germany held 20%, while in the United States these institutions held 44,3 % of the shares in domestic public corporations (France: 3,9%; United Kingdom: 50,1%).

[244] Unfortunately, the NYSE TOP 100 firms do not publish regional shareholder structures.

[245] Source: Database available at www.bafin.de, and tested against recent corporate announcements.

Table 6 demonstrates the impact of concentrated ownership on attendance at German shareholder meetings. Of the ten companies with the highest attendance rates, eight have a controlling shareholder or a controlling group of shareholders (holding more than 30% of the votes). Of the remaining two companies, the founders' families of ThyssenKrupp AG together hold approximately 23.5% of the votes. A large number of municipalities, Allianz AG, and Munich Re AG together hold 27.68% in RWE AG.

Third: Until the year 2001, banks organized the proxy voting process in German companies, while management was prohibited from collecting and exercising proxies. Organizing proxy voting is burdensome, costly, and – particularly in the case of small banks and credit co-operatives, which have no influence on management, – does not pay out directly nor indirectly. Thus, banks have become increasingly more likely to refrain from offering proxy voting to their clients. Despite the use of new technologies, management-organized proxy voting has not demonstrated the same efficacy in increasing turnout rates, which is largely due to a prohibition on using proxies to vest discretion with the management[246] and/or to give long-term proxies to management.

Fourth: the last factor influencing the statistics is rooted in a different practice regarding the publication of overall numbers of outstanding shares in the United States and Germany. American firms publish the number of *outstanding* common stock in the quarterly report regarding the shareholder meeting. Shareholder meeting notices of German firms merely publish the nominal share capital. Different legal regimes governing share buybacks may account for these differences. While American firms buy and sell their stock on a regular basis, German companies are subject to strict limitations when buying back their shares.[247] These share buybacks may impact German turnout figures up to 10%.[248]

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[246] Noack, in FS Lutter (2000), at 1480; *Pikò/Preissler,* in Zetzsche (ed.), *The Virtual Shareholder Meeting* (2002), Rn. 348 with further citations.

[247] S. 71 GSCA lists an exhaustive catalogue.

[248] E.g., by 28 June 2004, Deutsche Bank had repurchased 10% of outstanding shares, see Press Release,, online: <www.deutsche-bank.de/presse/index.html?contentOverload=http://www.deutsche-bank.de/presse/releases_1502.shtml>]. The adjusted attendance rate is approximately 36%, rather than 31,98%, as *Appendix C* suggests, the "German only turnout" is 76,60%, rather than 68,04%. Based on the data of outstanding shares published for end of April 2004 at www.stoxx.com, the average turnout at the DAX30

The margin of error provided by these four factors suggests that turnout measured in votes may be an inaccurate proxy for shareholder activism.

b) Personal Attendance at Shareholder Meetings

The personal attendance of shareholders at shareholder meetings may be a better proxy for shareholder activism. From an economic point of view, one would suggest that shareholders rarely attend shareholder meetings in person, since they have very little to gain by attending personally, while they bear the direct (journey, hotel) and indirect (time, loss of salary) costs of attendance.

American evidence supports this hypothesis. The few data that are available[249] suggest that the average attendance at shareholder meetings of large American companies is in the vicinity of 200 to 300 persons per meeting.[250] Only a few corporations have significantly more shareholders in their meetings. For example, Procter & Gamble has a three year average (2002-2004) of more than 1500 shareholders per meeting. In contrast, German shareholder meetings are huge public events. In the German sample, the lowest three-year average (2002-2004) was 519 shareholders (adidas-salomon AG), and the highest was Siemens AG (10,867 shareholders per meeting), resulting in an overall three-year average of 4,039 shareholders per meeting.[251] Between 0.24% (Deutsche Telekom AG) and 6.83% (Henkel AG) of all shareholders of the corporation visited the shareholder meetings personally.

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firms for 2004 were 47,7% rather than 47,21%. These data, however, were in some respects inconsistent with information published by the companies.

[249] Since the EDGAR files did not contain data on personal attendance and very few companies even collect data on personal attendance, empirical data covering the sample for attendance measured in votes cannot be given here. Thus, American data is rather sketchy.

[250] A representative of the Deutsche Schutzvereinigung für Wertpapierbesitz (DSW) reported merely 200-300 shareholders present at the shareholder meeting deciding upon the amalgamation of Daimler-Benz and Chrylser in 1998. This is consistent with figures the author received from some firms of the American sample. The American firms wished not to be mentioned by name.

[251] The data regarding BASF AG and TUI AG are estimates based on data kindly provided by gsc research, see www.gsc-research.de. Estimates regarding earlier years are based on company information. The probably largest shareholder meeting ever was the meeting of DaimlerChrysler AG in 1999 with 16.500 shareholders. After that meeting, DaimlerChrysler moved its meeting location from Stuttgart, its traditional place, to Berlin, which resulted in lower personal attendances.

These figures suggest that shareholder meetings are of substantial importance to German corporations and shareholders, while the American numbers support the proposition that shareholder meetings are not a particularly important aspect of the American firms.[252] Further, the fact that German firms keep track of personal attendance, while American firms do not, might be itself understood as evidence for the relevance of personal attendance in Germany, while, in the United States, only votes matter. Both aspects are consistent with the Implicit / Explicit distinction presented herein.

c) Control Considerations

The high turnout at shareholder meetings might be explainable by two factors that are not obviously related to a culture of shareholder activism. First, German companies might be more generous with respect to indirect rewards provided for their shareholders' personal attendance than are American firms.[253] The same effect might yield from the fact that, under German tax law, costs for attending shareholder meetings are tax deductible from capital gains. Both aspects may positively influence the likelihood of attendance for shareholders whose time is of relatively little value, such as pensioners. This explanation, however, leads to the question of what explains the generosity of the firms or the state that results in luring shareholders to the Annual Meeting? Firms and the state would not be generous unless they regarded a high personal attendance at shareholder meetings a good thing. In light of this observation, it is possible that the German corporate world and the state understand a high personal attendance as a proxy for good Corporate Governance, which is – again – consistent with the Explicit System.

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[252] Bernhard Pellens and Joachim Gassens recently held that (merely) 52% of German retail investors would sell their voting rights for a premium of 20% of the share prices, see www.investorrelations.dpwn.de, at "IR News". Given that merely 0,23% - 2,15% participate personally (and an unknown number of retail investors by proxy), this number is remarkably low.

[253] While a few years ago these indirect payments might have been more important, today, German corporations generally refrain from exhibiting a generous attitude towards their shareholders. For example, Henkel AG decided in 2001 to refrain from handing out shareholder gifts (pakets of Persil, which is the most prominent detergent in the German market). The next year, the turnout was 2.900, rather than 3.900 (as in 2001).

Table 7: Shareholder / Corporation Ratio[254]

Country	Shareholders	% (population)	Public Corporations	Ratio
Canada	5,746,000	37.00%	3635	1,580
France	5,600,000	12.70%	*750*	7,467
Germany	4,600,000	7.10%	829	6,696
Switzerland	1,666,000	31.90%	286	5,825
United Kingdom	12,500,000	23.00%	2322	5,383
United States	78,800,000	25.40%	5261	14,978

Second, even though the small shareholder's most efficient behavior in market systems is said to be to free-ride on other shareholders' monitoring expenses and rely on capital market pricing,[255] not all shareholders behave in a perfectly economical rational manner. Further, when it comes to economic matters portfolio theory strongly promotes the advantages of diversification.[256] Then, time and wealth restraints might increase incentives to refrain from attending all of the shareholder meetings of corporations in which a shareholder holds shares. Thus, one could hypothesize that, rather than resulting in an overall higher level of shareholder activity, a lower overall number of public corporations as compared to the overall number of shareholders is a possible explanation for a higher number of shareholders personally attending the meetings. Table 7 presents data pertaining to the shareholder / corporation ratio in selected countries. It shows that the ratio of shareholders per company is much greater in the United States than in Germany. Given a comparable level of activism, one would suggest that more shareholders attend the meetings in the United States than in Germany. However, the United States is a much larger country than Germany and, thus, other factors like the location of the meeting might significantly influence the decision to travel to a meeting. Hence, a proxy that is unrelated

[254] Data taken from DAI, Factbook (2003). The number of Shareholders of Switzerland is of 2002, and that of U.K. and U.S. of 1999. The number of French public corporations is estimated on basis of data kindly provided by Euronext NV (www.euronext.com). The number of Canadian public corporation is the number of issuers listed on TSX and TSX venture exchange per 30 June 2004 (see www.tsx.com).

[255] Supra, note 4.

[256] Ross, Westerfield, Jaffe, *Corporate Finance* (1999), at 10.3, pp. 235 et seq,

to the influence of the number of shareholders, or the size of the country could strengthen the persuasiveness of the above evidence.

A review of the means by which corporations report about shareholder meetings provides this evidence. Firms in the American sample rarely report about annual general meetings on the company's website. Shareholders will find the mandatory information regarding shareholder meetings on the company's website[257] under the headline "SEC filing". Under the headline "events & presentation," approximately 50% of the American firms publish the presentation of the board at the shareholder meeting,[258] in between financial presentations to capital market audiences like analysts, institutional investor circles, or general statements made by the CEO in public. Only a few American firms provide some kind of additional information on shareholder meetings under the headline "shareholder meeting".[259] Since American corporations are not responsive to requests for information regarding shareholder meetings,[260] access to meeting-related information is limited to the items voted upon and the meeting results. Additional information, for example on procedural issues or discussions in the meeting, is generally unavailable.

Though German corporate law already requires extensive reporting about the meeting in publicly accessible databases,[261] the German Corporate Codex[262] suggests that the corporation engage in additional reporting about shareholder meetings. All German DAX30 firms have a specific part of their investor relations website devoted to shareholder meetings, and all but 4 companies offered (per July 2004 – hence, long after the proxy season -) some kind of additional information, such as retrospective views on the content of the last meeting, web-casts, press releases, or abstracts of the discussion in the meeting.

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[257] Proxy statement, Annual Reports, Quarterly Report (From 10-q) with voting results.

[258] Either as webcast, or (more often) as text.

[259] For example, Abbott Laboratories and Altria (press releases). PepsiCo. offers a webcast of the full meeting, incl. Q&A session.

[260] From 32 American corporations that the author questioned about their shareholder meetings, merely 7 firms reacted, but merely two firms answered to the authors questions. In contrast, 28 of 30 German corporations answered the author's questions. The reluctance of American corporations to answer is partly due to many questions of academic nature, and partly due to strict and burdensome securities regulation.

[261] For an overview see Noack, *Database for Corporate Information* (2003).

[262] Online: <www.corporate-governance-code.de/ger/kodex/2.html >.

Given the size of the firms included in this sample, costs can hardly be a reason for the passivity of American firms when it comes to providing information regarding shareholder meetings. In the absence of any other plausible explanation, these data suggest that shareholder meetings are a low priority for most American firms, and a high priority for most German firms. The approximate length of shareholder meetings augments this impression: The webcast of the PepsiCo. shareholder meeting of the year 2004 is 61 minutes long,[263] while the length of large German shareholder meetings can be estimated to comprise between 5 and 11 hours.[264]

This leads to the question of what role shareholder meetings play in the two corporate cultures. American literature tends to understand shareholder meetings merely as an institution that legitimizes the board's ultimate power over the corporation.[265] Corporate control issues are rarely considered, as websites of the American sample demonstrate. While board issues are reported under the sub-domain "Corporate Governance", none of the firms include information about shareholder meetings under this headline. In contrast, the German Corporate Governance Codex starts with provisions on shareholder meetings in Chapter 2, before considering board-related issues, and German firms' reports on Corporate Governance,[266] or Annual Reports, usually allude to shareholder meetings when reporting about Corporate Governance. One can thus reasonably assume that shareholder meetings in Germany are an important facet of corporate control, while they fulfil other needs in Anglo-America. In light of above analysis of shareholder monitoring through meetings,[267] it is unclear, though, which needs they fulfil in particular, given the inefficiency of a meeting that has been reduced to voting procedures.[268]

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[263] Online: < phx.corporate-ir.net/phoenix.zhtml?c=78265&p=irol-audiopresentations >.

[264] This estimate is based on the author's own experience as former organizer of shareholder meetings. Special Meetings can be even longer. However, some entrepreneurial shareholders' undertaking to utilize shareholder meetings for "strike suits", as well as some ideologist shareholders, abuse the meeting through extensive questioning. The problems resulting from this abuse are considered *infra*, C.III.2.a).

[265] Clark, *Corporate Law* (1986), at 389.

[266] See, for example, SAP AG (online: <www.sap.com/company/governance/>), but also Allianz, Bayer, Commerzbank, DaimlerChrysler, Deutsche Bank, Deutsche Lufthansa.

[267] Supra, B.III.2.c).

[268] Besides providing an alternative to a takeover bid for a change in control, see Zetzsche, "Shareholder Procedural Rights", *supra* note 139, at D.I.3.

IV. Intermediate Result

This section posited that the main difference between shareholder rights in Continental Europe and Anglo-America pertains to the usage of explicit and implicit ways of exercising shareholder influence in public corporations. The paper provided historical, statutory, and empirical evidence in support of this proposition: corporate law development in France and Germany was driven by a strong state's desire to hamper the impact of market forces, to the benefit of weaker parts of society. This predominant public goal was rooted in Catholic and Lutheran ethics, which were consistent with the Germanic value of responsibility for one's "followers." Shareholders in Continental Europe thus were to embrace their "social responsibility" rather than concentrating on maximizing profit through a pre-occupation with selling, as was generally acceptable in Anglo-America. These public goals were most likely to be achieved by a system that maximized direct shareholder influence on the management, while at the same time the system denied shareholders an exit at an adequate price. Thus, shareholder meetings became a central concern in the legal frameworks of Germany. Statutory evidence showed a greater direct shareholder influence through procedural rights preceding the meeting, information rights, and shareholder suits, as well as lower directorial deference. These shareholder rights established the predicate for shareholder monitoring based on the three pillars of publicity, nuisance value, and severe sanctions for disregarding minority shareholder interests. Empirical figures demonstrated that a relatively higher proportion of shareholders attend shareholder meetings in German corporations, as compared to American firms, that German firms used to report extensively about shareholder meetings, and that shareholder meetings in Germany are considered to be part of Corporate Governance, while American firms refer to shareholder meetings merely for (dubiously) legitimising the board's ultimate power over the corporation. In light of this evidence, the analysis of current Corporate Governance developments in Anglo-America, France, and Germany is well grounded in a prime categorization of Explicit and Implicit Systems of corporate control.

C. The “Convergence Cycles”

The remainder of this paper provides speculations regarding the future development of *Anglo-American and Continental European* Corporate Governance systems on the basis of the categorization of Explicit and Implicit Systems of corporate control. This section, in particular, analyses the extent to which *the corporate law regarding internal control systems of corporations* will converge.[269]

I. Formal Convergence on Intermediate Ground

On the basis of above categorization, a convergence of Anglo-American, French and German systems of corporate control toward a system that is neither exclusively Explicit, nor Implicit is the most likely occurrence. Such a system would have both strong market institutions for external control, as well as strong institutions for internal control of management and directors. The weaknesses of both systems[270] would be mitigated by the existence of the other form of control instrument. It is unlikely that this ideal system will be the American market-model,[271] nor will it be an ethically based model of direct shareholder influence, as is prevalent in Continental Europe. Rather, convergence forces are more likely to push both archetypes toward an intermediate ground, finally resulting in formal convergence.

I suggest that the force that drives convergence toward an intermediate ground will be a phenomenon that I term “Convergence Cycles.” The prime assumption underlying Convergence Cycles is that none of the current Corporate Governance systems is perfect. On the lookout for better solutions, both Anglo-American and Continental European legislatures are looking at the other’s system and attempting to isolate its positive and negative aspects. Where the weaknesses in one’s own system are obvious, corporate reform will draw on foreign experiences. Rather than immediately adopting provisions or

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[269] Since this thesis primarily addresses shareholder rights, there will not be a detailed analysis of other Corporate Governance issues, such as the board of directors or “external Corporate Governance”. See Branson, “The Very Uncertain Prospect”, *supra* note 13, at 359-361, criticizing that corporate scholars would miss the important issues of the world.

[270] Supra, B.II.2., and – more in detail – C.II. *infra*.

[271] Supra, note 12.

institutions of the alternative system, the legislatures will strive for "local optima," hence there will be the adoption of certain variants that are predicated upon the foreign regulatory concept, but adjusted to take into account national interests. Then the (now) less successful (older) system will review whether an adoption of the more successful (newer) variant makes sense, and the process will recur, with different aspects of the system. It may turn out, in fact, that the national variant is inefficient or unsustainable. In this case, an adoption of the more successful foreign variant is possible, but so is a regression. In struggling to find the best corporate law for national interests, convergence forces will finally push the development in a direction that enables more convergence, rather than less.[272] In between, various steps of imitation and refusal will occur.

In light of these Convergence Cycles, I hypothesize that the "end of history"[273] will not come in the form of a big bang, but in many small regulatory steps, narrowing down the space in which regulatory devices will be adjusted. Though it might take a while, the Convergence Cycles may finally lead to formal convergence.

II. Potential Counter-Arguments

The likely outcome of convergence has been subject to a rich discussion.[274] Reviewed separately, many conceptually argued positions appear consistent and logical, while, at the same time, they contradict other equally convincing views. The almost unlimited number of factors that potentially influence future convergence accounts for a situation in which the one side of the story can be as strongly conceptually argued as the opposing view. When results regarding the future become somewhat arbitrary, another aspect of convergence theory becomes more important, which is the inherent task of deciphering present strains of developments on the basis of statutory and empirical evidence. In light of this observation, the author limits the conceptual argument in favor of a development in Convergence Cycles to a minimum that shows the theory's position within the present state of academic debate, and focuses on the evidential part as the core of the argument.

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[272] Convergence forces will de facto be supported by provisions of hybrid character, in particular those regarding information, since these provisions facilitate both the Explicit and the Implicit System.

[273] Hansman & Kraakman, "The End", *supra* note 7.

[274] Supra, notes 11-14.

The theory of Convergence Cycles, finally resulting in a convergence toward a new system that combines explicit and implicit elements of corporate control, is "surrounded" by three academic "adversaries:" the divergenists (below sub 1.), the functional convergenists (below sub 2.), and the Americanocentric convergenists (below sub 3.).

1. Divergenists

It is anticipated that divergenists would submit that divergence forces will hinder the convergence forces to push the development in a direction that enables more convergence, by pushing in the opposite direction. If the small development toward convergence falters, the overall development in Convergence Cycles will as well.

a) Divergence Forces

Divergence forces have been intensively examined.[275] In essence, divergenists have brought forward cultural, political, and economical (efficiency-) arguments. With respect to **culture**, divergenists emphasize the relative *uniqueness and insularity* of Anglo-America, which is said to be founded upon the ideal of free speech and the egoistic pursuit of happiness. The result is a society which clings to the notions of unbridled individualism and capitalism, and has a propensity towards conflicts. The rest of the world is said to pursue concepts of capitalism that are embedded in traditional social and family values, thereby maintaining ideals of tolerance, responsibility for society as a whole, and harmony. Cultural differences would therefore account for backlashes against American values and legal regimes.[276] **Political arguments** include *rent-seeking* by national incumbents who defend their turfs, a *lack of transparency and political accountability* in international convergence initiatives, and the apprehension that convergence *relocates competitive factors* to the benefit of foreign competitors. All three factors would add to political resistance against convergence, resulting in persistence of the old regime.[277] Finally, **efficiency**

[275] Supra, note 13.

[276] E.g. Bebchuck & Roe, "A Theory of Path Dependence", *supra* note 13, at 168; Branson, "The Very Uncertain Prospect", *supra* note 13, at 325, and 343 et seq.

[277] E.g. Lucian Arye Bebchuck, "A Rent-Protection Theory of Corporate Ownership and Control" (1999) Harvard L. School Olin-Center Discussion Paper No. 260 (from SSRN); Bebchuck & Roe, "A Theory of Path Dependence", *supra* note 13, at 142 et seq.; Branson, "The Very Uncertain Prospect", *supra* note 13, at 338.

considerations refer to *complementarities*, structures that, though different in design, fulfil equivalent functions in corporate control,[278] "*local optima*" whose reform (even if it results in efficiency gains) is more costly than keeping the existent structure and accepting the (relatively small) losses,[279] and the *irrelevancy argument*, which holds that legislatures would consider other issues much more pressing than the improvement of Corporate Governance.[280] Divergenists assume that all of these factors render a path dependent development of corporate law the most likely alternative.[281]

b) Counter-Arguments

Since convergence forces have been almost exhaustively expounded upon,[282] they do not require repetition at length. In short, they include an *increasing the exchange of knowledge* within the corporate world,[283] *pressure* from outsiders[284] and insiders[285] to adopt more efficient Corporate Governance structures, and *political developments*, such as globalization and regional harmonization.[286] In light of arguments for and against convergence, the discussion between the divergenists and the convergenists has reached a stalemate.

The idea of Convergence Cycles, however, could reanimate the discussion, since it differs from other statements predicting formal convergence by arguing convergence towards a middle ground. All of the aforementioned divergence arguments are less convincing if one considers convergence towards an intermediate ground, rather than towards the American

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[278] E.g. Schmidt & Spindler, "Path Dependence and Complementarity", *supra* note 13.

[279] E.g. Bebchuck & Roe, "A Theory of Path Dependence", *supra* note 13, at 139, 155 et seq.

[280] E.g. Branson, "The Very Uncertain Prospect", *supra* note 13, at 352.

[281] As its core, "path dependency" is a collective action problem: Though the overall economy would benefit from a reform, the individuals cannot agree on the division of costs that a reform would impose on some parts of society.

[282] For an instructive overview, see Jeffrey N. Gordon & Mark J. Roe, Introduction, in: Gordon/Roe, *Convergence and Persistence* (2004), at 4 (emphasising competition, firm's choice and supranational institutions), and Siems, *Convergence* (2004), at 289 et seq.

[283] Which is due to telecommunications revolution and an ease of international jet travel, see id.

[284] Regulators, stock exchanges, pension funds & others, see id.

[285] Directors due to stock-price related compensation plans, controlling shareholders due to gain in their personal wealth, see id.

[286] E.g. Cunningham, "Commonalities and Prescriptions", *supra* note 12, at 1148 et seq.; Gordon, "Pathways", *supra* note 12, and "An International Relations Perspective", *supra* note 7.

model. *Cultural sentiments* between the United States and Europe will not provide barriers, if corporate law converges toward an intermediate ground. Continental Europeans fear American hegemony, but not the United States itself. European states will not resist American ideas *per se*, unless they are imposed on them by either economic or military force. Better solutions for serious problems – the core of the Convergence Cycles – will find fertile European grounds.[287] Domestic scandals will reveal the loopholes in each system's efficiency. On the other hand, the American system has proven to be highly adaptable due to a practical, rather than an ideological, approach to policy by American regulators. *Political barriers* do exists. However, European and American economies are already deeply intertwined, and it is logical to suggest that nationalistic tendencies in one economy will provoke countermoves in the other that will eventually balance *external rents* of the economies on an even ground. To the same extent, the costs of change can be assumed to be lower if both sides share the costs of change. Under these circumstances, it is likely that internal resistance will be lowered, and chances are greater that the collective action problems that path dependency creates might be overcome. Proportionally, the remainder of *internal rent-seekers* will become weaker, and will finally be overcome by pressure exerted by firms that rely on exports into other economies.[288] Finally, since Continental European and Anglo-American states already have the basic institutions necessary for further convergence, which are capital markets with active regulators, firms, managers, shareholders, and shareholder meetings,[289] the costs of change can be presumed to be relatively low. Thus, *efficiency considerations* are less likely to result in "local optima" situations that stall further development. Instead, due to lower information and transaction costs that formal convergence presents, the states' experiments in an effort to

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[287] The common perception that "Americanization" is pejorative in Europe implicates American hegemony through economic or political influence. In contrast, European nations love to free-ride on American experience, where America provides good solutions for problems. An example is the EDGAR-system of the SEC. European Regulators currently develop an equivalent for European corporate data, see Noack, *Database for Corporate Information* (2003).

[288] Siemens' and DaimlerChrysler's recent agreement with worker representatives to increase weekly average labor hours from 35 to 40 per Week is a good example, see *supra* note 44.

[289] Siems, *Convergence* (2004), at 289 et seq. terms this tendency "convergence through congruence." As Part B. has shown, this does not exclude that some idiosyncracies exist. For example, Continental European shareholders can be presumed to be more active, and American capital market structures can be assumed to be more efficient.

find the best combination of implicit and explicit elements is more likely to finally result in formal convergence.

2. Functional Convergenists

It is anticipated that functional convergenists[290] would criticize the convergence cycle model on the grounds that Convergence Cycles might stop turning when a functional equivalent has been found within an existing Corporate Governance system. They would allege that such a functional equivalent will be as efficient as a potential future system and will represent a lower cost alternative. The existence of a functional equivalent will thus stifle the continuation of Convergence Cycles.

a) The Idea of Functional Adaptability

Functional convergenists assume that "functional convergence operates behind a façade of [traditional] local institutions."[291]

> [The development of Corporate Governance systems] was driven, domino-like, by the linking of complementary institutions. … [The] institutional form is still constrained by the initial starting point. … When external economic changes counsel altering one institutional attribute, the change may cause the productivity of the entire system to decline dramatically because other attributes were selected to make good use of the now altered attribute. [Thus, traditional institutions may establish a] barrier to change if altered economic conditions reduce the resulting system's efficiency. [292]

Gilson also compared national institutions to "plate tectonics, in which the demands of current circumstances grind against the influence of initial conditions."[293] Thus, functional convergence is presumed to be the first, and formal convergence is presumed to be the last state of institutional harmonization.[294]

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[290] Supra, note 14.

[291] Gilson, "Globalizing", *supra* note 14, at 133 et seq.

[292] Gilson, "Globalizing", *supra* note 14, at 135, citing Paul Milgrom & John Roberts, "The Economics of Modern Manufacturing: Technology, Strategy and Organization" (1990) Am. Econ. Rev. 80, 511.

[293] Gilson, "Economic Efficiency", *supra* note 14, at 332.

[294] As typical example of functional, rather than formal convergence, these commentators cite the specific structure of venture capital businesses, on which bank-centered systems could "piggyback," but that bank-centered systems could not simply copy, see Gilson, "Globalizing", *supra* note 14, at 142, and Ronald Gilson

b) Why Formal Convergence Will Nevertheless Occur

Functional convergenists assume that convergence forces rarely cause *formal* convergence if a Corporate Governance system has sufficient flexibility to find a solution within its path dependent limits.[295] I suggest, however, that the present state of Corporate Governance development in Anglo-America and Europe does not fulfil this condition, as follows: The tech bubble of 1998 through 2000, and its aftermath, have (once again)[296] shown the vulnerability of the Implicit System for all the world to see. These weaknesses include the possibility of market frenzies, and the inherent risk of imposing massive losses in declining markets on powerless investors.[297] *During the bubble*, most market institutions proved incapable, foul, or both. The amount of information available exceeded the capacity of market institutions to evaluate and process information.[298] Firms, investment bankers and analysts collaborated to the detriment of investors.[299] Finally,

> under perfect capital markets, fully informed traders with unlimited access to capital immediately pounce on mispriced securities. If arbitrageurs were available to trade

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& Bernard S. Black, “Venture Capital and the Structure of Capital Markets: Banks vs. Stock Markets (1998) J. Fin. Econ. 47, 47. However, new studies shed doubt on the uniqueness of Venture Capital structures, while emphasising the importance of the legal environment of Venture Capital markets, see John Amour & Douglas Cumming, “The Legal Road to Replicating Silicon Valley” (2003) Working Paper (from SSRN).

[295] Gilson, “Globalizing”, *supra* note 14, at 138.

[296] For earlier market inefficiencies (“bubbles”), see supra, note 63.

[297] Supra, at B.II.1.

[298] Fuller, “Filtering through the flood“, Fincial Times Financial Markets of 13.1.2003, p. 6: „The sheer weight of data available on US companies discouraged investors from doing their own homework – by the time they had done it, they would have missed a buying opportunity“.

[299] Ekkehart Boehmer & Raymond P.H. Fisher, "Who Receives IPO Allocations? An Analysis of 'Regular' Investors" (2004) Working Paper (from SSRN); Daniel J. Bradley, Bradford D. Jordan, and Jay R. Ritter “The quiet period goes out with a bang” (2003) Journal of Finance 58, 1; Stephen J. Choi & Adam C. Pritchard, "Should Issuers be on the Hook for Laddering? An Empirical Analysis of the IPO Market Manipulation Litigation" (2004) Michigan Law and Economics Research Paper No. 04-009 (from SSRN); John C. Coffee, “Understanding Enron: “It’s About the Gatekeepers, Stupid” (2002) Bus. Lawy. 57, 1403; Douglas Cumming & Jeffrey G. MacIntosh, “Venture Capital Finance and Litigation over the boom and bust cycle” (2003) on file with author, at 4 et seq.; Joan MacLeod Heminway, “Enron's Tangled Web: Complex Relationships; Unanswered Questions” (2003) University of Cincinnati Law Review_71, 1167; Martin Lipton, “The Millennium Bubble And Its Aftermath: Reforming Corporate America And Getting Back To Business” (2003) Working Paper (from SSRN), at 3; Jay Ritter & Ivo Welch, “A Review of IPO Activity, Pricing, and Allocations” (2002) 57 The Journal of Finance 1795, at 1803, 1810; Seligman, *Transformation of Wallstreet* (2003), at 727 et seq. A famous example is Credit Suisse First Boston’s “Friends of Frank-” list of clients preferred in IPO allocations. The charges were finally admitted, see SEC Litigation Release 17327, January 22, 2002, online: <www.sec.gov./litigation/litreleases/lr17327.htm >.

against the noise traders, then their action would suffice to return prices to efficient levels.[300]

Studies, however, have shown that arbitrageurs, which market theory expected to establish a counterweight against noise traders, such as Hedge Funds, either refrain from activity in highly volatile settings[301] or drive both sudden rises and declines to their own benefit.[302] In the *aftermath of the bubble*, when one corporate scandal after the other was revealed and stock prices crashed en masse, investors faced immense losses, while scarce financial compensation flew primarily to entrepreneurial lawyers.[303] Finally, the picture painted of greed, egoism, unfairness, and disgrace within the capital markets was completed when SEC investigations revealed that mutual funds and their brokers interacted to the detriment of other (primarily retail) investors through illicit short-term share trading,[304] foreshadowing the end of a system that is based primarily on market control.

The Explicit system, however, did not fare much better. Internationalization and transition from bank-driven to manager-driven proxy systems deprived shareholder meetings of representative turnouts, as measured in votes.[305] Devices of explicit influence were abused by blackmailers and ideological activists, the result being that many shareholders would actually leave shareholder meetings before the vote, or they would vote in favor of management in order to vote against blackmailers.[306] The sharp sword of revision-directed suits that were grounded in allegations that the corporation withheld information and

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[300] Gilson & Kraakman, “MEMO - The Hindsight Bias”, *supra* note 63, sub. III.

[301] See Andrei Shleifer & Robert W. Vishny “The limits of arbitrage” (1997) Journal of Finance 52, 35.

[302] An arbitrageur might profit from the valuation error of noise traders, by taking either long, or short positions, in the anticipated future direction. If the prices are anticipated to rise, an arbitrageur might drive up the price of already overvalued stocks, and thereby prolong and increase the overpricing.., see J. Bradford DeLong, Andrei Shleifer, Lawrence Summers & Robert Waldman, “Positive Feedback Investment Strategies and Destabilizing Rational Speculation” (1990) J. Fin. 45, 379; Jeremy Bulow & Paul D. Klemperer “Rational Frenzies and Craszes” (1994) J. Pol. Econ. 112, 1.

[303] This phenomenon was predicted by Romano, “The Shareholder Suit”, *supra* note 88; Thompson & Thomas, “Acquisition-Oriented Class Actions,” *supra* note 88, however, posit that minority shareholders are likely to receive compensation for expropriation by majority shareholder.

[304] See “SEC, state charge Putnam in mutual fund probe”, in Wall Street Journal, as reprinted in The Globe and Mail 29 October 2003, “Spitzer to huddle with SEC on fund probe”, and “Brokers to be charged over fund trades”, in Financial Post of 3 November 2003; “”Mutual fund reform gather steam in U.S.” and “Scandal / Fees found to be grossly inflated”, in The Globe and Mail of 4 November 2003, B1 and B7.

[305] Supra, B.III.3.a).

[306] Dirk Zetzsche, “The Virtual Shareholder Meeting” (2003) BKR 2003, 736.

bypassed formalities, cut deep into the flesh of corporations that were pursuing objectively reasonable restructuring plans. The Explicit System imposed almost no obligation on crooks to refund the benefits of market manipulation through semi-true and super-euphoric statements. Though there is no evidence that large and established corporations were involved in the aforementioned activities,[307] investor faith went down to zero. The (traditionally weak) Initial Public Offering market ceased to exist, which prevented primarily young firms from gaining external financing, and led to a decline in share issuances by large firms.[308]

Given these developments, the need for ongoing reform and modernization is obvious. Both systems experienced crises at the same time, though with different results. In the United States, some of the largest and most well-established firms were involved in scandals.[309] These are the kinds of firms in which corporate finance predicts that *market control* is most useful, since financial slack increases managerial incentives to steal and shirk, while dispersed share ownership reduces shareholder incentives to directly monitor the management.[310] In contrast, young tech companies in which entrepreneurial managers often held a majority of the voting shares, were often the subject of scandals in Germany. One would assume that minority shareholder monitoring is most intense (and, thus, most efficient) in these firms, since managerial and majority shareholders interests are aligned. However, it was not, for three reasons: (1) most dispersed shareholders were inexperienced in holding shares, and thus, they were inefficient monitors; (2) legal loopholes facilitated the deficiency of minority shareholder monitoring;[311] (3) this problem was inflamed by the

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[307] German shareholders merely associate corporate scandals with young Tech-stocks and the Neuer Markt, see the list of 45 firms that went either bankrupt or were subject to examinations by the Federal Agency for Financial Services, see Manager Magazin Online, <www.manager-magazin.de/geld/artikel/0,2828,186368,00.html>.

[308] In 2003, there was not a single Initial Public Offering of domestic issuers in Germany. The IPO market, measured in market value and Mio €, developed, as follows: 10,474 (1999), 26,558 (2000), 2,692 (2001), 249 (2002), 0 (2003). Already listed firms issued shares, measured in market value and Mio €, as follows: 31,341 (1999), 18,721 (2000), 7,971 (2001), 3,025 (2002), 12,231 (2003). Source DAI, Factbook (2003).

[309] In 2000, Enron was 7th of Fortune 500. Worldcom, Tyco, Adelphia, and Global Crossing also were among the American corporate establishment of corporate America, let alone their helpers, such as the accounting firm Arthur Andersen.

[310] See citations *supra* note 234.

[311] The provisions of German *Konzernrecht* will merely apply, if the controlling shareholder is an enterprise. A (legal or natural) person is presumed to be an enterprise, if he/she/it is involved in other

fact that many majority owners who were also managers were – although honest - inexperienced and inefficient managers. Thus, minority shareholders could not rely on majority monitoring.

Both systems developed inefficiencies precisely where current Corporate Governance theory predicted they would be most effective. These inefficiencies imposed immense costs on investors, firms and the overall economy.[312] Though one might also take a different view, I hypothesize that these costs have reached a magnitude that justifies institutional reforms that go beyond the limits provided by an Implicit or Explicit system of corporate control, and thus, that formal, rather than functional convergence will occur.

3. Americanocentric Convergenists

It is anticipated that Americanocentric convergenists would assert that efficiency considerations and the influence of the more successful investors will drive convergence toward the American standard-model, rather than toward an intermediate ground.

a) The Proposition

Americanocentric convergenists rely primarily on efficiency and political arguments: the main competitive advantage of the American model consists in the access it provides to equity markets at lower costs due to the (apparently) stronger rights it attributes to minority shareholders.[313] Thus, the value of dispersed shareholdings is presumed to be less diluted than in weak legal regimes, resulting in stronger capital markets overall. Allured by a possibly higher valuation of their shares,[314] dispersed (and also some controlling)

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businesses or occupations than the corporation itself, so that conflicts of interests can occur. This definition excludes entrepreneurs who only hold the stocks of "their" firms. By then, a market rule regime covering the relationships to affiliates were not developed.

[312] The costs include loss of faith in the institutions governing corporate control, which indirectly affect firms' financing costs (this is a serious concern for small German firms), the loss of investment capital (though an old German proverb concerning losses at capital markets states: "The money is not gone, it is just in someone else's pocket."), and overall reduced economic growth, due to a paucity of capital.

[313] Citations *supra* note 58, and, in particular, Hansman & Kraakman, "The End", *supra* note 7, at 450. Critical towards a "blind adoption" of American solutions for European problems Siems, *Convergence* (2004), at 263, 283, 388, 417.

[314] Id., at 461.

shareholders would press firms to move towards American-style market regimes. Thus, more and more firms would seek to exploit the superiority of the American system.[315] Issuers who refrain from seeking this advantage would eventually falter in the efficiency competition with other firms. Inefficiently organized and non-pecuniary oriented firms and their controlling shareholders would become less successful, less important, and less influential.[316] On the other hand, the shareholders of efficiently organized firms would become more and more wealthy and influential, until they would finally be able to influence the national polity to adopt an American style regime for the national securities markets as a means of reducing the information and transaction costs for their investments, eventually resulting in formal convergence.

b) A Different View

The 1990s were indeed the decade of the Americanocentric convergenists: backed by the longest sustained bull-market in Unites States history from 1981 through 1999[317] and the breakdown of the USSR, many legislatures looked toward the United States when reforming their systems. However, legislatures around the world might interpret the weaknesses of the Implicit System that the early 2000s highlighted[318] as the first signs of a "downfall of the West," that has "seriously undermined the confidence in … the fundamentals of market-based capitalism."[319] Further considerations support the view that American corporate law is not as superior to other Corporate Governance systems as its protagonists have posited.

(1) The Americanocentric theory is rooted in the belief that American-style Corporate Governance is superior because of its **stronger protection of minority rights**. Part B. of this paper, however, has shown that American Corporate Governance theory has neglected

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[315] Id., at 460.

[316] Id., at 462 et seq.

[317] Seligman, *Transformation of Wallstreet* (2003), at 623. While growth in the United States in the 1990ies improved as compared to the period 1980-1990, it declined or stagnated in the leading economies of Europe in the same period, see OECD, "The New Economy: Beyond the Hype" (2001) Final Report on the OECD Growth Project – Executive Summary, homepage OECD, online: <www.oecd.org/dataoecd/2/26/2380634.pdf>, at 7.

[318] See supra, C.II.2.b).

[319] Clarke, "Cycles of Crisis and Regulation", *supra* note 10.

an important aspect of other corporate systems, namely, the use of explicit control mechanisms as a substitute for implicit control devices. The Americanocentric literature has failed to provide a satisfactory justification for the neglect of such mechanisms.

(2) Despite the fact that there might not be stronger protection of minority rights, Anglo-American Corporate Governance models could nevertheless result in higher share prices at the capital markets in the short run, for the simple reason that powerful American investors, just as American academia, are not familiar with the Explicit System. Thus, looking merely for characteristics of the Implicit System, they would discount shares of countries in which implicit elements are not as strongly developed as in the United States. Higher evaluations would be rooted in *ignorance of*, rather than *superiority of*, corporate law.

If this is, in fact, true, it will be doubtful whether American money can lure foreign issuers in the long run, given that European Capital Markets will gain strength in the 2000s.[320] In 2004, Europe has become the earth's **largest economy**.[321] The bulk of investments of more than 450 million Europeans is likely to flow through European capital markets. Further, **European harmonization** is far from providing "dismal failure,"[322] as recent events demonstrate: The Directive on the European Company has been enacted, providing a solution for the co-determination debate that has stalled European Corporate Governance reform for almost two decades.[323] European regulators have almost finished the works on the ambitious Financial Services Action Plan [FSAP][324] that aims to establish a uniform

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[320] The gap between European and American capital markets widened in the 1990s: while from 1991 to 2003 the market capitalisation of American domestic firms increased from 4,099,479 to 14.266.175,70 Mio. U.S.$ (times 3,48), the market capitalization of European firms increased from 2.684.429,10 to 7.714.390 Mio. U.S. $ (times 2,87). Without the United Kingdom, market capitalization has risen from 1.698.321,90 to 5.288.568,00 Mio. U.S. $ (times 3,11). This figures do not include the new countries entering into the EU in 2004. Source: DAI, Factbook (2003).

[321] European Commission, Press Release "Europe celebrates its enlargement" 3 May 2004, online: <europa.eu.int/comm/enlargement/docs/newsletter/weekly_030504.htm>.

[322] Branson, "The Very Uncertain Prospect", *supra* note 13, at 337; also Hansman & Kraakman, "The End", *supra* note 7, at 454.

[323] EC, Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees (27 November 2001), and Council Regulation 2001/2157/EC of 8 October 2001 on the Statute for a European company (SE) (26 November 2001), online <europa.eu.int/comm/internal_market/en/company/company/news/ >.

[324] Vgl. EC, Commission, *Financial Service Action Plan* (COM(1999), 232) of 11 May 1999, adopted by the European Council at Lissabon in March 2000, and at Stockholm in March 2001. For details, see the overview online: <www.europa.eu.int/comm/internal_market/en/finances/actionplan/annex.pdf >. The FSAP

European accounting, securities regulation and corporate law framework for public corporations by 2007. This framework empowers the European Commission and a network of cooperating national securities agencies (with the assistance of expert associations) as the **central enforcement agencies**.[325] The **competition of three stock exchanges**[326] drives the efficient development of trading structures. The **rise of Asian economies**, lead by China's rapid development, may further threaten American economic hegemony. If American superiority of *corporate law* is merely a myth, then the truth will be soon revealed – by market forces.

(3) Finally, since 11 September 2001, for the first time since the American-Canadian war, the United States faces a foreign threat on its own grounds. Though the impact of terrorism on American politics is still uncertain, one possible outcome is that the United States is looking for closer ties to its cultural allies. These ties could provide for partial solutions for increasingly pressing economic, social and environmental issues.[327] I speculate that one aspect of closer cooperation could be more flexibility regarding Corporate Governance on the American side of the negotiation table *to the benefit of both economies*. Teamwork of American and European regulators will be more likely, once European corporate law is harmonized, and Europeans are speaking with one voice.

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includes yet 39 legislative steps, with only 5 more to follow, e.g., European accounting law for public corporations under the IFRS, the European Primary and Secondary Markets regulations, the Takeover Directive, the Proposal for a 10th Company Law Directive on cross-border mergers, and the Proposal for a 14th Company Law Directive on cross-border transfer of seats. The European Commission has recently announced to work on a specific Corporate Law Action Plan, in order to drive further intra-European convergence of corporate law.

[325] See the various legal sources of European Law pertaining to financial services, online: <europa.eu.int/comm/internal_market/finances/index_en.htm >.

[326] Deutsche Börse AG in Frankfurt, London Stock Exchange, and Euronext in Amsterdam/Brüssel/Paris.

[327] Since America and Europe constitute by far the majority of world trade, and – more important – their populations consume the most of world's production, a ban of products made under violation of certain environmental (energy!) or social restrictions would result in de facto trade standards worldwide. Though such a policy is likely to violate the WTO treaty, it might nevertheless become a likely policy, given the the export of jobs in countries with low social and environmental standards.

III. The Evidence

While all aforementioned theories, including mine, are speculations that can each be convincingly argued, and whose substance will be tested only by the wheel of time, statutory and empirical evidence strengthens the persuasiveness of my prediction, relative to the others.

1. Anglo-America: The Re-Invention of Shareholder Rights

Anglo-American corporate law development of recent years could bear the headline "(re-)invention of Explicit shareholder rights."

a) Trajectory towards the Explicit System

The takeover friendly judicature in the *Unocal*, *Revlon* and *Paramount* cases[328] initiated an intra-American takeover boom. In light of this boom, more than 30 American states adopted anti-takeover laws. Takeover activity diminished significantly in the years following the introduction of such laws,[329] thereby reducing the impact of market forces as well. To the same extent that the takeover market lost momentum, mechanisms of the Explicit System were developed. The Council of Institutional Investors started co-ordinating activities of investment funds to control directors in 1985. Following its recommendations,[330] institutional investors concentrated more and more on "voting", rather than on just buying and selling. Meanwhile, large pension and mutual funds, such as CalPERS and Vanguard, but also the Canadian Coalition for Good Governance, adopted policies that encouraged investors to take an active role in shareholder meetings.[331]

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[328] *Unocal Corp. v. Mesa Petroleum, Co.,* 493 A.2d 946; 1985 Del. LEXIS 482; Fed. Sec. L. Rep. (CCH) P92,077 (Del. Supreme Court 1985); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173; 1986 Del. LEXIS 1053; 66 A.L.R.4th 157; Fed. Sec. L. Rep. (CCH) P92,525 (Del. Supreme Court 1986); *Paramount Communications, Inc. v. QVC Network, Inc.,* 637 A.2d 34, 48; 1994 Del. LEXIS 57; Fed. Sec. L. Rep. (CCH) P98,063 (Del. Chancery Court 1994). The principles resulting from this judicature were adopted by the influential ALI, *Principles of Corporate Governance* (1994). Also Stephen M. Bainbridge "Director Primacy in Corporate Takeovers: Preliminary Reflections"(2002-2003) 55 Stan. L.R. 791, 793 et seq.

[329] Klein & Coffee, *Business Organization and Finance* (2002), at 182 et seq.

[330] Council of Institutional Investors, online: <www.cii.org/dcwascii/web.nsf/doc/policies_index.cm>.

[331] See, e.g., the CCGG policy online: < www.ccgg.ca/web/website.nsf/web/ccggvoteyourproxies >.

A first reaction to increasing institutional investor activism was the reform of the federal proxy rules in 1992. Prior to their revision, the federal proxy rules effectively dampened collective shareholder action.[332] In 1992, federal securities regulation softened the rules pertaining to communication among shareholders sufficiently to permit an open exchange of views among shareholders.[333] In 1999, some burdensome information requirements for proxy votes in takeover situations were abandoned.[334] In the aftermath, a wave of shareholder activism flooded corporate Anglo-America, which lead to some enthusiastically celebrated “victories” of shareholder activists over corporate managers.[335]

b) Statutory Evidence

Statutory evidence regarding the new rules on board composition, the SEC proposal on the election of directors, and the holding of the SEC that shareholders may decide upon a firm’s dividend policy, evidence the rise of the Explicit System.[336]

First: while jurisdiction over Corporate Governance rules, other than proxy regulation, was traditionally vested with the states, in 2003, the SEC and the Stock Exchanges began regulating board functions. While the SEC rules require enhanced transparency regarding the operation of the boards of directors of the companies,[337] stock exchanges required American corporations to elect a majority of independent directors with specific

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[332] For example, proposals were costly, and severe restrictions were imposed on communication among shareholders. Shareholders who engaged in even non-solicitation communications potentially adverse to management needed to stand the risk of accusations that they had violated the rules promulgated under either Section 13D or Section 14A of the Securities Exchange Act of 1934.

[333] SEC, "Regulation of Communication Among Shareholders." Securities Exchange Act Release No. 31,326, 57 Federal Register 48,276 (15 October 1992). For example, Rule 14a-2(b)(1) exempted inter-shareholder communications by Rule 14a-8 proponents, subject to limited restrictions. On the reform, see Stuart B. Morrow, “Proxy Contests and Shareholder Meetings” (2003) 36 U.B.C. L.R. 483, at 511.

[334] The Commission significantly revised Item 14 of Schedule14A as part of a comprehensive revision of tender offer, proxy, and merger rules, adopted by Sec. Act Rel. 7760, 70 SEC Dock 2229 (1999).

[335] See, for example, the Investor Responsibility Research Center’s [IRRC] announcements, online: <www.irrc.org>.

[336] For further evidence, see Siems, *Convergence* (2004), at 174 et seq.

[337] SEC, “Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors,” 17 CFR Parts 228, 229, 240, 249, 270 and 274, online: <www.sec.gov/rules/final/33-8340.htm>. Also, Roberta S. Karmel, "Realizing the Dream of William O. Douglas - The Securities and Exchange Commission Takes Charge of Corporate Governance" (2004) Brooklyn Law School, Public Law Research Paper No. 7 (from SSRN).

functions.[338] A mandatory distinction between the position as Chief Executive Officer and the Chairman of the board is likely to be the next step in disentangling the position of executives and supervising directors.[339] Thus, American regulators adopted the advantages of the German two-tier board system with worker co-determination on supervisory boards[340] without taking its downside, which is the involvement of another greedy stakeholder group at the top of the corporate ladder. The adoption of one part, but not all of, the German system may trigger a turning around of the cycle. The next step might constitute a *de facto* abolition of the worker co-determination through the competition for firms incorporating in Europe.[341]

Second: under current federal proxy rules, a shareholder proposal must not be included in the management's circular if the proposal relates to a director election.[342] Due to the extensive use of proxy forms in the United States, dissidents, dissatisfied with management, must generally[343] undertake a proxy contest, along with its related expenses, to put nominees before the security holders for a vote.[344] This is an uneven contest since the

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[338] S. 303A of the Listing Manual of the New York Stock Exchange determines that independent directors are to sit on the nomination and the compensation committee (as amended per November 2003). These rules will be adopted by Canadian regulators through "Proposed Multilateral Policy 58-201 Effective Corporate Governance and 58-101 Disclosure of Corporate Governance Practices." (16 January 2004).

[339] Insofar, Nr. 2.2.3 of the Canadian "Proposed Multilateral Policy 58-101 Disclosure of Corporate Governance Practices" (16 January 2004) is a step ahead.

[340] German laws guarantee workers in supervisory boards independence from executive sway. Thus, functionally, workers are independent directors. See also Klaus J. Hopt & Patrick C. Leyens, "Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy" (2004) ECGI Law Working Paper No. 18/2004 (From SSRN), at 22 et seq.

[341] The European Directive on the European Company (*supra* note 323) enacts that the state (rather than the seat) of incorporation determines which board election regimes apply. Since corporations are not restricted by incorporating in any state they want, competition will show whether worker co-determination in Germany will last. See Schiessl, "Devices of management and control", ZHR 2003, 235, and Reichert & Brandes, "Worker Co-determination in the European Company", ZGR 2003, 767. Competition, however, might also result in more worker co-determination, see Larry Fauver & Michael E. Fuerst, "Does Good Corporate Governance Include Employee Representation? Evidence from German Corporate Boards" (2004), Working Paper (from SSRN).

[342] Rule 14a-8 (i), sub 8.

[343] In extraordinary cases, shareholder lawsuits might enable shareholders to include candidates for the board of directors into the management's circular. See, e.g., the settlement in Hanover Compressor Company, Form 8-K filed May 13, 2003 and Homestore, Inc., Form 8-K filed August 13, 2003.

[344] The situation is less clear in countries with either a higher presence of shareholders in the meeting, or a different default rule on proxies given in the period of time preceding the meeting, as in Germany and France. For example, pursuant to Art. L225-131-2, any abstention stated in the form or based on the lack of a vote in

corporation bears the cost of the candidacies of nominees who the board proposes.[345] This has caused a lively discussion in the United States about shareholder access to the ballot,[346] which has resulted in a moderate proposal to change the current SEC proxy rules.[347] Pursuant to the SEC draft proposal, shareholders will be empowered to include candidates in the management's proxy statement and the form of proxy, subject to four conditions.[348] In the context of this paper, SEC Chairman William H. Donaldson's reasoning for the requirement to add shareholder candidates to the management slate is noteworthy:

> In over-simplified terms, our current proxy rules give dissatisfied shareholders just two options: start a proxy fight for control or sell their stock. We are seeking to find middle

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the statement shall be treated as a vote against the resolution. Pursuant to s. 665 of the *BGB* (German Civil Code), proxy holders, incl. those solicited by the board, must vote in the best interest of the beneficiary.

[345] In exceptional cases, incumbent directors must pay for extraordinary expenses, though the case law is unclear, see *Hall v. Trans-Luc Daylight Screen Picture Corp.*, 20 Del. Ch. 78, 171 A. 226 (1934); *Rosenfield v. Fairchild Engine & Airplane Corp.*, 309 N.Y. 168, 128 N.E.2d 291 (1955).

[346] SEC Division of Corporation Finance, "Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors" (15 July 2003), online: <www.sec.gov/news/studies/proxyrpt.htm>, at 2 – 5; "The Case for Shareholder Access to the Ballot" (2003) Bus. Lawy. 59, 43; Bebchuk (ed.), *Symposium on Corporate Elections* (2003); Grundfest, "Advice and Consent", *supra* note 212; Martin Lipton & Steven A. Rosenblum "Election Contests In the Company's Proxy: An Idea Whose Time Has Not Come" (2003) Bus. Lawy. 59, 67; Robert C. Pozen "Institutional Perspective on Shareholder Nominations of Corporate Directors" (2003) Bus. Lawy. 59, 95; Task Force on Shareholder Proposals of the Committee on Federal Regulation of Securities (Section of Business Law of the American Bar Association) "Report on Proposed Changes in Proxy Rules and Regulations Regarding Procedures for the Election of Corporate Directors" (2003) Bus. Lawy. 59, 109; Janet McFarland, "SEC's small step for shareholders", Globe and Mail Report on Business (8 October 2003), at B2.

[347] Proposed Rule: Director Nominations, Exchange Act Release No. 34-48626 (14 October 2003), online: < www.sec.gov/rules/proposed/34-48626.htm >, stating a new §240.14a-11 "Security holder nominations"; see for the current status of the proposal online: <www.sec.gov/spotlight/dir-nominations.htm>. On the comparative aspects, see David C. Donald, "Nomination of Directors under U.S. and German Law" (2004) Johann Wolfgang Goethe University, Frankfurt/Main, Institute for Law and Finance Working Paper Series No. 21, online: <www.sec.gov/rules/proposed/s71903/dcdonald033104.pdf>, and Zetzsche, "Shareholder Procedural Rights", *supra* note 139, at C.II.4..

[348] 1) as formal requirements, the candidates must be supported by a minimum ownership of 5% of the voting rights with a two-year holding requirement as of the date the proposal, and lengthy information about the candidates, see Proposed Rule 14a-11(b) and (c). The requirements are in essence similar to that required for a proxy statement under Item 7 of Schedule A of Regulation 14A. (2) The requisitionists can only nominate a minority (1-3) of director candidates [short slate], see Proposed Rule 14a-11(d); (3) The candidate must be independent from the nominating shareholder, see Proposed Rule 14a-11(c), sub 4., and (d); (4) A triggering event must demonstrate the need for additional shareholder power. Triggering events are: (i) a shareholder proposal (submitted pursuant to Rule 14a-8) to subject the company to shareholder access regime wins a majority of the votes cast; (ii) at least one of the board's nominees for director receives "withhold" votes from at least 35% of the votes cast, see Proposed Rule 14a-11(a), sub (2).

ground, particularly at a time when Corporate Governance, while improving, is still not where it should be.[349]

There is some likelihood that the SEC draft will be further softened before adoption.[350] Its trajectory is nevertheless consistent with another new SEC rule, which requires a description of the company's policy "with regard to board members' attendance at annual meetings and a statement of the number of board members who attended the prior year's annual meeting."[351] The attendance of all or most of the directors, which is likely to follow from this proposal, is apt to further direct accountability and responsiveness of directors to shareholders in annual meetings. The SEC's strategic plan for the years 2004-2009 suggests that the SEC will further encourage the development towards more substantial shareholder meetings.[352]

Third: while European company laws vest the right to decide upon how to use profits of a corporation in *shareholders*,[353] American *directors* have traditionally held the power to declare dividends.[354] In 2002, however, shareholders of Cisco Sys., Inc. launched a shareholder proposal to vote on the declaration of a quarterly dividend.[355] Shareholders of Potlach Corp. proposed in 2003 that the board prepare a report explaining the corporation's past and current dividend policy.[356] In both cases the SEC staff denied the board permission to omit the proposal from the management's circular.[357] Whether this trend toward reducing directorial deference will persist, might be clarified in the Hollinger-case, in which the

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[349] SEC Chairman William H. Donaldson, "Remarks to the Council of Institutional Investors" Washington, D.C., March 25, 2004, online: www.sec.gov/news/speech/spch032504whd.htm.

[350] See Deborah Solomon, "compromise may rescue SEC rule on directors," The Wall Street Journal of 11 August 2004, as reprinted in The Globe and Mail, at B6, stating that the SEC works on a new draft that includes mandatory negotiations between shareholders and management before shareholders can put candidates on the management slate.

[351] New SEC Rule 33-8340, introducing new Paragraph (h)(3) of Item 7 of Exchange Act Schedule 14A, which demands: "Describe the registrant's policy, if any, with regard to board members' attendance at annual meetings and state the number of board members who attended the prior year's annual meeting."]

[352] SEC, *Strategic Plan for 2004-2009* (2004), at 38, (online: www.sec.gov/about/secstratplan0409.pdf).

[353] See ss. 119 (1) Nr. 2, 174 (1) GSCA; Art. L. 232-11, 232-12 French Code de Commerce; Art. 102 of Table A to British *Companies Act of 1985*.

[354] S. 6.40 MBCA and s. 170 DGCL. Critical Cunningham, "Commonalities and Prescriptions", *supra* note 12, at 1181, with a proposal de lege ferenda (but inaccurate with respect to Germany).

[355] See Sisco Sys., Inc., 2002 Fed. Sec. L. Rep. (CCH) ¶78,330 (avail. 19 Sept 2002).

[356] Potlatch Corp., 2002-2003 Fed Sec. L. Rep. (CCH) ¶78,450 (avail. 18 Feb 2003).

[357] Pursuant to Rule 14a-8(i) of Regulation 14A under the Securities Exchange Act of 1934.

Delaware Chancery Court is to make explicit the conditions under which shareholders are entitled to vote on sales of corporate assets.[358]

c) Empirical Evidence

Statutory changes will be futile if the cultural differences between the Anglo-America and Continental Europe serve to stifle the development of shareholder activity or passivity, respectively. Empirical evidence indicates, however, that this is not, in fact, the case.

Press releases by the Investor Responsibility Research Center – a social shareholder activist -, suggest that the number of shareholder proposals in the United States has been steadily increasing.[359] Since data covering a longer period of time are not publicly available, the author analysed the sample of American firms of the NYSE TOP 100 index, which were used for determining the average turnout at American shareholder meetings,[360] with respect to the number of shareholder proposals that were voted on at annual meetings.

Table 8: Number of proposals in American Sample

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Overall	**36**	**55**	**44**	**45**	**49**	**59**	**76**	**71**	**71**	**112**	**122**
Set of data	28	29	30	31	31	31	31	31	31	32	29
Average	**1.29**	**1.90**	**1.47**	**1.45**	**1.58**	**1.90**	**2.45**	**2.29**	**2.29**	**3.50**	**4.21**

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[358] Online: <www.irrc.org/company/news_fulltext.htm#Court >.

[359] 2001: Of overall 138 *social policy proposals*, 27 proposals garnered support from 10 percent or more of shareholders. 15 of these addressed global labor standards or fair employment. (Online: <www.irrc.com/company/06292001_RecordVotes.html>); 2002: Resolutions on *global labor standards*: 21 resolutions filed in 1996 (average support 6%) to 49 each in 2001 (average support 8%) and 2002 (average support app. 10%) (<www.irrc.com/company/10092002_sweatshops.html>); 2003: 26 *global warming resolutions* have been filed, up from 21 in 2002. 322 (2002: 106!) resolutions related to *CEO compensation* have been submitted; 56 (2002: 51) resolutions related to *classified boards* (<www.irrc.com/conference/thanks.html>). 2004: 28 *global warming proposals* have been filed at 22 companies (including three filings at two Canadian companies). 11 came to votes, several others withdrawn when the targeted companies agreed to conduct the requested reviews; 28 companies--nearly twice as many as last year--asking them to report generally on their *sustainability policies*, 11 so far have come to votes; 56 resolutions on *classified boards*, with – so far – 66,2% average support (in 2003: 48 with average level of support of 63%). 49 proposals dealing with *expensing stock options* (in 2003: 69, on average 47.4 % support.) 16 companies adopted proposals for expensing options in 2003 and consequently had the proposal withdrawn from the ballot. (<www.irrc.com/company/stock_options.html>).

[360] Supra, B.III.3.

Appendix E, of which Table 8 is an excerpt, demonstrates that the average number of shareholder proposals per meeting has risen from 1.29 per year in 1994 up to 4.07 in 2004.

While these figures do suggest that some shareholders were more active in proposing resolutions, they do not provide evidence that shareholders in general have become more active. As a measure of general shareholder activity, the number of accepted proposals might be a better proxy for activism. Furthermore, a distinction between proposals made by social activists, and those pursuing better Corporate Governance can reveal insights into the maturity of investors. The data shown in detail in *Appendix E* evidence that American shareholders have, indeed, become more active: While no shareholder proposals were successful in the years 1994 through 1998, the years following show an increasing number of successful proposals.[361] Out of 332 social activist and 400 corporate governance proposals that shareholders submitted, merely 2 out of 29 proposals that were accepted by shareholders were social activist proposals. This ratio indicates that American shareholders distinguish between the different kinds of proposals presented to them. Though both the scope and volume of the sample data is relatively constricted, it nevertheless suggests that shareholder activity through explicit devices has increased in the United States.

2. Germany: The Rise of the Market Model

Commentators have realized that Germany has become increasingly willing to accept of the market model.[362] Exogenous[363] and endogenous[364] forces pushed the German system to

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[361] 1999: 1; 2000: 3; 2001: 2; 2002: 4; 2003: 11; 2004: 8 (with 27 of 32 firms reported, as of 22 August 2004).

[362] Cioffi, “Restructuring “Germany Inc.””, *supra* note 30; Coffee, “The Rise”, *supra* note 10, at 12 et seq.; Cunningham, “Commonalities and Prescriptions”, *supra* note 12, at 1147 et seq.; Gordon, “An International Relations Perspective”, *supra* note 7; Eric Nowak, "Investor Protection and Capital Market Regulation in Germany", in: Jan Pieter Krahnen, Reinhard H. Schmidt (eds.), *The German Financial System*, (Oxford University Press, 2004) [Nowak, "Investor Protection and Capital Market Regulation”]; Siems, *Convergence* (2004), at 287 et seq.

[363] Globalisation diminished protective barriers, and increased competitive forces. The globalised market, however, is more similar to the (chaotic historical) conditions in Anglo-America, than the state-dominated jurisdictions of Continental Europe. Thus, the states and firms in Continental Europe needed to adapt their traditional social and legal systems to the new conditions in order to stay competitive. These costs of change might account for the current competitive disadvantages of Continental European economies.

[364] The development may be explained as follows. Once the economy spluttered, the cookie that was to share between the parties of the social contract became smaller, rather than larger, as in the years before, which resulted in conflicts between the parties of the “social contract”: (1) employees concentrated on

open up to implicit elements. The fact that the German state could take advantage of stronger capital markets[365] might have added to the legislature's propensity to bear the costs of change, though European developments triggered the launch towards the Implicit System at a much earlier time.[366]

a) Statutory Evidence

Since 1989, the German legislature has installed a disclosure based system of securities regulation,[367] the rules of which are enforced by a specific enforcement agency.[368] Takeover regulation followed in 2001.[369] The adoption of the European FSAP[370] will further increase the momentum of German equity markets. One step taken to implement the FSAP is the proposal of an "Investor Protection Improvement Law" which is likely to come into force in 2005. It enhances the management's duty to publish a prospectus and increases the liability for making misleading statements. It also forces security analysts to disclose conflicts of interest, and it improves devices designed to prevent insider trading and market manipulation.[371] Where American rules are arguably more efficient, both the FSAP and

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maximizing their own, rather than the firm's, return; (2) the state raised taxes and increased state debt, thereby implicitly raising the firms' costs of external finance; (3) managers thought to increase their salaries; (4) the developments (1) through (3) have tipped a system that was originally beneficial to shareholders to their disadvantage. Consequently, shareholders looked for ways to re-adjust their returns by investing more in (foreign) firms without being obliged to monitor. These conflicts have stalled necessary reforms.

[365] Gordon, "An International Relations Perspective", *supra* note 7, and "Pathways", *supra* note 12.

[366] The development started with the harmonization of European Accounting Law through the 2nd and 3rd Directive on Company Law in the 1970s, see Zetzsche, *Shareholder Information* (2004), at 204 et seq.

[367] See Nowak, "Investor Protection and Capital Market Regulation", *supra* note 362. The legislative steps include the four Laws on Strengthening Capital Markets [FMFG]: *Gesetz zur Stärkung des Finanzplatzes Deutschland* (1. FMFG) of 11 July 1989, Federal Bulletin I (1989), 1412; *Zweites Finanzmarktförderungsgesetz* (2. FMFG) of 26 July 1994, Federal Bulletin I (1994), 1749; *Drittes Finanzmarktförderungsgesetz* (3. FMFG) of 29 March 1998, Federal Bulletin I (1998), 529; *Viertes Finanzmarktförderungsgesetz* (4. FMFG) of 21 June 2002, Federal Bulletin I (2002), 2010.

[368] In 1994, the "Federal Agency for the Supervision of Securities Market" [BAWe] was established. In order to enable strong enforcement, following the example of the SEC, the BAWe was united with two other federal agency in the Bundesaufsichtsamt für Finanzdienstleistungsaufsicht ("Federal Agency for the Supervision of Financial Services") [BAFin] in 2002.

[369] With the Wertpapier- and Übernahmegesetz - WpÜG ["Law on Security Offers and Takeovers"] in 2001, which was put into force 2002.

[370] See above, C.II.3.b).

[371] See Bundesregierung, "Entwurf eines Gesetzes zur Verbesserung des Anlegerschutz (Anlegerschutzverbesserungsgesetz - AnSVG)" (translated: Federal Government, Proposal of a "Investor Protection Improvement Law") of 21 April 2004, online:

German securities laws strive for convergence with these more efficient aspects of the American system. However, where the regulation provides European solutions (rather than carbon copies of the American solutions), hence "local optima," it initiates the next turn of the Convergence Cycle.

At the same time, regulators also strived for improvement of the Explicit System, esp. with respect to individual information rights, and the doctrinaire distinction between control and the financial value of equity, which constitutes the legal basis for the rigidity of revision-directed shareholder suits. Both devices have been abused in the past for blackmailing[372] and social activism. In accordance with recent judicature from the German constitutional court,[373] two decisions of the German Federal Supreme Court enhanced shareholders' ability to get financial compensation, where the statutes suggested that non-financial sanctions would be sufficient. The decision in *MEZ* enhanced the power of courts to soften the impact of a revision-directed suit, which is a de facto blocking of a merger, until the end of court proceedings that might come by way of judgment or settlement.[374] Drawing on an analogy to another statutory form of merger, the court applied provisions regarding a corporate mediation proceeding that is aimed at financial compensation, rather than those regarding revision-directed suits. Before this judgment, the scope of this statutory mediation proceeding had been strictly limited. In *Macrotron*, the court held that shareholders need to be financially compensated for the loss in liquidity caused by a voluntary retreat of the firm from the securities market ("delisting") that was initiated by a

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<www.bundesfinanzministerium.de/Anlage23988/Entwurf-eines-Gesetzes-zur-Verbesserung-des-Anlegerschutz-Anlegerschutzverbesserungsgesetz-AnSVG.pdf>.

[372] Baums, "Legal Opinion F. for the 63rd Conference of German Jurist Forum".

[373] In the judgments of the German Constitutional Court in BVerfGE 14, 263, 282 – Feldmühle -; SEN – ZIP 1999, 533; - DAT/Altana -, ZIP 1999, 1436, 1439 f.; ZIP 2000, 1670, 1671 f. – Moto Meter -, the court established a three step test for interference with shareholder property rights. An interference to be lawful requires (1) a *justification*, relying on the specific situation of the underlying business and those of related parties, (2) a *financial compensation* of the full economic value of the shares, and (3) effective judicial review.

[374] BGHZ 146, 179 (1.Ls.) bzw. 186 – MEZ -; ditto BGH, ZIP 2001, 412 – Aqua-Butzke-Werke -.

controlling shareholder. At the same time, it cut down the scope of the revision-directed suit by preferring financial compensation to a revision of the meeting's decision.[375]

The German legislature follows the same trajectory as do the courts. Upholding the Explicit System in principle,[376] and in particular the individual information right and the revision-directed suit, the legislature is going to further disarm these devices in order to prevent abuses. One such action is an acknowledgement that information published on a company's website is the equivalent of answers given by the boards in shareholder meetings. Another action is the establishment of a preliminary procedure in certain revision-directed suits. In this preliminary procedure courts will decide whether the transaction that is being challenged will be blocked until the end of judicial proceedings, or whether financial compensation may substitute for the revision-directed suit if the suing shareholder eventually prevails. Effectively, the scope of the revision-directed suit will be reduced to the benefit of financial compensation for infringements of corporate law. At the same time, the German legislature is planning to lower the thresholds for shareholder derivative suits against directors – originally requiring the shareholder(s) to hold 10% of the shares or shares with a face value of 1 million € for at least three months before the filing - to a face value of 100,000 €, with a new preliminary court proceeding providing an additional gatekeeper for shareholder actions.[377]

Both the court decisions and the new draft is consistent with the trajectory of the EU-Takeover Directive that also facilitates the "commercialisation" of shares.[378]

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[375] BGHZ 153, 57 = ZIP 2003, 387, 390 = NZG 2003, 280, 282; see Zetzsche, "Voluntary Delisting" (2000) NZG 2000, 1046 et seq.

[376] See the improvements relating to shareholder proposals preceding the meeting, *supra* B.III.2.

[377] See ss. 131, 243, 247a, 147a GSCA, as amended by UMAG, *supra* note 148.

[378] Art. 5 of European Directive 2004/25/EG requires national governments to implement a sell-out right for minority shareholders for cases in which an acquirer acquired a very large stake of the shares through a tender offer.

b) Empirical Evidence

Empirical evidence for the trajectory towards the Implicit System consists of (1) the increasing number of shareholders, (2) the decline of bank influence, and (3) the increase in takeover activity since 2001.

Table 9: development of investment ownership in Germany[379]

(in million)	1988	+/-	1994	+/-	1997	+/-	2000	+/-	2004	**1988/2004** resp. **1997/2004**	+/-
Shareholders	3,192	23.25%	3,934	-0.36%	3,920	58.44%	6,211	-26.36%	4,574	1,854	43.30%
Shareholders & Fund Unit Owners	n.a.		n.a.		5,601	111.18%	11,828	-10.74%	10,558	4,957	88.50%

(1) Table 9 demonstrates that the number of German shareholders has risen significantly since the implementation of securities regulation in 1989, despite some setbacks in the aftermath of the bubble. Per July 2004, 16.4% of the German population invests in shares or funds, a rise from 8.9% in 1997.

(2) Commentators have posited that **bank influence in Germany** is declining.[380] Data provided by DAI, which cover the period when the German federal government gave up income taxation of profits from sales of corporations, or parts thereof, in 2001, support these results. While German market capitalization dropped from 2,631 billion € in 1999 to

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[379] Data taken from DAI, *Factbook* (2003).

[380] Mark Roe, *Strong Managers, Weak Owners* (1994), at 210 et seq.; Coffee, "The Rise", *supra* note 10; Gordon, "An International Relations Perspective", *supra* note 7; Hoepner & Krempel, "The Politics", *supra* note 29. Three changes drive the decline of bank influence: (1) the more burdensome procedure in collecting proxies, (2) higher competitive pressure, forcing banks concentrate on their core business, which implicates selling large shareholdings in German corporations, (3) more complex rules on board memberships. Since securities regulation hinders "insiders" to trade in securities, and current Corporate Governance legislation demands a stronger involvement of the supervisory board in business decisions, bank representatives in supervisory boards were more and more prevented from either participating in the supervisory board's work, or from using any knowledge about the firm for business purposes, since market participants would assume the use of insider information. Thus, banks faced more obstacles than benefits from their participation in Corporate Control.

1,477 billion € - or 43.8% -, bank shareholdings dropped from 350 billion € in 1999 to 159,1 billion € in 2002, or 54.5%. Banks reduced their investment, measured in proportion to overall investment in shares, in 2001, by 8.26%, and in 2002, by 25.32%. At the same time, the proportion of non-financial enterprises, insurance companies, investment funds and international investors increased.[381]

(3) Until the year 2001, Germany did not have any **takeover law,** while tax law required full income taxation of profits in the case of sales of corporations, or parts thereof.

Table 10: Takeover related announcements in Germany[382]

Notice of	Control	Takeover	Other Bids	Total
2002	17	27	2	46
2003	19	29	0	46
2004 (per 31 July)	10	9	0	19

The German legislature eliminated both obstacles to takeovers in 2001. As of July 2004, 65 takeover have been were launched. While, at first glance, Anglo-American spectators might consider this figure insignificant, it needs to be interpreted in light of an overall small number of 687 public corporations that are listed in regulated markets in Germany.[383] Thus, in 2.5 years that were marked by capital market depression,[384] 9.46% of all corporations within the scope of German takeover law have been the *target* of takeover bids.

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[381] Data taken from DAI, Factbook (2003).

[382] Derived from the database of the German Agency for the Supervision of Financial Services [BAFin], online <www.bafin.de >.

[383] Source: DAI, *Factbook* (2003). The data in Table 7, *supra* at B.III.3.c), showing the existence of 829 German public corporations, includes corporations listed at the unregulated "Freiverkehr", which is not within the scope of German takeover law, pursuant to s. 1 of *WpüG* (German Law on Security Offers and Takeovers).

[384] See the data provided in Table 9.

c) Path Dependency Overcome

The statutory and empirical evidence suggests that, in Germany, significant convergence forces have opened up the Explicit System for the introduction of elements of the Implicit System. Since 1989, German politics has invested significantly in creating the legal and institutional preconditions for a strong securities market. Regarding elements of the Implicit System, it is reasonable to assume that Germany has already paid most of the costs of convergence, which primarily comprise setting up an institutional and legal framework for market control. Naturally, change requires time. As the data on declining shareholdings after the peak in 2000 suggest, German investors and institutions have not yet permanently absorbed the idea of market control. Thus, besides its theoretical advantages over the Implicit System in certain situations, the Explicit system also remains important in the day-to-day control of managers.

3. The Cycles are Turning …

While the above merely suggests that Germany is adopting particular elements of an Implicit System, and the United States is adopting particular elements of an Explicit System, some developments underpin the functionality of Convergence Cycles themselves, as well. These include the new American propensity to adopt the International Financial Reporting Standards [IFRS], the time-lines of current change reports, and the harmonization of market and shareholder needs with respect to German individual information rights.

(1) In 2002, the European states within the European Union agreed on adopting the IFRS for all public corporations by 2005.[385] Recently, American regulators announed their willingness to consider the adoption of the IFRS, as well.[386] Though the IFRS are rooted in British – hence implicit – philosophy, adopting the IFRS nevertheless constitutes convergence on a middle ground. American and European accounting specialists are

[385] Technically, the European Commission adopts provisions suggested by the IASB. For details, see Regulation (EC) No 1606/2002 of 19 July 2002 [published 11 September 2002 in official bulletin, L243]

[386] According to Janet McFarland, “U.S. accounting rule maker open to change”, in The Globe and Mail, 22 October 2003, B4, FASB Chairman Herz announced that the United States would adopt global standards within seven years.

equally represented on its standard setting body, the International Accounting Standards Board [IASB]. Though British experts are among those who represent Europe, thereby giving representatives of Implicit System a de facto majority, Continental European states may block IFRS proposals at the level of the European Commission and its affiliated expert commissions, which effectively forces the IASB to consider Continental European standards as well.[387] It is thus reasonable to assume that Anglo-America and Continental Europe will enact rules that are somewhere on the middle ground.

(2) European member states need to ensure that issuers inform the public “as soon as possible” of inside information by filing current change reports.[388] In contrast, American law set relatively lax timelines and provided a relatively narrow exhaustive catalogue in Form 8-K. As originally adopted, companies could file the Form 8-K as late as 10 days after the end of the month in which an event requiring disclosure occurred. This meant that a company did not have to report a Form 8-K event occurring on the first day of a month until 40 days later. These provisions furthered an issuer’s apathy with respect to an early filing of material information, where the efficient market hypothesis would require it the most.[389] In 2004, the SEC dramatically shortened the filing deadline for Form 8-K to two business days after an event triggering the form's disclosure requirements, and added various new items to the Form 8-K.[390] In this case, American securities regulation

[387] One example for the influence of Continental features is the regulation of the Management Discussion & Analysis [MD&A] (Financial Review by Management). According to s. 289 (2) of the HGB (German Commercial Code), this report contains forward looking statements, and disclosure of qualitative, rather than quantitative data. Being afraid of liability for misleading statements, Anglo-American firms had refrained from both. This was particularly unfortunate, since markets used to regard data on future developments as more important than data pertaining to the past. In 1979, the SEC adopted its safe harbour rule, which enabled American firms to publish forward looking statements with little risk, if they provided a disclaimer. Nevertheless, a comprehensive qualitative analysis of the quantitative data provided by management and reviewed by an auditor, has not become commonly accepted until recently. Another example constitutes the present discussion in the EU about the adoption of IAS 39 regarding derivatives.

[388] See Article 6 (1) of European Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) [published 12 April 2003 in official bulletin, L96/16], According to s. 15 *WpHG* (German Securities Trading Law), this might mean hours, rather than days. According to the FSAP, issuers might postpone the current change report on their own risk of liability, if they guarantee that the information will not be disclosed to, or used by, any market participant.

[389] Loss & Seligman, *Fundamentals of Securities Regulation* (2001), at 475.

[390] Regulation 13a-11, as amended by Rule 33-8400, *Release No.:* 34-49424 on “Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date” of March 16th 2004, *Effective Date:* August 23, 2004, online: <www.sec.gov/rules/final/33-8400.htm>. These amendments are responsive to the "real time issuer disclosure" mandate in Section 409 of the Sarbanes-Oxley Act of 2002.

converged toward (more advanced) European law, which itself had been previously modelled after the Implicit System.

(3) As shown above, a crucial element of the Explicit System is the individual information right. At the same time, according to the majority opinion, the Implicit System requires equal access of all market participants to disclosure of material information.[391] These may conflict if shareholders ask for material, though yet undisclosed, information in shareholder meetings. Now having both advanced Explicit *and* Implicit Systems, German law faces the problem of how to harmonize both functional requirements. Giving up one of these would reduce the efficiency that the system provides, and this paper has shown that both systems may augment each other's effectiveness.[392] Thus, most commentators hold that the board might refrain from providing an answer in the shareholder meeting until a current change report is filed. The report, however, must be filed before the shareholders vote in the meeting.[393] This compromise guides the way for future convergence toward a middle ground of Implicit and Explicit Systems.

IV. Intermediate Result

This section argued that the Explicit and the Implicit Systems of corporate control converge toward an intermediate ground due to the government's propensity to learn from the other system, and to permanently improve its own system. This pattern of corporate law development was termed Convergence Cycles. Statutory and empirical evidence has demonstrated the American tendency toward integrating Explicit Elements into the system, while regulators attempt to perfect the Implicit System. In Germany, recent years have shown a rise in the use of Implicit System mechanisms, while the Explicit System has been permanently ameliorated. Further evidence supported the assumption that the Convergence Cycles remain remarkably vital in the present.

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[391] See the discussion initiated by Henry Manne, *Insider Trading and the Stock Market* (1966), as reflected by Easterbrook & Fischel, *Economic Structure* (1991), at 253, 259 et seq.

[392] Supra, B.II.2. and B.III.2.c).

[393] Assmann/Cramer, in: Assmann/Schneider (eds.), *Securities Trading Law* (1999), § 14 Rn. 51; Zetzsche, *Shareholder Information* (2004), at 168 (with further citations).

In light of these observations, though path dependence has defined the starting points of Corporate Governance development, the future probably lies in the convergence of *corporate law*. The theory of Convergence Cycles, which I presented herein, suggests that the development will result in formal, rather than functional convergence.

D. Convergence of Ownership: An Equilibrium Hypothesis

Assuming that corporate laws will eventually converge, will dispersed or concentrated ownership structures persist? Convergence literature on ownership development has only partially accepted the established corporate finance literature pertaining to ownership structure. This resulted in an overly simplified "black and white" discussion, more or less pre-occupied with the question of whether concentrated or dispersed ownership is generally preferable. Equivalent to the former sections' inherent call for a concentration of the convergence debate back to the corporate law roots, this section strives to encourage comparative Corporate Governance scholars to more carefully consider what corporate finance has to tell us about ownership structures. It suggests that the combined forces of comparative and corporate finance research would probably result in much more complicated assumptions about ownership structure convergence than the current positions in literature reflect. It is the author's intention to push the discussion's focus from the overly simplistic question of "which ownership structure is better?" to the more difficult question of "which ownership structure is most efficient for which type of firm in a world of convergent corporate law?"

The depths and rich facets of corporate finance theory inherently limit the scope of such an undertaking. Thus, I merely demonstrate the fertility of a corporate finance based convergence theory through one example based on *Michael Jensen*'s theory of free cash flow. The Boston Consulting Group's [BCG] Matrix of business life cycles of a firm reflects this model in an easy-to-understand way. The application of the free cash flow theory to the question of what the best ownership structure is, suggests a dynamic, rather than static view: Ownership structures will neither systematically converge toward diffused, nor toward concentrated ownership. Instead, under efficient corporate law regimes, the ownership structure of a firm is likely to evolve with the business life cycle of the firm, starting with concentrated ownership, moving to dispersed ownership in the growth period, and moving back to concentrated ownership in the Cash Cow and the Dog periods. Neither the dispersed ownership structure that is said to prevail in the United States, nor the concentrated ownership of Germany will be permanent. Rather, the structures will move towards a cycle-dependent equilibrium.

Part I. introduces the discussion of which ownership structure is preferable, Part II. progressively develops the aforementioned proposition, Part III. considers why corporate law correlates with the ownership structures, and Part IV. examines the equilibrium ownership structure for Cash Cows, in particular. Finally, Part V. provides (partially empirical) support for the argument contained herein.

I. Shareholder Monitoring and the Convergence Debate

Convergence theorists have considered the impact of shareholder structures on monitoring efficiency.

It is generally acknowledged that shareholders add value to the corporation as either monitors or advisors. The former function, in particular, may prevent managers from expropriating shareholder assets through shirking or stealing.[394] **Shirking** diminishes the value of shareholder assets through all kinds of agency costs resulting from mismanagement, laziness or passivity that is caused by the drive to maximize managerial utility to the detriment of the firm and its stakeholders. Advanced corporate laws impose a duty of care which should prevent shirking.[395] However, the duty of care allows directors to retain a wide latitude when it comes to decision-making.[396] Courts have been reluctant to replace directorial discretion regarding *ex ante* business decisions with their own *ex post* wisdom. Instead, they have judged the directors' conduct under a quasi-procedural standard known as the "business judgement rule."[397] Under this standard, courts take into account

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[394] With respect to the following section, see Edward M. Iacobucci, "A *Wise* Decision? An Analysis of the Relationship between Corporate Ownership Structure and Directors´ and Officers´ Duties" (2002) 36 Can. Bus. L.J. 337 – 367, at pp. 343 – 346; see also Mark J. Roe, "Corporate Law's Limits" (2002) 31 J. Legal Studies 233, 234-235.

[395] For example, s. 122 (1) (b) CBCA, ss. 76, 93 GSCA, s. 8.30(a) MBCA and *Guth v. Loft, Inc.*, 5 A.2d 503 (Del Ch. 1939), aff'd, 19 A.2d 721 (del 1941), for details see Clark, Corporate Law (1986), at 123 et seq.

[396] Klein & Coffee, *Business Organization and Finance* (2002) , at p. 150-157; VanDuzer, *The Law of Partnerships and Corporations* (2003), at p. 303 et seq.

[397] *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. S.C. 2000): "Courts do not measure, weigh or quantify directors' judgements. We don't even decide if they are reasonable in this context. Due care in the decisionmaking context is process due care only. Irrationality is the outer limit of the business judgement rule. Irrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business judgement rule."; see also *Shlensky v. Wrigley*, 247 N.E. 2d 776 (Ill. App. 1968); *Paramount Communications Inc. v. QVC Network Inc.*, 637 A,

whether the directors explored all relevant facts, whether they had considered expert opinions before a decision was made, and whether the decision itself was reasonable, fair and made in good faith.[398] The wide discretion of directors allowed under the "business judgement rule" results in a legal vacuum, which needs to be filled by exogenous restraints, such as investor monitoring. **Stealing** includes all forms of illegal asset diversion from the corporation to someone else, for example to the managers themselves, their friends and families, and controlling shareholders. Advanced corporate laws address the problem of stealing in three ways.[399] First, they require approval of every potentially beneficial transaction by (an independent committee of) the board of directors or the supervisory board as a prerequisite for its validity. Second, they require disclosure of the nature of the transaction. Third, they impose liability on managers (and controlling shareholders) through the concept of fiduciary duties. Without monitors who trigger its legal consequences, the fiduciary duty concept is, however, - despite its sharp and clear design - merely theoretical. With respect to restraining managers, large blockholders are considered to be more efficient as compared to other forms of shareholders.[400]

In light of this functionality, comparative governance theorists have extensively debated about which form of shareholding (concentrated vs. dispersed) provides more benefits to holders of small shares. Commentators tend to hang on to one of two static positions on the development of ownership structures. Either they hold that concentrated ownership will

2d 34 (Del. 1994), at 45; adopted for Canada for example in *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 39 O.R. (3d) 755 (Gen. Div.).

[398] *Cinerama, Inc, v. Technicolor, Inc.*, 663 A.2d 1156 (Del. S.C. 1995); *Smith v. Van Gorkhom*, 488 A. 2d 858 (Del. S.C. 1985); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. S.C. 1984), and the judgements cited *ib*. The German Federal Supreme Court adopted the basic concept of the business judgement rule in BGHZ 135, 244, 253 - *ARAG/Garmenbeck* -.

[399] See Black, "The Legal and Institutional Preconditions", *supra* note 24, at 784 et seq.

[400] The argument goes in three steps: Larger shareholders have more incentives closely to monitor managers than smaller shareholders, due to a better cost-outcome proportionality. If larger shareholders have better incentives to monitor managers, managers have fewer chances to shirk. If managers have fewer chances to shirk, losses to all shareholders from shirking are likely to be lesser, as compared to a system in which managerial shirking is not or barely monitored by shareholders with small shareholdings. Consequently, concentrated ownership is likely to result in more efficient management supervision with respect to shirking than diffused ownership, and thus reduces managerial agency costs, see Gilson & Gordon, "Controlling Controlling Shareholders", *supra* note 52, at 789; Guido Alessandro Ferrarini, Niamh Moloney, Cristian Vespro, "Governance Matters: Convergence in Law and Practice Across the EU Executive Pay Faultline" (2004) J. of Corp. L. St. 2 (from SSRN); Roe, "Corporate Law's Limits", *supra* note 9, at 235 et seq.; Shleifer & Vishny, "Large Shareholders", *supra* note 50.

persist, due its superior monitoring efficiency of managers,[401] or they allege that competitive capital, takeover, product, and managerial labor markets would be as effective in restraining managers, as would large blockholders. However, concentrated ownership would result in illiquid blocks, which rational (large) investors would avoid, as well as a depressed value of small shares, due to the danger of expropriation by the blockholder. Thus, in developed markets, dispersed ownership would eventually prevail.[402]

II. The Business Life Cycle Equilibrium

Shareholders' monitoring capacity is merely one of the possible restraints on managers that influence ownership structures. Others include firm size,[403] the volatility of a firm's cash flow depending on the industry of the firm,[404] exposure of the firm to the public,[405] state regulation, either directly,[406] or indirectly through regulation of financial intermediaries,[407] states' protective policy, resulting in a lack of competition,[408] and the stage in the firm's business life cycle.[409] Given the rich array of possible influences on ownership structures, a convergence discussion that focuses on merely one aspect can be assumed to provide overly simple answers to complicated questions. This assumption is consistent with the present state of the discussion, which primarily focuses on the question of whether dispersed or concentrated ownership provides more efficient monitoring.

Instead, this section proposes a multidimensional view on convergence of ownership structures, resulting in a dynamic theory of ownership convergence. As (only) one example of the likely impact of a multidimensional corporate finance view on ownership

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[401] E.g. Bebchuck & Roe, "A Theory of Path Dependence", *supra* note 13; Roe, "Corporate Law's Limits", *supra* note 9, at 235 et seq.

[402] Hansmann & Kraakman, "The End", *supra* note 7; also Siems, *Convergence* (2004), at 321 et seq.

[403] Demsetz & Lehn, "The Structure of Onwership", *supra* note 234, at 1158.

[404] Id., at 1161 et seq.

[405] Id., at 1170 et seq.

[406] Id., at 1161 et seq.

[407] Mark Roe, "A Political Theory of American Corporate Finance" (1991) Colum. L. Rev. 91, 10, and Roe, *Strong Managers, Weak Owners* (1994), and Ronald J. Daniels & Edward M. Iacobucci, "Some of the Causes and Consequences of Corporate Ownership Concentration in Canada" in: Randall K. Morck (ed.), *Concentrated Corporate Ownership* (2000), at 97 et seq.

[408] Daniels & Iacobucci, id., at 89 et seq.

[409] See the following notes.

convergence, this paper emphasises the fact that, besides exogenous factors, such as shareholder and creditor monitoring and market pressure, managers are also restrained by endogenous, hence business dependent, factors. Depending on the level of endogenous restraints that are operating effectively within the firm, there may or may not be a need for stronger exogenous restraints. In some cases, in fact, there will be little need for exogenous restraints if endogenous factors completely substitute for exogenous pressures that prevent directors from stealing and shirking. Since cash is crucial for the company's survival in the short term and, thus, may provide for strong restraints on managers, an analysis of the likely level of endogenous restraints provided by the cash-flow of the firm might be particularly insightful.[410] Thus, this section models the impact of cash restraints on the ownership structure of the firm, based on the simplified model of a firm's life cycle that a matrix developed by the Boston Consulting Group provides.

1. The BCG Matrix[411]

According to the BCG matrix, a business can be categorized as falling within one of four stages in the business life cycle: (1) Problem Children / Question Marks, (2) Stars, (3) Cash Cows, or (4) Dogs.

(1) Problem Children are firms with a low share of a high growth market. They consume excessive resources and generate little return. Problem Children absorb cash in an attempt to increase their market share. If they are successful, they become Stars. If they are unsuccessful, they become Dogs.

(2) Stars are firms that provide products to high growth markets while they have a relatively high share of that market. Stars tend to generate high amounts of income. Growth might, however, consume significant parts of the income generated. When the market growth slows down, a Star will become a Cash Cow. When the Star falters in catching up with technological change, it will become a Dog.

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[410] See Jensen, "Agency Costs", *supra* note 234, at 324-35.

[411] See to this and the following sections Stern & Stalk (eds.), *Perspectives on Strategy from The Boston Consulting Group* (1998), at 35, 43 & 195 et seq.; for a critical review of the life cycle concept see Bartolomeo, *Life cycle assessment in industry and business : adoption patterns, applications and implications* (2000).

(3) Cash Cows deliver products to slow growth markets, where they have high market shares. Cash Cows generate more income than is invested in them. When technological change provides a substitution for the products provided by the Cash Cow and, thus, the Cash Cow's market share declines, it might become a Dog.

(4) Dogs hold a low share of a low growth market. They do not generate cash, but tend to absorb it. Dogs constitute prime candidates for restructuring or insolvency.

2. Different Level of Endogenous Restraints

The level of endogenous restraints that align managerial interests with those of shareholders **differs** from stage to stage.

(1) The **Problem Child / Question Mark** has no income and no growth. Cash is scarce and needs to be acquired from external financiers at a high cost (for example, from venture capitalists, creditors, friends & families, etc.). On the other hand, chances are that managerial effort will contribute to the firm's growth, resulting in higher managerial benefits, through an increase in salary, a higher value of the management's share in the firm, and a boost to the reputation of the managers. Since endogenous restraints push the manager's back to the wall and, at the same time, provide positive incentives to managers, exogenous restraints should not be required to prevent managers from shirking. The monitoring role of shareholders is negligible. Shareholders might, however, participate in the firm in advisory, rather than supervisory, functions.[412]

(2) **Stars** use large amounts of cash and are leaders in their business, so they should generate large amounts of cash. If the market share remains high, the reward will be the progression to a Cash Cow. In order to attain this goal, managers must work hard. In addition, despite their large market share, Stars are under permanent cash restraints because of their immense growth, while external financing is hard to achieve: The investment in Stars is – despite the large market share – risky, since the market growth can easily change the position of the Star into that of a dog, if the incumbent's market share is outweighed by

[412] Wiliam A. Sahlman, "The structure and governance of venture-capital organizations" (1990) J. Fin. Econ. 27, 473, at 508.

that of a new entrant. Thus, creditors are unlikely to provide cash to the firm, and external financing through share issues would dilute the entrepreneurial stake, which the entrepreneur tries to avoid. Thus, during the Star period, growth provides significant endogenous restraints on the firm.

(3) The **Cash Cow** produces more cash than its slow growth consumes. Its management has an easy job and the high returns create the inherent risk that managers will engage in inefficient investments for their utility's sake. For example, managers might reinvest substantial cash amounts in their businesses which are mature and not growing anymore, or might engage in "empire building," which subsequently results in higher management salaries than the profitability of the firm would justify.[413] In Cash Cow businesses, endogenous restraints are low.

(4) In **Dog** businesses, cash is (or has become) scarce, and the managerial position is in danger. With their backs to the wall, managerial shirking is unlikely. However, employees and managers might resist pressures to restructure or declare insolvency, due to the risk of losing their jobs, by "fighting an impossible battle" and, even worse, by engaging in hopeless or excessively risky[414] attempts to "turn the business around." Thus, specific endogenous pressures are insufficient to keep managerial and shareholder interests aligned.

3. Equilibrium of Ownership Structure

In light of this analysis, one can determine a "perfect ownership structure" for each stage in the business life cycle. As the level of endogenous restraints declines, the need for effective exogenous restraints increases in order to prevent managers from shirking. Assuming (1) that inefficiently organized firms will falter either in the product or the equity markets,[415]

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[413] Jensen, "Agency Costs", *supra* note 234.

[414] This paper does not deal with the shareholder – creditor conflict that occurs in the vicinity of insolvency, see, e.g., Edward M. Iacobucci, "A *Wise* Decision? An Analysis of the Relationship between Corporate Ownership Structure and Directors´ and Officers´ Duties" (2002) 36 Can. Bus. L.J. 337, 343–46.

[415] Demsetz & Lehn, "The Structure of Ownership", *supra* note 234, at 1156, and *supra* note 6.

and (2) that large shareholders are good monitors of managers,[416] leads the way to an **equilibrium theory of ownership structures**, as follows.

(1) Managers of **Problem Children** are bound by strong endogenous restraints. Insofar, there is no need for shareholder monitoring through concentrated ownership. However, blockholders may contribute to firm value through the provision of advice (which might be even more costly than monitoring). Furthermore, diffusion is likely to falter since the firm is inexperienced and unknown, which makes an investment highly speculative. Risk-adjusted share prices would be low, and the costs of investor relations are high in proportion to the income of the firm. Thus, concentrated ownership would be the "perfect ownership structure" of the firm.

(2) Growth provides strong endogenous restraints on **Stars**. In this stage, liquidity restraints may substitute for the impact that concentrated ownership could have on managerial incentives. The barriers to equity financing that exist at the Problem Children stage is likely to cease to exist to the same extent as the cash needs and the size of the firm increase. In theory, step-by-step, the entrepreneurs' (or their heirs') influence diminishes through dilution. According to the free cash-flow theory followed herein, as long as the Star consumes cash faster than it accumulates income, diffused ownership is likely to be the "perfect ownership structure," due to an efficient level of endogenous restraints that balances management's incentives to steal and shirk.

(3) In **Cash Cows**, endogenous restraints do not exist: The product market might provide for sufficient restrains at the product level. However, the firm's size and its established products might even impede competitors' entry into the market. Furthermore, the capital market will not provide for restraints, since Cash Cows can rely on internal financing rather than tapping the capital markets. Further, share buybacks can keep share prices high, and render takeovers unlikely. Consequently, the free cash-flow theory suggests that concentrated ownership is most needed in the Cash Cow stage: the larger management's leeway, the more that stronger shareholder influence is required in order to protect the firm

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[416] Supra, B.II.1. and D.I.

from managerial stealing and shirking.[417] The precise level of concentration required depends on some other Corporate Governance aspects and, thus, will be explored more fully below.[418]

(4) As shown above, in **Dog** firms, strong exogenous influence is required to pressure the firm into restructuring or insolvency.[419] Shareholders will likely press for restructuring, while secured creditors will press for insolvency and reorganization if the shareholders' pressure is unsuccessful. Consequently, exogenous pressure through concentrated ownership is required to save the rest of shareholders' money (if there is any); otherwise, reorganization might result in re-concentration of ownership by equity issuances as part of a reorganization plan.

4. Caveats

The above view requires two cautionary notes. First, the practical problem created by the above proposition is to determine which firm is in which stage of its life cycle. Established firms tend to have a mix of products some of which are Cash Cows, and others which could be either Problem Children or Dogs. While the applicability of the above proposition is thus somewhat restrained, it should apply to firms that focus on a specific line of products.[420] Second, other endogenous restraints which corporate finance considers to be important, for example the intensity of research & development that the business of the firm requires, or the workers' fluctuation, may be interrelated to the restraining effect that a scarcity of cash provides. Therefore, it needs to be emphasized – again - that the application of the BCG matrix should merely provide one example of the possible outcome of more closely connecting the convergence debate with corporate finance theory.

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[417] Jensen, "Agency Costs", *supra* note 234, at 327 et seq.

[418] *Infra* D.IV.

[419] Supra, D.II.2.; see also Roe, *Strong managers, Weak Owners* (1994), at 253.

[420] Portfolio theory suggests that unsystematic risk disappears in well diversified portfolios, and that shareholders can diversify at lower costs than firms. Further, investors can more easily diversify their portfolio with stocks of firms with a clear risk structure, see Ross, Westerfield, Jaffe, *Corporate Finance* (1999), at 10.6, pp. 250 et seq. In light of portfolio theory, many firms strive for specialisation in order to lower their costs of capital. However, some firms (e.g. General Electric) resist this pressure and "diversify within themselves."

III. The Correlation of Ownership Structure and Corporate Law

The above has not yet explained why this equilibrium depends on efficient corporate law, hence, why efficient corporate law correlates with the equilibrium theory of ownership structures. The answer to this question provides arguments against both those offered by proponents of concentrated ownership and those of diffuse ownership persistence.

Since only strong corporate law can protect small shareholders from expropriation by managers, some commentators have posited that the development of strong corporate law would result in strong capital markets with dispersed shareholdings.[421] The conclusion is, however, not cogent. As shown above, strong corporate law provides for devices that enable active shareholders to prevent managers from *stealing*, while the wide discretion of directors allowed under the "business judgement rule" results in a legal vacuum that exogenous restraints may fill.[422] Thus, having a blockholder who prevents managerial *stealing and shirking* may be a superior ownership structure to dispersed ownership, if corporate law and active[423] minority shareholders prevent blockholders from diverting more assets than their monitoring function adds to the value of minority shareholders' shares through both lower monitoring costs with respect to managers, and higher returns due to less managerial shirking.

Without strong corporate law, shareholders will neither be interested in investing in a firm with dispersed shareholdings, nor in becoming minority shareholders. Minority shareholders in firms with concentrated ownership will fear expropriation by the majority, and those in firms with diffused ownership will fear expropriation by managers. Thus, strong corporate law is a prerequisite for the existence of small shareholding in any firm.[424]

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[421] See citations, *supra* note 58.

[422] Supra, D.I.

[423] Corporate law does not help inactive shareholders. If no one triggers efficiency of corporate law, managers or concentrated owners will get away with their shirking and stealing despite of strong corporate law in the books. Any ownership structure that does not provide sufficient incentives for shareholder activity is useless, when it comes to monitoring purposes. Dispersed ownership in its most extreme form provides the greatest collective action problems and free-rider phenomena, see citations *supra* note 4.

[424] Close to my position is Gilson, "Complicating", *supra* note 52, at II. and III., who distinguishes between efficient and inefficient controlling shareholders. However, Gilson supports a static model, hence he

Consequently, strong corporate law does not necessarily result in strong capital markets *with dispersed shareholdings*.

IV. Equilibrium for Cash Cows

In light of above considerations, one may determine an equilibrium ownership structure for Cash Cows. This will be demonstrated by a simplistic model that merely regards the triad of restraints that strong corporate law, shareholder monitoring, and the firm's cash flow provide.

Though explicit minority shareholder influence (which corporate laws may facilitate, for example through *Konzernrecht*) can protect minorities from expropriation by the majority, concentrated ownership may nevertheless be an inefficient structure. This is for the simple reason that concentrated owners may not be required to efficiently monitor the firm due to sufficient endogenous pressures. If this is the case, the potential damage of expropriation by a blockholder outweighs the potential benefit associated with decreased managerial shirking. Further, commentators have held that controlling shareholder monitoring systems are less flexible and thus may not be able to

> adapt quickly to large and abrupt changes in the economic environment. [Thus, t]he stability associated with an efficient controlling shareholder system [may] become a barrier to necessary adaption; in this circumstance, a widely-held shareholder system, with control open to the market, likely will be more efficient.[425]

Both considerations support the proposition that dispersed ownership might be an optimal structure for high growth firms in the Star-stage.[426]

Different might be true, however, with respect to Cash Cows. Given that blockholders are better monitors than dispersed shareholders, better monitoring may increase the value of all shares, due to higher returns of the firm (assumption 1).[427] On the other hand, while

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suggests that one type of ownership structure may substitute for the other as device of functional convergence, while I posit a dynamic model of ownership structures.

[425] Gilson, "Complicating", *supra* note 52, at IV., referring to Gilson, "Economic Efficiency", *supra* note 14.

[426] Supra, D.II.3.

[427] Supra, D.I.

corporate law can confine the ability of blockholders to expropriate the assets of the minority, corporate law is not perfect in doing so, nor are there always active minority shareholders who monitor the majority. Thus, even though corporate law is strong, the presence of large blocks of shares constitutes a risk that depresses share prices. One can assume that the risk increases in proportion to the size of the block, until it reaches the control level. Beyond the level of control, the risk should stay constantly very high (assumption 2). While assumptions 1 and 2 push share prices in different directions, it is likely[428] that there is a point of equilibrium at which blockholders are effective monitors who provide little threat to the value of the remaining shares, thereby creating an overall positive effect for minority and majority shareholders alike.

Economists' data show a significant correlation between directorial share ownership[429] and market evaluation, as measured by Tobin's Q. This correlation is understood to reflect the market evaluation of the incentive structure for directors on the one hand, and the tendency and capability of the directors to shirk and steal on the other hand.[430] The data show a point at which the percentage of directorial ownership optimises the value that the director adds to the firm. This point has been found to exist at approximately 5% of a firm's stock. Larger concentrations (>5%) affect share prices negatively.[431] Very large blocks (>65%) also positively correlate with added value. These very large concentrations, however, can be presumed to result in high discounts due to the risk of minority expropriation, and will therefore be excluded for the purposes of further analysis. Smaller blocks (<5%) do not affect share prices as positively as 5% blocks. These data suggest that the equilibrium at which blockholders are the most efficient monitors, while at the same time the value of the minority shareholders' stake suffers only to a minor degree, lies in the vicinity of 5%.

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[428] This equilibrium is the logical consequence of the assumption that corporate law is effective in preventing majority from stealing, and the assumption that blockholders are efficient monitors. Why, if not for the benefit of their shares, should blockholders bear the costs for monitoring? Then, if corporate law is effective, there should not be a (very large) difference between the gains of blockholders, and those of minority shareholders.

[429] It can be assumed for the purposes of this analysis that significant block-holders are directors, or at least represented in the board.

[430] Randall Morck, Andrei Shleifer & Robert Vishny, "Management Ownership and Market Valuation: An Empirical Analysis" (1988) 20 J. Fin. Econ. 293, at 297 et seq.

[431] Id., at 301.

These data are quite dated. Since *Randall Morck* and others have studied the impact of directorial shareholdings on share prices, corporate law has increased its firm grip on majority shareholders. Thus, some control considerations based on current corporate law provisions might help to define the equilibrium ownership more accurately. On the one hand, large shareholdings correlate with stronger influence on management. For example, 5% or 10% of the shares may constitute a threshold for the exercise of important minority rights.[432] Furthermore, management can hardly deny a shareholder who holds shares in the range of 10% or more a seat on the board of directors without risking retaliation through a proxy fight or a takeover bid. This threat will account for permanent access to management and influence on the financing and investment structure of the firm. Thus, blocks in the range of 5% - 10% or more provide for influence that could be used for effective monitoring.

However, the utility curve of large shareholdings does not rise permanently. Size can become costly, both factually and legally. Size negatively correlates with liquidity of the stocks,[433] and with portfolio diversification, hence risk-spreading. Burdensome disclosure duties apply to large shareholdings.[434] Large shareholders might be considered to be controlling shareholders under the American doctrines of piercing the corporate veil[435], and of lender liability and equitable subordination,[436] or the German material equity doctrine,[437]

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[432] For example, under Delaware corporate law, 10% is the threshold for proposals on the election of directors. Under German corporate law, a 5% minority (but also a minority representing 500.000 € face value of the shares) can require the board to call for a meeting, see Zetzsche, "Shareholder Procedural Rights", *supra* note 139.

[433] See citations *supra* note 215.

[434] For example, pursuant to ss. 20, 21 *WpHG* (German *Securities Trading Law*), every 5% step must be disclosed.

[435] For the United States (close corporations): *Minton v. Cavaney*, 56 Cal. 2d 576, 364 P.2d 473, 15 Cal. Rptr. 641 (1961); *Walkovsky v. Calrton*, 18 N.Y.2d 414, 223 N.E.2d 6, 276 N.Y.S.2d 585 (1966); *Bartle v. Home Owners Cooperative, Inc.*, 309 N.Y. 103, 127 N.E.2d 832 (1955); for England and Canada: *Clarkson Col. Ltd. v. Zhelka*, [1967] 2 O.R. 565 (Ont. H.C.); *Woolfson v. Strathclyde Regional Council*, [1978] S.L.T. 159, [1979] J.P.L. 169, 38 P. & C.R. 521 (H.L.); *Adams and Others v Cape Industries Plc and Another*, [1990] Ch 433, BCLC 479, 2 WLR 657, BCC 786, [1991] 1 All ER 929, (C.A.). See also Easterbrook & Fischel, *Economic Structure* (1991), at 54 et seq.

[436] For the United States: *Pepper v. Litton*, 308 U.S. 295, 304-05, 60 S.Ct. 238, 244, 84 L.Ed. 281 (1939); *Heiser v. Woodruff*, 327 U.S. 726, 733, 66 S.Ct. 853, 856, 90 L.Ed. 970 (1946); *Costello v. Fazio*, 256 F.2d 903 (9th Cir. 1958); *In the matter of Mobil Steel Co.,* 563 F.2d 692, 699 (5th Cir. 1977); *Re American Lumber Company v. First National Bank of St. Paul,* 5 B.R. 470 (1980); For Canada not yet decided, see *Canada*

and *Konzernrecht*.[438] Furthermore, large shareholdings might trigger specific fiduciary duties to minority shareholders, the duty to establish special meetings of the board, the duty of a mandatory tender offer[439] or the applicability of provisions of the appraisal remedy.[440] Eventually, tax authorities might re-characterize the firm's financing and dividend distribution behavior, with negative tax consequences following for the controlling shareholder.

Thus, control comes at high costs, while – given effective corporate law and active minority shareholder monitoring – the benefits of control are not guaranteed. In these circumstances, large, but not necessarily controlling, shareholding might be efficient. Since judicature created many of the large shareholder's possible obligations, the threshold that triggers these duties is not always defined with a high degree of precision or certainty. It may, however, be suggested that a block of more than 15% comes with significant financial risks. A large shareholder will also consider the aforementioned liquidity and diversification restraints. Further, having a lower overall share might encourage other shareholders to share in the burden of monitoring, while a negligible share raises the overall costs, due to the additional costs associated with coordinating many shareholders. Thus, I hypothesize that the **equilibrium** of positive influence on management through monitoring, and the negative impacts of large shareholdings is in the **vicinity of 5-10%.**

Deposit Insurance Corp. v. Canadian Commercial Bank, [1992] 97 D.L.R. (4th) 385, 419 (SCC). See also Robert Charles Clark, "The Duties of the Corporate Debtor to Its Creditors" (1977) Harv. L.R. 90, 505.

[437] This is the German equivalent to the American doctrine of equitable subordination. The German Federal Supreme Court has held that the threshold for the re-qualification of credit into "material equity" is generally 25% of a stock corporation, see BGHZ 90, 381 – WestLB/BuM-.

[438] In the absence of additional factors, control is triggered at 30%.

[439] With respect to last three devices under Delaware Corporate Law, see Gilson & Gordon, "Controlling Controlling Shareholders", *supra* note 52, at 791, 827, 835 et seq. German judicature holds that majority shareholders owe duties to minority shareholders (but also otherwise), see Federal Supreme Court, BGHZ 103, 184 - *Linotype* and BGHZ 129, 136, 158 et seq. – *Girmes* -. Ss. 29 (2), 35 of the German Securities Acquisition and Takeover law (WpÜG) trigger a duty to tender offer at a threshold of 30%.

[440] Supra, B.II.2.

V. A Tendency

The equilibrium hypothesis only regards a tiny aspect of the rich corporate finance literature. It nevertheless provides an interesting example for the fertility of the combination of traditional corporate finance with the convergence debate. A closer examination of the model presented here would need to examine whether and why the aforementioned dynamic model will substitute for the static position. In particular, it would require a detailed argument against the position of functional convergenists that difference Corporate Governance systems may solve the same monitoring problem through different institutions.[441] This detailed argument is beyond the scope of this section that merely intended to encourage further consideration of corporate finance literature in the convergence debate. Despite the lack of completeness, and although corporate law convergence is not yet complete, some data nevertheless support the accuracy of the dynamic model of a cycle-dependent ownership equilibrium theory.

1. Concentration and Diffusion

On the one hand, *Mark Roe* has presented empirical data that suggest ongoing concentration of ownership in the United States.[442] On the other hand, *John Coffee* has presented data that suggest a decline of concentrated ownership in Germany.[443] Data that the author retrieved from his survey augment the overall picture.[444] These figures are consistent with data provided on declining attendance rates in shareholder meetings provided in *Appendix C*.[445]

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[441] Gilson, "Economic Efficiency", *supra* note 14, at 332, and "Globalizing", *supra* note 14.

[442] Roe, "Corporate Law's Limits", *supra* note 9, at 250, note 24, cites a study, which put forth that the average directors' ownership has risen from 13% of the voting stock in 1935 to 21% in 1995.

[443] Coffee, "The Rise", *supra* note 10, at p. 15 et seq. shows the decline in block-holdings in Continental Europe. Siems, *Convergence* (2004), at 325 et seq., presents further studies showing the same trajectory.

[444] For example, in the 2000s, blockholders reduced their shares in the following firms (blockholder in brackets): Allianz AG (Munich Re in 2002-2003), Deutsche Telekom (Federal Republik of Germany through secondary offering in 2000), Infineon (Siemens, 2001-2004), MAN AG (Regina, through exchange of non-voting shares into voting stock in 2002), Munich Re (Allianz in 2002-2003), RWE (municipalities, since 2002), ThyssenKrupp (foundation of Thyssen, 2003).

[445] Supra, B.III.3.a).

In addition, *Appendix F* provides an overview with respect to foreign ownership development in some German DAX 30 firms. In only 4 of 20 firms in the German sample foreign do shareholdings decrease. Since international investors are primarily institutional investors, internationalisation can be interpreted as a proxy for both ongoing dispersion (as compared to former concentrated ownership) and ongoing concentration (as compared to diffused ownership) in German firms.

2. Legal and Contractual Concentration

The former figures merely cover the development of concentrated ownership in the form of a legal person that holds the shares. This, however, does not cover the full array of the topic. Since the equilibrium for Cash Cows was developed from the necessity of efficiently controlling managers, while averting the likelihood of minority expropriation, any kind of coordinated (threat of) exercising of a large number of shareholder rights may have the desired monitoring effect: On the one hand, concentration of ownership power can mean legally concentrated ownership, i.e. that shares are held by one legal entity [legal concentration]. This does not, however, necessarily imply that the beneficiary is just one natural person or family, as the examples of holding or investment companies demonstrate. On the other hand, concentrated ownership can also mean contractually concentrated ownership [contractual concentration]. This means that many (per se less efficient) small monitors enter into an agreement resulting in increased pressures on managers. The most intense form is the employment of an external monitor by the shareholders. Less intense forms might include factual cooperation coordinated through a central agency to which contractual relationships exist.

This other form of ownership concentration prevails in the United States. While for a long time the bank's trust business was the sole form of contractual concentration,[446] in the last 15 -20 years a form of contractual concentration that is independent of any connection to banks has developed in the United States,[447] which is probably due to the fact that

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[446] See citations *supra* note 31.

[447] The Council of Institutional Investors was founded in 1985. For the history of shareholder activism, see Stuart L. Gillan & Laura T. Starks, "A Survey of Shareholder Activism: Motivation and Empirical Evidence" (1998) Contemporary Finance Digest 2, 10

burdensome securities laws blocked the path of legal concentration.[448] The United States has further developed the path of contractual concentration through an intermediary. This intermediary can be a proxy voting service like Institutional Shareholder Services (ISS) or Georgeson Shareholders that recommends voting to a large number of its clients, or an institutionalized activist group that coordinates its members' actions, such as the Council of Institutional Investors (CII), or the Investor Responsibility Research Center (IRRC). Though not as stable – and hence not as efficient in monitoring managers –as compared to legal concentration, these associations are a fluent form of concentrated ownership power. Under this definition, there is ongoing concentration of ownership power in the United States.

In Germany (facilitated through traditionally less burdensome rules), legal concentration is (still) prevailing, in the form of holding and insurance companies. Most of the dispersed shareholders were represented by their banks, which is itself a form of contractual concentration of ownership power. Shareholders' association of interests filled the niche for those shareholders who did not want to assign the bank in representing their interests. Until recently, voting services were not viable businesses in Germany, given that banks and shareholder association charged no additional fees[449] for the aforementioned services to either the corporation or the shareholders. One can assume that the need for bank-independent forms of contractual concentration will increase to the same extent, as legal concentration decreases, and banks retreat from offering proxy services at no costs.

Though both above theory and its empirical testing excluded many other factors that might have influenced ownership structure development, it is nevertheless noticeable that – in light of a contractual ownership perspective - ownership structures in the United States and Germany apparently converge on a middle ground between dispersed and concentrated ownership. This result, that is consistent with the path that the (very limited) equilibrium hypothesis above predicted, is apt to encourage further studies, which interrelate corporate finance and comparative Corporate Governance theory.

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[448] See Mark Roe, *Strong Managers, Weak Owners* (1994), at 51 et seq.

[449] Besides regular depository or membership fees.

E. Conclusion

Many answers to questions of comparative Corporate Governance theory depend on whether one has an optimistic or pessimistic attitude towards the world. Thus, to the same extent that the precise prediction of the *future* is deemed to be valuable in that it enables one to make better choices in the present, the academic achievement of convergence theory consists of the insights that a comparative study provides into the similarities and differences, and into the functionality of, *present* Corporate Governance systems.

With respect to these characteristics of comparative Corporate Governance analyses, this study is no exception: in providing a new categorization for systems of shareholder rights that utilizes the concepts of Implicit and Explicit Systems of corporate control, it has emphasized one efficient functional aspect of the present American and German systems that other studies have neglected to point out. This aspect pertains to the different meaning ascribed to the shareholder rights by each system, which is signalled through different provisions regarding the shareholder meeting's preparation, execution, and the sanctions following from a showing of disrespect for the law. This difference was explained to the reader as being predicated upon the different ethical ideals that eventually resulted in either a friendly or hostile attitude towards market forces.

The predictive part included one hypothesis regarding corporate law, and one hypothesis regarding ownership. Regarding corporate law, recent years have shown the practical attitude of the legislatures that are on the lookout for efficient solutions to the problem of how to control managers and majority shareholders. Thus, a development in Convergence Cycles, hence the legislatures' tendency to mimic good solutions, and to learn from each other's failures, is likely and might finally result in the formal convergence of corporate law. Regarding ownership, it has been demanded that comparative Corporate Governance more closely interrelates with established corporate finance theory, which complicates the questions that academia must answer, but increases the probability of achieving accurate results. As an example for the fertility of such coordination, the application of the free cash flow theory to comparative Corporate Governance resulted in a dynamic, rather than static position on the convergence debate pertaining to ownership structures: Dispersed and concentrated ownership are likely to become proxies for different stages of the firm in the

business life cycle. Concentrated ownership is likely to prevail at the beginning, and at the end, while the period of strong and profitable growth is marked by a diffusion of ownership. During the Cash Cow period, the theory suggests that ownership re-concentrates, either in the hands of one or more legal entities holding large blocks of shares, or through the indirect or direct contractual co-ordination of a large number of smaller institutional investors.

Eventually, the wheel of time will show who is wrong and who is right with respect to the two hypotheses regarding future developments. Besides predicting the future, academia's function is, however, to look out for solutions to problems of the present. The idea of convergence towards a point between Skylla and Charybdis, hence on a middle ground between a system relying primarily on market forces, and a system primarily relying on direct shareholder influence, might best fulfil this other purpose of academic study. Authors tend to exaggerate the meaning of their own work. The author nevertheless hopes that the insight he has provided will help to spur legislative activity on both sides of the Atlantic Ocean - which, at the same time, would initiate the next turn of the Convergence Cycles. In light of this prediction, it might not be coincidental that many cultures associate the geometric form of circle with perfection.

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Proportion of the sectors of total shareholdings

Year	Private Investors	Non-Financial Corporations	Government	Banks	Insurances	Inv. Funds	(Inv. Funds for public inv.)	International Investors	Total
1950	46,81%	18,17%	10,82%	2,84%	0,97%	n.a.	n.a.	20,39%	100,00%
1955	30,04%	45,59%	10,16%	6,86%	1,91%	n.a.	n.a.	5,44%	100,00%
1960	30,33%	40,66%	12,01%	7,99%	3,44%	n.a.	n.a.	5,57%	100,00%
1965	30,57%	39,32%	9,95%	7,55%	3,70%	n.a.	n.a.	8,91%	100,00%
1970	31,26%	37,38%	9,54%	9,11%	4,22%	n.a.	n.a.	8,49%	100,00%
1975	25,12%	42,09%	8,92%	9,75%	4,23%	n.a.	n.a.	9,89%	100,00%
1980	21,21%	42,75%	8,51%	11,66%	4,76%	n.a.	n.a.	11,11%	100,00%
1985	22,51%	38,82%	7,53%	10,98%	5,78%	n.a.	n.a.	14,38%	100,00%
1991	22,43%	39,38%	2,57%	12,70%	5,51%	4,75%	1,51%	12,66%	100,00%
1995	20,94%	40,33%	2,05%	12,93%	7,21%	7,13%	2,43%	9,41%	100,00%
2000	17,31%	31,89%	0,66%	13,14%	8,94%	15,01%	5,59%	13,05%	100,00%
2002	14,79%	35,91%	0,63%	11,44%	9,82%	13,19%	4,78%	14,22%	100,00%

Source: with kind permission by DAI Factbook, www.dai.de

Attendance in American sample measured in % of outstanding shares	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	3/2-year-av.
General Electric Co.	83,11%	84,21%	84,03%	84,61%	83,28%	81,51%	82,79%	81,08%	82,91%	81,15%	81,22%	**81,76%**
Exxon Mobil Corp.	80,54%	83,91%	85,54%	85,70%	84,08%	85,99%	82,42%	82,59%	82,56%	83,68%	83,62%	**83,29%**
Pfizer Inc.	86,72%	86,99%	89,29%	88,13%	85,22%	85,73%	83,10%	85,36%	86,99%	87,01%	85,44%	**86,48%**
Citigroup Inc.	84,88%	89,80%	90,40%	89,96%	87,81%	81,99%	83,09%	83,65%	85,57%	84,38%	85,68%	**85,21%**
Bank of America Corp.	78,38%	85,44%	83,84%	88,72%	82,94%	85,15%	84,05%	84,05%	87,00%	85,29%	85,45%	**85,91%**
Johnson & Johnson	85,58%	86,51%	87,53%	84,28%	84,39%	85,21%	83,66%	83,37%	87,06%	81,86%	80,72%	**83,21%**
American International Group Inc.	90,61%	90,13%	93,80%	94,04%	92,35%	90,54%	87,13%	88,43%	90,77%	90,18%	91,26%	**90,74%**
Procter & Gamble Co.	92,49%	91,53%	91,46%	87,81%	88,15%	92,25%	89,53%	87,40%	89,81%	88,77%	n.a.	**89,29%**
International Business Machines Corp.	79,88%	83,04%	83,24%	81,01%	82,37%	81,72%	81,51%	82,97%	82,32%	80,01%	83,87%	**82,07%**
Wal Mart Stores Inc.	n.a.	89,41%	89,78%	90,53%	91,61%	90,36%	89,84%	90,24%	91,46%	90,25%	91,11%	**90,94%**
J.P. Morgan Chase & Co.	n.a.	87,44%	87,44%	87,06%	86,62%	86,38%	86,09%	84,45%	85,16%	88,41%	84,09%	**86,78%**
Coca-Cola Co.	87,69%	87,56%	89,23%	88,50%	87,52%	88,09%	84,50%	86,89%	87,27%	84,30%	85,19%	**85,59%**
ChevronTexaco Corp.	82,04%	82,02%	77,66%	77,31%	77,64%	77,46%	76,76%	81,99%	80,89%	86,07%	n.a.	**83,48%**
Merck & Co. Inc.	72,06%	79,08%	81,81%	82,25%	82,95%	84,60%	82,40%	81,65%	81,86%	74,73%	84,92%	**80,50%**
Altria Group Inc.	81,80%	83,90%	86,00%	81,00%	84,70%	80,40%	81,20%	80,90%	84,20%	81,00%	84,30%	**83,17%**
Wells Fargo & Co.	86,80%	86,19%	82,27%	84,50%	77,18%	79,85%	n.a.	82,73%	83,94%	86,74%	86,71%	**85,80%**
Verizon Communications Inc.	78,98%	79,77%	81,04%	80,27%	81,45%	80,84%	80,71%	79,98%	81,79%	81,45%	82,92%	**82,05%**
PepsiCo Inc.	71,64%	74,88%	85,00%	86,84%	85,89%	84,16%	87,26%	85,60%	85,60%	84,83%	86,03%	**85,49%**
Home Depot Inc.	85,76%	n.a.	86,69%	86,99%	86,87%	86,15%	86,75%	85,72%	87,97%	84,34%	88,73%	**87,01%**
SBC Communications Inc.	80,58%	80,35%	82,80%	84,02%	81,35%	77,59%	82,91%	82,89%	83,43%	82,87%	79,00%	**81,77%**
Time Warner Inc.	82,07%	81,58%	99,17%	99,83%	90,20%	82,67%	90,19%	82,97%	83,69%	83,85%	90,32%	**85,95%**
Eli Lilly & Co.	88,19%	89,55%	91,29%	90,31%	89,71%	88,05%	84,93%	86,52%	87,83%	86,85%	87,99%	**87,56%**
3M Co.	83,19%	84,05%	82,20%	82,63%	84,60%	83,12%	82,96%	81,37%	83,21%	83,98%	86,53%	**84,57%**
Tyco International Ltd.	92,87%	84,27%	82,29%	77,43%	77,43%	n.a.	81,64%	84,94%	84,28%	88,92%	86,89%	**86,70%**
Fannie Mae	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	88,10%	91,01%	**89,56%**
Abbott Laboratories	86,61%	87,04%	87,59%	86,65%	84,66%	81,81%	84,84%	86,17%	85,15%	86,20%	89,05%	**86,80%**
Medtronic Inc.	81,24%	83,51%	83,05%	81,41%	83,22%	82,78%	80,56%	79,67%	83,81%	82,78%	n.a.	**83,29%**
Wachovia Corp.	78,21%	88,17%	83,64%	82,43%	84,86%	84,86%	83,74%	87,60%	84,17%	83,24%	84,81%	**84,07%**
American Express Co.	81,75%	87,86%	86,03%	85,45%	85,70%	85,70%	83,48%	85,73%	87,40%	87,73%	89,95%	**88,36%**
Hewlett-Packard Co.	84,26%	83,31%	81,90%	83,34%	85,21%	n.a.	86,02%	84,98%	81,87%	86,06%	86,02%	**84,65%**
Walt Disney Co.	n.a.	n.a.	n.a.	86,96%	83,38%	85,31%	84,55%	84,34%	82,30%	86,25%	88,23%	**85,59%**
Morgan Stanley	n.a.	n.a.	83,72%	94,63%	87,84%	85,41%	89,18%	85,66%	84,56%	83,81%	90,49%	**86,29%**
Average	***83,26%***	***85,05%***	***85,99%***	***85,96%***	***84,88%***	***84,33%***	***84,26%***	***84,25%***	***85,06%***	***84,85%***	***86,26%***	***85,44%***
Set of Data	27	28	30	31	31	29	30	31	31	32	29	

Number of Votes represented in shareholder meeting has been taken from EDGAR 10-q files

Due to American practice of share buybacks the overall number of shares entitled to vote may vary. Number of outstanding shares has been taken from EDGAR 10-q files or EDGAR 10-k files.

Attendance Rates measured in % of nominal capital in German Sample	Share Type	1998	1999	2000	2001	2002	2003	2004	3-year average
adidas-Salomon AG	bearer	35,07	43,86	45,44	30,00	31,52	23,17	28,25	**27,65**
Allianz AG	reg.	70,92	69,06	60,60	53,70	46,71	39,97	37,15	**41,28**
Altana AG	bearer	n.a.	76,00	71,71	65,21	64,00	63,00	67,22	**64,74**
BASF AG	bearer	53,03	49,48	46,02	43,59	36,82	31,31	34,99	**34,37**
Bayer AG	bearer	47,53	44,79	37,53	35,90	33,21	36,00	32,50	**33,90**
HypoVereinsbank AG	bearer	64,10	59,10	51,99	53,48	57,39	55,56	49,88	**54,28**
BMW AG	bearer	73,00	73,00	64,40	64,04	66,57	65,84	63,70	**65,37**
Commerzbank AG	bearer	46,54	43,91	55,97	56,07	58,93	57,31	46,53	**54,26**
Continental AG	bearer	45,93	40,63	37,06	40,64	41,66	33,57	34,44	**36,56**
DaimlerChrysler AG	reg.	63,97	39,02	39,00	37,64	38,25	38,84	43,69	**40,26**
Deutsche Bank AG	reg.	44,69	37,50	31,73	34,44	33,41	38,75	31,98	**34,71**
Deutsche Börse AG (listed since 2001)	reg.				65,00	63,40	44,63	31,55	**46,53**
Deutsche Lufthansa AG	reg.	31,90	34,60	35,25	34,90	41,14	46,37	41,09	**42,87**
Deutsche Post World Net AG (l. since 2001)	reg.				76,18	77,37	79,35	72,71	**76,48**
Deutsche Telekom AG	reg.	85,61	82,67	75,86	69,52	56,45	59,47	63,53	**59,82**
E.ON AG (listed since 2000)	bearer				39,01	37,35	31,00	35,00	**34,45**
Fresenius Medical Care AG	bearer	62,40	67,88	64,79	61,06	62,59	64,97	65,00	**64,19**
Henkel AG (Voting Shares)	bearer	65,11	86,40	76,54	84,50	83,73	79,39	80,22	**81,11**
Infineon Technologies AG (l. since 2000)	bearer				74,74	41,66	31,88	17,59	**30,38**
Linde AG	bearer	59,00	56,46	54,40	53,67	54,19	50,08	50,72	**51,66**
MAN AG	bearer	61,00	59,81	55,80	50,62	52,80	48,41	45,51	**48,91**
Metro AG	bearer	78,49	77,72	87,53	66,93	66,38	65,86	65,27	**65,84**
Munich Re	reg.	75,80	72,33	69,80	65,60	53,45	57,49	44,89	**51,94**
RWE AG	bearer	75,01	67,15	63,90	65,09	66,08	39,06	60,00	**55,05**
SAP AG	bearer	59,77	53,36	56,70	50,85	55,37	58,04	59,53	**57,65**
Schering AG	bearer	43,16	47,01	43,33	37,40	37,00	34,84	33,00	**34,95**
Siemens AG	reg.	46,66	44,97	24,93	22,00	36,40	47,51	32,67	**38,86**
ThyssenKrupp AG (former Thyssen)	bearer	58,74	55,90	64,14	62,62	60,06	61,66	56,18	**59,30**
TUI AG (former Preussag)	bearer	65,41	66,87	39,30	37,21	37,21	54,18	54,30	**48,56**
Volkswagen AG	bearer	43,70	37,62	34,39	36,99	32,98	29,01	37,21	**33,07**
Average		***58,26***	***57,20***	***53,39***	***52,29***	***50,80***	***48,88***	***47,21***	***48,97***

Number of shareholders personally attending Annual Meetings (DAX 30)	Share Type	1998	1999	2000	2001	2002	2003	2004	3-year-average	Total Number of shs.	%
adidas-Salomon AG	bearer	482	700	655	524	579	480	498	519	95.000	0,55%
Allianz AG	reg.	2.823	3.154	4.021	4.335	5.700	7.500	6.000	6.400	550.000	1,16%
Altana AG	bearer	*600*	*640*	*680*	*720*	766	768	840	791	50.000	1,58%
BASF AG	bearer	4.600	5.500	5.900	6.700	6.800	6.800	7.500	7.033	520.000	1,35%
Bayer AG	bearer	*5.000*	*7.600*	*5.000*	*7.600*	6.000	6.500	5.000	5.833	496.000	1,18%
HypoVereinsbank AG	bearer	3.835	4.994	4.126	4.196	4.896	5.434	5.330	5.220	250.000	2,09%
BMW AG	bearer	2.371	2.767	4.552	4.601	4.635	4.744	5.316	4.898	n.a.	n.a
Commerzbank AG	bearer	3.013	3.271	2.974	3.144	2.887	3.043	2.717	2.882	360.000	0,80%
Continental AG	bearer	n.a.	n.a.	n.a.	n.a.	1.570	1.690	1.620	1.627	n.a.	n.a
DaimlerChrysler AG	reg.	11.800	16.500	10.370	10.350	10.680	9.160	9.270	9.703	1.900.000	0,51%
Deutsche Bank AG	reg.	4.800	6.500	5.600	5.300	6.500	5.500	5.100	5.700	500.000	1,14%
Deutsche Börse AG (listed since 2001)	reg.				1.000	1.000	800	600	800	37.500	2,13%
Deutsche Lufthansa AG	reg.	4.700	6.000	3.000	4.000	4.000	5.000	4.000	4.333	470.000	0,92%
Deutsche Post World Net AG (l. since 2001)	reg.				4.500	4.000	4.000	5.500	4.500	820.000	0,55%
Deutsche Telekom AG	reg.	3.996	4.501	6.658	8.612	8.241	8.550	7.611	8.134	2.800.000	0,29%
E.ON AG (listed since 2000)	bearer				4.800	4.800	4.800	4.800	4.800	478.000	1,00%
Fresenius Medical Care AG	bearer	450	420	390	418	424	628	565	539	n.a.	n.a
Henkel AG (Voting Shares)	bearer	*3.400*	*3.900*	3.400	3.900	2.900	2.800	2.700	2.800	**41.000**	6,83%
Infineon Technologies AG (l. since 2000)	bearer				2.900	3.700	3.300	3.500	3.500	n.a.	
Linde AG	bearer	n.a.	n.a.	n.a.	*1.500*	*1.500*	1.660	1.350	1.503	**29.000**	5,18%
MAN AG	bearer	1.100	1.700	2.400	1.500	1.500	1.700	1.800	1.667	**60.000**	2,78%
Metro AG	bearer	n.a.	n.a.	1.467	1.325	1.429	1.653	1.865	1.649	n.a.	n.a
Munich Re	reg.	1.700	1.830	2.240	2.650	3.880	3.790	3.950	3.873	180.000	2,15%
RWE AG	bearer	*3.500*	*3.500*	*3.500*	3.500	3.800	4.500	5.000	4.433	260.000	1,71%
SAP AG	bearer	5.000	7.000	3.500	5.000	5.500	4.000	3.500	4.333	550.000	0,79%
Schering AG	bearer	n.a.	n.a.	n.a.	*1.800*	1.765	1.930	1.619	1.771	135.000	1,31%
Siemens AG	reg.	*10.000*	*10.000*	*10.000*	*10.000*	9.800	12.000	10.800	10.867	1.000.000	1,09%
ThyssenKrupp AG (former Thyssen)	bearer	3.400	3.100	3.000	4.900	4.900	4.800	4.700	4.800	300.000	1,60%
TUI AG (former Preussag)	bearer	*1.500*	*1.500*	*2.000*	*2.000*	*2.500*	*2.500*	*3.000*	2.667	*90.000*	2,96%
Volkswagen AG	bearer	*3.700*	*3.400*	*3.700*	*3.400*	*3.700*	*3.400*	*3.700*	3.600	**728.000**	0,49%
Average		***3717***	***4476***	***3875***	***3972***	***4012***	***4114***	***3992***	***4039***		

Data in italics are estimates based on company information and reports by gsc research

Bold print signals old data (< 2002)

Shareholder Proposals at Annual Meetings in U.S.	**1994 total**	**social**	**CG**	**1995 total**	**social**	**CG**	**1996 total**	**social**	**CG**	**1997 total**	**social**	**CG**	**1998 total**	**social**	**CG**	**1999 total**	**social**	**CG**	**2000 total**	**social**	**CG**
General Electric Co.	4	4	0	6	5	1	8	5	3	6	4	2	8	5	3	9	6	3	11	8	3
Exxon Mobil Corp.	2	1	1	2	1	1	1	1	0	2	1	1	2	2	0	4	2	2	7	4	3
Pfizer Inc.	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Citigroup Inc.	0	0	0	1	1	0	0	0	0	0	0	0	0	0	0	2	1	1	3	0	3
Bank of America Corp.	2	1	1	2	1	1	0	0	0	2	0	2	3	0	3	4	0	4	3	2	1
Johnson & Johnson	1	1	0	3	2	1	0	0	0	1	1	0	1	0	1	0	0	0	1	1	0
American International Group	2	2	0	2	1	1	2	0	2	2	0	2	2	0	2	4	1	3	5	1	4
Procter & Gamble Co.	3	2	1	4	1	3	1	0	1	2	1	1	3	2	1	1	0	1	4	3	1
IBM	1	1	0	1	1	0	1	1	0	0	0	0	1	0	1	1	0	1	2	1	1
Wal Mart Stores Inc.	0	0	0	1	0	1	0	0	0	1	1	0	1	1	0	0	0	0	1	0	1
J.P. Morgan Chase & Co.	n.a	n.a.	n.a.	3	2	1	3	2	1	2	0	2	2	0	2	0	0	0	1	0	1
Coca-Cola Co.	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	3	2	1
ChevronTexaco Corp.	3	2	1	2	1	1	5	2	3	2	2	0	1	1	0	3	3	0	3	3	0
Merck & Co. Inc.	2	0	2	3	0	3	4	1	3	5	2	3	1	0	1	3	0	3	5	1	4
Altria Group Inc.	4	3	1	6	3	3	4	2	2	3	2	1	2	2	0	4	4	0	6	4	2
Wells Fargo & Co.	0	0	0	0	0	0	0	0	0	2	0	2	1	0	1	1	0	1	0	0	0
Verizon Communications Inc.	4	1	3	3	0	3	4	0	4	3	0	3	5	0	5	5	0	5	4	0	4
PepsiCo Inc.	0	0	0	5	4	1	4	3	1	3	0	3	3	0	3	1	0	1	1	0	1
Home Depot Inc.	0	0	0	0	0	0	0	0	0	2	0	2	2	1	1	2	1	1	2	1	1
SBC Communications Inc.	1	1	0	3	0	3	0	0	0	0	0	0	2	1	1	2	1	1	2	1	1
Time Warner Inc.	1	0	1	2	1	1	3	1	2	1	1	0	0	0	0	0	0	0	0	0	0
Eli Lilly & Co.	0	0	0	0	0	0	1	1	0	0	0	0	0	0	0	2	1	1	3	2	1
3M Co.	0	0	0	2	0	2	1	0	1	0	0	0	0	0	0	0	0	0	0	0	0
Tyco International Ltd.	0	0	0	0	0	0	0	0	0	0	0	0	1	0	1	0	0	0	3	0	3
Fannie Mae	n.a	n.a.	n.a.	n.a	n.a.	n.a.	n.a	n.a.	n.a.	n.a	n.a.	n.a.	n.a	n.a.	n.a.	n.a	n.a.	n.a.	n.a	n.a.	n.a.
Abbott Laboratories	2	2	0	1	1	0	0	0	0	0	0	0	1	1	0	2	2	0	1	1	0
Medtronic Inc.	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Wachovia Corp.	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	1
American Express Co.	4	1	3	3	1	2	2	1	1	4	2	2	2	0	2	3	1	2	0	0	0
Hewlett-Packard Co.	0	0	0	0	0	0	0	0	0	0	0	0	2	1	1	0	0	0	0	0	0
Walt Disney Co.	n.a	n.a.	n.a.	n.a	n.a.	n.a.	n.a	n.a.	n.a.	2	1	1	3	1	2	3	2	1	2	0	2
Morgan Stanley	n.a	n.a.	n.a.	n.a	n.a.	n.a.	0	0	0	0	0	0	0	0	0	3	1	2	2	1	1
Average	**36**	22	14	**55**	26	29	**44**	20	24	**45**	18	27	**49**	18	31	**59**	26	33	**76**	36	40
Percentage		**61,11%**	38,89%		47,27%	**52,73%**		45,45%	**54,55%**		40,00%	**60,00%**		36,73%	**63,27%**		44,07%	**55,93%**		47,37%	**52,63%**
Set of data	28	28	28	29	29	29	30	30	30	31	31	31	31	31	31	31	31	31	31	31	31
Proposals per meeting / averag	1,29	0,79	0,50	1,90	0,90	1,00	1,47	0,67	0,80	1,45	0,58	0,87	1,58	0,58	1,00	1,90	0,84	1,06	2,45	1,16	1,29
Shareholder Proposals reach Majority																		1			3
Percentage																		3,03%			7,50%

Appendix E

Shareholder Proposals at Annual Meetings in U.S.	**2001 total**	**social**	**CG**	**2002 total**	**social**	**CG**	**2003 total**	**social**	**CG**	**2004 total**	**ideo**	**CG**	**1994 - 2004 total**	**social**	**CG**
General Electric Co.	7	4	3	8	3	5	11	6	5	15	7	8	**93**	**57**	***36***
Exxon Mobil Corp.	8	3	5	8	4	4	12	7	5	8	4	4	**56**	**30**	***26***
Pfizer Inc.	0	0	0	0	0	0	0	0	0	5	4	1	**5**	4	1
Citigroup Inc.	4	2	2	6	2	4	5	2	3	3	1	2	**24**	9	15
Bank of America Corp.	4	1	3	1	0	1	1	0	1	5	2	3	**27**	7	20
Johnson & Johnson	1	1	0	1	1	0	0	0	0	1	1	0	**10**	8	2
American International Group	3	1	2	1	0	1	0	0	0	3	2	1	**26**	8	18
Procter & Gamble Co.	6	3	3	4	2	2	2	1	1	n.a.	n.a.	n.a.	**30**	15	15
IBM	2	1	1	4	1	3	5	1	4	8	3	5	**26**	10	16
Wal Mart Stores Inc.	1	1	0	2	2	0	6	2	4	6	3	3	**19**	10	9
J.P. Morgan Chase & Co.	0	0	0	0	0	0	0	0	0	8	3	5	**19**	7	12
Coca-Cola Co.	3	2	1	4	2	2	7	3	4	6	2	4	**23**	11	12
ChevronTexaco Corp.	3	3	0	3	2	1	3	1	2	n.a.	n.a.	n.a.	**28**	**20**	8
Merck & Co. Inc.	3	1	2	4	1	3	4	2	2	5	4	1	**39**	12	***27***
Altria Group Inc.	6	6	0	3	3	0	6	4	2	5	5	0	**49**	**38**	11
Wells Fargo & Co.	1	0	1	1	0	1	2	0	2	4	1	3	**12**	1	11
Verizon Communications Inc.	4	0	4	5	0	5	8	0	8	8	2	6	**53**	3	***50***
PepsiCo Inc.	4	2	2	4	2	2	3	2	1	2	2	0	**30**	15	15
Home Depot Inc.	2	1	1	1	1	0	5	1	4	6	1	5	**22**	7	15
SBC Communications Inc.	1	0	1	0	0	0	3	0	3	0	0	0	**14**	4	10
Time Warner Inc.	0	0	0	1	1	0	2	2	0	2	2	0	**12**	8	4
Eli Lilly & Co.	1	1	0	0	0	0	2	0	2	2	1	1	**11**	6	5
3M Co.	1	0	1	1	0	1	1	0	1	0	0	0	**6**	0	6
Tyco International Ltd.	1	1	0	0	0	0	6	1	5	3	1	2	**14**	3	11
Fannie Mae	n.a	n.a.	n.a.	n.a	n.a.	n.a.	1	0	1	1	0	1	**2**	0	2
Abbott Laboratories	1	1	0	1	1	0	1	0	1	4	3	1	**14**	12	2
Medtronic Inc.	0	0	0	0	0	0	0	0	0	n.a.	n.a.	n.a.	**0**	0	0
Wachovia Corp.	1	1	0	0	0	0	0	0	0	3	1	2	**5**	2	3
American Express Co.	1	1	0	1	0	1	4	1	3	2	1	1	**26**	9	17
Hewlett-Packard Co.	1	1	0	2	2	0	6	1	5	1	0	1	**12**	5	7
Walt Disney Co.	1	0	1	4	2	2	4	2	2	3	2	1	**22**	10	12
Morgan Stanley	0	0	0	1	0	1	2	1	1	3	1	2	**11**	4	7
Average	**71**	38	33	**71**	32	39	**112**	40	72	**122**	**59**	**63**	**740**	335	405
Percentage		**53,52%**	46,48%		45,07%	**54,93%**		35,71%	**64,29%**		48,36%	**51,64%**			
Set of data	31	31	31	31	31	31	32	32	32	29	29	29			
Proposals per meeting / averag	2,29	1,23	1,06	2,29	1,03	1,26	3,50	1,25	2,25	4,21	2,03	2,17			
Shareholder Proposals reach M			2			4			11		2	6	**29**		
Percentage			6,06%			10,26%			15,28%		3,39%	9,52%			

Appendix F

Increase in Foreign Shareholdings in German Sample	2003/20004 (%)	Earlier Study (%)	In Year	Average Annual Increase (%)
adidas-Salomon	66,00	57,00	2002	6,00
Allianz	33,90	32,00	2002	1,27
Altana	*23,00*	20,00	2002	2,00
BASF	52,40	35,00	2001	6,96
Bayer	42,00	39,00	1999	0,67
HypoVereinsbank	12,00	25,70	2000	-3,91
Commerzbank	48,00	35,50	2002	8,33
DaimlerChrysler	45,00	45,00	2001	0,00
Deutsche Bank	53,00	41,00	1998	2,18
Deutsche Börse	59,00	47,00	2002	8,00
Deutsche Lufthansa	23,90	29,10	2002	-3,47
Deutsche Telekom	32,49	34,32	2002	-1,22
E.ON	43,00	42,00	2002	0,67
Linde	*35,00*	31,00	2000	1,14
Munich Re	36,70	22,00	1998	2,67
SAP	40,70	34,80	2000	1,69
Schering	52,00	36,00	2000	4,57
Siemens	56,30	48,00	2000	2,37
ThyssenKrupp	20,00	26,00	2002	-4,00
TUI	25,00	21,60	1995	0,40

Appendix G

Firm	Non-Broker Votes	Remarks
American International Group	7,49%	
Wal Mart	8,89%	
Morgan Stanley	9,27%	
Fannie Mae	10,30%	
Lilly Eli	10,60%	
American Express	11,28%	
Wells Fargo	12,64%	
HewlettPackard	13,89%	
Verizon	14,38%	
J.P. Morgan Chase	14,45%	
Walt Disney	14,63%	
PepsiCo	14,65%	
Tyco	14,65%	
Abbott	15,16%	
Wachovia	15,66%	(incl. abstentions)
Bank of America	16,01%	
Citigroup	16,34%	
Exxon Mobil Corp.	16,60%	
Johnson & Johnson	16,73%	
Pfizer Inc.	16,81%	
Time Warner	17,66%	
General Electric	19,12%	
Merck Co Inc.	19,29%	
HomeDepot	20,15%	
IBM	21,79%	
Altria	24,17%	
Procter & Gamble	n.y.r.	
ChevronTexaco	n.y.r.	
Medtronic	n.y.r.	
SBC	not voted on shareholder proposals	
3M	not voted on shareholder proposals	
Average (of 26 reported votes)	**15,10%**	