The Manner in Which Corporate Law and Financial Regulations Are Made

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*University of Pennsylvania*

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*Goethe University*

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GLOBAL RESEARCH SEMINAR ON
Comparative Corporate Governance

The Manner in which Corporate Law and Financial Regulations are made

present to

Prof. Brigitte Haar (Goethe-University)
Prof. Jill E. Fisch (Penn Law School)

written by

Sharareh Zand (Goethe-University)
Supawich Sirikanchana (Penn Law School)
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<tr>
<td>§§</td>
<td>section(s)</td>
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<tr>
<td>AEUV</td>
<td>Treaty on the Functioning of the European Union</td>
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<td>AktG</td>
<td>Stock Corporation Act</td>
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<tr>
<td>AG</td>
<td>Stock company</td>
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<td>AT</td>
<td>Official section</td>
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<tr>
<td>B-Corp</td>
<td>Benefit Corporation</td>
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<tr>
<td>BGB</td>
<td>German Civil Code</td>
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<td>BGBL</td>
<td>Federal Law Gazette</td>
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<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
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<td>Cf.</td>
<td>compare</td>
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<td>DCGK</td>
<td>German Corporate Governance Code</td>
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<tr>
<td>DGCL</td>
<td>Delaware General Corporation Law</td>
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<td>DNotZ</td>
<td>German Notary Journal</td>
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<tr>
<td>Dodd-Frank</td>
<td>Wall Street Reform and Consumer Protection Act</td>
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<tr>
<td>DRC</td>
<td>Democratic Republic of Congo</td>
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<tr>
<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<tr>
<td>e.g.</td>
<td>for example</td>
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<tr>
<td>eBanZ</td>
<td>Elektronischer Bundesanzeiger</td>
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<tr>
<td>EC</td>
<td>Treaty establishing the European Economic Community</td>
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<tr>
<td>ECMH</td>
<td>Efficient Capital Market Hypothesis</td>
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<tr>
<td>ESOP</td>
<td>Employee Stock Option Plan</td>
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<tr>
<td>et seq(q).</td>
<td>and the following(s)</td>
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<tr>
<td>EuGH</td>
<td>European Court of Justice</td>
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<td>F(f).</td>
<td>Following(s)</td>
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<tr>
<td>G-20</td>
<td>Group of Twenty</td>
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<td>GmbH</td>
<td>Limited Liability Company</td>
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All online sources were lastly checked on 21 February 2016.
The Manner in which corporate law and financial regulations are made

A. Introduction

Substantial differences exist in the systems of corporate law from an international perspective. There are different approaches concerning the law-making. Starting from possible reasons for the differences, this paper shall serve as a comparative analysis of the manner in which corporate law is made in Germany as well as in the United States. In the light of the topic of this seminar the focus of this paper will lay on corporate governance.

After a detailed representation of the law-making analysis in Germany, followed by that of the United States, the third part will consist of a comparative analysis of both systems. For analyzing the possible reasons for the differences in both jurisdictions, connections of legal history, legal theories and other backgrounds, as well as the roles of the different institutions and guidelines are included. In the context of legal harmonization, the third part will also offer a determination of attempts for harmonizing the legal systems as well as a possible prospect for future developments and endeavors.

B. The manner in which corporate law is made in Germany

In the course of the history until now German corporate law and the manner in which it was made often changed and constantly developed. Like no other legal field, the development of German jurisdiction can be illustrated by German corporate law, considering historical, political and social aspects. For this reason, in order to classify and compare German corporate law, this first part of the paper contains an analysis of German corporate law, starting in its very beginnings and coming to its most current expression, being the subject of corporate governance, while passing all relevant steps in between. Reaching today’s time Corporate Governance shall be classified and analyzed in the light of globalization, Europeanisation, new challenges and influences. In all those parts, special attention shall be given to the legal form and nature of corporate law. Having set the scene of German corporate law, German corporate governance and the German Corporate Governance code shall be classified, analyzed and legally classified in a national and international context.
I. An introduction to German corporate law

One common definition of German corporate law states that corporate law covers the law of associations under private law\(^1\) which are established for the purpose of reaching a certain common goal through legal transaction.\(^2\) In the course of the time this definition became deceptive and questioned since companies with a sole shareholder are not associations but are, nevertheless, subjected to corporate law under certain circumstances.\(^3\) However, other definitions have not been able to fully establish themselves.

Subject of German corporate law are various legal forms, which are ruled in different laws. The German Civil Code (\textit{Bürgerliches Gesetzbuch}, hereafter referred to as “BGB")\(^4\) holds provisions for the basic forms of associations (\textit{Vereine}, section 21 et seqq. of the BGB) and corporations (\textit{Gesellschaften}, section 705 et seqq. of the BGB). Further, the German Commercial Code (\textit{Handelsgesetzbuch}, hereafter referred to as “HGB")\(^5\) contains rules for partnerships (\textit{offene Handelsgesellschaften}, hereafter referred to as “OHG”; section 105 et seqq. of the HGB), limited partnerships (\textit{Kommanditgesellschaften}, hereafter referred to as “KG”; section 161 et seqq. of the HGB) and other legal forms\(^6\) which are less relevant in this context.

Those legal forms of great practical importance are ruled by own laws which are exclusively created for the particular legal form. The most important ones for these are the Stock Corporation Act of 1965 (\textit{Aktiengesetz}, hereafter referred to as “AktG")\(^7\), providing laws for stock companies (\textit{Aktiengesellschaften}, hereafter referred to as “AG”), as well as the Act on Limited Liability Companies (\textit{Gesetz betreffend die Gesellschaften mit beschränkter Haftung}, hereafter referred to as “GmbHG")\(^8\), containing the relevant laws for Limited Liability Companies (\textit{Gesellschaften mit beschränkter Haftung}, hereafter referred to as “GmbH”). This division, which is common for European legislations, does not refer to the size of the company.\(^9\) However, only shares of a stock corporation can be listed and traded on the stock market.\(^10\) For this reason stock

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\(^1\) Schmidt, Gesellschaftsrecht, § 1 I 1a).
\(^2\) Grunewald, 1-2; Kübler/Assmann, Gesellschaftsrecht, § 1 I; Klunzinger, Grundzüge des Gesellschaftsrechts, § 1 I.
\(^3\) Kübler/Assmann, Gesellschaftsrecht, § 1 II 1.
\(^4\) German Civil code as of 18 August 1896 (RGBl. I p. 195).
\(^5\) German Commercial Code as of 10 May 1897 (RGBl. I p. 219).
\(^6\) E.g. silent partnerships (\textit{stille Gesellschaften}, section 230 et seq of the HGB) and shipping companies (\textit{Reedereien}, section 489 et seq of the HGB).
\(^7\) Stock Corporation Act as of 6 September 1965 (BGBl. I p. 1089).
\(^8\) Act on Limited Liability Companies as of 20 April 1892 (RGBl. I p. 477).
\(^9\) Mäntysaari, Comparative Corporate Governance, 242; Baums/Birkenkaemper, CG, I.
\(^10\) Mäntysaari, Comparative Corporate Governance, 242.
corporations is rather the legal form to choose for large, publicly held firms with widely distributed ownership.\textsuperscript{11}

II. Historical development of German corporate law

The historical foundations and roots of German corporate law are not only academically of interest, but also provide a better understanding for today’s corporate law in Germany as well as legal comparisons and the Europeanization of corporate law.\textsuperscript{12}

1. The origins of German corporate law

The manner in which today’s corporate law is made is a product of the past two centuries even though certain elements have their origin much earlier.\textsuperscript{13} Corporate law, as nearly all German laws, has been subject to wide array of influences from Roman law.\textsuperscript{14} However, even if certain structures resemble some of today’s legal forms of corporations, there is an important structural difference being that all former expressions of legal forms of corporations were integrated in a corporate-estates based social order which was concededly stable but far from flexible.\textsuperscript{15}

2. Corporate law in the time of German liberalism

The birth of modern corporate law in Germany was the transition from a corporate-estates-based to a civil-liberal social order.\textsuperscript{16} The reorganization of the community order as well as the incorporation of principles such as private autonomy, private property and freedom of trade marked the end of the feudal system making every citizen a potential entrepreneur whose economic expansion should, from then on, only be regulated by the market itself and who should be free to choose the legal form of a corporation.\textsuperscript{17} At this time, corporate law was still incorporated in codified commercial law\textsuperscript{18} but opened to citizens of all social backgrounds. However, in this period of time the old mentality of the estate-based order was still present, with the result that German people still had strong conservative aversions towards extensive and liberal codes.\textsuperscript{19}

\textsuperscript{11} Baums/Birkenkaemper, CG, I.
\textsuperscript{12} Kraushaar, 275; detailed in Donald, 19-22.
\textsuperscript{13} Kübler/Assmann, Gesellschaftsrecht, § 2 I 1.
\textsuperscript{14} Cf. Kraushaar, 40; Mousourakis, 267.
\textsuperscript{15} Cf. Winkler, 235; Kübler/Assmann, Gesellschaftsrecht, § 2 II 1.
\textsuperscript{16} Winkler, 234.
\textsuperscript{17} Kübler/Assmann, Gesellschaftsrecht, § 2 II 1.
\textsuperscript{18} Public German Commercial Code (\textit{Allgemeines Deutsches Handelsgesetzbuch}), 1869.
\textsuperscript{19} Kübler/Assmann, Gesellschaftsrecht, § 2 II 1.
With the General German Commercial Code (Allgemeines Deutsches Handelsgesetzbuch) of 1861 the first codification as known today was introduced. However, not until the turn of the century the complete codification of corporate law was completed. With the coming into force of the HGB and the BGB the basic structures of legal forms such as the corporation, associations and companies were set.

3. The 20th century: dissociation from codification

Detailed codifications shaped the picture of corporate law in the beginning of the 20th century. Deep social transformations and historical happenings, such as the economic liberalism, the resulting industrial revolution, the further resulting decay of the homogenous civil society and the simultaneously developed grouping of people in the form of labor unions or the first forms of associations, were the reason for many and fast changes of this time’s corporate law. Another product of these happenings was the ongoing nationalization of commercial policies.

However, already in the very beginning of the 19th century a movement away from complete codifications was noticeable and indicated the decay of the concept of full codifications. More and more frequently, special laws were needed, that would not be incorporated in codes, as for example the right of the GmbH. As there were needs of the society for a less complex and a better-conditioned regulated corporation, the GmbH was introduced in 1892 and captured a new legal form without any historic or international example. Another example for the outdated idea of extensive codes was the formation of the AktG. The extension of the regulation program regarding the AG and its policies led to a duplication of the sections and thereby for the regulations concerning the AG to fall out of the HGB and to the formation of the AktG.

However, not only the increased number of special laws led to the changing mentality concerning codifications but also an increased number of above- and sub-statutory provisions that replaced or stepped beside parliamentary laws. On the other side, cases in which legal regulations were complemented, modified and suppressed by case law as well as statutory and contract

20 Kübler/Assmann, Gesellschaftsrecht, § 2 III 3.
21 Kübler/Assmann, Gesellschaftsrecht, § 2 III 1, § 2 III 3.
22 Kübler/Assmann, Gesellschaftsrecht, § 2 III 3.
23 Ulmer, in Ulmer/Habersack/Löbbe, A3; Westermann, in Scholz, introduction para. 43.
25 Kübler/Assmann, Gesellschaftsrecht, § 2 III 4.
practices constantly grew.\textsuperscript{26} Especially the influence of further developments of law by judicial decisions experienced constant growth in the course of time.\textsuperscript{27} The importance of those developments depended on the presence and the extent of adaptions by the governing law.

An example for this is the stock corporation law. Here, existing provisions are regularly adapted to changed circumstances. Furthermore, there is comparatively rare processing in stock corporation law, wherefore further developments of law by judicial decisions has little meaning.\textsuperscript{28} In other laws, such as the partnerships only little changes were made since the coming into force of the codification. Instead, numerous principles and provisions were formulated by the Imperial Court of Justice\textsuperscript{29} as well as the German Federal Supreme Court.\textsuperscript{30}

In the course of this century, however, much more changed than the outer shape of corporate law. In prior times corporate law only had limited regulatory content and was mainly about the legal relationship between the entrepreneurial company, the investment company and the shareholder creditors and therefore mostly represented the interests of those groups. The legislator trusted in the self-regulation of those interests and provided legal forms to choose from as well as nearly unlimited contractual possibilities.\textsuperscript{31} In the following era of single legislations an opposite trend can be observed. Much more, corporate law aims at better general organizations of corporations and thereby increases the importance of interests of other involved groups turning corporate law more and more to mandatory law.\textsuperscript{32}

These changes of the objective of corporate law – turning away from providing suitable organizational structures for private associations, but increasingly to economic and rather distributional objectives – can be very well shown on AktG as of 1965.\textsuperscript{33} The provisions aim improvements of different aspects of corporate law such as improved publicity, more transparency and more influence of the shareholders organized in the shareholder’s meeting on the profit appropriation. Further, the AktG shall protect investors and savers from bad investments and fraudster. On that point, generally, an increasing orientation of corporate law to concrete economic and

\textsuperscript{26} Kübler/Assmann, Gesellschaftsrecht, § 2 III 4.
\textsuperscript{27} Detailed in Fischer, 17.
\textsuperscript{28} Kübler/Assmann, Gesellschaftsrecht, § 2 III 4c).
\textsuperscript{29} The imperial Court of Justice (Reichsgericht) was the supreme criminal and civil court of the German empire from 1879 to 1945 based in Leipzig, Germany.
\textsuperscript{30} Kübler/Assmann, Gesellschaftsrecht, § 2 III 4c).
\textsuperscript{31} Kübler/Assmann, Gesellschaftsrecht, § 2 III 5.
\textsuperscript{32} Kübler/Assmann, Gesellschaftsrecht, § 2 III 5.
\textsuperscript{33} Kübler/Assmann, Gesellschaftsrecht, § 2 III 5b).
sociopolitical purposes can be captured.\textsuperscript{34}

Germany’s corporate law in the 20\textsuperscript{th} century can be described as a catalogue of regulated legal forms, that consisted of the sum of the laws regulating the individual legal forms. At that time, problems arose when the existing mandatory law could not provide for the need of regulation with regard to provisions ruling hybrid forms of corporations. This need for provisions that captured hybrid and flexible forms of corporation, to this time, indicated a call for impending change in the legal appearance of German corporate law.

4. Corporate law (on its way) in the 21\textsuperscript{st} century

A new movement starting from the United States marked a new change in corporate law in the 1990s. An extensive deregulation of corporate law led to the displacement or elimination of mandatory law by dispositive rules that led to more flexibility and attractiveness for corporations.\textsuperscript{35}

In the light of the the ongoing Internationalization of global businesses the rigid corset of lengthy legislative processes did not seem to fit into the dynamic, global economy. A faster-working and more flexible statutory framework was needed,\textsuperscript{36} wherefore the German lawmakers were forced to react in order to be competitive.\textsuperscript{37} Therefore, the resulting loosening of the strict structures of parts of German Corporate Law can be best explained by the internationally growing competitive pressure.\textsuperscript{38} Against this background, the significance of law as the central control element in a democratic and constitutional state decreased.\textsuperscript{39}

However, after the collapse of Lehman Brothers in 2008 and the resulting financial crisis the topic of executive compensation was amongst the most controversial topics about time.\textsuperscript{40} The fact that the very institutions and individuals that caused the collapse of the economy continue to receive extraordinary salaries and benefits seems deeply unfair and the voices grew demanding adjusted regulations concerning executive compensation, forcing regulators to react.\textsuperscript{41} While in many other countries endeavors were limited or hindered, Germany surprisingly took a leading

\textsuperscript{34} Kübler/Assmann, Gesellschaftsrecht, § 2 III 5 b).
\textsuperscript{35} Kübler/Assmann, Gesellschaftsrecht, § 2 IV 1.
\textsuperscript{36} Möllers/Fekonja, 778
\textsuperscript{37} Cuervo-Cazurra/Aguilera, 430.
\textsuperscript{38} Mathieu, 579, 605; Kübler/Assmann, Gesellschaftsrecht, § 2 IV 3; Armour/Ringe, Oxford LSRP No. 63/2010, 3.
\textsuperscript{39} Möllers/Fekonja, 779.
\textsuperscript{40} Achleitner/Rapp/Schaller/Wolff, ZCG 2010, pp. 113, 113-115.
\textsuperscript{41} Mathieu, 579, 582.
position, taking concrete steps towards systematically changes of the structures of executive compensation.\textsuperscript{42} It did so, however, extraordinarily quickly, yet productive and efficient.

With its Act on the Adequacy of the Management Board’s Compensation (\textit{Vorstandsvergütungsangemessenheitsgesetz}, hereafter referred to as “VorstAG”)\textsuperscript{43} Germany encouraged companies to more efficient goal-setting and increased transparency being applicable to all tradable stocks.\textsuperscript{44} The enacting of this law significantly contributed to improved corporate governance structures and growing attention of shareholders and created a stir. With its VorstAG, at the latest, German law making proved its competitiveness and that it is able to adjust to the needs and interests of the society in short time.

\section*{III. Europeanization of German corporate law}

Having reached the 21\textsuperscript{st} century, a new level of law-making arose and constantly grew in terms of importance. Since the establishment of the European Union legislative approaches of the European Commission were actively followed regarding the harmonization of national business laws, to become internationally competitive as well as an attractive location for corporations.\textsuperscript{45} Other factors, such as various national corporate scandals and finally the financial crisis, also produced reform efforts towards the Europeanization and harmonization of national business laws.\textsuperscript{46}

In this context, the European Court of Justice (\textit{Europäischer Gerichtshof}, hereafter referred to as “EuGH”), played an ever growing role in harmonizing and setting the rules for a corporate legal system on European level.\textsuperscript{47} In particular, the jurisdictions of the EuGH concerning the freedom of establishment, that no longer allow member states to prohibit or complicate the usage of legal forms from jurisdictions of other member states are of relevance.\textsuperscript{48} This matter shall be presented in the following, illustrating the scope as well as the significance of the decisions of the EuGH for the member states.

\begin{footnotes}
  \item Mathieu, 579, 583.
  \item Act on the Adequacy of the Management Board’s Compensation as of 31 July 2009 (BGBI. I p. 2509).
  \item Mathieu, 579, 583.
  \item Mathieu, 579, 610; cf. Armour/Ringe, Oxford LSRP No. 63/2010, 3.
  \item Kübler/Assmann, Gesellschaftsrecht, § 2 IV 4; Armour/Ringe, Oxford LSRP No. 63/2010, 1; Armour, ECGI No. 54/2005, 1.
  \item Armour, ECGI No. 54/2005, 1.
  \item Kübler/Assmann, Gesellschaftsrecht, § 2 IV 4.
\end{footnotes}
1. Daily Mail

Starting point of a series of decisions concerning principles of law in the context of freedom of establishment was the Daily Mail case in 1988. Daily Mail plc, a company registered in England, intended to move its tax residence to the Netherlands due to its more favourable tax regimes, while keeping its company subject to British company law. This relocation under English law, required the consent of the British Treasury Department. The latter, however, refused permission for the transfer of seat. Daily Mail argued that this refusal was in conflict with its freedom of establishment, referring the question to the EuGH. Applying a restrictive approach, the EuGH ruled that companies are “creatures of national law” and must comply with the restrictions of its national law. Member states, therefore, could preclude national companies from transfer their de facto head office.

2. Centros

Ten years later the EuGH revisited these ruling in Centros. A Danish couple established Centros Ltd as an offshore company in the UK, in order to avoid the minimum capitalization requirement for Danish limited liability companies. However, the Danish commercial registry refused Centros Ltd to register a branch in Denmark, arguing this to be an unlawful circumvention of the Danish minimum capitalization rules.

The court held that it is unlawfully to deny a company’s status as a legal person, which has been validly conferred by another jurisdiction, just because it has been conferred by another jurisdiction. The court also held that the member states are prohibited from discriminating.

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49 Case 81/87, R v HM Treasury and Commissioners of Inland Revenue, ex p Daily Mail and General Trust plc, 27 September 1988; hereafter referred to as “Daily Mail”.
51 Daily Mail, para. 6.
52 Daily Mail, para. 5, 6; section 482 (1) (a) of the Income and Corporation Taxes Act 1970.
53 Daily Mail referred to its freedom of establishment as ruled in articles 52, 58 of the Treaty establishing the European Economic Community, which is by now overruled by the Treaty on the Functioning of the European Union (hereafter referred to as “TFEU”). The freedom of establishment as concerned in this context is now governed in articles 49, 54 of the TFEU.
54 Armour/Ringe, Oxford LSRP No. 63/2010, 8; Daily Mail, para. 8.
55 Daily Mail, para. 19.
56 Daily Mail, para. 19.
57 Daily Mail, para. 31.
58 Case C-212/97, Centros Ltd v Erhvervs- og Selskabsstyrelsen, 9 March 1999; hereafter referred to as “Centros”.
59 Centros, paras. 2, 3, 18.
60 Centros, paras. 7, 12, 16.
against companies on the ground that they were formed under the law of another member state in which it has its registered office but does not carry on any business forcing the Danish authorities to recognize the legal status of Centros Ltd.

This decision caused a stir. To this time national corporate laws were not harmonized to this extent, so that the possibility of an establishment of a company in other member states could not be taken for granted.

3. Überseering

Not until Überseering two years later, the significance of this overruling decision became clear, where the EuGH went even further. A limited liability company validly formed under Dutch law moved its head office to Dusseldorf, Germany. There, it filed a suit against a debtor out of a work contract. However, the German courts refused to recognize the company’s existence, holding that the corporation did not have legal capacity to sue and be sued under German law and dismissing the Dutch company from court proceedings in Germany.

The EuGH overruled this decision by reference to Centros, after which the company’s status as such had been established by Dutch law, wherefore it was entitled to rely on freedom of establishment and the other member state is required to recognize the company’s legal capacity.

4. Inspire Art

After Centros, it was recognized, that branches of foreign companies with their head offices in another state must be registered in that other state. Nevertheless, the member states tried to equate those companies to their own companies. A law in the Netherlands ruled that their own capital financing regulations should as well apply on foreign companies with their head offices in the Netherlands. In this context the EuGH made another fundamental decision.

Inspire Art Ltd, a company established under the laws of England and Wales, requested the registration of the company’s Dutch branch office at the commercial registry in the Nether-

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65 Art. 4, 6 of the Law on Formally Foreign Companies as of 17 December 1997 (Wet op de Formeel Buitenlandse Vennootschappen, Staatsblad 1997 No 697, hereafter referred to as “WFBV”).
66 Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, 30 September 2003; hereafter referred to as “Inspire Art”.
67 Inspire Art, para. 2, 34.
lands.\textsuperscript{68} The registry intended to apply WFBV, containing specific Dutch rules for foreign entities registered in the Netherlands. Under this law, Inspire Art Ltd would have been required, to use a suffix indicating its foreign origin,\textsuperscript{69} and to comply with the minimum capital rules for Dutch limited liability companies.\textsuperscript{70}

The case ended up before the EuGH which, however, reiterated the points it has made in its prior decisions in favor of freedom of establishment.\textsuperscript{71} The court ruled that it is contrary to the provisions governing the freedom of establishment for national legislation “impose on the exercise of freedom of secondary establishment in that State by a company formed in accordance with the law of another Member State certain conditions provided for in domestic company law in respect of company formation relating to minimum capital and directors' liability. The reasons for which the company was formed in that other Member State, and the fact that it carries on its activities exclusively or almost exclusively in the Member State of establishment, do not deprive it of the right to invoke the freedom of establishment guaranteed by the EC Treaty, save where the existence of an abuse is established on a case-by-case basis.” \textsuperscript{72}

5. **Range and meaning of the decisions of the EuGH**

Germany, as most members of the European Union, has traditionally adhered to the “real seat” theory, which implies that companies should be governed by the law in which its headquarters is located.\textsuperscript{73} After this theory a company can only chose another member’s corporate law if it is willing to move its headquarters, which often outweighs the advantage of the more attractive corporate law, in terms of the costs for the relocation.\textsuperscript{74} However, the EuGH overruled the real seat theory by applying the “incorporation” theory.\textsuperscript{75} The incorporation theory looks to the law of the place of the firm’s incorporation, meaning that entrepreneurs can simply incorporate their business in the jurisdiction of their choice and are free to choose the corporate law of their choice.\textsuperscript{76}

With its decisions the EuGH, finally and unambiguously made clear, that the freedom of

\textsuperscript{68} Inspire Art, para. 36.
\textsuperscript{69} Inspire Art. Para. 36; Art. 2 WFBV.
\textsuperscript{70} Inspire Art, para. 23; Art. 2-5 WFBV.
\textsuperscript{71} Inspire Art. paras. 91, 94, 98, 120, 135.
\textsuperscript{72} Inspire Art, para. 144.2.
\textsuperscript{73} Dammann, Fordham 2003, 607, 611; Armour/Ringe, Oxford LSRP No. 63/2010, 6.
\textsuperscript{74} Dammann, Fordham 2003, 607, 611.
\textsuperscript{75} Eidenmüller/Engert/Hornuf, ECGI 127/2009, 1 f.
\textsuperscript{76} Eidenmüller/Engert/Hornuf, ECGI 127/2009, 2.
establishment demands that a corporation that was effectively founded in a member state of the European Union should be recognized as such in all other member states in which it settles. European entrepreneurs are now free to choose a governing law of their choice among the member states, what practically means that the EuGH overruled member states’ national laws in favour of European entrepreneurship.

The EuGH concretized and confirmed its rulings around the freedom of establishment, however, the cases of Centros, Überseering and Inspire Art sufficiently illustrate the scope of the increasing importance of the EuGH and the consequences of its overruling for the member states.

6. **Further endeavors towards Europeanization: Societas Europaea**

Moreover, further steps were taken towards increased harmonization, flexibility and mobility of companies in Europe. Since October 2004, listed companies have the choice to choose not only between competing corporate laws of the member states, but also can choose the law of the European Company (Societas Europaea, hereafter referred to as “SE”). A SE is a legal form for a European stock company that is entirely ruled by a standardized law of the European Union.

Legal foundation of a SE is on the one hand the Regulation 2157/2001 of the European Council and the council Directive 2001/86/EC of 8 October 2001. The SE regulation is both, binding law as well as tied into national law with individual national legislation of the member states governing how the gaps in the supranational framework are supposed to be filled in. Germany has implemented the directives into their corporate law by way of the European Company Implementation Act.

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77 Kübler/Assmann, Gesellschaftsrecht, § 18 I 4d).
78 Zimmer, NJW 2003, 3585, 3585, 3587.
80 Case C-196/04 Cadbury Schweppes plc vs Commissioners of Inland Revenue, 12 September 2006; Case C-210/06, Cartesio Oktató és Szolgáltató bt, 16 December 2008.
81 Kübler/Assmann, Gesellschaftsrecht, § 2 IV 1; Theisen/Wenz, in EG, A II 3.
83 Herdegen, §14 III.
84 Council regulation 2157/2001 as of 8 October 2001 on the statute for a European company (SE); SE Regulation and council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees.
85 Braendle/Noll, SE, 1, 4.
IV. Corporate Governance in Germany

Germany got into the “corporate governance game”\textsuperscript{87} comparatively late. However, at the latest, since the implementation of the German Corporate Governance Code the topic is all around and highly controversial discussed.\textsuperscript{88} The further focus of this part shall therefore lay on corporate governance since it uniquely illustrates the development of the manner in which corporate law is made and the adaption of German corporate law to the ongoing internationalization and Europeanization.

There are uncountable reputed definitions of the term corporate governance,\textsuperscript{89} that all involve the organization, management and control of companies as well as the functionality of the management and control bodies of the company and the control of its behavior, either through external mechanisms or through internal provisions of its corporate constitution.\textsuperscript{90} Corporate governance ultimately aims globally recognized standards for good and thoroughly leadership and supervision of companies,\textsuperscript{91} in order to improve the company’s efficiency and to increase shareholder value.\textsuperscript{92} Corporate Governance can therefore be best described as the sum of all legal and actual rules and provisions for the leadership and the supervision of (noted) companies.\textsuperscript{93}

Various media-effective acquisitions, management issues and company crises moved the topic into general awareness.\textsuperscript{94} Cases, in which the board of an AG could practice bad speculations, mismanagement or deceitful actions that only came to light when creditors, business partners and shareholders suffered damages running into millions and thousands of employees lost their jobs.\textsuperscript{95} Moreover, the financial crisis brought further failures to light.\textsuperscript{96} Nevertheless, corporate governance is more than mere weak point analysis, aiming to prevent described crises.\textsuperscript{97} The discussion about corporate governance also entails a fundamental rethinking of general concerns of the capital markets on, such as transparency and management principles, on an international

\textsuperscript{87} Mathieu, 579, 604.  
\textsuperscript{88} Hopt, ECGI 170/2011, 1; Vetter, DNotZ 2003, 748, 748; Grundeit/Zaumseil, in Grundsei/Zaumseil, 17.  
\textsuperscript{89} Hopt, ECGI 170/2011, 6.  
\textsuperscript{90} Vetter, DNotZ 2003, 748, 748; Hopt, ECGI 170/2011, 8.  
\textsuperscript{91} Lutter, in Handbuch Corporate Governance, 124; Seibert, in Festschrift für Peter Hommelhoff, 1111, 1111.  
\textsuperscript{92} Vetter, DNotZ 2003, 748, 748, 750  
\textsuperscript{93} Seibert, in Festschrift für Peter Hommelhoff, 1111, 1111.  
\textsuperscript{94} Feddersen/Hommelhoff/Schneider, in Feddersen/Hommelhoff/Schneider, 4 f.; Seibert, in Festschrift für Peter Hommelhoff, 1111, 1114; with examples: Becht/Bolton/Roell, ECGI No. 02/2002, 841.  
\textsuperscript{95} Eisenhardt/Wackerbarth, para. 552; Feddersen/Hommelhoff/Schneider, in Feddersen/Hommelhoff/Schneider, 4 f.; Vetter, DNotZ 2003, 748, 748-749.  
\textsuperscript{96} Hopt, ECGI 170/2011, 5.  
\textsuperscript{97} Vetter, DNotZ 2003, 748, 749.
level, increasing the competitive aspect of the economy, resulting in the shareholder to be enabled to be more selective.\textsuperscript{98}

In this context, the history of Germany plays an important role shaping corporate law through its specific needs after both world wars. For a long time, the main focus of German economy was the rapid reconstruction of the industries and the economy. In these times only few investors invested in stocks. In need of other forms of financing, companies focused mainly on bank loans, wherefore shareholder played a comparatively minor role.\textsuperscript{99} With the stabilization and resurrection of the German economy and the entrance into the international competition this changed, so that German companies were then faced with big competitors.\textsuperscript{100}

Against this background, the idea over a public and easily accessible corporate governance code, as known of other jurisdictions, arose, that should help eliminating competitive disadvantages of German companies, marketing German companies\textsuperscript{101} to foreign investors and providing those with an overview of the German corporate governance model and the German corporate constitution.\textsuperscript{102}

1. “Legal” basis: The German Corporate Governance Code

On 26 February 2002 the German governmental commission named “Deutscher Corporate Governance Kodex”, that was appointed by the Federal Government, decided the code of the same name and handed it over to the Federal Minister of Justice.\textsuperscript{103} Meanwhile the German Corporate Governance Code (\textit{Deutscher Corporate Governance Kodex}, hereafter referred to as “DCGK”)\textsuperscript{104} already has been published in the electronic Federal Gazette\textsuperscript{105} and has been supplemented and amended several times.\textsuperscript{106}

Before, two private initiatives developed codes and principles that were then replaced by

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\textsuperscript{98} Cf. Goette, in MüKo AktG, § 161 para. 37 f.
\textsuperscript{99} Donald, 22.
\textsuperscript{100} Vetter, DNotZ 2003, 748, 750; Kübler/Assmann, Gesellschaftsrecht, § 2 IV 1.
\textsuperscript{101} “[A] marketing tool” according to Mäntysaari, Comparative Corporate Governance, 246; Müller-Michaels, in Gründei/Zaumseil, 61; Schiller, 20.
\textsuperscript{102} Vetter, DNotZ 2003, 748, 750; Mäntysaari, Comparative Corporate Governance, 246; Schiller, 20.
\textsuperscript{103} Lutter, in Handbuch Corporate Governance, 124; Kübler/Assman, Gesellschaftsrecht, § 14 II 3d); Vetter, DNotZ 2003, 748, 750; Mathieu, 579, 607; Goette, in MüKo AktG, § 161 para. 22.
\textsuperscript{105} German Corporate Governance Code as of 20 August 2002 (eBAnz AT1 2002 B1).
the DCGK. However, the decisive impulses were international ones, being the OECD Principles of Corporate Governance of 1999 and the English “Combined Code of Best Practice” of 1998 serving as precursors.

The DCGK introduced recommendations for standards of conduct for the management boards and the supervisory boards of listed company. It consists of a summary of legal provisions concerning the management and supervision of companies. Furthermore, the DCGK recommends compliance with rules and provisions that are aimed to prevent the weaknesses of the corporate constitution in Germany, such as the lacking transparency of German management and the limited orientation of the interests of shareholders.

2. Section 161 of the AktG

The governmental commission not only worked out the code itself, but also proposed, what nowadays is held by section 161 of the AktG. The idea is to link the code to an obligation to publish a declaration of conformity demanding the managing and the supervisory board of listed companies to declare annually whether or not the recommendations of the DCGK were followed. This declarations need to be permanently available to the shareholders, which is supposed to create pressure in order to further encourage compliance with the provisions of the DCGK.

3. Structure of the DCGK

The provisions of the DCGK are divided in three categories. In accordance with its mission to inform about the existing law, half of the DCGK is a reproduction and description of the law. Another large part are recommendations marked with the word “shall”, meaning that companies can deviate but are, however, obliged to “comply or explain” according to section 161

107 The precursors were the Corporate Governance-principles from a Frankfurt-based initiative and the Berlin-based German Code of Corporate Governance, both of 2000. Cf. Mäntysaari, Comparative Corporate Governance, 245.
108 Lutter, in Handbuch Corporate Governance, 124.
110 Mäntysaari, Comparative Corporate Governance, 245; Kübler/Assmann, Gesellschaftsrecht, § 14 II 3d); Müller-Michaels, in Grundei/Zaumseil, 59
111 Eisenhardt/Wackerbarth, para. 552.
112 Müller-Michaels, in Grundei/Zaumseil, 61; Goette, in MüKo AktG, § 161 para. 1.
113 Haar, 100 Jahre Rechtswissenschaft in Frankfurt, 471, 473.
114 Eisenhardt/Wackerbarth, para. 552; Goette, in MüKo AktG, § 161 para. 78 f.
115 Mäntysaari, Comparative Corporate Governance, 245.
116 Lutter, in Handbuch Corporate Governance, 127.
of the AktG. Finally, the DCGK contains suggestions indicated by the word “should”, being in no way legally binding but suggested to ensure good corporate governance.

4. **Legal nature of the DCGK or “comply or explain”**

Although the DCGK came into force more than ten years ago the classification from a legal-dogmatic perspective still turns out to be complex. The code, as a summary of mere recommendations, is technically not binding, yet has a legal basis. The DCGK attains normative force through section 161 of the AktG, a legally binding provision of a parliamentary legislative proceeding. The code itself was, however, worked out by a governmental commission and therefore did not pass a legislative parliamentary procedure.

The wording as well as its legal presentation further illustrate the self-conception of the code being not legally binding. The law explicitly allows companies to explain that they chose to opt-out certain provisions or the whole code. Following the British model this phenomenon is captured by the concise formulation of “comply or explain”, which might be, however, deceptive, since the companies are not asked to explain, but to merely state if they complied with the code or not. Yet, No. 3.10 of the Code itself recommends to explain potential deviations from the code, so that the formulation “comply or explain” also fits the German model.

The code does not fit in the traditional German system of legal sources wherefore the classifying of the code turns out to be difficult, especially in terms of enforcement. Often, the DCGK will be referred to as “soft law” since the provisions of the code can voluntarily be called in and non-compliance cannot be legally punished. However, the fact that the provisions of the DCGK are legally non-binding rather implicates that the provisions cannot be described as

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117 Schiller, 21-23, Foreword DCGK; Lutter, in Handbuch Corporate Governance, 127.
118 Schiller, 21-23, Foreword DCGK.
119 Leyens, in Großkommentar zum AktG, § 161 para. 100; Möllers/Fekonja, 781.
120 Section 161 of the AktG demanding the respective statement of compliance became effective on 26 July 2002.
121 Kübler/Assmann, Gesellschaftsrecht, § 14 II 3d; Lutter, in Handbuch Corporate Governance, 129.
122 Müller-Michaels, in Grundein/Zaumseil, 60.
123 Vetter, DNotZ 2003, 748, 754.
125 Goette, in MüKo AktG, § 161 para. 9.
126 Vetter, DNotZ 2003, 748, 754.
127 Heintzen, ZIP 2004, 1933, 1933.
128 Wymeersch, 3, 20.
129 Lutter, ZGR 2000, 18; Möllers/Fekonja, 782; Kübler/Assmann, Gesellschaftsrecht, § 14 II 3d); Vetter, DNotZ 2003, 748, 754.
130 Leyens, in Großkommentar zum AktG, § 161 para. 102.
any kind of legally binding law,\(^\text{130}\) wherefore the regular division of soft and hard law does not provide any help.

Further, the German Corporate Governance Code is no trade usage in the sense of section 346 of the HGB,\(^\text{131}\) since it misses a common and voluntary practice.\(^\text{132}\) It is also is not captured by customary law since the legislatively granted possibility of voluntary adoption would conflict the legislator’s intention to not be legally binding by customary law.\(^\text{133}\) Finally, an introduced doctrine of secondary sources of law attempts to describe the binding effect of rules created by private entities such as the DCGK,\(^\text{134}\) but, however, misjudges the factual, economic forces effecting companies in acting, being the market itself and the intent to compete.

The binding effect of the legally non-binding DCGK can be explained by the market pressure.\(^\text{135}\) Especially the case of Germany, which was originally shy towards corporate governance standards, serves as a good example to illustrate to which extent the market pressure drills jurisdictions out of their own national legal tradition towards market-resist solutions.\(^\text{136}\) Furthermore, the companies act out of the fear to be punished by the market, since the declarations need to be made public and investors might prefer companies complying with the rules rather than not, making self-interest and the intent to not lose the trust of investors another factor of the indirectly binding effect of the code.\(^\text{137}\)

In this context the financial press also plays an important role.\(^\text{138}\) Not compliance can naturally become a discussed topic, so that the companies might also act out of the fear to be legally sanctioned by losing their reputation through non-compliance.\(^\text{139}\) Summing up, compliance with the code is voluntarily, however there is an indirect operating duty to comply.\(^\text{140}\) Since this duty is of no legal nature, the force acts on the grounds of self-regulation and market pressure.\(^\text{141}\) Concluding on the legal nature of the code, it does not appear surprising in light of German law-

\(^{130}\) Hommelhoff/Schwab, in Handbuch Corporate Governance, 77; Goette, in MüKo AktG, § 161 para. 1.
\(^{131}\) Möllers/Fekonja, 781; Lutter, in Kölner Kommentar zum AktG, § 161 AktG, para. 11; Goette, in MüKo AktG, § 161 para. 24.
\(^{132}\) Müller-Michaels, in Grundei/Zaumseil, 60; Möllers/Fekonja, 781.
\(^{133}\) Lutter, in Kölner Kommentar zum AktG, § 161 AktG, para. 11.
\(^{134}\) Detailed representation in Möllers/Fekonja, 778-786.
\(^{135}\) Haar, 100 Jahre Rechtswissenschaft in Frankfurt, 471, 473.
\(^{137}\) Hopt, ECGI 170/2011, 14; Stiglbauer, ZCG 2011, 105, 105-107.
\(^{138}\) Hopt, ECGI 170/2011, 64.
\(^{139}\) Hopt, ECGI 170/2011, 63.
\(^{140}\) Möllers/Fekonja, 778, 784; cf. Wymeersch, 3-5.
\(^{141}\) Hopt, ECGI 170/2011, 15/64; Cuervo-Cazarra/ Aguilera, 421; Wymeersch, 2; Von Preen/Pacher/Raible, ZCG 2015, 162, 165.
making history that a code, worked out by a governmental commission, consisting of a summary of recommendations by a non-legislative institution, operating in the way of self-regulation, will be subject to criticism and incomprehension. However, the “legal” form of the DCGK proved, as especially the larger companies rather intended to comply than to risk being punished by the market, wherefore the concept of self-regulation was successful. Furthermore, since the code does not have to pass legislative instances, flexibility in which the code can react to market happenings is a central advantage. Summing up, the code constitutes an interesting approach of a new phenomenon lying somewhere between self-regulation and regulation by law.

5. The DCGK under German constitutional law

After all, the legal nature of the DCGK is problematic under German constitutional law. Main points of criticism in academia and literature were the doubted constitutional conformity of the code as well as the lacking parliamentary involvement. In particular, the authorship of the code can be subject to criticism in light of democratic legitimacy. According to article 20 of the Basic Law of the Federal Republic of Germany (Grundgesetz) all state power emanates from the people. In case the code should be classified by public law it would be subject to democratic legitimacy. Prerequisites for this would be adequate standards on factual and personal legitimacy. This standard is provided by the provision of section 161 of the AktG, wherefore the argument against the democratic legitimacy of the DCGK can be easily levered. The same applies for the argument concerning the parliamentary involvement, since section 161 of the AktG passed the regular legislative rule-making process, wherefore the interaction of the code and section 161 of the AktG invalidate most points of constitutional criticism.

V. Conclusion

The manner in which corporate law is made in Germany has been a product and affected

142 Ulmer, ZHR 2003, 150, 178-181.
143 Goette, in MüKo AktG, § 161 para. 19; Gräwe, ZCG 2013, 24, 30.
144 Oder/Orth, in Pfitzer/Oder, 493, 494.
146 Möllers/Fekonja, 783.
147 Goette, in MüKo AktG, § 161 para. 20.
148 Ringleb, in DCGK, introduction para. 63.
by its history. For this reason and for a better understanding of the German legal tradition in regard of codifications and other particularities, the most important steps of history were shown. As much as the attitude of German corporate law towards codifications changed back and forth in the course of time, today’s flexibility and adaptability of German law-making as shown on the VorstAG was unequalled on this level. Bearing in mind, that Germany had to catch up with its international competition with years behind, because of its historical background, the VorstAG shows that Germany finally caught up and plays with the international competition on a high level, setting new standards and maybe even handling the resulting situation of the financial crisis more efficient than other countries.

Furthermore, an expression of today’s manner in which corporate law is made is the DCGK. The DCGK, as well, greatly contributed to the competitiveness of Germany on an international comparison. Before the adoption of the code, foreign investors experienced fears of contacts to German corporate law being faced with a comparatively small capital market, no comparable supervisory institutions as the SEC, 400 sections in the decisive law and a foreign language.\(^{153}\)

Even if the legal nature of the code is subject to controversial discussions, the code stood the test and performed its task to inform foreign investors about German corporate law and thereby create pressure for the companies to comply and to attract investors in a process of not law but the self-regulation of the market.\(^{154}\)

Looking ahead, a way back to codifications and more nationally orientated laws seems unlikely. The trend is towards a harmonized law on a European level with the EuGH setting the tone as it did with its decisions regarding the freedom of establishment.

\(^{153}\) Lutter, in Handbuch Corporate Governance, 125.
\(^{154}\) Müller-Michaels, in Grundeit/Zaumseil, 61.
C. United States

In order to research on the topic of the manner in which corporate law and financial regulation are made, three methodologies have applied, which are: First, the legal theories of corporate law and financial regulation. Second, the development through the historical perspective of them and finally, the comparative law method which is going to be applied in the comparative part of this research paper. Since this topic is very broad, researcher decided to focus mainly on corporate governance related matters. As a result, this research paper will wholly illustrate and discuss on the U.S. law and related financial regulations in regarding to the U.S. corporate governance which can briefly define as “a set of relationships between a company’s management, its board, its shareholders and other stakeholders”.  

I. The U.S. Corporate Governance Structure

The U.S. corporate law has a distinct attribute as every state has its own basic corporate statues, while federal law creates minimum standards for trade in company shares and governance rights for publicly traded corporation. The U.S. Constitution was interpreted by the U.S. Supreme Court to allow corporations to incorporate in the state of their choice, regardless of where their headquarters are. Therefore, regarding to the realm of corporate law and financial regulation, there are two main sources of corporate governance in the U.S. which are state law and federal statue.

1. State Law

In the U.S., the term “corporation” generally refers to incorporated business entities, or entities chartered under the laws of a particular state. The corporate law of a state where a corporation was incorporated generally governs that corporation. Despite some attempts to unify corporate law in the U.S. (e.g. the Revised Model Business Corporation Act, which was adopted by many states), the corporate laws of various states differ. Therefore, some states, notably Delaware has become almost a brand name for the “business” of serving as the official home for cor-

Corporations (especially American public corporation)\textsuperscript{158} since: First, the Delaware General Corporation Law (DGCL) is one of the most advanced and flexible corporation statutes in the nation. Second, the Delaware courts are highly respected for corporation suits, both the Court of Chancery and the Delaware Supreme Court. Third, the state legislature takes seriously its role in keeping the corporation statute and other business laws current. Finally, the DGCL is, in a sense, have been using as a model corporate law in other jurisdictions. Hence, when this research paper mentions about state law, it shall refer to DGCL.

To be concise, business entities in the USA may take the form of a sole proprietorship, partnerships (general partnership, limited partnership, limited liability partnership and limited liability limited partnership), a limited liability company (LLC), and corporation (private and public) including S corporation and C corporation which are subject to different taxation rules. However, we will focus solely on corporation which in particular contains five characteristics; legal personality, limited liability, transferable shares, centralized management under a board structure, and shared ownership by contributors of capital.\textsuperscript{159}

(1) Legal personality

One can create a corporation by filing a document called the article of incorporation with the appropriate government office of the chosen state of incorporation, then the state will announce the existence of the corporation\textsuperscript{160}. By permitting the corporation to serve as a single contracting party that is distinct from the various individuals who own or manage the firm. It enhances the ability of these individuals to engage together in joint projects. The core function of this separate personality has been termed ‘entity shielding,’ to separate the assets of the corporation from the corporation’s owners.

(2) Limited liability

The creditors are limited to making claims against assets that are held in the name of the corporation itself, and have no claim against assets that the firm’s shareholders hold in their own names. It protects the assets of the firm’s owners from the claims of the firm’s creditors and shifts downside business risk from shareholders to creditors. This makes creditors as monitors of the

\textsuperscript{158} Lewis S. Black, Jr., Why Corporations Choose Delaware 1-10 (Delaware Department of State eds., 2007).
\textsuperscript{160} Stephen M. Bainbridge, Corporate Law 1-2 (3rd ed. 2015).
firm’s managers, a task which they may be in a better position to perform than are the shareholders in a firm in which share ownership is widely dispersed.

(3) Transferable shares

Transferability permits the firm to conduct business uninterruptedly as the identity of its owners changes and in turn enhances the liquidity of shareholders’ interests and makes it easier for shareholders to construct and maintain diversified investment portfolios.

(4) Centralized management under a board structure

Corporate law typically vests principal authority over corporate affairs in a board of directors or similar committee organ that is periodically elected, exclusively or primarily, by the firm’s shareholders. Corporations are distinguished by a governance structure in which all but the most fundamental decisions are delegated to a board of directors.

(5) Shared ownership by contributors of capital

Investors of the corporation have two rights which are the right to control the firm, and the right to receive the firm’s net earnings. More specifically, investors have the right to participate in control which generally involves voting in the election of directors and voting to approve major transactions and the right to receive the firm’s residual earnings, or profits that typically proportional to the amount of capital contributed to the firm.

The basic rights of shareholders relative to directors in the corporate entity have been determined in the state law level, as federal law has not supplanted the shareholder-director relationship as determined by the states. Under corporate law in all states, directors manage the business and affairs of the corporation. Shareholders have only a limited role: They can vote, sell, or litigate.

To start with voting, shareholders’ voting right is a key part of corporate law, but that does not mean that shareholders can vote on every issue. Most business decisions are left entirely to the board of directors or those to whom they delegate such authority. Shareholders participate only infrequently in a limited set of decisions, including the election of directors, fundamental corporate changes, and ratification. In details as follows:

(1) Election of directors: Directors are usually elected annually, but this pattern can be varied by the corporation’s articles of incorporation or other private ordering. Shareholders also

have the power to remove directors in some circumstances. Under DGCL, staggered board (classified board) is very popular among U.S. corporations, A company with a staggered board groups directors into classes (typically three), with each class elected by shareholders at successive annual meetings. Together with poison pills that consist of stock warrants or rights that allow the holder to buy an acquirer’s stock (a so-called “flip over” provision), or the target’s stock (a “flip in” provision), or both, at a substantial discount from the market price. They provide antitakeover protection both by forcing any hostile bidder, no matter when it emerges, to wait at least one year to gain control of the board and requiring such a bidder to win two elections far apart in time rather than a one-time referendum on its offer.

(2) Fundamental corporate changes: Mergers and similar transactions require the approval of shareholders as well as directors and, thus, are an exception to the usual rule that leaves corporate decisions entirely in the hands of the directors. In many cases, the directors act as gatekeepers: The shareholders can vote only on those transactions that are recommended to them by the directors.

(3) Ratification: Shareholders occasionally vote on the ratification of self-dealing transactions by interested directors. The vote can cleanse the transaction of any taint or shift the burden of proof in a legal challenge.

Secondly, selling, the ability to sell one’s shares is a core right for shareholders and one that corporate law has, for the most part, left to the market. Appraisal right is a rare exception where corporate law guarantees shareholders the right to sell their shares.

Thirdly, litigating, in addition to voting and selling, a shareholder’s ability to sue serves as a constraint on the actions of managers and is a regular part of the governance foundation. Litigation rights of shareholders include derivative suits, direct suits and class actions, and inspection and other ancillary rights.

(1) Derivative suits: In particular circumstances, such as breaches of fiduciary duty by those in control of the corporation, DGCL permits a shareholder to bring a suit in the name of, and on behalf of, the corporate entity. This type of suit is an exception to the usual rule that direc-

tors act for the corporation. It occurs when directors are disabled by conflict or are otherwise unable to meet their fiduciary duty.

(2) Direct suits and class actions: Shareholders can also bring direct suits, which may be class actions if numerous shareholders are affected by common questions. In contrast to derivative suits, in which the loss to the shareholder is derivative of the harm to the collective enterprise, direct suits may be brought for an injury that the shareholder feels individually, such as deprivation of a right to vote or a contract right.

(3) Inspection and other ancillary rights: Shareholders also have ancillary rights at state law, such as the right to inspect the books and records of the corporation, including the list of shareholders. Such inspection may be the first salvo in a litigation battle, an effort to sell shares, or a voting campaign.

On the other hand, the U.S. courts and state legislators have developed a robust fiduciary standard through time to set standards for board of directors of the company to use their managerial discretion for utmost shareholders’ value. Corporate director’s fiduciary duties generally fall into two principle categories. These are the duties of loyalty and the duty of care. The duty of loyalty requires that corporate fiduciaries duty exercises their authority in a good faith attempt to advance corporate purposes. In particular, it bars directors from competing with corporation; appropriating its property, information, or business opportunities; and especially from transacting business with it on unfair terms. By contrast, the duty of care reaches every aspect of a director’s conduct. It requires director to act with “the care of an ordinarily prudent person in the same or similar circumstances.” By the way, the key for applying and adjusting these concepts by court is the “business judgement rule.”

2. The Idea behind State Law

In the U.S., corporation is developed to serve as a tool to increase shareholders welfare or in other words, it maximizes the size of the economic pie for stockholders. On the other hand, corporate law enables entrepreneurs to transact easily through the medium of the corporate entity, and thus lowers the costs of conducting business. Corporate law in the U.S. has long been

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evolved under the influence of a relationship between shareholders and director. The long battle between the conservative, private, shareholder-wealth-maximization school of corporate legal thought and the progressive, public, stakeholder-protection/social-responsibility school is now over. The victor, it is claimed, is the conservative school, also known as the “nexus-of-contracts” approach, which holds that corporations should be run for the exclusive benefit of shareholders (“shareholder primacy”). This is the backbone principle of the U.S. corporate law leads us to the current idea of the U.S. corporate governance. In order to invigorate the mentioned idea, as a common law jurisdiction, the most appropriate way is to start with a prominent case of the topic which for this study is the “Dodge v. Ford Motor Company” case.

**Dodge v. Ford Motor Company**

This case, ruled by the Supreme Court of Michigan in 1919, indicates that the corporation have to operate in the interests of its shareholders, rather than in a charitable manner for the benefit of its employees or customers. It is often cited as affirming the principle of "shareholder primacy" in the US corporate law. On the other hand, the case also affirmed the business judgment rule, leaving director an extremely wide discretion about how to run the business. The case can be briefed as follow.

The shareholder made their complaint and demand for further dividends after the Ford Motor Company had concluded its most prosperous year of business but declared no special dividend during the business year. It had been the practice for the company, under similar circumstances, to declare larger dividends. It had been the policy of the corporation for a considerable time to annually reduce the selling price of cars, while keeping up, or improving, their quality. The plan is not intended to produce immediately a more profitable business, but a less profitable one; not only less profitable than formerly, but less profitable than it is admitted it might be made. The apparent immediate effect will be to diminish the value of shares and the returns to shareholders. Instead, Henry Ford’s ambition is to still employ more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and

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170 Dodge el al. v. Ford Motor Co. et al., 170 N.W. 668 (1919).
their homes. In order to do this the company needed to pay sixty per cent of its capitalization to reinvest for the growth of the company. As a result, no dividends other than the regular dividends had been paid. The Court held that Henry Ford could not lower consumer prices and raise employee salaries. In its opinion, the discretion of the directors is to be exercised in the choice of means to attain that end, and does not extend to the reduction of profits or the non-distribution of profits among stockholders in order to benefit the public. Because this company was in business for profit, it could not be turned into a charity. This case turned finally upon the point, the question, whether it appears that the directors were not acting for the best interests of the corporation. A business corporation is organized and carried on primarily for the profit of the stockholders and the powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes. There is committed to the discretion of directors, a discretion to be exercised in good faith.

Combining all the information above together, they not only made the corporation uniquely attractive for organizing productive activity but also generate tensions and tradeoffs that lend a distinctively corporate character to the agency problems that corporate governance must address.171 It is undeniable that the agency problem is one of the most essential and all-time discussed problem in the U.S. Possibility of conflict between shareholders and director has long been with us and will continue to be so long as business activity is conducted through the corporate form. Corporate governance now provides a tested and familiar nomenclature for addressing the issues involved, and a substitute analytical paradigm has yet to emerge. Then the most powerful protection against wrongdoing or simple misdirection of corporate asset is a good corporate governance and, in the U.S., they emerge from best practices that are accepted in the marketplace.172

3. Federal Statute

There has been superimposed upon state corporation law a vitally important and constantly expanding area of regulation consisting of the federal securities acts and their rules and regula-

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tions (the Securities Act of 1933 and the Securities and Exchange Act of 1934, as amended by laws like the Public Company Accounting Reform and Investor Protection Act of 2002 and the Wall Street Reform and Consumer Protection Act of 2010). In this connection, major attention has been focused on federal securities regulation. This aspect of “federal corporation law”

looms large on the current corporate scene. The approach of the federal securities laws has not been to define or create the internal corporate relationship between directors and shareholders, but to make that relationship better for shareholders or investors. For federal securities laws, usually has been defined through greater disclosure requirements for publicly traded corporations. In addition, it has also been developed through the attempt to prevent future uproar against systemic loopholes and financial crises. Accordingly, the historical facts suggest a much more piecemeal evolution.

Then the best way to explain the distinction of the U.S. corporate governance is to display by historical perspective and fulfill with the external factors behind those changes.

a) Managerial Capitalism Era

Between 1960s and 1970s, it was a decade characterized by strong managers and weak owners, as corporate law tended to increasing flexibility for directors and decreasing rights for shareholders. Corporate ownership became dispersed and the separation of ownership and control was seen as giving power to managers and resulting in what came to be called agency problems. Individuals rarely were actively engaged in corporate governance and shareholder activism achieved little influence. During this period the U.S. corporate law is a matter of state rather than federal regulation. Only securities law is regulated at the federal level, and the emphasis of the SEC is usually on disclosure rather than substantive provisions regarding company struc-

175 Gregory Jackson, Understanding Corporate Governance in the United States an Historical and Theoretical Reassessment 9-11 (2010).
176 Gregory Jackson, Understanding Corporate Governance in the United States an Historical and Theoretical Reassessment, 11-13 (2010).
Many investor rights are essentially vested with the board, companies have great latitude in shaping the structure and powers of boards in practice. The federal nature of corporate law laid the foundations for managerialism within U.S. corporate governance, since shareholders rights remained relatively weak under this competitive structure. Corporate boards were predominately made up of insiders, chosen from company executives and former executives, or friends of the executives. These directors had a largely advisory role, and would rarely overturn or even mount major challenge to executives’ decision. Meanwhile, shareholders had little direct say on the election of board members, since legal rules required them to go through an expensive process of proxy voting rather than having direct access to propose candidates. After this, the SEC began requiring disclosure of the existence of an audit committee and published guidelines about the activities of audit committees. Meanwhile, no regulations existed regarding compensation committees. Executive remuneration consisted mostly of fixed salaries and bonuses tied to annual performance of the company. Salaries were strongly correlated to the size of company revenues, and remained relatively insensitive to corporate performance or long-term value creation.

Although the U.S. has never developed a stakeholder model of corporate governance, managerial capitalism did allow scope for certain elements of quasi-stakeholder orientation. Firms developed paternalistic forms of ‘welfare capitalism’ characterized by stable employment and large internal labor markets, particularly for white-collar employees. However, the U.S. law enshrined a strict distinction between firm governance and contractual bargaining relationships with employees, who were seen as external to the corporation and restricted the scope of collective bargaining in ways that protected managerial prerogative. Nonetheless, labor union

183 Gregory Jackson, Understanding Corporate Governance in the United States an Historical and Theoretical Reassessment, 12 (2010).
strength and commitments to core employees exerted some check on managerial authority and retained some significance in managerial decision making during this period.\(^{185}\)

b) Investor Capitalism Era

During the 1980s, the power of managers was challenged by a variety of new developments. Power began to shift substantially toward investors due to the rise of new types of institutional investors and the advent of hostile takeovers. Institutional investors emerged as an important new category of shareholder. Institutional investors had diversified portfolios and became much more active players in corporate governance, using their growing blocks to exercise greater voice in corporate management.\(^{186}\) Most strikingly, a wave of hostile takeovers threatened the dominance of U.S. managers. The diversified conglomerates of the past decades proved to be undervalued in the stock market by the emerging institutional investors, as an aftermath, diversified firms were taken over at high rates.\(^{187}\) Parallel to these changes, the role of the board also underwent a critical examination. As the rapid increase in the proportion of independent directors and a growing number of outside directors were appointed at this period, but executives still retained almost complete control over the actual selection process. Executives continued to see directors nominated by shareholders as lacking independence and representing the particular interests of a shareholder group.\(^{188}\)

By the way, the growing attention to stock prices and ‘shareholder value’ also placed executive pay under growing scrutiny, and shifted attention to strengthening links between pay and company performance. A key development here was the introduction of share options and other equity-based incentives. Equity-based incentives were also used to reward managers under leveraged buy-out schemes. Finally, to weaken their resistance to hostile bids, managers were offered ‘golden parachutes’ that awarded bonuses to those managers who lost their jobs in association with changes in corporate control.\(^{189}\) However, shareholders have no direct ‘say on pay’ under

\(^{185}\) Mark S. Mizruchi and Howard Kimeldorf. The Historical Context of Shareholder Value Capitalism, Political
\(^{186}\) Michael Useem, Investor capitalism: how money managers are changing the face of corporate America 253-259 (2006).
\(^{188}\) Jay W. Lorsch and Elizabeth MacIver, Pawns or Potentates: The Reality of America’s Corporate Boards, 75-96 (1989).
\(^{189}\) Michael C. Jensen and Kevin J. Murphy, Remuneration: Where we’ve been, how we got to here, what are the problems, and how to fix them, Leaflet No.44/2004, ECGI - Finance Working Paper (2004).
corporate law, hence leaving it to the board to influence the size and form of managerial pay schemes.

c) Executive Defense and the Ideology of Shareholder Value Era

In 1990s, the trend toward greater shareholder influence continued, but was reshaped by the responses of managers. On one hand, executives sought to defend their own power by shielding firms from unwanted takeover bids. On the other hand, managers aligned themselves increasingly with the interests of shareholders through new forms of executive pay and adopting the ideology of shareholder value. Shareholder value refers to the concept that the primary goal for a company is to increase the wealth of its shareholders by paying dividends and/or causing the stock price to increase. Somewhat paradoxically, although shareholder power was tamed, shareholder value became a powerful new ideology.\(^\text{190}\) In terms of share ownership, institutional investors not only grew in size, but gradually began voting more actively against takeover defenses proposed by management and even supported initiatives to remove such defenses.\(^\text{191}\) Besides, federal proxy rules were revised to give shareholders enhanced latitude to communicate amongst themselves. Then, the scope of issues targeted by shareholder activism expanded further to cover changes in board structure and function, as well as executive and director compensation.\(^\text{192}\)

By the early 1990s, the proportion of independent directors has increased among the public firms. Meanwhile, this trend slowly spread to smaller firms. Despite the growing importance of independence, two facts are worth noting. First, the legal definition of an independent director remained rather weakly developed and was specified only in state corporation law. Second, a majority of U.S. firms still combined the role of CEO and chairman within the board. This fact puts some doubt on the genuine independence of other board members.\(^\text{193}\) In particular, the rise of equity-based pay such as stock options had given managers a greater stake in promoting restructuring and orientating their strategies toward the stock market. In addition, the SEC had changed the rule, making possible for executives to exercise stock options and sell their stocks at the same

\(^{190}\) Gregory Jackson, Understanding Corporate Governance in the United States an Historical and Theoretical Reassessment, 16-20 (2010).

\(^{191}\) Stephen M. Bainbridge, Director vs. Shareholder Primacy in the Convergence Debate, Leaflet No.02-04, UCLA School of Law, Research Paper (2002).


time, thereby exploiting very short-term movements in stock prices to their own advantage.\textsuperscript{194} The 1990s was the decade in which senior executive compensation shifted from being primarily cash-based to being primarily stock-based. With this change, management became focused not simply on the relationship between market price and break-up value (which the advent of the bust-up takeover compelled them to watch), but on the likely future performance of their firm’s stock over the short-term. Far more than the hostile takeover, equity compensation induced management to obsess over their firm’s day-to-day share price.\textsuperscript{195} As a result, the new forms of executive pay, greater executive turnover, and golden parachutes, shifted managerial interests away from the long-term development of the firm, and linked their own interests with shareholder value.\textsuperscript{196}

d) The Public Company Accounting Reform and Investor Protection Act of 2002 (The Sarbanes–Oxley Act)

By the early 2000s, the U.S. corporate governance were in big remodel by increasing shareholder engagement, expanding boards’ independent and rewarding through long-term equity based incentives linked to share price performance, providing more flow of information from the board which must be certified by outside gatekeepers, such as auditors and accountants.\textsuperscript{197} This reformation of corporate governance was triggered by the crisis and collapse of Enron sparked a wide-ranging re-examination of corporate governance in the U.S. Enron (also happened to Tyco International, Adelphia, Peregrine Systems, and WorldCom) exposed the fact that the various elements of that time system were not functioning together. To begin with, the ground for this reform is that shareholders failed to rationally value Enron because the Enron board failed to protect the integrity of financial disclosure.\textsuperscript{198} These board members also had high levels of relevant competence, and were incentivized by stock options or other equity-based incentives. The executives of Enron were incentivized to adopt high-risk strategies oriented to earnings management and propping up an overvalued stock in order to maintain the value of their stock options. Fur-

\textsuperscript{194} Michael C. Jensen ET.AL., Remuneration: Where we’ve been, how we got to here, what are the problems, and how to fix them, Leaflet No. 04-28, ECGI - Finance Working Paper (2004).
\textsuperscript{197} Gregory Jackson, Understanding Corporate Governance in the United States an Historical and Theoretical Reassessment, 21-22 (2010).
thermore, gatekeepers such as the auditing firm of Arthur Anderson critically failed as an effective interface between management and investors.\textsuperscript{199} Finally, unlike situations were corporations underperform, the market for corporate control provided little effective discipline or remedy for the “over-valued” stock prices at Enron.\textsuperscript{200} This situation can be easily stated as executives were stealing from the company.

The Sarbanes–Oxley Act (SOX) was enacted as a reaction to a number of major corporate and accounting scandals. It created many changes on corporate governance which can be grouped under three categories:\textsuperscript{201} audit-related changes, board-related changes, changes in disclosure and accounting rules, and shareholder empowerment. This is a big overhaul in the U.S. corporate governance system.

First, audit-related changes can be grouped into two major categories:

Conflict-reducing rules could be done by three methods:

(1) Limits on multiple roles and services by auditors as external auditors are prohibited from providing certain kinds of non-audit services to their auditing clients. In practical terms, this means they may not help clients choose, install, and operate accounting-related tasks.

(2) Shift the power to hire, fire and compensate the external auditors to the company’s audit committee and require that all members of the audit committee must be “independent,” and also gave the new definitions of independence are stricter than past.

(3) Reduction of interpersonal bonding between auditors and the audited by having a mandatory periodic rotation of audit firms, and requiring that audit engagement partners and audit reviewing partners must be rotated off the engagement after five years.

Action-inducing rules can be done by four methods:

(1) Required internal control processes by requiring attestations about the effectiveness of internal accounting controls. Under the new regime, public companies must have a system of internal controls, management must make disclosures and attestations about the internal controls, and the external auditors must also test and evaluate the system.

\textsuperscript{199} Bala G. Dharan and Williams R. Bufkins, Red Flags in Enron’s Reporting of Revenues & Key Financial Measures (Feb. 10, 2016, 10:00 PM), http://ssrn.com/abstract=1172222.

\textsuperscript{200} Michael C. Jensen and Kevin J. Murphy, Remuneration: Where we’ve been, how we got to here, what are the problems, and how to fix them, Leaflet No.44/2004, ECGI - Finance Working Paper (2004).

(2) Certification of financial reports by requiring the SEC to adopt rules requiring principal executive officers and principal financial officers of reporting companies to certify quarterly and annual reports. Specifically, these officers must now verify that they have actually reviewed the report.

(3) Requiring financial literacy and financial expertise on audit committees for increasing the chance that the committees will monitor well and effectively.

(4) Introducing new and independent auditing regulatory body called the Public Company Accounting Oversight Board (PCAOB), the function of which is to oversee and regulate external auditing firms and their auditing processes.

Second, board-related changes may be grouped into two categories:

Providing conflict-reducing standards as exchanges require higher standard for listing public companies to have a majority of independent directors on their boards (with an exception for controlled companies) with stricter definitions of independence. In addition, the key committees which are audit, compensation, and nominating committee can contain only independent directors. Then, increasing action-inducing standards for directors to act diligently by providing feedback of performance to them. Furthermore, require all members of audit committees to be financially literate. Last but not least, require boards to adopt and disclose both “corporate governance guidelines” and “a code of business conduct and ethics” and also require boards to engage formally in periodic self-assessments and evaluations.

Third, disclosure enhancements and accounting rule changes; this involves financial disclosures to shareholders and other public investors. The underlying premise is that better information enables investors to use their powers more effectively. The disclosure rules will be added new duties and liabilities for agents and gatekeepers.

The details can be summarized as:

(1) Off-balance-sheet arrangements by requires public companies to disclose more about special purpose entities and off-balance-sheet arrangements.

(2) Critical accounting policies by forcing public companies to identify and discuss their “critical accounting policies” in their annual form 10-K reports (which are filed with the SEC and available online to the public).

(3) Related party transactions are obstructed by requires public companies to disclose more, and more about, related party transactions. The premise is that such transactions might be
unfair to the company and its shareholders, and public disclosure may discourage unfairness or facilitate remedial action.

(4) Accelerated filing requirements by mandates accelerated filing requirements for public companies.

(5) Expensing stock options by requires listed companies to expense stock options and disclose that information to public.

Fourth, shareholder empowerment; the best illustration of this point is the proposed SEC rule to allow shareholder nomination of directors under certain conditions. More precisely, the rule would allow shareholders meeting the requirements to put alternative nominees on the company’s proxy statement, which is distributed to all of its shareholders at the company’s expense, and thus save these shareholders from the high cost of preparing and distributing their own proxy materials. Another example of an atmospherically facilitated governance change is the shift from classified boards to annual election of all directors at an increasing number of companies are following this.

Nevertheless, SOX produced changes in corporate governance standards applicable to U.S. corporation governance but it did not come all at once, or from one standard-setting source, but in related waves.²⁰² Beginning with the federal level which enacted sweeping governance changes and called for the SEC to adopt implementing rules and procedures on various topics. Then follow by the new listing requirements for publicly traded companies governed by the exchanges that impose new corporate governance rules, for instance, the New York Stock Exchange CG Rule. Next, the growth in influence of increasingly detailed and stringent corporate governance rating systems devised by private rating agencies and proxy advisers. Finally, an apparent change in the tone and emphasis of judicial opinions, at least in important courts of Delaware made corporate governance in the U.S. tangible and robust.

e) The Wall Street Reform and Consumer Protection Act of 2010

In response to the financial crisis of 2007-2008 which major roots of problem are rapid growth of credit extension (including for residential mortgages) with deteriorating credit standards, financial product innovation, leverage of financial institutions, and flaws of securitized

credit intermediation.\textsuperscript{203} Congress passed the Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank). Even though, most of the provisions deal with financial regulation but some provisions, however, also impose new corporate governance regulations to all public corporations.\textsuperscript{204}

We can conclude that the failure of conventional corporate governance can be divided into three categories which consist of:\textsuperscript{205}

1. Formalism of corporate governance: the last era has developed in the direction of a relatively formalistic system of independence requirements for members of the board of directors and its committees, as well as under the SOX. All of these requirements illustrate primarily driven by events such as Enron and WorldCom, where integrity was perceived to be at the center of the problems.

2. Structure and process rather than content: the last era focus on structure and process, the content of risk management and control activities as well as the experience of board members may arguably not have received the attention they would have deserved.

3. Corporate governance as a co-sponsor of the crisis: As the boards of directors had led into the crisis with independent rather than experienced board members. For their risk management efforts, they will have emphasized structure and process of the controls, rather than trying to understand the substance of the risk.

The aforesaid reasons have leaded to the amendment of provisions to the U.S. corporate governance circle.\textsuperscript{206}

First, the “say on pay” mandate which requires periodic shareholder advisory votes on executive compensation. To be more precise, this provision forces reporting companies must conduct a shareholder advisory vote on specified executive compensation not less frequently than every three years. At least once every six years, shareholders must vote on how frequently to hold such an advisory vote. In addition, a shareholder advisory vote is required with respect to golden parachutes. The vote must be tabulated and disclosed, but is not binding on the board of directors.

Second, the compensation committees of reporting companies must be fully independent and that those committees be given certain specified oversight responsibilities.

Third, the SEC require companies to provide additional disclosures with respect to executive compensation. By each reporting company’s annual proxy statement must contain a clear exposition of the relationship between executive compensation and the issuer’s financial performance. The disclosure must give investors an easy way of comparing executive compensation and firm performance over time. The proxy statement also must disclose whether employees are allowed to hedge the value of company stock they own.

Fourth, expands SOX’s rules regarding clawbacks of executive compensation. In the event a corporation is obliged to restate its financial statements due to “misconduct,” the CEO and CFO must return to the corporation any bonus, incentive, or equity-based compensation they received during the 12 months following the original issuance of the restated financials, along with any profits they realized from the sale of corporate stock during that period. Dodd-Frank significantly expands this provision by direct the self-regulatory organizations to require their listed companies to disclose company policies for clawing back incentive-based compensation paid to current or former executive officers in the event of a restatement of the company’s financials due to material non-compliance with any federal securities law financial reporting requirement. Issuers failing to adopt such a policy must be delisted.

Fifth, affirms that the SEC has authority to promulgate a so-called “shareholder access” rule pursuant to which shareholders would be allowed to use the company’s proxy statement to nominate candidates to the board of directors.

Sixth, requires that companies disclose whether the same person holds both the CEO and Chairman of the Board positions and why they either do or do not do so.

Seventh, affords small issuers an exemption from the internal controls auditor attestation requirement of the SOX. By permanently exempted non-accelerated filers from compliance with the auditor attestation requirement.

Eighth, provides whistleblower protections by expanding the SOX’s provision to additional employees and also apply this provision to non-publicly traded subsidiaries of publicly

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traded companies. Moreover, including new strong monetary incentives provided to employees to report compliance issues to the regulators.

Hence, Dodd-Frank marks an important expansion of the federal role in regulating corporate governance. The new provisions will have important consequences for all publicly traded corporations and it tends to prevent upcoming cries as well.

4. The Idea behind Federal Statute

Side-by-side with state law, federal statute also plays an important role for driving corporate governance in the U.S. After the realm of “deregulation policy”, the “cost-benefit analysis standard” is used to evaluate financial regulation again. Most of the literature on corporate governance has involved with this theory which has focused on explaining the relationship between the activities of a corporation and its governance structure. Federal statutes supplement state law principally by increasing the protection of shareholders. But, traditionally, federal law has not supplanted the shareholder-director relationship as determined by the states. It is a prime example of “the federalism.”

In the U.S., the Securities and Exchange Commission (SEC) plays an important role under the securities law to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The laws and regulations that govern the securities industry in the U.S. derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security. Only through the steady flow of timely, comprehensive, and accurate information can people

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make sound investment decisions.\textsuperscript{213} These disclosure requirements for protection of shareholders originally designed based on “the Efficient Capital Market Hypothesis” (EMCH). A realistic appraisal of the implications of the ECMH for securities regulatory policy must be made in light of the stated purposes of the regulation. While the legislative histories of the securities law do not articulate clearly the original purposes, one purpose of the legislation was to improve the economic functioning of the capital markets to achieve better resource allocation. The SEC, however, has come to perceive the primary purpose of the securities laws to be the protection of investors, rather than improved resource allocation. In implementing this protective purpose of the securities legislation, the SEC implicitly has based its regulation on an idealized model of the informed layperson making investment decisions in a market populated by equally informed investors. The SEC believes that it can best protect investors by making certain that all investors trade on the basis of equal information, which has led to a conclusion that the dominant theme of the securities laws is in fact "market egalitarianism."\textsuperscript{214} To achieve such market egalitarianism, and to make the informed layperson model a reality, the SEC has attempted to direct the flow of useful information so that it is equally available to and comprehensible by all investors. Thereby, the ECMH should be regarded as a vital economic tool for shaping regulation of the securities markets.

Moreover, the theory of “behavioral finance” is also being used concurrently with the measures of mandated information disclosure and regulation of insider trading. This theory involves with “behavioral decision theory” that emerged from cognitive psychology’s study of human thought processes that raised substantial doubts about rational choice theory while noise theory emerged from financial economists who applied those insights to capital market phenomena. The result is behavioral finance, a marriage of cognitive psychology and the financial economics of market inefficiency.\textsuperscript{215} It starts with a proposal to promote and expand investor education concerning the cognitive biases behavioral finance exposes. It proceeds to introduce and propose reforms in three critical areas of law and policy that this model impacts: First, the market regulatory environment in which investors participate, including suitability and churning rules.

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\item \textsuperscript{213} The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation (Feb. 15, 2016, 10:30 PM), https://www.sec.gov/about/whatwe.shtml.
\end{itemize}
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and policies relating to day trading, margin trading, and circuit breakers; Second, the legal duties of boards of directors in making capital allocation decisions such as equity offerings, dividend distributions and stock acquisitions; and finally, issues in corporate and securities litigation, principally the reliance requirement in securities fraud cases and the stock market exception to the appraisal remedy in cash out mergers. The insights of behavioral finance will be useful as a tool in evaluating a whole range of existing and potential future legal and policy positions in corporate and securities law. Nevertheless, federal statutes also have developed other measures apart from these two theory, but the core principles still focus on them.

5. Conclusion

The development of corporate law and financial regulation is based on two propelling engines which are the legal norms and the external factors which influenced such norms. Legal theories, surrounding situations, past dilemmas, and unique legal structure are among those external factors. In detail, the most prominent factors are the shareholder primacy regime, the dispersed share ownership structure, the mandatory disclosure regime, and the competition between states. It is totally clear to mention that the corporate governance regime in the U.S. is mostly based on the relationship between shareholders and the board of director so this generic conflicts may usefully be characterized as the ‘agency problems.’ Therefore, corporate governance plays an important role to solve this problem by structuring through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance will provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and also facilitate effective monitoring. Though, the characteristic of the corporate governance in the U.S. tends primarily to fix past dilemmas and seal up former loop-holes but I believe that the structures and provisions that had established will also prevent the forthcoming cries as well. Since, the structures and provisions seems to be circumspectly tailored to make the system to be a lot more protective. Therefore, corporate governance is unlikely to become moribund from a policy or intellectual perspective.


ernance. If corporation is similar to the bare bone of our body, then corporate governance is similar to flesh and blood which cover and fulfill those bare bone.
D. **Comparative Part**

I. **Legal Practice of Corporate Governance in the U.S. and Germany**

Since the 1990s there is an ongoing corporate governance movement. Particularly in the aftermath of the financial crisis in 2008 stronger efforts were made in analyzing weak points of management behaviors against the background of their corporate governance and compliance system. In this context, comparative aspects are under special observation indicating the success or failure of the predominant corporate governance system in each jurisdiction.

This following section shall compare and analyze the manner in which corporate governance is made concentrating on important differences between the U.S. and Germany. Special attention is given to the question of harmonization of the corporate governance systems, reasons for this and future prospects.

1. **How Corporate Governance Is Made in the US**

   In the U.S., concisely, there are two main sources of corporate governance which are state law and federal statutes. For state law, the most distinct one among fifty states is Delaware law which both excellent in judiciary and court of justice. The Delaware judiciary is a leader in stamping its early approval on many new legal innovation and emerging best practices relating to corporate governance in Delaware General Corporation Law (DGCL). Along with, the Delaware Court of Chancery and the Delaware Supreme Court are also play a crucial role in making precedent on corporate governance matters. American common law concerned corporate governance is unique since it blends both code of corporation law- DGCL- and judge-made-law together. However, Delaware law has only a marginal impact on changes affecting key corporate governance topics such as executive pay and shareholder activism. On the other hand, its role still considerable with board of directors’ related problem, for instance, a series of well-known Delaware court decisions in the mid-1980s fortified the status of independent directors and provided incentives for boards to be attentive. Also, Delaware court rulings helped to bring to an end the hectic takeover activity of the 1980s. In addition, the federal securities law and regulations, which fundamentally based on disclosure regime, also brings about significant change in corporate governance. Securities and Exchange Commission (SEC), who plays leading role on the topic, first

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218 V. Werder, „Ökonomische Grundfragem der Corporate Governance“ in DCGK, introduction para 3 f.
brought corporate governance on to the official reform agenda in the mid-1970s. Next, The Sarbanes-Oxley Act of 2002 (SOX), which Congress enacted in response to high-profile corporate scandals involving companies, contained numerous provisions relevant to corporate governance. Then, The Dodd-Frank Act of 2010, despite focusing primarily on the regulation of banks, contained a sub-title entitled “Strengthening Corporate Governance” applicable to all issuers falling under the SEC’s jurisdiction. Last but not least, Private actors such as the stock exchanges also set corporate governance requirements in their listing rule and institutional shareholders also lobby for corporate governance changes as they have enough bargaining economic power as well. This is a summary of how corporate governance in the U.S. has been made.

2. How Corporate Governance Is Made in Germany

Corporative governance discusses the question of good and thoroughly leadership and supervision of companies. This is nothing new to German law since questions concerning supervision and leadership traditionally were much discussed in regard of revisions of the AktG and led to an own chapter in the AktG. However, Germany entered the discussions about corporate governance decades after they first arose in the US.

Traditionally, corporate governance was governed by laws in most jurisdictions. In the course of time, laws became inflexible due to their long process of developing and being passed, wherefore the role of self-regulation grew. Against this background, corporate governance of other forms, such as soft law or other expressions have gained ground. The idea of this is to not corset companies into inflexible structures and enable to react flexibly to the market developments. Germany, like many other countries adopted a code and thereby followed the example of the United Kingdom.

In the light of German law-making, this process was far from evident. Historically, Germany is known for it’s traditional and rather complex legal system. As a country with a code-based jurisdiction, the largest parts of law were ruled in extensive codifications, for more than

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221 Sections 76-116 AktG.
222 Hopt, p. 10.
223 Cf. Mathieu, 579, 608.
224 The United Kingdom model is the Combined Code of Corporate Governance.
225 Dammann, 48.
226 Mathieu, 579, 604.
a century, that were passed more than 100 years ago. New laws must have been enacted by the German Bundestag and had to pass lengthy processes until coming into force. However, with the international forces, the market, the globalization and internationalization, the process of deregulation inserted and the role of national laws is slowly decreasing.

The DCGK, as most other corporate governance codes, contains mostly recommendations as to how to ensure good corporate governance directed to noted companies. The code itself does not have any legal force, however, legal force is indirectly attained by section 161 of the AktG. The “comply or explain” principle of section 161 AktG is the obligation of noted companies to add a declaration of conformity related to the DCGK in their annual report, naming those recommendations that were not followed. The idea is to link the code to a legally binding provision and thereby forcing reactions regarding the companies.

In Germany, a country of a long tradition and history concerning codifications, critics were loud, since the code was established by a non-parliamentary body and the criticism went against the idea of “recommendations”. In the light of constitutional law the justification of binding forces which were made by informal or private bodies of law, instead of the known legislative process was rather complex. Until now German constitutional lawyer claim that the recommendations are on some level forcing companies without no parliamentary background, which cannot hold in the light of democracy and parliamentary legislature. These criticism is true: adherence of the company is high and the companies might react out of the fear to be punished by the market, since the adherence with the code is an important information for foreign investors and influences in the decision of investing in those companies. However, this regulation mechanism proved.

However, the German approach of law-making still shows influences of its code-based mentality. It appears that the government tends to turn soft law into binding law if the recommendations or suggestions were not sufficiently followed. The German Management Compensation Disclosure Act (Gesetz über die Offenlegung der Vorstandsvergütung, hereafter referred to

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227 Mathieu, 579, 579.
228 Mathieu, 579, 606.
229 Haar, 100 Jahre Rechtswissenschaft in Frankfurt, 471, 473.
230 Cf. Möllers/Fekonja, 783.
232 Cf. Möllers/Fekonja, 783.
233 Cf. Haar, 100 Jahre Rechtswissenschaft in Frankfurt, 471, 473.
as “VorstOG”) serves as an example for this. Firstly, the idea that individualized compensation figures should be disclosed, was made in the form of a mere suggestion in the DCGK. 15 months later the DCGK in its version of 2003 changed the same idea to a recommendation, meaning that, boards must follow the “comply or explain” principle and were thereby set under more pressure due to an actual obligation to comply. Since the government was of the opinion that even the recommendations did not lead to the expected extent of transparency and disclosure it turned the idea into binding law with the VorstOG.

3. The shareholder approach in the context of US law principles

In the U.S., from my aspect, there are three major factors which formed corporate governance to the way it is. They are shareholders primacy regime, dispersed share ownership, and mandatory disclosure regime. Although, these factors play a significant role in shaping the U.S. corporate governance but they also cause dilemma through times. There are a lot of issues follow these factors which by the way can both consider as a good archetype for other countries and as a unique obstacle for the U.S. socioeconomic. We are going to take a closer look on them.

a) Shareholders Primacy Regime

It is a norm in the U.S. corporate law that the goal of corporation is to maximize shareholder wealth. There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value. We can call this a dominance of a shareholder-centered ideology. The foundation of the shareholder primacy norm is found in the directors’ fiduciary duty to make decisions that are in the best interests of the shareholders. In addition, it is also strengthened by the business judgment rule. Regardless of how stupid, egregious or irrational a board decision may be that destroys, rather than maximizes, shareholder wealth, it provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a good faith effort to advance corporate interests. In particular, it is hard to say that the U.S. corporate law tends to increase social welfare

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234 German Management Compensation Disclosure Act as of 11 August 2005 (BGBl 2005 p. 2267 ff.).
235 DCGK 4.2.4. in its version of 2002.
236 Cf. Haar, 100 Jahre Rechtswissenschaft in Frankfurt, 471, 473.
237 Mathieu, 609.
239 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (1985)
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and asserting that this means furthering the interests of shareholders.\footnote{Dodge et al. v. Ford Motor Co. et al., 170 N.W. 668 (1919).} According to the U.S. corporate law, corporation, especially public corporation, is solely privilege shareholder interests over those of other constituencies such as creditors, employees, suppliers, customers, or even the interests of the society as a whole. This is not because we believe that shareholder ownership of corporations is an indisputable and sacred property right. Rather, it is because of three reasons.\footnote{Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 Geo. L.J. 439, 451 (2001).} First, the firm’s residual claimants cannot be adequately protected by contract. Then, to protect their interests, they must be given the right to control the firm. Second, if the control rights granted to the firm’s equity holders are exclusive and strong, they will have powerful incentives to maximize the value of the firm. And a third reason is that the interests of participants in the firm other than shareholders can generally be adequately protected by contract and regulation, so that maximization of the firm’s value by its shareholders complements the interests of those other participants rather than competing with them. The shareholder-oriented model does more than assert the primacy of shareholder interests, however. It asserts the interests of all shareholders, including minority shareholders. More importantly, it is a central tenet in the standard model that minority or non-controlling shareholders should receive strong protection from exploitation at the hands of controlling shareholders.\footnote{Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 Geo. L.J. 439, 447 (2001).} In publicly-traded firms, this means that all shareholders should be assured an essentially equal claim on corporate earnings and assets.

The objective of maximizing shareholder welfare runs deeply through the relevant statutory and case law that it is rarely questioned, except when the conflict between the interests of shareholders and those of other corporate constituencies grows too acute. In general, there are three principal sources of conflicts in corporation which are conflict between agents and shareholders, conflict among shareholders, and conflict between shareholders and the corporation’s other constituencies, for instance, creditors, employees. Among a large number of cases in the U.S., the most mentioned conflict is the conflict between agents and shareholders which can be characterized as the ‘agency problems’.\footnote{John Armour ET AL., The Essential Elements of Corporate Law: What is Corporate Law?, Leaflet No. 643, John M. Olin Center’s Program on Corporate Governance, Harvard Law School (2009).} It is totally clear to mention that the corporate governance regime in the U.S. is mostly based on the relationship between shareholders and the board of
directors since directors tend to alter the way the shareholder primacy primarily should be by turn the benefit more for themselves. It can be concluded that the core idea of the U.S. corporate governance is to balance the shareholders’ primacy with the board of director’s discretion on using business judgement. Besides, once shareholder welfare is identified as the principal objective of corporate law and there are only two main ways that shareholders can profit from a corporation: by receiving distributions of the company’s profits and by selling all or part of their interest in the corporation. It follows easily that economic efficiency is the logical criterion for evaluating corporate law. Any factor that increases residual value of the firm to its shareholders is efficient by the criterion.\footnote{William T. Allen ET AL., Commentaries and Cases on the Law of Business Organization 2-3 (4th ed. 2012).}

The U.S. corporate governance has also developed various tools, for instance, the employee stock option plan (ESOP) and the stock option for firm’s directors, for distributing the benefits of firm’s growth to the workforce and executive. This affirms that the U.S. model also care of stakeholders but instead of paying money or offering benefits directly, we turn them to shareholders which will add more incentive to improved productivity and increased profits for the corporation. At the end this will help build a better society.

In my opinion, the U.S. system is flexible, as managers with broad discretion may more easily respond to changed external circumstances. After balancing the outcome with shareholders primacy, this can make corporation’s growth rapidly increases. On the other hand, managerial insulation may be the cause of the system’s instability and the recurrence of large scandals in another way apart from shareholders’ interest.\footnote{Martin Gelter, The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance, 50.1 HARV. INT’L L.J. 129, 193-194 (2009).} The absence of shareholder influence on these problems implies that the conflict with stakeholders are relatively insignificant from the view of the U.S. corporate governance.

b) Dispersed Share Ownership

The nature and number of corporate shareholders surely leave a mark on the structure of corporate law. In the U.S., there are large numbers of publicly-traded corporations that have dispersed share ownership, such that no single shareholder, or affiliated group of shareholders, is capable of exercising control over the firm. Though, the evolution of capital market drives innovation in corporate governance forward, so focusing solely between the relationship of dispersed
shareholders and directors of large public firms might become obsolete. Since the supervisory role on the executives has shifted to an institutional investor. As a result, now the ownership and control of corporation are separated as old-day shareholders have turned to be just beneficial owners for receiving only benefits, for instance, dividend and other interests, and institutional investors, as a record owner, play an important role of representing beneficial owner and monitoring corporate’s executives. This shift of equity ownership from a widely distributed ownership to concentrated institutional ownership gave rise to “agency capitalism” era, as approximately owned over 70% of the outstanding stock of the thousand largest U.S. public corporations. In the light of the aforesaid situation, it can vividly state that the “agency capitalism”, which in turn leads to the problem of separation of ownership from control, has a major impact on modern corporate governance in the U.S.

As an aftermath, institution investors should play a significant role as the shareholder activists but the only concern is the passivity role of them. In other words, institution investors very rarely get involve with the matter on corporate governance of their stock-holding corporations. Institution investors, consist of mutual fund and pension fund, do not run a role of shareholder activists willingly for reasons, for instance, the cost of agency, the worthiness of benefit to overall portfolio, the lacking of experience or internal mechanism, the lacking of incentive for fund managers, and last but not least, the need of focusing on macro view than micro view. On the other hand, hedge fund and proxy advisory firm can act as an activist shareholders by working hand–in-hand with pension fund and mutual fund. Since they are not pursuit of private benefits of control, specialize in monitoring companies to identify strategic opportunities and can then persuade their enthusiastic solution to pension fund and mutual fund for their approval. In return, the activist can be compensate by the quality of their work. This process can bring balance between large firms’ executives and beneficial owners, though, this model seems to be more practical than the old-day which minority shareholders needed to gather their votes together, because

249 David F. Larcker, Allan L. McCall, and Gaizka Ormazabal, Outsourcing Shareholder Voting to Proxy Advisory Firms, J.L. & Econ., 1, 6-7 (2014).
institution investors already held a majority sum of large firm shares. But institution investors must be free of conflict of interest and be professional in proxy voting services.\textsuperscript{251}

In my opinion, despite the fact that nowadays institutional investors play a crucial role in the U.S. corporate governance system, but they still act as only a record holder for individual investors. In other words, the dispersed share ownership structure in the U.S. still remains. So in the end, the beneficiary shareholders behind those institutional investors still exists but their right tends to be more efficiently protected by the activist institutions. As a result, in substance, public firms in the U.S. are not belong to specific group of people, but instead indirectly held for benefit by dispersed group of people. Then we may summarize that because of our disperse shareholder structure, we do not need to care for stakeholder’s value that much as shareholders in the U.S. can well represent stakeholders in the society.

c) Mandatory disclosure regime

The desirability of mandatory disclosure requirements in securities regulation has been the subject of a longstanding debate in the field of corporate governance in the U.S. The debate has largely focused on the desirability of mandatory disclosure requirements in the U.S., a country characterized by dispersed ownership structures. This requirement aims to protect investors by creating equality among them. The presence of a demanding disclosure regime would have the socially desirable effect of increasing competition in the capital and product markets and also providing investors information which directly relate to their decision to buy or sell securities.\textsuperscript{252} Disclosure obligations are imposed on the issuer, a nonparty to the transaction, to protect the parties’ investment decisions. The duties owed in that setting are not unlike traditional corporate law duties, albeit usually imposed on the directors rather than the corporation to protect other shareholder decisions. It is undeniable that the mandatory disclosure regime is the core of securities regulation in the U.S. and can be stated that it is a core policy for securities regulation all over the world. On the other hand, the duty to disclose firms’ information also be a great cost for firms as well so one of the most important agenda for the policy maker and/or regulator is to balance the mandatory disclosure regime by caring on both the investors’ benefit and the firm’s management and operation cost.


This disclosure regime at first glance seems market-based, rather than governance-based. Such a market/governance distinction has been attractive to some who advocated federal preemption of the regulation of market transactions. Yet, any clear division between corporate governance and regulation of market transactions has blurred to such an extent that the line seems difficult to preserve. Modern financial theory recognizes the direct link between market rules and governance rules, in which the existence of market constraints can reduce the need for legal rules of governance. One of the most obvious example in the U.S. is the rise of the reporting on the presence of conflict minerals from the Democratic Republic of the Congo (DRC) in their supply chains. Beginning May 31, 2014, publicly traded companies will be required to declare to the SEC whether or not their products or components contain tin, tungsten, tantalum or gold which can be abbreviated as “3TG” materials, since this issue relates to human rights abuses in the DRC. Many businesses have been dragging their feet on preparations for complying. Many have yet to create a reporting structure with their suppliers, contract manufacturers and other supply-chain partners because minerals covered by the rule are found in countless consumer goods, including electronics products, automobiles, packaging and medical devices. Given that the average public company works with between 2,000 and 10,000 first-tier suppliers, and many thousands more further up the supply chain, the task of tracing product content all the way back to the mine is a daunting one. As a result, the cost of compliance promises to be huge.

In my opinion, the conflict-minerals rule probably won’t be the last time that regulators seek control over the human-rights policies of global business. It could conceivably be extended to other parts of the world, or additional raw materials. Then we need to rethink about the policy behind the mandatory disclosure regime in the U.S. The question is, the U.S. is going to expand types of information that firms need to disclosure to the public. In other words, the role of the disclosure regime in the U.S. is going to be broader. We are about to cross the line of the goal of protecting shareholders right for investing to the new area of international agendas. On the other hand, the cost of disclosure still be an important issue to consider about. By the way, this demonstrates that the border of the mandatory disclosure regime is gradually getting broader and broader.

4. **The stakeholder approach**

Germany, as most European countries, follows the stakeholder approach. According to the stakeholder approach, the focus of corporate governance is not only the maximization of shareholder wealth, but broader, involving also the interest of other groups of stakeholders. By common understanding stakeholders can be of all groups of natural persons and institutions that transact with the company and have economic interest as to what happens in the company, such as customers, creditors or suppliers. Main interest for the stakeholder is the compensation of contributions made for the company. Employees are stakeholders as well. If a company promises a new workplace in another city and the employee in reliance upon this information moves to that other city only to be told that the company cannot hire due to economic struggles, the employee is directly affected by the happening of that company.

Employees, however, enjoy a special role in German corporate law. As in many other European countries there is mandatory labor codetermination. Whereas in most other states labor usually represents a third of board membership, German corporate law mandates shareholder and labor membership at parity on the supervisory board. Against this background, Labor codetermination might be one of the most intense expressions of the stakeholder approach in corporate governance.

In the U.S., the idea of “stakeholder theory” starts with “corporate philanthropy” which is the act of a corporation or business promoting the welfare of others, generally via charitable donations of fund, product, service or time. The best example is the Microsoft Corporation donates a lot of software to nonprofits around the world. Then the idea developed to “corporate social responsibility” (CSR) in a form of corporate self-regulation integrated into a business model. CSR policy functions as a self-regulatory mechanism whereby a business monitors and ensures its active compliance with the spirit of the law, ethical standards and national or interna-

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254 Dammann, p. 607; Von Werder, in Handbuch Corporate Governance, pp. 4, 8.
255 Von Werder, in Handbuch Corporate Governance, p. 9.
256 Von Werder, in Handbuch Corporate Governance, p. 9.
258 Microsoft Philanthropies (Feb. 10, 2016, 9:00 PM), https://www.microsoft.com/about/philanthropies/our-employees/employee-giving/.
tional norms. U.S. businesses freely acknowledge their ethical and social obligations. They accept the idea that businesses bear economic, legal, ethical, and discretionary responsibilities. After that, the U.S. has developed the concept of “stakeholder theory” further to “benefit corporation” (B-Corp). In the U.S., B-Corp is a type of for-profit corporate entity, authorized by more than half of all states in the U.S. that includes positive impact on society and the environment in addition to profit as its legally defined goals. B-Corp differ from traditional corporations only in purpose, accountability, and transparency, but not in taxation and board of directors’ fiduciary duty. To be a B-Corp, the charter of incorporation must contain the charter provision that comply with the purpose of B-Corp. On August 2013, Delaware’s new benefit corporation law came into effect, making Delaware the 19th state to authorize the formation of benefit corporations. B-Corp a special type of corporation that requires directors to consider the advancement of certain specified public benefits when making management decisions for the company.\textsuperscript{260} Delaware’s adoption of the B-Corp model is significant, because Delaware has historically been a leader in American corporate law. The purpose of a benefit corporation includes creating general public benefit, which is defined as a material positive impact on society and the environment. A benefit corporation’s directors and officers operate the business with the same authority as in a traditional corporation but are required to consider the impact of their decisions not only on shareholders but also on society and the environment. Transparency provisions require B-Corp to publish annual benefit reports of their social and environmental performance using a comprehensive, credible, independent, and transparent third-party standard.\textsuperscript{261} The major concern in the U.S. is on the difficulty of raising capital of the B-Corp because of charitable function. This in turn might disincentives profit-making institution investors from investing but will work for long-term investors.

II. Harmonization

1. On a global level

Since the mid-twentieth century, global rule making has been increasingly the province of “international organization”. Institutions defined by academics as grounded in a formal ratified treaty and enjoying “state membership, tangible manifestations of organizational bureaucracy,

\textsuperscript{260} B-Corp in Delaware (Feb. 10, 2016, 9:00 PM), http://communityenterpriselaw.org/delawares-new-benefit-corporation-legislation/.

\textsuperscript{261} Why become a B-Corp (Feb. 10, 2016, 9:00 PM), http://www.bcorporation.net/become-a-b-corp/why-become-a-b-corp.
and an adequate legal pedigree.” 262 By contrast, in the international financial system, the production of international standards and rules arises through largely information institutional arrangements grounded in nonbinding bylaws, charters, and accords which, as such, aren’t recognized under international law 263 and they can be introduced as “soft law”. These soft law have been set by the group of “G-20” which contains both the U.S. and Germany. Although, the commitments made by international financial organizations have no legal effect and are unrecognized and non-binding as a matter of international law, but they can still be enforced in international forum. Since international financial rules and standards are adopted robustly across borders, regulators are better able to ensure adequate cross-border supervision of market participants, no matter where they operate. Opportunities for arbitrage and regulatory competition are dramatically reduced, and enforcement cooperation and information sharing among jurisdictions is enhanced. 264 These are the incentive of complying with soft law. On the other hand, if a regulator deems certain rules disadvantageous to its domestic markets, it may fail to honor its commitments. Since the international financial regulation, though formally a species of “soft law,” is bolstered by various disciplining mechanisms that render it, under circumstances, more coercive than traditional theories of international law predict. For instance, the loss of reputation and ability to create coalitions and alliances in the future, the cost of capital for firms operating in noncompliant jurisdictions will increase and also be banned from international fund raising transaction as well. 265

Soft law instruments can be grouped into three broad categories 266:

(1) Best practices: International financial law often takes the form of best practices to promote sound regulatory provisions. They tend to define the minimum shared standards necessary for a good financial regulatory system.

(2) Regulatory reports and observations: They are acknowledged as the data collected, assessed, and utilized by national and international regulators to craft policy. They are another important source of international financial law. Reports create an official record of fact and help

establish a basis for policymaking and often generate normative undercurrents that help define the appropriateness of different regulatory responses. Furthermore, help establish tacit commitments by national authorities.

(3) Information sharing and enforcement cooperation: Many international financial agreements spell out procedural means by which greater information sharing and enforcement cooperation can be achieved. Information-sharing agreements are usually promulgated through memorandum of understanding (MOU) and address the reality that many domestic financial institutions are globally active. They help coordination with other international regulators. Moreover, enforcement agreements, detail the terms by which different countries agree to provide assistance to one another for enforcing domestic or international rules.

In the field of corporate governance, there are two major organizations which set an international standard for corporate governance. They are Organization for Economic Co-Operation and Development (OECD) and International Organization for Securities Commissions (IOSCO).

To begin with, OECD\textsuperscript{267} has three main aims; first to promote policies designed to achieve sustainable economic growth in member countries while maintaining financial stability; contribute to sound economic expansion in member/non-member countries in process of economic development; and to contribute to the expansion of world trade. The main role of OECD is to develop standards and guidelines for countries to devise or retain effective corporate governance frameworks. This has formed the basis of the corporate governance component of the world. Though, membership stands at only 31 countries but has informal relationships with 71 non-members. Despite exclusive membership requirements, defines itself as a forum for governments to compare policies, seek answers to common problems, and identify good practices.

Second, IOSCO\textsuperscript{268} has duty as a standard setter for securities regulation. From historical view, it is tied to the rapid internationalization growth of securities markets. Its membership expanded to include not only the U.S. but also many countries around the world. It adopted a more aggressive means of facilitating enforcement cooperation through its multilateral memorandum of understanding (MMOU), an agreement memorializing a process whereby regulators can ask assistance from their foreign counterparts to help prosecute cases in which witnesses or the pro-

\textsuperscript{267} About OECD (Feb. 20, 2016, 8:45 PM), http://www.oecd.org/about/.
\textsuperscript{268} About IOSCO (Feb. 20, 2016, 9:00 PM), http://www.iosco.org/about/?subsection=about_iosco.
ceeds of fraud are located in other jurisdictions. In exchange of that they need to follow the standard that IOSCO has set and one of the most important standard is the standard for disclosure of information of the publicly traded corporation.

2. On EU level

Europe is a continent with rich, various and different traditions in all its member states. In terms of the prevailing law, the economic, social and cultural aspects and conditions lead to path-dependent developments in different directions.\textsuperscript{269} However, with the establishment of the European Union in 1993, the focus was laid on creating a single European airspace and guarantee the fundamental freedoms. A united European Union aimed on a European community in order to become stronger and to be able to face big competitors east of Germany as well as overseas. Furthermore, the market itself contributed to national legislators to internationally compare and analyze their national system in order to find weak points and eliminate them.\textsuperscript{270} The need for harmonization, therefore, is a result of many independently acting forces, such as the market and the intent to stay competitive as well as the idea behind the European Union.

In regard to corporate law, the European legislator planned to create uniform and harmonized conditions and options for entrepreneurs in conformity with the EU domestic market.\textsuperscript{271} For this, the European legislator has different instruments.

a) Approximation of national corporate laws

Directives are the main force for the approximation of the national corporate laws and are directed to the national legislators. They are based on article 50 II g) of the Treaty on the Functioning of the European Union (\textit{Vertrag über die Arbeitsweise der Europäischen Union}, hereafter referred to as “AEUV”). Directives, however, are not directly legally binding but attain normative force after being transferred by the national laws of each country.

An example for this was the council Directive 2001/86/EC of 8 October 2001 directing legislators of all member states to create rules to implement the SE into their national law. Germany did so by passing the European Company Implementation Act.\textsuperscript{272}

\textsuperscript{269} Hopt, ECGI 170/2011, 8
\textsuperscript{270} Cf. Hopt, ECGI 170/2011, 14, 66.
\textsuperscript{271} Baums, ILF 01/2008, 1.
b) New supranational legal forms

In the same context, harmonization is encouraged by the creation of new legal forms on a supranational level. The SE is the most known supranational legal form in corporate law. Supranational legal forms such as the SE step beside national options of corporations and provide companies another choice, encouraged by the EU. Being ruled entirely by the law of the European Union choosing this legal form promises maximal legal certainty and attains attractiveness thereby. Moreover, the SE offers a simplified possibility to act transnational and furthermore promotes transnational mergers of companies from the member states.

c) Control by the EuGH

The decisions of the EuGH regarding the freedom of establishment have shown the scope of power, that the EuGH has with its ruling. With overruling existing schools of thoughts, as it did by deciding against the seat-theory, it can change the legal direction of all member states, obliging them to follow. In its decisions the EuGH explicitly accepts companies to take advantage of other member states’ more preferable corporate laws, thereby promoting flexibility among companies in the member states. Against the background of harmonization, the EuGH plays an important role by diffusing and standardizing across national borders. 273

III. Conclusion

Corporate Governance is an issue that was first raised in the U.S. Only decades later it arrived Europa via the United Kingdom and reached Germany. 274 International competition forced the European countries to catch up in order to compete. In this context, the predominant jurisdictions are experiencing a “regulatory competition” 275 to convince and attract investors and companies. However, approaches are different. Responsible for this are the differences in the background of both jurisdiction being economical, historical and political differences.

Disparities grew since both countries approached opposing theories. The U.S. strongly believe in the shareholders primacy regime but Germany chose to follow the path of stakeholder benefit. However, at present, it seems that either the U.S. or Germany views’ on corporate gov-

273 Cuervo-Cazurra/ Aguilera, 418.
274 Tridimas, 23-25.
275 Donald, 1.
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erance tend to be in harmony with each other. There are many evidences affirmed this assumption as we both have illustrated in this part of this report. This might be the dawn of the stakeholder welfare’s protection, instead of shareholder’s benefit maximization. Furthermore, we are confident that in the near future the harmonization will be seen much clearer because of the impact of the business globalization. To be more precise, the unification of nations and the drive of international trade and investment will make corporation law’s structure resemble.

Although the trend follows the idea of harmonization, one should not forget, that developments in terms of corporate governance are deeply linked to the crises and driven by corporate scandals of the individual jurisdiction.276 These problems, however, are not necessarily identical across borders. For this reason, corporate governance solutions of other countries not be simply copied and implemented into another jurisdiction of another background with the same success.277

Furthermore, the rise of soft law era will play a major role for harmonization of financial regulation in every jurisdiction. As a result, corporate and financial lawyers around the world need to adjust their legal thought on this change and be ready for the upcoming wave of globalization.

Summing up, the trend goes to the opening of both jurisdictions towards each other.278 Despite the convergence, however, substantial differences prevail, which were products of the individual development of the country and its history.279

276 Hopt, ECGI 170/2011, 4 f., 16.
277 Hopt, ECGI 170/2011, 5.
278 Bagaric/Du Plessis/Hargovan/Harris, Principles of Contemporary Corporate Governance, 403.
279 Cuervo-Cazurra/ Aguilera, 417.