Labor and Comparative Corporate Governance in Times of Pension Capitalism. Independent Directors, Shareholder Empowerment and Long-Termism: the Transatlantic Perspective

Dr. Markus Roth∗

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* Professor of Law, University of Marburg, Chair for Private Law, Labour Law, German and European Commercial and Business Law; Senior research fellow, Max Planck Institute for Comparative and International Private Law, Hamburg (2002–08); Visiting fellow, University of Cambridge, 2008. This article is based on lectures at the University of Kyoto and Fordham University School of Law (Eugene P. and Delia S. Murphy Conference on Corporate Law, 2012) and in parts on a German article in the Zeitschrift für Unternehmens- und Gesellschaftsrecht, 40 ZGR 516 (2011). I thank the participants of the conferences for their helpful comments, Martin Wilhelm for translation and language revision, and the team of the Fordham Journal of Corporate & Financial Law.
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INTRODUCTION

Correctly understood, the effects of labor and pensions are not only central to the corporate governance debate; as the United States, United Kingdom, the Netherlands, and Switzerland show, pension systems largely make up capital markets. Other continental European countries, such as Germany and Austria, illustrate that a lack of significant pension assets corresponds with a lack of deep capital markets. While pension assets in the United States, the United Kingdom, Switzerland, and the Netherlands exceed their gross domestic product (“GDP”), occupational pension assets account for less than a quarter of GDP in Germany and Austria. Germany and Austria provide for quasi-parity or third-parity


2. See TOWERS WATSON, GLOBAL PENSION ASSETS STUDY 7 (2013), available at http://www.towerswatson.com/en/Insights/IC-Types/Survey-Research-Results/2013/01/Global-Pensions-Asset-Study-2013 (finding the following ratios of pension assets to GDP: Netherlands 156%, Switzerland 118%, United Kingdom 112%, United States 108%, Germany 15%). The ratio of private pension assets, including individual (private or personal) pension assets, is higher than the ratio of occupational pensions to GDP. See OECD PRIVATE PENSIONS OUTLOOK 44 fig.1.2, 61 fig.2.5 (2008): Netherlands 149.1 versus 132.2%, Switzerland 151.9 versus 119.4%, United Kingdom 96.4 versus 86.1%, United States 124.0 versus 74.3%, Austria 18.8 versus 4.7%, Germany 17.9 versus 4.1% (data for 2007); for more recent data for occupational pensions, see OECD, PENSIONS AT A GLANCE 2011 173 (2011), available at http://www.oecd-ilibrary.org/docserver/download/8111011e.pdf?expires=1359327528&id=id&accname=guest&checksum=A3F306006CF6843EB837A73326C37B31 (a higher ratio of pension assets to GDP exists when individual (personal) pensions are included).
board-level co-determination of employees, which is unknown to the United Kingdom, the United States, and Switzerland, and not mandatory for international holding companies in the Netherlands. Although the Netherlands does provide for third-parity co-determination for national companies, international holding companies like EADS, the parent company of Airbus, are co-determination free.

Reflecting the great importance of occupational pensions and public pension funds in the United States, Peter Drucker popularized the phrase “pension-fund socialism” shortly after the introduction of the Employee Retirement Income Security Act (“ERISA”) in the 1970s. This concept captures the overwhelming importance of the pension fund industry in the U.S., and of employees as ultimate beneficiaries. In the United Kingdom, the term “pension-fund capitalism” was coined at the height of the stock market around the new millennium. Until then, countries that lacked, or had only a minor presence of, occupational pensions tended to have a blockholder corporate governance system, while dispersed ownership was the common form in countries focused on occupational pensions. The ownership structure has evolved, at


6. See Drucker, supra note 5 at 1 (Through their pension funds, employees of American business today own at least 25% of its equity capital; pension funds of the self-employed, of the public employees, and of school and college teachers own at least another 10%).

7. Gordon L. Clark, Pension Fund Capitalism (2000). Focusing on defined benefit schemes, David Blake, Pension Schemes and Pension Funds in the United Kingdom 575 (2d ed. 2003), stated that in 2000, through their pension funds, companies in Britain owned about one-third of one another. For a comprehensive analysis of the evolution of the British Corporate Governance System from a company law perspective, see Brian R. Cheffins, Corporate Ownership and Control: British Business Transformed (2008).

8. For an early comparison of the United States and Germany, see Richard M. Buxbaum, Institutional Owners and Corporate Managers: A Comparative Perspective, 57 BROOK. L. REV. 1 (1991), and Friedrich K. Kübler, Institutional Owners and
least in Germany, leaving many blue chips in dispersed ownership and most with a majority of foreign shareholders. In a separate worldwide trend, occupational pension schemes changed from defined benefits (“DB”) to defined contributions (“DC”), thereby shifting the investment risk from the employers to employees, and investment from pension funds to investment companies. Therefore, the term “pension capitalism” is more accurate and will be used in this contribution on comparative corporate governance from the transatlantic perspective.

Different levels of reliance on occupational pensions correlate with total market capitalization of the respective countries and, inter alia, different funding levels of financial supervisory agencies. This correlation is more significant than the civil law/common law country explanation. The importance of private pension assets may better explain such differences than investor protection as measured by La Porta et al. This approach has been criticized for failing to consider all relevant mechanisms of investor protection. The shareholder

_Corporate Managers: A German Dilemma, 57 Brook. L. Rev. 97 (1991)._ Since the United States and United Kingdom pension funds shifted their investment strategy towards foreign equity, institutional investors are now the most important class of investors in countries with a minor presence of private pensions.


10. At the end of 2011, a majority of pension assets were in the form of DC plans in the United States, Australia and Switzerland, (57%, 81% and 60%, respectively). See Towers Watson, Global Pension Assets Study 36–37 (2012), available at http://www.towerswatson.com/en/Insights/IC-Types/Survey-Research-Results/2012/01/Global-Pensions-Asset-Study-2012. Data in the following study is slightly revised and Switzerland is excluded for the peculiarity of the Swiss occupational pension system. In the seven most important markets, DC assets rose to 43% in 2011 from 38% in 2001. Also, in countries where DC was of minor importance or even non-existent in 2001, DC assets rose: in Canada from 3% to 4%, in Japan from 0% to 2%, and in the Netherlands from 2% to 7%. The most significant increase was in the United Kingdom, from 8% to 39% (In 2012, the level stood at 26%).

11. Roth, Employee Participation, supra note 4, at 56–58.

12. Id.


empowerment debate in the United States highlights this critique.  

In continental Europe, nominating directors is a common mechanism for investor protection. This mechanism is now available in the United States as well—it is procedurally and economically feasible—with pension funds having played a critical role in the political process. Interestingly, the United States played a central role in implementing director primacy in German corporate governance. However, director primacy has not gone so far as to exclude shareholders from nominating directors.

Besides the balance of shareholder rights and director primacy in corporate governance, this article focuses on independent directors and long-termism in times of pension capitalism. The independent director paradigm was the first principle promoted by the Council of Institutional Investors (“CII”), and was later accepted. On its website, CII stresses that shareholders in the 1980s “had little say in most corporate decisions,” suggesting that CII promoted and successfully launched shareholder empowerment. Independent directors and shareholder empowerment are linked insofar as director accountability is provided by independent directors that, \textit{inter alia}, are channels for expressing concerns.


17. For the Dodd-Frank Act, see \textit{infra} Part III.A.1.
18. \textit{See infra} Part III.B.
20. See Markus Roth, \textit{Unabhängige Aufsichtsratsmitglieder}, \textit{ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT UND WIRTSCHAFTSRECHT [ZHR]} 605, 611 (2011) (Ger.).
22. \textit{See infra} Part II.
A third main feature of corporate governance principles promoted by both pension funds and pension fund associations is long-termism.23 This principle is not yet established. As the European Commission highlighted in a recent Green Paper on corporate governance, pension money does not lead to long-term investment.24 Long-termism is nevertheless promoted in some company law principles, such as the discharge of directors (backing of director actions) instead of mandatory reelection, thereby incentivizing long-term strategies.25 Remuneration in Germany is also now linked to the sustainable development of the company.26 An issue that is yet to be discussed is whether different levels and methods of pension funding contributed to global imbalances, a matter of growing concern since the financial crisis. Due to international diversification of assets and short-termism of asset managers, sustainable development might be hindered; a detailed analysis of this issue is beyond the scope of this contribution.

Part I of the article begins by discussing labor and pensions as determinants of the firm in a comparative perspective. While in the United States and the United Kingdom labor plays a minor role in the corporate governance of firms, in continental Europe co-determination is not restricted to pension funds such as Hermes Fund Managers (UK) or Californian Public Employees Retirement System (“CalPERS”) (US).27 Moreover, while strict quotas for women on boards have been implemented in some countries such as Norway, the Netherlands, Spain, and France, the UK Corporate Governance Code introduces a more flexible model.28 Other corporate governance principles correlate with the rise of institutional investors; these investors are largely based in the United Kingdom and the United States, but relevant in most industrialized countries.29 Parts II and III of this article address the already implemented features, such as independent directors and shareholder empowerment. These principles continue to spread worldwide due to investments abroad; according to the US Treasury, US

23. See infra Part IV.
25. See infra Part IV.B.2.
27. Roth, Employee Participation, supra note 4, at 70–75.
portfolio holdings account for more than 10% of market capitalization in Germany, Japan, South Korea, and France; up to 19% in the United Kingdom; and 26% in Switzerland. 30 Like long-termism, the core corporate governance feature which is yet to be established— independence and the balancing of shareholder rights with director primacy—will be discussed in Part IV. This feature will be assessed in the global perspective, taking into account country-specific peculiarities.

I. LABOR AND PENSIONS AS DETERMINANTS OF THE FIRM IN THE COMPARATIVE PERSPECTIVE

A. LABOR IN GERMANY AND THE UNITED STATES

1. Industrial Relations in Germany and the United States

Protection against dismissals is a central feature of German labor law. 31 In plants with more than ten employees and for employment contracts lasting at least six months, dismissals require good cause and are subject to judicial review. 32 By contrast, the United States is one of the very few countries still subscribing to the employment-at-will doctrine; restrictions concerning dismissal must be incorporated into the employment contract. 33 However, “business affairs” are considered good cause for dismissals in Germany. Business judgment was first

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31. The legal basis is the Kündigungsschutzgesetz [KSchG] [Protection Against Dismissal Act], Aug. 10, 1951, BGBl. I at 1317, as amended (Ger.); see generally ULRICH PREIS, PRINZPIEN DES KÜNDIGUNGSRECHTS BEI ARBEITSVERHÄLTNISSEN (1987).

32. Protection Against Dismissal Act §§ 1, 23. If employment contracts were in force before January 1, 2004, a plant with more than five employees would be subject to the rule. Id. § 23(2).

introduced in Germany in this context, and only in 2005 was the German business judgment rule adopted for director liability.

In Germany, collective bargaining is performed, in principle, industry-wide. This reflects the business structure in Germany, which relies heavily on the concept of “Mittelstand” (small and medium family-owned firms), as well as on large family-owned firms. Large enterprises in particular, such as Volkswagen (“VW”), have enterprise-specific collective agreements. International studies show a correlation between industry-wide collective bargaining and board-level co-determination.

2. Employee Participation via Board Representatives in Germany

In Germany, a unique system of employee co-determination on boards prevails. Stock corporations employing more than 2,000 within Germany are subject to quasi-parity co-determination, while those


37. Even among the hundred largest German enterprises, only in twenty-one are the majority of shares in dispersed ownership. *German Monopolies Commission, Neunzehntes Hauptgutachten der Monopolkommission 2010/2011*, German Parliamentary Papers 17/10365, at 165, ¶ 326.


40. *Gesetz über die Mitbestimmung der Arbeitnehmer [Mitbestimmungsgesetz] [Act on Co-determination by Employees (Co-Determination Act)], May 4, 1976, BGBl. 1 at 1153, last amended by the Act, Mar. 23 2002, BGBl. 1 at 1130 (Ger.), available at http://www.bmwi.de/English/Redaktion/Pdf/__Archiv/labour-law/act-on-co-determination-by-employees.*
employing more than 500 are subject to third-parity co-determination.\(^{41}\) For the coal, steel, and mining industries, a special parity co-determination regime was introduced shortly after World War II,\(^{42}\) laying the foundation for post-war employee participation at the board level.\(^{43}\) The British government of the German industrial heartland of Rhein/Ruhr established employee representation in part as an insurance device against the re-militarization of Germany.\(^{44}\) Therefore, the political dimension of co-determination is key;\(^{45}\) the same is true for the objectives of progress in European company law.\(^{46}\)

For German stock corporations, three models of employee representation can be distinguished: third-parity co-determination, introduced in 1952,\(^{47}\) and now under the One-Third Participation Act in companies with more than 500 employees;\(^{48}\) quasi-parity co-determination under the Co-Determination Act of 1976 with a decisive vote of the supervisory board’s chairman in companies with more than 2,000 employees;\(^{49}\) and parity composition of the board with an

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\(^{41}\) Gesetz über die Drittelbeteiligung der Arbeitnehmer im Aufsichtsrat [Drittelbeteiligungsgesetz] [One-Third Participation Act], May 18, 2004, BGBL. I at 974 (Ger).

\(^{42}\) Gesetz über die Mitbestimmung der Arbeitnehmer in den Aufsichtsräten und Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie [Co-Determination Act for the Coal, Steel and Mining Industry], May 21, 1951, BGBL. I at 347 (Ger).

\(^{43}\) For the development of German board-level co-determination, see Hartmut Oetker, *Vorbemerkung zur Mitbestimmung der Arbeitnehmer im Aufsichtsrat [Foreword on Co-Determination]*, in AKTIENGESETZ: GROßKOMMENTAR COMMENT NO. 12 (Klaus J. Hopt & Herbert Wiedemann eds., 4th ed. 1999) (Ger).

\(^{44}\) Roth, *Die unternehmerische Mitbestimmung in der monistischen SE*, supra note 39, at 432–33.


\(^{46}\) For an example of the political dimension in European private company law, see Jan Bremer, *Kompromissvorschlag zur Europäischen Privatgesellschaft (EPG) vorgelegt*, 2011 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 695 (discussing a proposal for compromise regarding the Societas Privata Europaea (a European statute for close corporations)).

\(^{47}\) Introduced in 1952 as part of the Betriebsverfassungsgesetz [BetrVG] [Works Council Constitution Act], Oct. 11, 1952, BGBL I at 681 (Ger).

\(^{48}\) Section 1 (1) One-Third Participation Act, May 18, 2004, BGBL. I at 974 (Ger).

\(^{49}\) See Co-Determination Act, May 4, 1976, BGBL. I at 1153, last amended by the Act, Mar. 23 2002, BGBL. I at 1130, § 29(2) (Ger.). The chairman is typically a shareholder representative. See Co-Determination Act § 27(1)–(2).
independent member pursuant to the special co-determination regime in the coal, steel and mining industries. The German co-determination system allows only for the representation of workers employed in Germany, which is strongly criticized. Supervisory board employee representatives are required not only on the supervisory boards of companies which themselves employ more than 500 employees, but also on those of companies incorporated as stock corporations or limited liability companies with subsidiaries employing more than 500 employees. In 2009, about 1,500 companies (695 stock corporations) were subject to third-parity co-determination and about 700 companies (280 stock corporations) were subject to quasi-parity co-determination. Thus, about 1,000 stock corporations in Germany are subject to co-determination.

Recent studies on the legal regimes in France and Portugal show significant effects from basing labor protection on productivity and firm

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50. In 2002, 45 companies reported having such a structure. See Klaus J. Hopt & Markus Roth, in AKTIENGESETZ: GROßKOMMENTAR, supra note 35, § 96, ¶ 13.


53. One-Third Participation Act § 2 (more than 500 employees); Co-Determination Act § 5 (more than 2000 employees).


The effects of co-determination on the legal form chosen by companies have become apparent with hindsight: after limiting mandatory co-determination for newly-founded stock corporations to companies with more than 500 employees in 1994, the number of registered stock corporations in Germany rose from under 3,000 to about 17,000. According to the statistics of labor representatives, the number of stock corporations, as well as the overall number of companies subject to quasi-parity co-determination, is in decline.

3. Shifting Demographics: Participation of Older People and Women in the Labor Market

Globally, the first wave of the so-called “baby boomers” is retiring, and in many countries birth rates are lower than needed for the replication of age cohorts. Due to greater life expectancy and lower fertility, demographics are shifting in Germany even more than in the United States, though they may be more heavily discussed in the latter. Life expectancy grew more or less linearly in prior decades, leading to added years in retirement, even considering prospected rises in pension age. To counteract the surge of public debt without further reforms, state pensions designed as pay-as-you-go schemes in Germany, as well


60. See, e.g., RICHARD A. POSNER, AGING AND OLD AGE (1995); LAWRENCE A. FROLIK & RICHARD L. KAPLAN, ELDER LAW IN A NUTSHELL (5th ed. 2010).

61. OECD, Pensions at a Glance 2011, supra note 2, at 34.

as slightly improving birth rates for women born in 1969 or later—and expected by the United Nations—are of great importance. The European Commission responded by launching Europe 2020, which aims to improve participation of women and older people in the labor market. Both participation rates have already risen; in particular, there might be a correlation between the participation rates of women and early steps of legislation concerning the right to work part-time and the provision of paternity leave.

The much-discussed female quota in boardrooms, a central feature in European corporate governance, should be viewed against this backdrop. European Commissioner Viviane Reding regularly announces a quota as part of the Agenda 2020. In 2004, Norway imposed a quota of 40% for women on boards, with others such as Spain and France following suit. The glass ceiling is well documented in U.S. economic and social literature, but neither the United States nor

66. Id. at 10 (“The employment rate of the population aged 20-64 should increase from the current 69% to at least 75%, including through the greater involvement of women, older workers and the better integration of migrants in the work force.”).
69. See Katja Langenbucher, Zentrale Akteure der Corporate Governance: Zusammensetzung des Aufsichtsrats, Zum Vorschlag einer obligatorischen Besetzungserklärung, ZGR 314, 322 (2012) (Ger.).
70. For an early discussion of the reform movement, see Poonam Puri, The Future of Stakeholder Interests in Corporate Governance 48 Canadian Bus. L.J. 427, 442 (2010). In France, the quota of 40% has to be fulfilled by companies in 2017.
the United Kingdom has imposed a binding quota. In the United States, the SEC has called for policy statements from issuers. Meanwhile, in the United Kingdom, the U.K. Corporate Governance Code will be amended in 2012 to require a special section on diversity in a company’s Annual Report. Early U.S. studies showed positive results for diverse boards, and recent economic literature suggests that radical gender shifts in the composition of boards can cause financial harm to companies without women on their boards.

4. Introduction of a 40% Quota with (Quasi-) Parity Co-determination?

Diversity is currently the hottest debate in German corporate governance. In its response to the Report of the Government Commission on German Corporate Governance, the government

http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1118&context=key_workplace.


73. FIN. REPORTING COUNCIL, FEEDBACK STATEMENT: GENDER DIVERSITY ON BOARDS 5 (2011) (announcing to amend provision B.2.4 of the UK Corporate Governance Code in 2012 as follows (in italics): “A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. This section should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director.”).


stressed that politicians expect improvement in the participation of women in supervisory and management boards.77 However, the way in which stronger participation of women in the boardroom should be implemented is not yet clear. Leading German company directors, politicians, and even the government are split over the question of whether a legal rule, as in Norway, the Netherlands, and France, should be enacted.78 Some commentators have questioned whether the Corporate Governance Commission had a mandate to include diversity in the German Code,79 and whether a legal quorum for women would be in line with the German Constitution80 and the European anti-discrimination rules.81

For a better understanding of the German discussion on diversity, one needs to consider that the German supervisory board is already highly politicized.82 Taking into account quasi-mandatory co-determination in big companies, implementing a 40% quota, as advocated by the Green Party,83 Social Democratic Party,84 and in September 201285 by the upper house of the German parliament

78. For discussion, see Katja Langenbucher, Frauenquote und Gesellschaftsrecht, 66 JURISTENZEITUNG [JZ] 1038 (2011).
80. Gerald Spindler & Kathrin Brandt, Verfassungsrechtliche Zulässigkeit einer Gleichstellungsquote im Aufsichtsrat der börsennotierten AG, 2011 NZG 401, 404–05; more flexible in this regard is Hans-Jürgen Papier & Martin Heidebach, Die Einführung einer gesetzlichen Frauenquote für die Aufsichtsräte deutscher Unternehmen unter verfassungsrechtlichen Aspekten, 2011 ZGR 305.
82. For co-determination, see Roe, supra note 45, at 29–37; see also id. at 71–82 (country analysis).
83. Deutscher Bundestag: Drucksachen und Protokolle [BT] 17/3296 (Ger.).
84. SPD-Entwurf eines Gesetzes zur Förderung der Chancengleichheit von Männern und Frauen in Wirtschaftsunternehmen (ChGlFoG) [Equal Opportunities Draft Bill of the Social Democratic Party], BT 17/8878 (Ger.).
85. For further developments in 2013, see infra text accompanying note 112.
would only allow shareholders to freely choose three out of ten directors. This might explain why the industry took the German Corporate Governance Code itself off the agenda—to hinder future action. \(^{87}\) Even if a repeal of the German Corporate Governance Code was highly unlikely due to this industry pressure, 2011 was the second year since the German Corporate Governance Code’s 2002 enactment in which it was not amended. However, a broad discussion of a quota for women on boards switched to a discussion of introducing a legal quota. On the basis of a report by Mathias Habersack on state and parastatal interventions in corporate governance (“Habersack Report”), \(^{88}\) the German Jurist Forum recommended an evaluation of experiences in other European countries, but not an introduction of a legal (binding or flexible) quota for German boards. \(^{89}\) While the German discussion has largely neglected European initiatives, \(^{90}\) issues such as shortcomings in the compatibility of family life with a woman’s career, as well as better conditions in neighboring countries, have been stressed. \(^{91}\) Empirical research shows a correlation

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86. Entwurf eines Gesetzes zur Förderung gleichberechtigter Teilhabe von Frauen und Männern in Führungs­gremien (GTeilhG) [Promotion of Gender Equality in Management Bodies], BUNDESRAT DRUCKSACHEN [BR] 330/12 (Beschluss).

87. Kremer, who comments on the Code, see HENRIK-MICHAEL RINGLEB, THOMAS KREMER, MARCUS LUTTER & AXEL V. WERDER, KOMMENTAR ZUM DEUTSCHEN CORPORATE GOVERNANCE KODEX (4th ed. 2010), and published an article on the Code, see Thomas Kremer, Der Deutsche Corporate Governance Kodex auf dem Prüfstand: bewährte Selbst- oder freiwillige Überregulierung?, 32 ZIP 1177 (2011), is chief compliance officer of ThyssenKrupp.

88. MATTHIAS HABERSACK, STAATLICHE UND HALBSTAATLICHE EINGRIFFE IN DIE UNTERNEHMENSFÜHRUNG, GUTACHTEN E ZUM 69. DEUTSCHEN JURISTENTAG, MÜNCHEN 34–43 (2012).

89. 69. DEUTSCHER JURISTENTAG MÜNCHEN 2012: BESCHLÜSSE [69TH GERMAN JURISTS FORUM, MUNICH 2012: DECISIONS], Abteilung Wirtschaftsrecht [Business Law Section], Staatliche und halbstaatliche EingriFFE in die Unternehmensführung, Resolution I.3, at 17 (Ger.) [hereinafter GERMAN JURISTS FORUM, MUNICH 2012].


91. Martin Peltzer, Der Bericht der Corporate Governance Kommission an die Bundesregierung, 2011 NZG 281, 283 (Ger.).
between the absence of women on supervisory boards and their exclusion in German supervisory board networks; it also shows that supervisory board networks that do have a woman on a supervisory board tend to place more women on other boards. Since the literature on positive economic effects of women in boardrooms is predominately from the United States, where only about 17% of the independent directors are women, a more cautious and evolutionary approach might be appropriate for European lawmaking on diversity. At the moment, a self-binding declaration of larger companies seems to be the most feasible policy option. Whether there will be a legal duty to make such a declaration is not yet clear. In October 2011, the DAX 30-companies declared that they were aiming to enhance the proportion of women in higher management, all but two made self-binding declarations, which generally aimed for significant future improvement. Quotas in individual companies currently range from 7.6% to 28.5%; however, quota increase goals aim to raise this range from over 10% to 32% between 2015 and 2020; the company with the highest ratio today plans to increase its quota by between 1% and 2% per year.

In March 2012, the parliamentary group (Fraktion) of the German Social Democratic Party (“SPD”) introduced a legislative initiative proposing a quota for supervisory boards of 30% female in 2013 and 40% in 2015. Within the German government, three ministers, all of whom are women, are involved in this issue. The Minister of Labor (Mrs. Von der Leyen) supports a quota, the Minister of Family (Mrs. Schröder) proposes a flexible quota (Flexiquote) set by the companies

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92. Michael Wolff et al., Der Einfluss der Aufsichtsratszusammensetzung auf die Präsenz von Frauen in Aufsichtsräten, 2010 ZEITSCHRIFT FÜR BETRIEBSWIRTSCHAFTLICHE FORSCHUNG [zfbf] 503, 523 (Ger.).
93. See, e.g., Carter et al., supra note 74.
94. SPENCER STUART, 2012 SPENCER STUART BOARD INDEX 16 (2012) (finding 17% of independent directors are women, up from 12% in 2000).
95. A study for the Ministry for Family, Elder, Woman and Youth is presented by Marc-Philippe Weller (University of Freiburg), see FRANKFURTER ALLGEMEINE ZEITUNG 19 (Aug. 6, 2011) (on file with author).
96. Florian Gathmann & Christian Teews, Zwei Ministerinnen im Quotenkampf, SPIEGEL ONLINE (Oct. 17, 2011, 6:57 PM), http://www.spiegel.de/politik/deutschland/0,1518,792261,00.html (Ger.).
97. Id.
98. Equal Opportunities Draft Bill, BT 17/8878 (Ger.).
themselves, and the Minister of Justice (Mrs. Leutheuser-Schnarrenberger) rejects a quota outright. The Prime Minister, Mrs. Merkel, is said to swing towards the promoters of a mandatory quota.

In December 2012 the German conservatives agreed to the introduction of a flexible quota. Consequently, the German Government at least initially rejected the European proposal for a strict quota.

The details of the legislative proposal are as follows: from 2013, supervisory boards shall consist of 30% women and management boards shall consist of 20% women. From 2015, management boards with four managing directors shall consist of 25% women and management boards with at least nine members shall consist of (at least) 40% women. For supervisory boards, women shall make up at least 40% of the board (if the number of directors greater than three). The quota for the supervisory board would apply to both shareholder and employee representatives. Due to the separate counting of men and women for employee and shareholder representatives, the 2013 quotas will effectively already be higher. The sanctions for failing to comply are important, as elections for supervisory board members shall only be

103. “Einsatz für Frauenquote war nie mehr als Schamschlägerei”, SÜDDEUTSCHE ZEITUNG, Mar. 6, 2013, at 5. For later developments infra note 112.
104. Equal Opportunities Draft Bill, BT 17/8878, art. 1, 13 no. 1.
105. Id., art. 2, 13 no. 2 (to be codified at German Stock Corporation Act § 76(4)).
106. Id., art. 2, 13 no. 2 (to be codified at German Stock Corporation Act § 96 (4) 1).
107. Id., art. 1, 2, 13 (to be codified at German Stock Corporation Act § 96 (3) 1, (4) 1).
108. Id., art. 1, 13 no. 1 (to be codified at German Stock Corporation Act § 96 (3)).
possible if the quotas are met.\textsuperscript{109} If the election fails for this reason and it is not resolved during the next annual general meeting, another proposed provision will apply: if the supervisory board does not satisfy the quota provided for by law or the articles of association, it will no longer be able to take resolutions.\textsuperscript{110} According to the proposal of the German Upper House of September 2012 and the current proposal by the Social Democratic Party and the Green Party, a 40% quota for larger supervisory boards shall be introduced until 2023.\textsuperscript{111} Shortly before the German Bundestag rejected that proposal in April 2013, the German conservatives agreed to implement a call for a 30% quota in 2020 in its programme for the elections in September 2013.\textsuperscript{112}

The United Kingdom contributes to the debate in another way by amending the UK Corporate Governance Code to provide for a flexible quota. Transparency is also to be provided due to a proposed European directive amending the European Audit Directives.\textsuperscript{113} Economists studying the Norwegian experience showed that companies with less than two women on their boards suffered from having to implement the high quota of 40% all at once.\textsuperscript{114} In 2012, the German government published the Eighth Family Report\textsuperscript{115} calling for part-time employment for senior employees as well, which may lead to more qualified women in the future.

\begin{footnotesize}
\textsuperscript{109} Id., art. 1, 13 no. 1 (to be codified at German Stock Corporation Act § 101 (1a)).
\textsuperscript{110} Id., art. 1, 13 no. 1 (to be codified at German Stock Corporation Act § 108 (2))
\textsuperscript{111} Entwurf eines Gesetzes zur Förderung gleichberechtigter Teilhabe von Frauen und Männern in Führungsorganen (GTeilhG), supra note 88. See also DEUTSCHER BUNDESTAG: GESETZENTWURF [BT] 17/11139, Art. 2, 16, providing tax-consequences for non-compliance with Art. 13.
\textsuperscript{112} The conservatives overruled the party resolution of December 2012. See Gender Gap: Germany Rejects Law Requiring Board Quotas, SPIEGEL ONLINE (Apr. 18, 2013, 6:51 PM), http://www.spiegel.de/international/germany/germany-rejects-law-requiring-board-quotas-a-895238.html.
\textsuperscript{114} See Ahern & Dittmar, supra note 75 at 162–69, 192–94.
\textsuperscript{115} BUNDESMINISTERIUM FÜR FAMILIE, SENIOREN, FRAUEN UND JUGEND, ZEIT FÜR FAMILIE, FAMILIENZEITPOLITIK ALS CHANCE EINER NACHHALTIGEN FAMILIENPOLITIK, ACHTER FAMILIENBERICHT DER BUNDESREGIERUNG (2012).
\end{footnotesize}
B. PENSION SYSTEM IN GERMANY AND THE UNITED STATES

1. The German Focus on State Pensions and Life Insurance

In the nineteenth century, Germany introduced the well-known Bismarck pension laws. Less known is the academic foundation for introducing social security. Viewed from a twenty-first century perspective, German social security might be seen as an early result of law and economy. Early German economists promoted the introduction of social security. Corresponding to the Austrian “Nationalökonomie,” the German “Verein für Socialpolitik” (German Economic Association) promoted a solution for the “soziale Frage” (social question). Heavy critique resulted in the phrasing of “Kathedersozialist” (lectern-socialist), which is still rooted in German language. At that time, German social security was capital-funded, providing disability as well as pension insurance. The retirement age was 70, equal or even greater to the average life expectancy at the time. Capital-funded state pensions were later given up due to the First World War and hyperinflation in the 1920s. Today, the German

116. Gesetz betreffend die Invaliditäts- und Altersversicherung [Disability and Old-Age Insurance Act], June 22, 1889, RGBL. at 97 (Ger.).
118. In the nineteenth century, up to 40% of the German Economic Association’s members were lawyers. For the economic analysis of German labor law up until the Weimar Republic, see Markus Roth, 150 Jahre Recht des Handlungsgehilfen: Vom ADHGB 1861 zum Arbeits(vertrags)gesetz(buch), 2012 RECHT DER ARBEIT [RDA] 1, 5–6.
120. Gesetz Betreffend die Invaliditäts- und Altersversicherung [Disability and Old-Age Insurance Act], June 22, 1889, RGBL. §§ 20(2), 21 (Ger.).
121. Id. § 9(5).
122. For commentary on the development of life expectancy, see Jim Oeppen & James W. Vaupel, Broken Limits to Life Expectancy, 296 SCIENCE 1029 (2002).
123. For a criticism of the concept of investment in assets of insurance companies analogous to the legal rules for guardians in light of hyperinflation, see MARKUS ROTH,
state pension is a pay-as-you-go scheme and provides for most of Germany’s retirement income—this is the real first pullar. Since the so-called Riester-reform, the second and third pillars (private pensions such as occupational pensions and individual pensions, respectively) have gained momentum. The fact that the third pillar occupies a greater role in society than the second pillar causes widely-accepted cost efficiency problems.

2. Employee participation Via Private Pensions in the United States

In the United States, more emphasis is placed on occupational pensions; social security is not as close to the insurance principle as it is in the German system. Unlike in Germany, US state pensions were never expected to provide a full retirement income for large parts of the population. United States pension assets are therefore by far the greatest asset in US capital markets and account for almost half of the world’s occupational pension assets. This is attributed to both state pension funds and a ‘union pension premium.’ As of 2008, state pension funds were said to hold one-fifth of US-listed equity. Even if they hold only one-tenth of US equity, state pension funds play a

126. See JOHN H. LANGBEIN ET AL., PENSION AND EMPLOYEE BENEFIT LAW (5th ed. 2010); DAN M. MCGILL ET AL., FUNDAMENTALS OF PRIVATE PENSIONS (9th ed. 2010).
127. McGILL, supra note 126. On the role of social security in the US Retirement System, see id. at 45–85.
128. TOWERS WATSON, supra note 2, at 7 (In 2012, total pension assets in the US accounted for $16.851 trillion out of the $29.754 trillion of total pension assets among the thirteen major pension markets); OECD, PENSIONS AT A GLANCE 2011, supra note 2, at 179 ($9.58 trillion out of $16.78 trillion in 2009, the latter number representing OECD countries).
129. Teresa Ghilarducci, Organized Labor and Pensions, in OXFORD HANDBOOK OF PENSIONS AND RETIREMENT INCOME 381, 385 (Gordon L. Clark et al. eds., 2006).
pivotal role in shaping corporate governance in the United States and worldwide due to the sheer size of their investment portfolios: it was CalPERS which paved the way for activist corporate governance by shareholders.132 As an association primarily representing the state pension funds, CII was instrumental in promoting the independent director paradigm and the corporate governance rules under the Dodd-Frank Act.133

3. Occupational Pensions in Germany

A union pension premium as seen in the United States134 is not common in Germany. While occupational pensions in Germany are widespread in the financial and chemical industries, industrywide pension provisions—as in the electro and metal industries—are relatively new phenomena, having been introduced in 2001.135 Metallrente, a joint-venture of the employer association Gesamtmetall and the union IG Metall, now owns assets of 1.5 billion Euros. Unlike in Switzerland and the Netherlands, occupational pensions in Germany are not subject to collective bargaining by the unions.136 In some cases, there is collective bargaining of works councils at the plant level.137 In the case of Metallrente, providing occupational pensions is merely a choice for the employee, and not a duty.138

Direct pension promises is the default rule in Germany, and until 2001, pension promises were mandatorily linked to the earnings of the company for adjustments in retirement.139 The German Occupational Pensions Act provides that pensions have to be adjusted for inflation if the financial situation of the company allows for it.140 The German Federal Labor Court ruled that adjustments do not have to be paid for

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133. See infra Part III.A.1, IV.A.1.
134. Teresa Ghilarducci, Organized Labor and Pensions, in OXFORD HANDBOOK OF PENSIONS AND RETIREMENT INCOME 381, 385 (Gordon L. Clark et al. eds., 2006).
136. ROTH, PRIVATE ALTERSVORSORGE 2009, supra note 123, at 324.
137. Id. at 319–20.
138. See METALLRENTE, supra note 135.
139. Betriebsrentengesetz [BetrAVG] [Occupational Pensions Act], Dec. 19, 1974, BGBl. I at 3610, § 16 (Ger.).
140. ROTH, PRIVATE ALTERSVORSORGE 2009, supra note 123, at 638–50.
out of the substance (assets), but rather from the revenues of the company, and of the revenues, that a reasonable interest rate—the interest rate for secured bonds plus 2%—has to be left out to allow for further investments as well as an appropriate return on investment in order to secure the existence of the company first.141

Pensions of state employees in Germany are at best partly funded.142 The biggest German public pension fund is the “Versorgungsanstalt des Bundes und der Länder” (VBL), which provides occupational pensions for public employees at the federal and state levels and has over €16 billion under management,143 compared to CalPERS $257 billion.144 In the United States, a large proportion of pension assets are held by public pension funds,145 even if the underfunding of such funds is a subject of concern.

Neither Germany nor the United States is likely to exercise best practices in pension policy. According to data provided by the OECD, Germany and the United States provide under-average replacement ratios, especially for low incomes.146 Moreover, only a minority of the working age population is enrolled in an occupational pension plan.147 Therefore, in both the United States and Germany, automatic enrollment, as in the UK Pension Act 2008,148 would enhance prospects for future retirees. Such reform has been suggested in Germany, inter alia, by the German Jurist Forum in 2004 and the Association for Occupational Pensions (“Arbeitsgemeinschaft für betriebliche Altersversorgung, AbA”) in 2011, as well as in the United States by various authors on the basis of several empirical studies.149

141. Bundesarbeitsgericht [BAG] [Federal Labour Supreme Court], 18.2.2003, 3 AZR 172/02, Entscheidungen des Bundesarbeitsgerichts [BAGE] 105, 72, 77.
142. This contrasts with other countries such as the US and Japan. Worldwide, the biggest pension funds are public pension funds. See Watson Wyatt International, Investment Matters 2008, at 32 (2008).
145. OECD PENSIONS OUTLOOK 2012, supra note 124, at 228.
146. Id. at 207.
147. Id. at 104 (about one-half of the workers).
4. Corporate Finance and the Trend from Defined Benefits to Defined Contributions

In the 1970s, Peter Drucker estimated that pension funds of the private sector held a quarter of all listed equity in the United States. Since then, employee stock ownership programs (ESOPs) have been strongly promoted. David Blake estimates that United Kingdom companies in the late twentieth century owned a third of each other via their pension funds. In post-World War II Germany, direct pension promises (“Direktzusagen”) contributed about 20% to self-financing of German firms. Due to the trend towards asset funding and international investments in equity (advisors conversely refer to a home bias in promoting international investments), direct and indirect self-financing is in decline.

Pursuant to ERISA, asset funding has been legally required since 1974 in the United States. Whether such asset funding is counteracting the alignment of employee and employer interests is now subject to discussion in the United States. The idea behind the promotion of occupational, and not state, pensions by General Motors in the 1950s was to invest in the American economy. In the aftermath of the 2008 financial crisis, General Motors had to file for insolvency due to pension and health care obligations. This is expected to result in

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150. Drucker, supra note 5, at 1.


152. Blake, supra note 7, at 575.


156. Drucker, supra note 5, at 5 (“Socialism came to America [through the efforts of] the most unlikely revolutionary of them all—the chief executive officer of America’s largest manufacturing company, General Motors.”).

further caution towards defined benefit promises, and is likely to propel the trend towards defined contributions even more.\footnote{158}

The trend from defined benefit to defined contribution must be seen against the backdrop of the lack of, or at least limited, financial risk for employers until the era of codification of occupational pension law in the 1970s.\footnote{159} In Germany, employers were allowed to revoke pension promises due to financial distress until the enactment of the Act on Better Occupational Pensions in 1974; even later on, there was still limited scope to do this.\footnote{160} In the United States, the insolvency of car manufacturer Studebaker gave rise to ERISA in response to employees and retirees losing all their pension claims.\footnote{161} Employers in the United States responded by switching pension promises from defined benefit to defined contribution, thereby shifting the asset management and longevity risks to the employees.\footnote{162} In Germany, employers reduced pension promises in general; the increase in pension promises since 2001 is due to the right of employees to convert up to 4% of their income into occupational pensions.\footnote{163}

C. THE RISE OF INSTITUTIONAL INVESTORS

1. The Rise of Institutional Investors in the United States and in the United Kingdom

The National Bureau of Statistics has closely documented the rise of institutional investors in the United Kingdom. In the 1970s and 80s, British institutional investors already held the majority of UK equity.\footnote{164} This was also due to Maynard Keynes, who advocated investments in

\footnote{158. For automatic enrollment as a tool to counteract this trend resulting in short investment horizons, see infra Part IV.A.2.}
\footnote{159. On the effect of ERISA on occupational pension practice, see McGill et al., supra note 126, at 436.}
\footnote{160. Roth, Private Altersvorsorge 2009, supra note 123, at 569.}
\footnote{161. McGill et al., supra note 126, at 424–25.}
\footnote{162. For a view critical of the risk shift, see Jacob S. Hacker, The Great Risk Shift: The New Economic Insecurity and the Decline of the American Dream (2006).}
\footnote{163. Occupational Pensions Act, Dec. 19, 1974, BGBl. I at 3610, § 1a (Ger.).}
equity while serving as an advisor to British insurers. While British life insurance companies have invested heavily in equity, such investments are rare internationally and in most countries, restricted by supervisory agencies. In the United States, reported percentages of equity held by institutional investors differ substantially. Gordon asserts that institutional investors already held the majority of US shares in the 1980s, while Cheffins says that this occurred at least in the 1990s, and Armour and Skeel date this to the 2000s. The Conference Board provides related data, claiming that institutional shareholding has declined in the new millennium. Data from the US Census Bureau for 2010 report households and foreigners holding about 50% of US equity, slightly more than the combined figures of pension funds, life insurance companies, mutual funds and ETFs.

The rise of institutional shareholders was legally embedded in generously sponsored, funded occupational and individual pension regimes. As previously discussed, US occupational pension law literature hints at the irony that it was auto giant General Motors that pressed for generous occupational pensions to prevent the rise of ‘socialism’ by granting sufficient state pensions to the middle class. In the 1970s, the iconic Peter Drucker commented on this in his book, The

166. For Germany, see ROTH, PRIVATE ALTERSVORVORGE 2009, supra note 123, at 298–300.
170. See THE CONFERENCE BOARD, supra note 131, at 25–26; Gelter, supra note 131, at 33.
171. U.S. CENSUS BUREAU, THE 2012 STATISTICAL ABSTRACT 746 tbl. 1201 (2012) (providing the following statistics for equity holdings and net purchases, by investor type, in the year 2010 (all in billions of dollars): Total: 23,293; Household sector: 8,514; Rest of the world: 3,091; Life insurance companies: 1,423; Private pension funds: 1,983; State and local government retirement funds: 1,779; Mutual funds: 4,801; Exchange-traded funds: 854).
Unseen Revolution: How Pension Fund Socialism Came to America.\textsuperscript{172} In the 1980s, Robert Clark promoted the idea of four stages of capitalism, beginning with the separation of ownership and management and continuing with institutional investors telling the people how much money they need to save.\textsuperscript{173} In 2008, GM went bankrupt largely due to its underfunded pension plan. For airlines in the United States, filing Chapter 11 has been a business model for much of the twenty-first century.\textsuperscript{174}

In the United States, the value of pension assets is about the same as GDP.\textsuperscript{175} In the 1970s, US trust law was re-designed according to the portfolio theory,\textsuperscript{176} and in the 1980s, states began to allow their pension funds to invest a higher ratio in equity.\textsuperscript{177} The United Kingdom followed suit; supervisory authorities traditionally allow life insurance companies to invest substantial parts of their assets in equity.\textsuperscript{178} In other countries, such as the United States and Germany, supervisory authorities limit investments in equities to contracts with guarantees.\textsuperscript{179}

2. Institutional Investors and Foreign Shareholdings

Following the rise of institutional investors, foreign stock ownership rose considerably. According to data from the advisory firm Towers Watson, US occupational pension assets are worth $16 trillion in total,\textsuperscript{180} with equity holdings of 44\% and about $7 trillion invested in

\textsuperscript{172} DRUCKER, supra note 5.
\textsuperscript{175} TOWERS WATSON, supra note 2, at 7 (Pension assets equal 107\% of GDP).
\textsuperscript{177} Gelter, supra note 131, at 36–37.
\textsuperscript{178} Keynes, supra note 165.
\textsuperscript{179} ROTH, PRIVATE ALTERSVORSORGE 2009, supra note 123, at 464–65, 467.
\textsuperscript{180} TOWERS WATSON, supra note 2, at 7 ($16.851 trillion).
It is estimated that about one-fourth of all equity is invested abroad, accounting for about the same as, or perhaps even exceeding, the market capitalization of all German equities. According to the US Department of Treasury, US portfolio holdings of foreign securities account for 13% of market capitalization of the German stock market, with comparable or even higher figures for other industrial countries: 18% in Canada, 12% in France, 11% in Japan, 17% in the Netherlands, 11% in South Korea, 26% in Switzerland, and 19% in the UK. In the case of Germany, the total US equity investments nearly tripled from the end of 2001 to the end of 2009, increasing from about $70 billion to about $200 billion. During this time, the German market capitalization shrank by nearly 20%.

3. Occupational Pensions and Foreign Shareholdings in Germany

In contrast to the United States, German pension assets account for only $498 billion, significantly less than half of the total market capitalization of German equity. About €170 billion of occupational pension assets are invested in DAX 30-companies, which invest about 20% in equity. Since other pension institutions are even more reluctant to invest in equity, 10% of all occupational pension assets invested in equity is likely to be a good guess, totaling about $50 billion.

181. Id. at 8 (52% in equity).
182. Id. at 7, 31–32 (about 25% of total equity in foreign stock, 52% of pension assets in equity, amounting to one-eighth of $16.851 trillion); Deutscher Börse, Cash Market Monthly Statistics: December 2011, at 41 (2012) (indicating a total market capitalization of German equity worth €912 billion).
183. Portfolio Holdings Report, supra note 30, at 12.
184. Portfolio Holdings Report, supra note 30, at 78 tbl.23 ($72.2 billion).
185. Id. at 39 tbl. A3 ($193 billion).
186. Deutscher Börse, supra note 182, at 41 (from €1,203,681 million to €1,065,713 million).
189. For insurance companies, there are strict limits for equity investments. See Roth, Private Altersvorsorge 2009, supra note 123, at 298–301, 464–75.
Even if all of this equity was German stock, this would not amount to more than 5% of the total market capitalization of German equity.  

Due to the internationalization of equity investment in Germany, it is likely that US pension funds invested in Germany doubles or triples the amount of domestic pension money. Considering UK and other pension money as well, foreign pension funds invested in German equity might be five times higher than domestic pension funds in Germany, and perhaps even up to ten times higher. It is also for this reason that domestic institutional investors play a minor role in Germany, and foreign institutional investors are assumed to hold the majority of shares in most German blue chips (DAX 30-companies). According to data from Deutsche Bundesbank, considerably more than 40% of shares, in terms of market value, are in the hands of foreign investors. Such ratios are also reported for other European countries such as the United Kingdom, France and Belgium, while in the United States less than 20% of equity is in the hands of foreign investors.

Investor relations websites of the top fifteen German blue chips show that according to market capitalization, most of them have no controlling shareholder. Only VW, BMW and Henkel are de facto controlled by families or the state; these families and the state have a

190. DEUTSCHE BUNDESBANK EUROSYSTEM, STATISTIK ÜBER WERTPAPIERINVESTMENTS 28 (2012) (Ger.) (market value of domestic equity equaling €1,105,140 million).
191. For U.S. holdings of German securities, see PORTFOLIO HOLDINGS REPORT, supra note 30, at 12. For pension asset allocation in domestic equity versus total equity exposure, see TOWERS WATSON, supra note 2, at 32.
192. TOWERS WATSON, supra note 2, at 13; DEUTSCHE BÖRSE, supra note 182, at 40.
195. FED’N OF EUROPEAN SEC. EXCHS., supra note 194, at 12.
196. U.S. CENSUS BUREAU, supra note 171, at 746 tbl. 1201 (about 15%).
significant role in VW, with the Porsche and Piech family controlling
the Porsche holding of 51% of VW, the German state Lower Saxony
holding another 20%, and Quatar holding 17% (these percentages refer
to voting shares; VW is in the DAX with preference shares giving no
voting rights). The other companies have no German investor holding
more than 10%. Of the twelve companies whose shares are in free float
(out of fifteen with the biggest market capitalization), virtually all of
them are in foreign hands, meaning a majority of foreign shareholdings.
Only Deutsche Bank is regularly switching from domestic to foreign
shareholder majority. In the case of BASF, foreign majority is likely
but not entirely clear. These two exceptions among the companies in
free float may also serve as examples of a long-term shareholder basis
through generous employee participation in company stock.

D. PENSION FUNDS AND CORPORATE GOVERNANCE

1. The Influence of Institutional Shareholders on US and UK Corporate
Governance

The term corporate governance came into vogue, or at least was
established, in the United States. Corporate governance began to
emerge with the inspections of companies reporting on bribes of foreign
officials, resulting in the Foreign Corrupt Practices Act and later the

198. See Shareholder Structure, VOLKSWAGEN AKTIENGESELLSCHAFT (Dec. 31,
201. For using ESOPs as a takeover defense in the US, see Hansmann, supra note 151, at 1797.
202. See Cheffins, supra note 168, at 2 (observing that the term “corporate
governance” came into vogue in one single country: the United States).
codified as amended at 15 U.S.C. §§ 78dd-1—78dd-3). Reporting on this and on the
Co-Determination Act of 1976, see Herbert Wiedemann, Die Zukunft des
Gesellschaftsrechts, in FESTSCHRIFT FÜR ROBERT FISCHER 883 (Marcus Lutter, Walter
Stimpel & Herbert Wiedemann eds., 1979) (Ger.).
OECD Convention on Combating Bribery. In academia, the work of Eisenberg was influential in this area. In practice, an association of state pension funds promoted corporate governance, with CalPERS the largest by assets, and CII. CII calls itself the ‘voice of corporate governance’ and stated that it championed the independent director paradigm which was later adopted. The National Association of Pension Funds (NAPF) has been of similar, if not greater, importance in the United Kingdom. In preparing a collection of essays, the Cadbury Report, they serve as a good starting point of the European corporate governance debate. When the Cadbury Report was issued, UK institutional investors, such as pension funds and insurance companies, held over half of the equity of UK listed companies.

2. The European Code of Conduct Movement

In the United States, corporate governance standards are mandatory in the listing rules and are not restricted to a comply-or-explain basis as in Europe. This more liberal regulatory approach was developed in the United Kingdom, where the European corporate governance debate

204. See generally THE OECD CONVENTION ON BRIBERY: A COMMENTARY ON THE CONVENTION ON COMBATING BRIBERY OF FOREIGN PUBLIC OFFICIALS IN INTERNATIONAL BUSINESS TRANSACTIONS OF 21 NOVEMBER 1997, (Marc Pieth et al. eds., 2007); see also Markus Roth, Die OECD-Empfehlung im Gesamtzusammenhang der Verhinderung von Bestechung, 56 RECHT DER INTERNATIONALEN WIRTSCHAFT [RIW] 737 (2010).
206. COUNCIL OF INSTITUTIONAL INVESTORS (CII), http://www.cii.org/about_us (last visited Jan. 20, 2013). Former version (http://www.cii.org/about/who_we_serve.) accessible via the webarchive, stated under the headline ‘Improving Corporate Governance’:

Many of the Council’s corporate governance policies, once considered radical, are now in the mainstream. Principles that we championed over time—from director independence to clear links between executive pay and company performance—have been adopted by U.S. companies; enshrined in regulation, legislation and stock exchange listing standards; and emulated abroad.
208. For the development of share ownership in the United Kingdom, see Armour & Skeel, supra note 169, at 1768–70.
began. Consistent with the regulatory philosophy of the City Code on Takeovers, the Cadbury Report and the Combined Code, now the UK Corporate Governance Code, used the comply-or-explain principle. This tenet operated as the role model for the European Union, which introduced the comply-or-explain principle in the Fourth Council Directive in 2006. Codes of conduct are better suited to more diverse companies according to shareholder structure, especially to companies with significant shareholders, and to co-determination and companies in countries with extensive regulation in stock corporation acts, such as Germany. In Germany, the comply-or-explain principle has been part of the German Stock Corporation Act since 2002. Initially only for listed companies, the Act now also applies to other capital market-oriented companies as well.

E. THEORY OF THE FIRM

I. The Shareholder Value Puzzle

From a continental European perspective, one of the corporate governance puzzles that US academia and practice almost universally accept is that while the firm is a nexus of contracts, shareholder primacy sets the standard for corporate action. In terms of shareholder power vis-à-vis management, however, such shareholder primacy was in part implemented only after the financial crisis by the Dodd-Frank Act. In Germany it is accepted that management may also take into account interests of other stakeholders, such as

211. For the UK Takeover Code, see Armour & Skeel, supra note 169, at 1727–30.
213. See Hopt, supra note 210, at 12.
215. Id.
218. See infra Part III.A.2.
employees;\textsuperscript{219} in contrast to the US, some go so far as to say that the enterprise is more than the company as a legal form; it also consists of the interests of the employees and other stakeholders.\textsuperscript{220}

2. \textit{Pensions Bridging the Rift Between Shareholder Value and the Stakeholder Approach}

The rift between the shareholder and the stakeholder approach may be bridged by focusing on long-termism as an appropriate overarching corporate governance principle in times of pension capitalism.\textsuperscript{221} Mirroring their own interests in a long-term increase in corporate value, private pension institutions place emphasis on sustainable corporate growth. Under the Corporate Governance Principles of Hermes, the primary goal is managing companies and establishing value in the long-term interest of shareholders.\textsuperscript{222} The doctrines championed by CalPERS are based on the conviction that the structures set up by their principles will deliver the best long-term results for shareholders.\textsuperscript{223} The Corporate Governance Principles of Hermes assume that independent directors are most likely to make decisions in the interests of all long-term shareholders.\textsuperscript{224} This focus on the long-term interests of shareholders ensures that shareholder interests are taken into account, as a company can only be successful in the long run if it has sufficient regard for the interests of customers, suppliers, and employees.\textsuperscript{225}

\begin{footnotes}
\item[219.] For a long-term focus on plurality of interests, see Michael Kort, \textit{in AKTIENGESETZ: GROßKOMMENTAR} § 76, no. 52 ff (Klaus J. Hopt & Herbert Wiedemann eds., 4th ed. 2002); leaning towards this view now, Peter O. Mülbert, \textit{Soziale Verantwortung von Unternehmen im Gesellschaftsrecht}, 2009 AG 766, 774.
\item[220.] On this discussion, see Roth, \textit{Employee Participation}, supra note 4, at 65.
\item[221.] See infra Part IV.
\item[223.] \textit{THE CALIFORNIA PUBLIC EMPLOYEES’ RETIREMENT SYSTEM (CALPERS), GLOBAL PRINCIPLES OF ACCOUNTABLE CORPORATE GOVERNANCE} 7, § III.A. (last updated Nov. 14, 2011) [hereinafter CALPERS, GLOBAL PRINCIPLES].
\item[224.] \textit{HERMES RESPONSIBLE OWNERSHIP PRINCIPLES}, supra note 222, § XI (the ability for boards to “act objectively and independently in the long-term interest of the company and its shareholders”).
\item[225.] Roth, \textit{Private Altersvorsorge 2011}, supra note 1, at 540.
\end{footnotes}
By focusing on long-term shareholder value, the enlightened shareholder value approach is appropriately implemented. This idea largely levels the classical conflict between the shareholder and stakeholder approaches. In the long term, shareholder value should only be created if the company also promotes the interests of employees, clients, suppliers, and the public. However, such a long term focus might be better implemented by also choosing a design which implements a more diverse view by giving human capital a “say” in corporate governance. Referring to corporate governance principles established in the United States, the independent directors provided for in the Investment Act of 1940 had a significant impact some fifty years later on the governance of “normal” firms. The representation of workers in United States pension funds, as required by some state laws—e.g., California’s CalPERS—might play a similar role in the future.

In Germany, there is a long doctrinal tradition of including stakeholder interests in the company enterprise. The German Corporate Governance Code endorses this approach by reference in its preamble to the interest of the enterprise. The Code “clarifies” the obligation of the management and supervisory boards to ensure the continued existence of the enterprise, as well as its sustainable creation of value in conformity with the principles of the social market economy. According to the German Code, the management board is responsible for independently managing the enterprise in its own best interest, thus taking into account the interests of shareholders, employees, and other stakeholders, with the objective of sustainable

226. Without such long-term focus, see, e.g., Companies Act, 2006, c. 46, § 172 (Eng.).
227. For a US perspective, see Hansmann, supra note 151, at 1816 (expressing the view that companies run for employees often perform better).
228. For German co-determination regimes, see supra Part I.A.2.
229. See infra Part II.A.1.
232. See id. § 4.1.1.
creation of value. Works councils, as company institutions within the company, are especially relevant in large companies.

The long-term shareholder value approach is aligned with the classical German approach of corporate interest (Unternehmensinteresse).\(^{233}\) According to Gerhard Spindler, § 70 AktG of 1937 cannot be classified solely as a National Socialist provision.\(^{234}\) Rather, the provision can also be based on the theory of the corporation (Theorie des Unternehmens); F.A. Mann has emphasized the influence of the teachings of the corporation (des Unternehmens) (§ 70 AktG) as such.\(^{235}\) Even the Government Draft Bill of 1930 explicitly recognized the principle that the “corporate interest as such is equally worthy of protection as interests of individual shareholders” (“dass die Interessen des Unternehmens als solches ebenso schutzbedürftig sind wie das individuelle Interesse des Aktionärs”), and concluded that if the company is managed properly and individual shareholders have an appropriate attitude, the interests of the company and shareholders should converge.\(^{236}\)

3. The European Company

About half of all operating European companies, and an even larger share of co-determined European companies, are of German origin;\(^{237}\) a partial explanation for this increasing number of European companies in


\(^{236}\) Entwurf eines Gesetzes über Aktiengesellschaften und Kommanditgesellschaften auf Aktien sowie Entwurf eines Einführungsgesetzes nebst erläuternden Bemerkungen: Erläuternde Bemerkungen, Einleitung 94 (1930).

\(^{237}\) According to the European Trade Union Institute (ETUI), 121 out of 244 European Companies with more than five employees are located in Germany as well as 40 out of 49 co-determined European Companies, ETUI, Overview of Current State of SE Founding in Europe, Update: 1 April 2013, 3, 10
Germany is the German co-determination law.\textsuperscript{238} While in German stock corporations only employees employed in Germany are represented in supervisory boards, in European companies (Societas Europaea, SE),\textsuperscript{239} employees located in other European Union countries are also represented.\textsuperscript{240} Considering, \textit{inter alia}, the demands for greater diversity on the supervisory boards, it appears questionable how long international pension funds will put up with the outmoded German co-determination model.\textsuperscript{241} The recommendation by the study group on co-determination (“\textit{Arbeitskreis ‘Unternehmerische Mitbestimmung’}”) to introduce a regime similar to the SE\textsuperscript{242} has rather unsurprisingly been rejected by the labor unions.\textsuperscript{243} International institutional investors are also questioning the mandatory participation of labor unions.\textsuperscript{244} Against this backdrop, Hermes is encouraging companies to consider a conversion to an SE.\textsuperscript{245} A striking observation in practical terms is that

\begin{itemize}
\item \textsuperscript{239} See \textit{ERNST & YOUNG, STUDY ON THE OPERATION AND THE IMPACTS OF THE STATUTE FOR A EUROPEAN COMPANY (SE): FINAL REPORT} 246 (2009) [hereinafter 2009 \textit{ERNST & YOUNG STUDY}] (explicitly labeling this as an advantage of the SE). On December 31, 2008, more than half of all SEs were incorporated/domiciled in Germany (45 of 73). See Berndt Keller & Frank Werner, \textit{Arbeitnehmerbeteiligung in der Europäischen Aktiengesellschaft (SE) – Empirische Befunde und (un-)erwartete Konsequenzen}, 62 \textit{WSI MITTEILUNGEN} 416, 419 tbl.2 (2009).
\item \textsuperscript{241} See Rüdiger von Rosen, \textit{Kapitalmarkt und Mitbestimmung, in STEFAN GRUNDMANN ET AL., UNTERNEHMENSRECHT ZU BEGINN DES 21. JAHNHUERTS: FESTSCHRIFT FÜR EBERHARD SCHWARK ZUM 70. GEBURTSTAG} 789, 799 (Christine Windbichler et al. eds., 2009) (maintaining the continued need for reform).
\item \textsuperscript{242} Arbeitskreis ‘Unternehmerische Mitbestimmung,’ Entwurf einer Regelung zur Mitbestimmungsvereinbarung sowie zur Größe des mitbestimmten Aufsichtsrats, 30 \textit{ZIP} 885 (2009).
\item \textsuperscript{243} For an unambiguous account, see the contribution by Hexel in the roundtable discussion, 30 ZIP (Beiilage zu Hef 48) 35, 36 (2009).
\item \textsuperscript{244} Thomas von Oehsen, \textit{Die Rolle von ISS im Kapitalmarkt und Perspektiven guter Corporate Governance, in 65. DEUTSCHER BETRIEBSWIRTSCHAFTER-TAG} 2011, 45 (2012).
\item \textsuperscript{245} \textit{HERMES EQUITY OWNERSHIP SERVS., HERMES CORPORATE GOVERNANCE PRINCIPLES – GERMANY} (2011). On the construction of the co-determination regime of the SE in Germany, Austria, Sweden and France, see Claudia Schubert, \textit{The National Implementation of Employee Participation in the Administrative Board of the SE in the}
all German co-determined SEs have so far chosen a dualistic board.\textsuperscript{246} This should change, however, if the proposal by Ernst & Young is adopted, under the terms of which the SE statute would explicitly limit equal co-determination to non-executive directors.\textsuperscript{247}

II. INDEPENDENT DIRECTOR PARADIGM AND BOARD COMMITTEES

A. INDEPENDENT DIRECTORS IN THE US, EUROPE AND ASIA

1. The Rise of Independent Boards

Institutional investors, particularly pension funds, place great value on independent supervisory boards or board members.\textsuperscript{248} On its website, the CII demands at least two-thirds of board members to be independent.\textsuperscript{249} In the early 1990s, the Cadbury Report provided for more than half of the non-executive board to be independent.\textsuperscript{250} The Combined Code has now extended this quota to the entire board; smaller companies should have at least two independent directors.\textsuperscript{251} The Principles of Corporate Governance of the Hermes pension fund deal with the ideal proportion of independent directors at the country level: in


\textsuperscript{246} See Roth, \textit{Employee Participation}, supra note 4, at 83. An exception to this is PUMA (a listed company with a foreign majority shareholder), which has converted to a monistic board system.

\textsuperscript{247} See 2009 \textit{ERNST & YOUNG STUDY}, supra note 239, at 285 (discussing Art. 43 of SE Regulation).


\textsuperscript{250} See \textit{Report of the Committee on The Financial Aspects of Corporate Governance} (Cadbury Report), reprinted in \textit{COMPARATIVE CORPORATE GOVERNANCE, ESSAYS AND MATERIALS}, Annex I/1 § 2.2 (Klaus J. Hopt & Eddy Wymeersch eds., 1997); see also John C. Shaw, \textit{The Cadbury Report, Two Years Later}, in \textit{COMPARATIVE CORPORATE GOVERNANCE, ESSAYS AND MATERIALS}, at 41.

the US, a simple majority; in Brazil, at least one-third must be independent.252 In its Guide for Superannuation Trustees, the Australian Council of Superinvestors (“ACSI”) requires a majority of the board to be independent.253 Yet, there is no evidence on whether independent boards generate greater value.254

For the United States, CII corporate governance principles require that at least two-thirds of the board members be independent.255 This exceeds considerably the listing rules of NYSE and NASDAQ, which require only a majority-independent board,256 and has contributed to the fact that in the United States more than 80% of directors are independent.257 In fact, the United States probably has the highest ratio of independent directors in the world.258 Another explanation for this might be its relatively lenient standards for independence. In contrast to the European Union, the US’s list of requirements for independence is relatively short and more lenient; for example, significant shareholders and their representatives are considered to be independent.259 Even if the US is not famous for concentrated ownership, this might have an effect since founder-directors in tech firms can be treated as independent even with voting shares of 10% or higher.

252. See, e.g., HERMES EQUITY OWNERSHIP SERVS., HERMES CORPORATE GOVERNANCE PRINCIPLES – UNITED STATES (2012); HERMES EQUITY OWNERSHIP SERVS., HERMES CORPORATE GOVERNANCE PRINCIPLES – BRAZIL (2012).


255. COUNCIL OF INSTITUTIONAL INVESTORS, supra note 249, § 2.3.

256. See NASDAQ OMX Group, Inc., NASDAQ STOCK MARKET RULES § 5605(b)(1); NYSE EURONEXT, NYSE LISTED COMPANY MANUAL § 303A.01.

257. SPENCER STUART US BOARD INDEX 2011, at 8 (2011) (84%).

258. For the United States, see id. For Europe, see HEIDRICK & STRUGGS, EUROPEAN CORPORATE GOVERNANCE REPORT 2011: CHALLENGING BOARD PERFORMANCE 42 fig.35 (2011). With better data, see Enriques et al., supra note 254, at 56, 70.

259. NASDAQ, supra note 256, § 5605(a)(2) (defining “independence”).
According to a European survey by Heidrick & Struggles, fewer independent directors are found in Europe.260 In the Netherlands, 75% of all supervisory board members are independent, as well as 72% in Finland; 62% in Switzerland; 61% in the United Kingdom; 51% in Norway; and 48% in Italy.261 Countries below the European average of 43% independent directors are, inter alia, France and Sweden (40%), Austria (36%), Spain (33%), Belgium (32%), Denmark (30%), and finally Germany (21%), which has lowest ratio of independent directors in the survey.262 In most European countries, independence standards are stricter than in the United States.263 For example, according to the European Recommendation on independence, a significant shareholder and his legal representatives are not independent.264 In the United States and Switzerland, even majority shareholders traditionally pass as independent, although some companies refrain from declaring them as such. For a long time, Germany was reluctant to follow the European Union proposal,265 but recently the Government Commission on Corporate Governance changed the German Corporate Governance Code to exclude majority shareholders from being independent.266

In Asia, independent directors are increasingly incorporated into national corporate governance regimes. By 2001, China had already incorporated independent directors into its unique corporate governance structure, with a board of directors that is overseen by a supervisory board.267 Chinese listing regulations require that a third of the board of

260. HEIDRICK & STRUGGLES, supra note 258.
261. Id. at 42.
262. Id.
263. For the United States, see NASDAQ OMX Group, Inc., NASDAQ STOCK MARKET RULES § 5605(a)(2); NYSE Euronext, NYSE LISTED COMPANY MANUAL § 303A.02. Calling for stricter independence standards in the US Hermes Equity Ownership Services, Hermes Corporate Governance Principles United States, Independence: companies should go beyond the definitions of independence according to the NASDAQ and NYSE. The new NYSE rules effective from July 1, 2013 does not reflect this.
265. See infra Part II.C.
266. GERMAN CORPORATE GOVERNANCE CODE § 5.4.2 (2012).
directors be independent. For South Korea, there is evidence that the existence of independent directors correlates with firm performance. South Korea first required outside directors after the Asian crisis. Since the definition of an outside director in the Korean Securities and Exchange Act excludes, inter alia, significant shareholders, at least half of the board has to be independent in large corporations. In Japan, the Tokyo Stock Exchange requires the appointment of one independent director; major shareholders are deemed not to be independent, and the number of independent directors correlates with foreign investments. While companies with a shareholding ratio below 10% appointed 1.51 independent directors on average, companies with a foreign shareholder ratio of at least 30% have appointed an average of 2.93 independent directors.


272. In terms of comparative Corporate Governance, this is a rather strict standard. For Switzerland, see ECONOMIESUISSE, SWISS CODE OF BEST PRACTICE FOR CORPORATE GOVERNANCE II.b.12, g.22 (2007). For the United States, see NASDAQ, supra note 256, § 5605(a)(2), (b)(1).


274. Id. at Rule 211(a)(d).

275. TOKYO STOCK EXCHANGE INC., WHITE PAPER ON CORPORATE GOVERNANCE 2011, 42 (2011).
2. Independent Chairpersons and Committees

Pension funds worldwide recommend an independent chairperson of the board,\(^\text{276}\) as in the UK Corporate Governance Code\(^\text{277}\) and the ACSI Governance Guidelines.\(^\text{278}\) Similarly, the Dodd-Frank Act requires the SEC to pass appropriate rules.\(^\text{279}\) Under the UK Corporate Governance Code, director independence is one of four criteria required for an appointment to the board,\(^\text{280}\) maintaining the requirement that at least half of the board members be independent.\(^\text{281}\) The Green Paper of the European Commission follows suit by including independence as a factor in selecting boards.\(^\text{282}\) Internationally, independence of the majority of members is not required or practiced for all control organs, as is shown by the common global practice of employees sitting on co-determined boards, or at any rate on the (supervisory) boards of occupational pension institutions. A controversial point is the benchmark for determining independence.\(^\text{283}\) According to the recommendation of the EU on the independence of supervisory boards and board members, even the representatives of major shareholders are

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\(^\text{276}\) See, e.g., CALPERS, GLOBAL PRINCIPLES, supra note 223, at III.B., Recommended Rule 1.4; HERMES EQUITY OWNERSHIP SERVICES, LTD., HERMES CORPORATE GOVERNANCE PRINCIPLES – UNITED STATES 2 (2012) (identifying combined Chair/CEO Roles, expectation to split roles); MILLSTEIN CENTER FOR CORPORATE GOVERNANCE AND PERFORMANCE, YALE SCHOOL OF MANAGEMENT, POLICY BRIEFING NO. 4: CHAIRING THE BOARD: THE CASE FOR INDEPENDENT LEADERSHIP IN CORPORATE NORTH AMERICA 21 (2009) (recommending independent chairmanship as the default model).


\(^\text{278}\) ACSI GOVERNANCE GUIDELINES, supra note 253, § 9.2.


\(^\text{280}\) UK CORPORATE GOVERNANCE CODE § B.1 (“The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.”).

\(^\text{281}\) Id. § B.1.2.

\(^\text{282}\) The Green Paper’s criteria for the selection of board members include: “merit, professional qualifications, experience, the personal qualities of the candidate, independence and diversity.” Green Paper, supra note 24, at 5, § 1.1.

\(^\text{283}\) Enriques et al., supra note 254, at 64.
not considered to be independent.\footnote{284} Furthermore, and quite appropriately, employee representatives are not regarded as independent;\footnote{285} the rights to appoint board members are viewed critically.\footnote{286}

According to the listing requirement of the NYSE and NASDAQ, audit committees, nomination committees and remuneration committees in the United States have to be fully independent; due to this rule’s mandatory nature, companies comply.\footnote{287} The UK Corporate Governance Code does not require full independence for all of these committees.\footnote{288} The EU’s recommendation on independent directors requires only a majority of the audit committee, the remuneration committee and the nomination committee to be independent.\footnote{289} Quotas in many European countries are lower than this; according to a study by Heidrick & Struggles, Germany has the lowest quota among European blue chips.\footnote{290}

In Germany, the nomination committee is restricted to the nomination of supervisory directors.\footnote{291} This allows a co-determination-

\footnote{284. Recommendation No. 2005/162, \textit{supra} note 264, at 63.}
\footnote{285. \textit{See} Klaus J. Hopt & Markus Roth, \textsection 100, \textit{in} \textit{AKTIENGESETZ: GROßKOMMENTAR}, \textit{supra} note 35, arguing this point originally, and more recently in Christine Windbichler, \textit{Die Rolle von Amtsträgern der Betriebsverfassung im Aufsichtsrat}, \textit{in} GRUNDMANN ET AL., \textit{UNTERNEHMENSRECHT ZU BEGINN DES 21. JAHRHUNDERTS}, \textit{supra} note 241, at 805. For a view raising doubts on this position, see Michael Kort, \textit{Standardization of Company Law in Germany, Other EU Member States and Turkey by Corporate Governance Rules}, 5 ECFR 379, 404 (2008); Michael Kort, \textit{Interessenkonflikte bei Organmitgliedern der AG}, 29 ZIP 717, 725 (2008).}
\footnote{286. For example, on the VW decision by the ECJ, see Gert-Jan Vossenstein, \textit{Volkswagen: The State of Affairs of Golden Shares, General Company Law and European Free Movement of Capital}, 5 ECFR 115, 125 (2008).}
\footnote{287. \textit{SPENCER STUART}, \textit{supra} note 257, at 9 (stating that only thirteen controlled companies do not have a fully independent nomination committee).}
\footnote{288. According to the UK Corporate Governance Code, the nomination committee has to be composed of a majority of independent directors. UK \textit{CORPORATE GOVERNANCE CODE} \textsection B.2.1 (2012).}
\footnote{289. Recommendation No. 2005/162, \textit{supra} note 264, at 58 Annex I, \textsection 2.1.2 (nomination committee), 3.1.2 (remuneration committee), 60 Annex I, \textsection 4.1 (audit committee).}
\footnote{290. \textit{HEIDRICK & STRUGGLES}, \textit{supra} note 258, at 44.}
\footnote{291. \textit{GERMAN CORPORATE GOVERNANCE CODE} \textsection 5.3.3 (2012).}
free composition. A personal or presidential committee commonly organizes the nomination and remuneration of managing directors. A remuneration committee is not specifically recommended, but is only mentioned by the German Corporate Governance Code. According to the German Stock Corporation Act, the remuneration and appointment of managing directors are to be decided by the supervisory board as a whole. Board committees in Germany are also subject to codetermination. In September 2012, the German Jurists Forum recommended the introduction of quotas for the audit and remuneration committees.

B. INDEPENDENCE AND EXPERTISE

The issue of appropriate expertise of supervisory directors has now come to the forefront of debate. In Germany, the requirements have already been made stricter for credit institutions, insurance companies, and pension funds. The draft of an act on the supervision of financial markets and the insurance industry also included the supervisory boards of retirement funds (Pensionskassen). This could, however, lead to problems for the rather common worldwide practice of employee representatives and retirees sitting on co-determined boards in pension funds. This is one reason why the legislature has refrained from

292. According to German Stock Corporation Act § 124(3), resolutions for proposing shareholder representatives to be elected by the general meeting may be taken by shareholder representatives.

293. See Klaus J. Hopt & Markus Roth, § 107, in AKTIENGESETZ: GROßKOMMENTAR, supra note 35, no. 340–47.

294. GERMAN CORPORATE GOVERNANCE CODE § 5.1, 2.

295. German Stock Corporation Act § 107(3).

296. See Klaus J. Hopt & Markus Roth, § 107, in AKTIENGESETZ: GROßKOMMENTAR, supra note 35, no. 277–89.


298. See Harald Hau & Marcel Thum, Subprime Crisis and Board (In-)Competence: Private vs. Public Banks in Germany, in 60 ECONOMIC POLICY 701 (2009) (finding the expertise of supervisory directors enhanced the performance of banks).


300. For the governmental draft, see DEUTSCHER BUNDESTAG: GESETZENTWURF DER BUNDESREGIERUNG [BT] 16/12783 (Ger.).

301. See ROTH, PRIVATE ALTERSVORSORGE 2009, supra note 123, at 211.
requiring a minimum level of expertise for supervisory board members of retirement funds.302

C. INDEPENDENT DIRECTORS IN GERMANY

The term independent director is not defined in the Stock Corporation Act.303 For the independence criterion of the “financial expert,” introduced by the German Stock Corporation Act to transpose the revised Auditor Directive,304 academia draws on the February 15, 2005 European Commission Recommendation regarding the role of non-executive or supervisory directors of listed companies and committees of the (supervisory) board.305 In contrast to the European Recommendation and the UK Corporate Governance Code, the German Corporate Governance Code provides a short list of criteria that indicate a lack of independence. This short list was recently proposed by the Governance Code Commission,306 but dropped after public consultation.307

According to the German Corporate Governance Code of May 2012,308 a supervisory board member is considered to be independent if he or she has no business or personal relations with the company, its management board, a controlling shareholder or an enterprise linked to

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303. Mathias Habersack, “Kirch/Deutsche Bank” und die Folgen – Überlegungen zu § 100 Abs. 5 AktG und Ziff. 5.4, 5.5 DCGK -, in *FESTSCHRIFT FÜR WULF GOETTE ZUM 65. GEBURTSTAG* 121, 126 (Mathias Habersack & Peter Hommelhoff eds., 2011).

304. Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at 1089, §§ 100(5), 107(4), last amended by Restrukturierungsgesetz [RStruktG] [Restructuring Act], Dec. 9, 2010, BGBL. I at 1900 (Ger.).


308. *GERMAN CORPORATE GOVERNANCE CODE* § 5.4.2 (2012).
the controlling shareholder, all of which may cause a conflict of interests. Academia is split on whether the EU Recommendation can be used to sharpen the independence requirements in the German Code.\textsuperscript{309} Not more than two former members of the management board shall be members of the supervisory board; members of the supervisory board shall not hold directorships or similar positions, or perform advisory tasks for important competitors of the company.\textsuperscript{310} In making proposals for the election of supervisory directors to the general meeting, holdings of 10\% or more of the shares of the company must be disclosed.\textsuperscript{311}

The supervisory board shall include what it considers to be an adequate number of independent directors.\textsuperscript{312} The concrete objectives of the supervisory board and the status of their implementation shall be published in the Corporate Governance Report.\textsuperscript{313} For Germany, it is appropriate to focus on shareholder representatives only; in major companies with a diversified shareholder structure, half of the board should be independent.\textsuperscript{314} The proxy-advisor Institutional Shareholder Services (“ISS”) calls for one-third of the entire board to be independent,\textsuperscript{315} leading to the independence of two-thirds of shareholder representatives in quasi-parity co-determined boards.\textsuperscript{316} On boards with a controlling shareholder located in countries that are in line with modern European corporate governance standards, e.g., France,\textsuperscript{317} the supervisory board may hold that it is “adequate” if one-third of the shareholder representatives are independent.\textsuperscript{318} For smaller companies, such as UK companies outside the FTSE 350,\textsuperscript{319} two independent


\textsuperscript{310} GERMAN CORPORATE GOVERNANCE CODE § 5.4.2 (3).

\textsuperscript{311} Id. § 5.4.1 (4), (6).

\textsuperscript{312} Id. § 5.4.2 (1).

\textsuperscript{313} Id. § 5.4.1 (3)2.

\textsuperscript{314} See Roth, Unabhängige Aufsichtsratsmitglieder, supra note 20, at 636.

\textsuperscript{315} Institutional S’holder Servs. Inc. (ISS), 2012 EUROPEAN PROXY VOTING SUMMARY GUIDELINES 8 (2011) [hereinafter GUIDELINES].

\textsuperscript{316} See Markus Roth, Information und Organisation des Aufsichtsrats, 2012 ZGR 343, 380.


\textsuperscript{318} See Roth, Unabhängige Aufsichtsratsmitglieder, supra note 20, at 636.

\textsuperscript{319} UK CORPORATE GOVERNANCE CODE § B.1.2 (2012) (U.K.).
directors is generally sufficient. Less stringent standards are also generally applied in Austria and Sweden, which require only up to two independent directors. In Austria, when the free float is more than 50%, the two supervisory directors must also be independent from the controlling shareholder; when the free float is over 20%, only one has to be independent. 320  In Sweden, at least two members must be independent in relation to the company’s major shareholders, regardless of the company size. 321

It is contested whether employee representatives are independent. Unions claim that the employees sitting on the board as employee representatives, as well as union delegates representing the employees in the supervisory board, are independent. 322  Decisions by the courts do not make this issue clear, and most academics argue that employee representatives are not independent. 323  The EU Recommendation regarding independent directors 324 is somewhat ambiguous, suggesting that employee representatives need not be declared non-independent. 325 In a recent survey, advisor Heidrick & Struggles classifies employee representatives as a distinct category, leading to far less than half of all supervisory directors being considered independent in Germany. 326 The German Jurists Forum recommends taking co-determination into account by articulating requirements for independence. 327

323. See Klaus J. Hopt & Markus Roth, § 100, in AKTIENGESETZ: GROßKOMMENTAR, supra note 35, no. 90.
325. Id. at 63, Annex II, 1(b).
326. HEIDRICK & STRUGGLES, supra note 258, at 42 (finding the actual number to be 21% of all supervisory directors).
327. GERMAN JURISTS FORUM, MUNICH 2012, supra note 89, Business Law Section, Resolution 12.a (approved 76:10:9).
D. INDEPENDENCE AS A SUBSTITUTE FOR CO-DETERMINATION AND THE TWO-TIER STRUCTURE?

1. Independent Directors in Co-Determined Boards

The independent director paradigm was invented in countries in which boards were not subject to mandatory co-determination. In the United States, the independence requirement has existed for a long time. Since 1940, the Investment Company Act has required 40% of investment fund directors to be independent. By contrast, German boards today have a rather small ratio of independent directors. This is due in part to quasi-parity co-determination for large companies with over 2,000 employees in Germany. Although it is disputed whether employee representatives are independent, they are not treated as independent by international proxy advisors such as ISS. German academia is split; the better view is that employee representatives are not independent. ISS call for the board to be one-third independent in co-determined German companies. For quasi-parity co-determined companies, this means that two-thirds of shareholder representatives have to be independent.

In order to highlight the problems arising from the implementation of independence in co-determined boards, it is helpful to note that the independence requirement in the US Investment Companies Act is contrasted by the absence of independent directors on the boards of pension funds. Employee representation on boards of occupational pension institutions can be found at CalPERS in the US, as well as in the UK and Switzerland. For a long time, Switzerland required mandatory parity co-determination in the occupational pension sector. In the UK, employees must appoint one-third of the trustees, with the State

328. See Roth, Unabhängige Aufsichtsratsmitglieder, supra note 20, at 605.
330. See HEIDRICK & STRUGGLES, supra note 258.
331. See supra Part I.A.2.
332. GUIDELINES, supra note 315, at 12.
333. See Roth, Unabhängige Aufsichtsratsmitglieder, supra note 20, at 630–631.
334. See GUIDELINES, supra note 315, at 8 (discussing board independence).
335. Only some pension funds like CalPERS give information about their boards.
336. Bundesgesetzes über die berufliche Alters-, Hinterlassenen- und Invalidenversorgung (BVG), AS 797 (1983), art. 51, para. 1 (Switz.).
Secretary authorized by the Pensions Act of 2004 to raise the employee proportion to one-half.\textsuperscript{337} The California Government Code provides for co-determination for CalPERS; the chairperson and the vice-chairperson represent the interests of the beneficiaries.\textsuperscript{338} In Germany, however, there is no mandatory board participation by beneficiaries or occupational pensioners in support funds, retirement funds, pension funds, or direct insurance offered by insurance companies.\textsuperscript{339} Following the introduction of quasi-parity co-determination under the Co-Determination Act 1976 (Mitbestimmungsgesetz (MitbestG) 1976), the book reserves intended to cover pension obligations often exceeded the equity capital.\textsuperscript{340} With the increase of external funding of occupational pensions, mostly by Dax-30 companies, the employee representatives of the supervisory board can no longer be considered representatives of a “different form of capital.”\textsuperscript{341} Other European countries implemented up to one-third parity co-determination at the board level.\textsuperscript{342} Though it has co-determined boards in principle, the Netherlands has the highest ratio of independent board members in Europe.\textsuperscript{343} The Dutch Corporate Governance Code provides that all but one member of the supervisory board shall be independent.\textsuperscript{344} Company employees and union officials involved in collective bargaining are excluded from representing employees on the supervisory board, unlike in Germany.\textsuperscript{345} However, international holding companies

\textsuperscript{337} Pensions Act, 2004, c. 35, § 243(1) (Eng.).
\textsuperscript{338} CAL. GOV’T CODE § 20090 (West 2012). Currently, Rob Feckner serves as Board president, representative of the school members, and George Diehr serves as Board vice president, representative of the state members. Press Release, CalPERS, CalPERS Board Re-Elects Feckner as President; Diehr as Vice President (Jan. 14, 2003), available at http://www.calpers.ca.gov/index.jsp?bc=/about/press/pr-2013/jan/board-reelects.xml.
\textsuperscript{340} Ernst Steindorff, Einzelfragen zur Reichweite des Mitbestimmungsgesetzes, 1977 ZHR 457, 464 (Ger.).
\textsuperscript{341} See Kübler, supra note 8, at 108 (original source); see also ROTH, PRIVATE ALTERSVORSORGE 2009, supra note 123, at 209–10.
\textsuperscript{342} See Roth, Employee Participation, supra note 4, at 71–72 (2010).
\textsuperscript{343} See HEIDRICK & STRUGGLES, supra note 258, at 42, 45.
\textsuperscript{344} DUTCH CORPORATE GOVERNANCE CODE, art. III.2.1 (2008).
\textsuperscript{345} BURGERLIJK WETBOEK [BW] [DUTCH CIVIL CODE], art. 2:270 (Neth.).
are co-determination-free; companies may implement co-determination at the highest national level.\footnote{346}{See Heidrick & Struggles, supra note 258, at 42, 45 (explaining the high ratio of independent directors).}

The Australian approach\footnote{347}{Australian Council of Super Investors (ACSI), International Voting Alert Guidelines 15 (2010).} of not counting employee representatives is in line with national custom, and it appears to be more suitable than the ISS approach. There would be some pressure on Germany to call for more co-determination if the majority of shareholder representatives were independent, but none of the employee representatives fit the description. Becoming a European company may create some diversity on the employee side, but that is not a real option if all the employees are working in Germany. If representatives of the controlling shareholder are treated as independent, employee representatives must be treated as independent as well.

2. Establishing Two-Tier Boards or Co-Determination in the US?

Even if co-determination was supported by some US economists\footnote{348}{See Larry Fauver & Michael E. Fuerst, Does Good Corporate Governance Include Employee Representation? Evidence from German Corporate Boards, 82 J. Fin. Econ. 673 (2006) (discussing the criticalness of only quasi-parity co-determination); for a view critical towards quasi-parity co-determination, see Gary Gorton & Frank A. Schmid, Capital, Labor, and the Firm: A Study of German Codetermination, 2 J. Eur. Econ. Ass’n 863 (2004).} and viewed more favorably after the way the financial crisis was handled in Germany, the spread of co-determination in the US hardly seems realistic. This is true even when taking into account co-determination in state pension funds and looking at independent directors as a substitute for labor representatives on the board of CalPERS, for example. The introduction of a two-tiered structure might be a better bet, even if it does not seem feasible today or in the near future. Such structures might arguably exist in the NYSE.\footnote{349}{Andreas M. Fleckner, Stock Exchanges at the Crossroads, 74 Fordham L. Rev. 2541, 2614 (2006) (on reporting to the independent directors).} From a comparative perspective, the system in which all directors other than the CEO are independent resembles a two-tiered structure. Such a functional view is even more appealing if one takes into account the fact that management boards in German companies usually attend entire supervisory board meetings. Recomposing and transforming boards into
a two-tier system might be a practical option if US Corporate Governance standards of independence are raised and significant shareholders and founders are considered dependent. If it still happens that more than two-thirds of the board consists of independent directors, it would be a practical choice to separate executives and non-executives onto different boards. In Europe, choosing between one-tier and two-tier boards is now becoming the norm; following the Habersack Report, the German Jurists Forum is now recommending that same choice for German stock corporations.

III. BALANCING DIRECTOR PRIMACY AND SHAREHOLDER RIGHTS

A. STRENGTHENING THE ROLE OF SHAREHOLDERS

1. Shareholder Empowerment in the US

The Dodd-Frank Act introduced European standards of shareholder rights to the United States. Since then, it has been possible for shareholders to nominate directors and to call for the separation of the Chairman of the Board and CEO roles; these have been two basic features of German company law since the 1861 enactment of the Commercial Code (which was codified in 1884). According to its

350. Hopt, supra note 210, at 23.
351. Habersack, supra note 88, at 70–71, 103.
352. German Jurists Forum, Munich 2012, supra note 89, Business Law Section, Resolution 19 (adopted by vote of 53 in favor, 26 against, and 5 abstentions) (the legislator should allow all stock corporations, as is the case already for European Companies (SE), to choose between the two-tier and the one-tier board).
policy statement, CII campaigned for the central corporate governance components of the Dodd-Frank Act, which were, *inter alia*, introduced by Senator Schumer and Maria Cantwell as the “Shareholder Bill of Rights.” In its policy statement, CII explicitly referred to European standards, stating that “[i]n the United States, unlike most of Europe, the only way that shareholders can run their own candidates is by waging a full-blown election contest, printing and mailing their own proxy cards to shareholders. For most investors, this process would be onerous and prohibitively expensive.”

One noticeable omission within US company law is the absence of federal company law. It is disputed whether the competition between the states for corporate business produced a race to the top or a race to the bottom. Either way, Delaware, as the long-time champion of that competition, is not only responsive to business in its state policies—for example, granting corporations the opportunity to exculpate directors for breaches of the duty of care after *Smith v. Van Gorkom*—but also has well-equipped, professional, and specialized courts (e.g., the Court of Chancery) for company proceedings. The practice of excluding shareholders from management decisions was developed in the early 20th century and served as a blueprint for German legislation some 75 years ago, with German financial institutions providing the initiative.

In contrast, institutional investors in the United States campaigned in the opposite direction, namely to raise shareholder rights.

### 2. Stewardship Codes

The corporate governance responsibilities of institutional investors are currently being debated. As a result of the recent financial and


357. For a German view, see Alexander Hellgardt & Andreas Hoger, *Transatlantische Konvergenz der Aktionärrechte*, 2011 ZGR 38.

358. 488 A.2d 858 (Del. 1985).

359. For the German perspective, see JAN VON HEIN, DIE REZEPTION US-AMERIKANISCHEN GESELLSCHAFTSRECHTS IN DEUTSCHLAND 479–83 (2008).

360. *See infra* Part III.B.
economic crisis, institutional investors have been criticized for not exercising sufficient control over companies, though many European companies already have a corporate governance or voting policy. It was against this backdrop in November of 2009 that the British Institutional Shareholders Committee presented a Code on the responsibility of institutional investors. Dealing with the same issue, the Stewardship Code was passed a few months earlier in July of 2009 by the British Financial Reporting Council; the latter also revised the Combined Code and subsequently published it as the UK Corporate Governance Code. The increasing emphasis on the importance of shareholders in corporate governance, as well as their glaring failure before and during the financial crisis, suggests that it may obtain significant importance. The European Commission Green Paper also addresses the issue, and similar initiatives can be found in France and the Netherlands.

362. RISKMETRICS, STUDY ON MONITORING AND ENFORCEMENT PRACTICES IN CORPORATE GOVERNANCE IN THE MEMBER STATES 159 (2009). A majority of the companies that were questioned welcomed a duty to report on their Corporate Governance policy. Id. at 164.
365. See infra Part IV.
366. For a contrary view, see Holger Fleischer, Zukunftsfragen der Corporate Governance in Deutschland und Europa, 2011 ZGR 155, 164–65 (questioning the merits of having the Code function as a role model).
367. Green Paper, supra note 24, at 11 (stating that there is a lack of appropriate shareholder engagement), 13 (asset managers as active stewards of the investee companies).
368. LE CLUB DES JURISTES, COMMISSION RECOMMANDATIONS ET BONNES PRACTIQUES À L’ATTENTION DES ÉMETTEURS ET DES INVESTISSEURS INSTITUTIONNELS (2010).
369. EUMEDION CORPORATE GOVERNANCE FORUM, BEST PRACTICES FOR ENGAGED SHARE-OWNERSHIP INTENDED FOR EUMEDION PARTICIPANTS 1 (2011).
B. THE LEADERSHIP PRINCIPLE IN THE GERMAN STOCK CORPORATION ACT 1937

If one were to count reinsurance companies as private pension institutions, or examine the traditional close ties between Munich Re (previously Münchener Rück) and Allianz, then even in Germany, private pension institutions have played a significant role in promoting corporate governance. The Stock Corporation Act (Aktienrecht) of 1937, which laid the foundation for the still applicable organizational structure (Organisationsverfassung) of the German Stock Corporation, is based largely on the ideas of various figures in the financial industry such as Wilhelm Kißkalt, CEO of Münchener Rück at that time. In 1934, in a report by Kißkalt for the Commission on Stock Corporation Law published in the Journal of the Academy for German Law, Kißkalt anticipated the stock corporation’s organizational structure and forewarned of the board of directors’ duty to take into account the interests of employees as well as that of the common good (Allgemeinwohl). He further suggested keeping the supervisory board as small as possible, with seven supervisory board members. Johannes C.D. Zahn’s Wirtschaftsführertum und Vertragsethik im neuen Aktienrecht (Leadership and Ethics in the New Stock Corporation Law), which he wrote during his time as legal advisor for the association of private banks (Centralverband des deutschen Bank- und Bankgewerbes), also had an impact on the drafting of the Stock Corporations Act. During the drafting of the new Stock Corporation

372. For the discussion, see 1 Akademie für deutsches Recht, 1933–1945: Protokolle der Ausschüsse/Ausschub für Aktienrecht, Protocols (Werner Schubert ed., 1986).
376. See Kißkalt, supra note 373, at 20.
Act, Zahn became general manager of the association of private banks; he later became CEO of the Bank Trinkhaus, now known as HSBC Trinkhaus. 377 Finally, the financial industry’s influence on the current organizational structure of the German Stock Corporation was completed by the Minister of Trade and Industry at the time, Kurt Schmitt, whom Kißkalt had earlier appointed to the Allianz board. 378

Keeping with the tradition of stock corporation law reform that took place during the Weimar Republic, 379 the organizational structure of the reform was developed comparatively. 380 In his monograph to US law, which was well-founded at the time, Zahn referred to the status of the general meeting of shareholders. 381 It also seems reasonable to presume Kißkalt’s proximity to the United States, seeing that he joined the board after the ‘Catastrophe of San Francisco’ (Katastrophe von San Fransisco), a disastrous 1906 earthquake that caused a series of fires and destroyed much of the city. 382 This explanatory pattern with regard to the supervisory board—which is of particular interest here—does appear to be complex, particularly given that in the United States the construction of the supervisory board as a board of directors was sought to be halted in Germany. 383 The founding of the supervisory board through the Commercial Code (Allgemeines Deutsches Handelsgesetzbuch (ADHGB)) of 1861 384 marked a major legal

379. See, e.g., WALTER HALLSTEIN, DIE AKTIENRECHTE DER GEGENWART: GESETZE ÜND ENTWÜRFE IN RECHTSVERGLEICHENDER DARSTELLUNG (1931).
381. See ZAHN, supra note 375, at 95; see also Lamb v. Lehmann, 143 N.E. 276, 278 (Ohio 1924); Manson v. Curtis, 119 N.E. 559, 562 (N.Y. 1918).
382. See Biography of Wilhelm Kißkalt, in AKADEMIE FÜR DEUTSCHES RECHT, supra note 372, at LVI.
383. See Kißkalt, Bericht über die 2. Erweiterte Sitzung vom 9.2.1934, supra note 374, at 47; see also ZAHN, supra note 375, at 202 (though he does not mention the independence of the management board from the supervisory board).
384. See JAN LIEDER, DER AUFSICHTSRAT IM WANDEL DER ZEIT (2006) (providing a historical overview); MARCUS LUTTER, Der Aufsichtsrat im Wandel der Zeit - von
innovation, though at that point in time setting up the supervisory board was still optional.\textsuperscript{385} Until then, control of German Stock Corporations was still largely, but by no means exclusively, held by the board of directors.\textsuperscript{386} With the lapse of government supervision and the transition to the formation of stock corporations simply by fulfilling the legal requirements of the Commercial Code, the supervisory board became a compulsory company organ.\textsuperscript{387} The board of directors was maintained in corporate practice, as expressly authorized by the Commercial Code of 1884.\textsuperscript{388} Under Article 225 (3) of the Commercial Code of 1884, further tasks could be given to the supervisory board, since it was devised in practice as a de facto board of directors.\textsuperscript{389} In 1933, a later editor of a monograph on the Stock Corporation Act of 1937, Friedrich Klausing, resisted a reversal of the de facto board of directors into a supervisory organ in the true sense; he later published the Stock Corporation Act of 1937, including an official explanatory report, in which he commented elaborately on the leadership principle,\textsuperscript{390} though still with a fair degree of skepticism.\textsuperscript{391}
An important new aspect of the organizational structure included in the Stock Corporation Act of 1937 was the exclusion of the general meeting of management.392 This made it possible to portray the management as ‘Führer,’ thereby raising the level of approval of the stock corporation as a legal form in the Third Reich, which was necessary because of the danger of falling out of favor at the beginning of the that period.393 Kißkalt justified his proposal with the missing practical significance of the general meeting’s status, by saying that he did not know of any cases in which the general meeting encroached on the management of the company.394 At the decisive second meeting, Kißkalt explicitly called on “gentlemen of the younger generation” to come up with new ideas and thoughts.395 These included Cornelius Freiherr Heyl zu Herrnhausen, who demanded the abolition of the supervisory board; 396 Hans Würdinger, who proposed a distinction between management shareholders (Verwaltungsaktionäre) and bearer shareholders, with only the former having a voting right; 397 and Werner Bachmann, who wanted the management board to be appointed by the supervisory board only and then confirmed by a government agency.398 The last speaker at the meeting was Zahn, whose proposals regarding the disempowerment of the general meeting and more subordinately, the limiting of the supervisory board’s powers eventually found their way, to a large extent, into the Stock Corporation Act of 1937.399 It can be assumed that Zahn’s proposals represented the ideas of the banks, which in the 1920s and the 1930s held the majority of the supervisory board seats.400

392. Stock Corporation Act, Jan. 30, 1937, RGBl. I at 107, § 95 (5) 1 (Ger.).
393. Roth, Besondere Regeln für geschlossene und börsennotierte Gesellschaften, Überlegungen aus Anlass des 67. Deutschen Juristentags 2008, supra note 374, at 1261, 1268, 1274 (explaining the reduction in the number of stock corporations as a result of the introduction of the minimum capital regime).
394. See Kißkalt, Bericht über die 2. Erweiterte Sitzung vom 9.2.1934, supra note 374, at 47–48 (noting that none of the people present were aware of such cases).
395. See id. at 20.
396. See id. at 21–23.
397. See id. at 26–28.
398. See id. at 36–37.
399. See id. at 60–65; see also ZAHN, supra note 375.
C. PRINCIPLES SURROUNDING ENLIGHTENED DIRECTOR PRIMACY

1. Shareholders Directly Contacting Independent Directors

Stewardship Codes are associated with institutional shareholders seeking contact with independent directors.401 The relevant pension associations in the United States and Australia, where no such Codes exist, stress that institutional investors should have access to the independent board members.402 Though such contact is rarely discussed in Germany,403 it is also possible under German law.

2. Director Accountability and Adequate Compensation

Some of the principles that were strengthened in order to balance the introduction of director primacy in the German Stock Corporation Act of 1937 were director liability,404 adequate director compensation,405 and annual discharge of liability406 for all board members (management and supervisory boards). The latter does not lead to exemption from liability, but rather is a mandatory signal of trust at every annual general meeting. These principles are also relevant for long-termism, and

401. See UK STEWARDSHIP CODE, Guidance to Principle 4 (suggesting that institutional investors consider contacting independent directors when they have concerns); see also id., Guidance to Principle 3 (advising institutional investors to meet with the chairman and, where appropriate, with other board members, to ensure that independent directors provide adequate oversight).

402. See AUSTRALIAN COUNCIL OF SUPER INVESTORS (ACSI), A GUIDE FOR SUPERANNUATION TRUSTEES TO MONITOR LISTED AUSTRALIAN COMPANIES (ACSI GOVERNANCE GUIDELINES) § 18(c) (2011) (“The board should respond, where practicable, to communications from shareholders. In particular, shareholders should have access to non-executive directors.”).


404. See infra Part IV.B.3.

405. See infra Part IV.B.1.

406. See Roth, Information und Organisation des Aufsichtsrats, supra note 316, at 368–69.
therefore will hopefully contribute to the international discussion in a more sustainable manner than capital requirements.407

IV. LONG-TERMISM

A. LONG-TERMISM IN THE INTERNATIONAL DISCUSSION

1. Long-Termism in the European Commission Green Paper on Corporate Governance

The Green Paper on corporate governance discusses the inconsistency between the increasing importance of private pension institutions and the short-termism of capital markets generally.408 Although private pension institutions have long-term obligations to their beneficiaries and their participation in capital markets has risen (according to the European Commission), the investment horizons in the last 20 years have decreased; due to a turnover of 150% of market capitalization, the average investment period is set to be eight months.409 The Walker Review already identified this inconsistency.410 The European Commission is remarkably frank in inquiring about rules that counteract the long-term interests of institutional investors,411 and taking into account the relationship between private pension institutions and their asset managers.412 At present, there are no concrete measures in sight that would promote long-term investment by long-term-oriented investors.413 In

407. See Fleischer, supra note 366, at 155, 169 (hoping for a transformation in German law); see also MARCUS LUTTER, KAPITAL, SICHERUNG DER KAPITALAUFRINGUNG UND KAPITALERHALTUNG IN DEN AKTIEN- UND GMBH-RECHTEN DER EWG (1964); Marcus Lutter, Legal Capital in Europe, 1 ECFR, Special Volume (2006).
408. See Green Paper, supra note 24, at 3 (presenting this as the second and most detailed point of its “three subjects which are at the heart of good corporate governance”). The other two points deal with the board of directors and the duty to comply or explain. See id.
409. See id. at 12.
410. See WALKER REVIEW, supra note 361, at 26–27.
411. See Green Paper, supra note 24, at 12.
412. See id. at 12–13.
413. See Green Paper Long-Term Financing of the European Economy, at 15, COM (2013) 150 final (Mar. 25, 2013) (“Ideas have also been advanced to encourage greater
France, shareholders that have held their shares for longer than two years obtain a double vote. 414 The Reflection Group recommended that the articles of incorporation mandate that a higher dividend be given to shareholders committed to long-term investments. 415 This is to be understood as a reaction to the change in ownership structure and the dominance of portfolio investors. So far, long-term investors have only had an incentive to monitor the management of their shares if their holdings were large enough to intervene directly in the management of the company. 416 With dispersed ownership, by contrast, it is in the short-term interest of institutional investors and their ‘principals’ (the beneficiaries) to sell their holdings swiftly, 417 as the costs of control typically exceed the uncertain reward.

An additional dividend for shareholders committed to long-term investments appears to be possible in Germany under the prevailing law. It should be recognized that companies with dispersed ownership have an interest in long-term, stable structures, and in appropriate circumstances, a proportional encroachment on the rights of short-term shareholders may be acceptable. 418 Seen from the perspective of minority shareholder protection, it is questionable whether owner-managers, which are very important in Germany, 419 should be entitled to a special dividend, in addition to being given a control premium for share sales. 420 Alternative mechanisms to promote the control of management by institutional investors could be the establishment of long-term shareholder engagement . . . such as . . . granting increased voting rights or dividends to long-term shareholders.”).

414. Code De Commerce [C. COM] art. L225-123 (Fr.) (stating that a double voting right can be provided for in the articles of association or in an extraordinary general meeting).


417. For a principles-based account, see ALBERT O. HIRSCHMAN, EXIT, VOICE AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS AND STATES (1970).

418. On the requirements, see, for example, UWE HÜFFER, AKTIENGESETZ [AKTG]: KOMMENTAR § 53a, comment 10 (9th ed. 2010).

419. Some examples of family-owned companies in the DAX are Beiersdorf, BMW, and Metro.

special committees of long-term investors, for example, or the establishment of such committees on the supervisory board. In Deutschland AG, the bank representatives on the supervisory boards fulfilled a similar role.

European reforms will probably focus on investor and financial reporting rules for long-term investors and their relationships with asset managers. In Germany, the laws on investments and deposits for life insurance companies make it essentially impossible for them to invest in company shares. In light of rising government debt, the risk of investments in shares, including occupational pensions, will have to be reconsidered. Asset managers’ remuneration of private pension institutions should be done on a long-term basis.

The OECD installed a working group to focus on the issue of longer-term investments and published its first policy paper. Globally, it is a challenge for the pension fund industry to bring its contracts with asset managers in line with its long-term obligations via its clients. Ensuring that hedge funds do not bet against the rest of the portfolio of the pension fund, thereby causing perhaps even more long-term harms by achieving short-term gains, seems difficult, if not impossible to achieve.

2. Changing Pension Design?

Enhancing long-termism in occupational pensions is not an easy task, especially since it is difficult to implement long-term investing. Matching pension obligations with long-term debt ignores the

421. See Walker Review, supra note 361, at 26–27, 72–75 (considering the introduction of institutional shareholder committees).


423. See Roth, Private Altersvorsorge 2009, supra note 123, at 298–300.


insolvency risk of firms and states. It is necessary to develop and practice an overall investment strategy. Short investment horizons are not per se unsustainable, and an effort should be made to avoid imperfect portfolios with different asset managers in danger of betting against each other.

In an ideal occupational pension plan design, automatic enrollment should be strengthened. In the United Kingdom, automatic enrollment was introduced by the Pension Act of 2008, leading to higher pension contributions of both employers and employees; with some state aid the total came to about 8% of employee earnings. The concept of automatic enrollment was also endorsed by the German Jurists Forum in 2004 and in 2011 by the AbA, the German association on Occupation Pensions. In the United States, many studies reflect favorably on automatic enrollment by showing improvements in participation rates and contributions. A recent study also showed that large plans with automatic enrollment have significantly fewer costs than large plans without it, or small plans.

With the general trend of the elderly working longer, occupational pensions seem to be acceptable even without guaranteeing a specific pension age. Pension age is rising in Germany, making lifetime working accounts that can be transferred into pension rights at will more attractive. Such multi-channeling might also provide the opportunity for saving via occupational pensions with the option for earlier retirement. Occupational pensions should also be accessible before.

normal retirement age. Generally, the confidence in guarantees has deteriorated due to the financial crisis and the ongoing accumulation of state debts following it, leading to a state debt crisis.

B. GERMAN LONG-TERMISM COMPANY LAW PRINCIPLES

1. Adequate Management Compensation

Another politically relevant issue, management remuneration, has now taken on a longer-term focus worldwide. In the background of this issue is the multilevel principal/agent problem; the dualistic board structure in Germany makes this problem particularly pertinent. Asset managers are agents of the pensioners and supervisory directors are agents of the shareholders, and essentially the asset managers. Management board members are agents of the supervisory directors. The existing rules on management remuneration, and the liability they imposed, were already reformed in Germany before the end of the financial crisis. Under the provisions of the VorstAG, the remuneration of management board members of listed companies must be based on sustainable company development (§ 87 (1) German Stock Corporation Act).
Internationally, there was a clear market failure with respect to the calculation of executive salaries. As a solution to this, the United States endorsed the ‘say on pay’ model, based on the British one. As a result of a referendum in Switzerland, ‘say on pay’ will be integrated in the Swiss Constitution in the form of a mandatory vote at annual meetings. The US pension funds demanded a ‘say on pay’ for the United States at the time of enactment of recent financial market regulations. The remuneration practice of directors has been questioned by some within the United States for a while; however, the academic focus is currently on the remuneration practice of banks. Financial service provider Hermes, as another example, now provides an opinion on executive salaries in Germany due to the increasing internationalization of share investments by Anglo-American pension funds. However, there are two corporate law issues which are yet to be resolved: first, whether the directors should be remunerated as entrepreneurs or as company employees, and secondly, the extent to which board members should be compensated by means of pension

441. See Walker Review, supra note 361, at 27.
443. Bundesverfassung [BV] [Constitution] Mar. 3, 2013, art. 95, para. 3 (Switz.). The Swiss regulation is heavily discussed in Germany and may lead to further changes of the German Stock Corporation Act. The Adequate Management Remuneration Act in 2009, supra note 439, also introduced a say-on-pay regulation. Resolutions of the general meeting concerning the system on remuneration of managing directors are possible, but not binding. See Stock Corporation Act, Sept. 6, 1965, BGBL. I at 1089, § 120 (4), last amended by Restructuring Act, Dec. 9, 2010, BGBL. I at 1900 (Ger.).
448. Peter O. Mülbert, Shareholder Value aus rechtlicher Sicht, 1997 ZGR 129, 147 (favoring a shareholder value approach); see also Peter O. Mülbert, Marktwertmaximierung als Unternehmensziel der Aktiengesellschaft, in Festchrift für Volker Röhricht Zum 65. Geburtstag: Gesellschaftsrecht Rechnungslegung Sportrecht 421 (Georg Crezelius et al. eds., 2005).
claims (in which case the remuneration structure would be based on the sustainable growth of the company). 449

In listed companies, remuneration of management board members must be aligned with the long-term success of the company. 450 The German Stock Corporation Act refers to ‘sustainability,’ 451 a phrase developed in 18th century German forest sciences and today widely used for environmental matters. In this context, ‘sustainability’ means long-termism as well as the careful handling of natural resources. 452 Whether the compensation of German executives has to be taken into account, and what the environmental consequences of the business may be, has not yet been discussed. The time needed for sustainable compensation might also be subject to judicial review. The German Corporate Governance Code refers only to multi-year compensation elements. 453 Although the German Stock Corporation Act contains a similar provision, 454 this specification might be too short. Real long-termism in management compensation might go beyond the five-year period discussed today and may also deal with pension payments. 455

2. Annual Discharge of Managing and Supervisory Directors

Annual discharge has been part of German practice since the early 19th century, and has been mandatory since the incorporation of the leadership principle under the German Stock Corporation Act of 1937. 456 Since then, ‘discharge’ is no longer simply a discharge from liability, but a sign of confidence for managing and supervisory directors. The company may not waive liability claims in the first three

449. See GERMAN CORPORATE GOVERNANCE CODE § 4.2.2, § 4.2.3, § 4.2.5, model tbl. 1 (2013). The 2013 amendment focused on management remuneration and on pensions: levels and disclosures. To base variable compensation components on a multi-year assessment (per the terms of § 4.2.3 of the German Corporate Governance Code) will be insufficient to achieve sustainability.

450. Stock Corporation Act, § 87.

451. Id. § 87(1).


453. GERMAN CORPORATE GOVERNANCE CODE § 4.2.3 (2) 3.

454. Stock Corporation Act § 87 (1) 3.


456. Stock Corporation Act, § 70.
years after director wrongdoings. 457 In light of the financial crisis, the limitation period for director liability was extended to ten years for listed companies. 458 Loss of such confidence is cause for the supervisory board to remove management directors; international scholars therefore assume ad nutum that removal is possible for managing directors. 459

Discharge and votes of confidence should be considered standard-setters in corporate governance. Annual re-elections of directors, as advocated by institutional investors internationally, might prove to be counterproductive when implementing long-termism in company law. At least at first glance, it seems counterintuitive to expect a director to seek re-election every year if corporate governance is directed to promote the long-term success of the company. 460 Nevertheless, such assumptions should not lead to the insulation of managers from shareholders. 461 Annual discharge of directors might even be accompanied by mandatory annual votes at the general meeting on the remuneration system and the maximum remuneration for managing directors.

3. Deductibles in D&O Insurance

The introduction of director primacy in the German Stock Corporation Act of 1937 was balanced by tightening liability standards. 462 If the premiums for D&O insurance are paid by the

457. Id. § 93 (4) 3.
458. Theodor Baums, Managerhaftung und Verjährung, 174 ZHR 593 (2010) (Ger.).
459. Sofie Cools, Europe’s Ius Commune on Director Revocability, 8 ECFR 199 (2011).
462. See supra Part III.C.2. For material standards of review, see Roth, Outside Director Liability, supra note 35, at 346–50, 354–69; for procedural requirements see Stock Corporation Act, Sept. 6, 1965, BGBl. I at 1089, §§ 147–48, last amended by Restructuring Act, Dec. 9, 2010, BGBl. I at 1900 (Ger.). See also Habersack’s proposal in the Habersack Report that every shareholder should be allowed to sue managing and supervisory directors. HABERSACK, supra note 88, at 91–96 (2012). The proposal was
company, the German Stock Corporation Act now mandatorily provides a suitable deductible (though this idea was only a recommendation in the German Corporate Governance Code).\(^\text{463}\) The Adequate Management Remuneration Act amended the German Stock Corporation Act in 2009.\(^\text{464}\) Now if a company takes out a D&O insurance policy for the management board, a deductible of at least 10% of the loss, consisting of up to 1.5 times the fixed annual compensation of the management board member, must be agreed upon.\(^\text{465}\) The German Corporate Governance Code recommends that a similar deductible be agreed upon in any D&O policy for the supervisory board.\(^\text{466}\)

The financial crisis showed that some sectors’ appetite for risk was too great.\(^\text{467}\) Regardless, it would be questionable to delete liability exposure in practice.\(^\text{468}\) If generous standards of judicial review are not met, personal liability leading to out-of-pocket payments must be an option.\(^\text{469}\) Whether there should be a deductible, and what the scope of a suitable deductible would be, can be worked out by referencing the settlements in the Enron and the WorldCom cases.\(^\text{470}\) It may be necessary to distinguish between violations of directors’ duties based on the level of severity; directors’ personal assets could be used in this calculation.\(^\text{471}\) It is useful to look at what other countries have done in such a situation. In Japan, a cap for director liability is possible, but it has to amount to the earnings of six years for executives and two years

rejected by the German Jurists Forum. GERMAN JURISTS FORUM, MUNICH 2012, supra note 89, Business Law Section, Resolution 22.

463. Stock Corporation Act § 93(2)3.
464. Adequate Management Remuneration Act, July 31, 2009, BGBl. I at 2509 (Ger.).
465. GERMAN CORPORATE GOVERNANCE CODE § 3.8(2)(1).
466. Id. § 3.8(2)(2).
467. See WALKER REVIEW, supra note 361, at 52.
470. See id. at 1057 (explaining that to settle the WorldCom case, twelve outside directors personally paid $24.75 million, and in the Enron case, ten outside directors paid $13 million for securities litigation and $1.5 million for ERISA claims).
471. See Roth, Outside Director Liability, supra note 35, at 371.
for non-executives.\textsuperscript{472} For minor errors in judgment, the range used by Germany, a quarter up to one year’s earning, might be appropriate. For the transatlantic discussion concerning a suitable deductible, the amount of the Japanese cap should also be taken into account.

C. ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES (ESG), ESPECIALLY GREEN INVESTMENT

CalPERS has plans to integrate environmental, social and governance issues (ESG) into their investment process; it published its first report in the spring of 2012.\textsuperscript{473} Generally, the long-term investment projections of private pension institutions suggest their support of sustainable investment policies. Against this backdrop, it makes sense that insurance companies and pension funds have a strong interest in sustainable investments\textsuperscript{474} and that appropriate indices are being developed. It should be noted that the United Nations examined the duties of asset managers with respect to their investments in comparative perspective.\textsuperscript{475} As part of a campaign by the insurance industry in the United Kingdom, ‘Climate Wise’ already represented 60\% of property insurers and 50\% of life insurers in 2008;\textsuperscript{476} in 2009 more than half of these incorporated a climate change analysis in their investment strategies.\textsuperscript{477} Climate Wise is supplemented by the Carbon Disclosure Project,\textsuperscript{478} an initiative strongly supported by British Telecom (the majority owner of Hermes pension fund); by the terms of the project, companies should set a goal of how much they plan to reduce their CO\textsubscript{2} emissions.\textsuperscript{479} Before the climate conference in Copenhagen, institutional investors (who in total manage $13 trillion worth of assets) signed a declaration stating which industrial nations

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\item \textsuperscript{472} Brian R. Cheffins & Bernard S. Black, \textit{Outside Director Liability Across Countries}, 84 TEX. L. REV. 1385, 1460 (2006).
\item \textsuperscript{474} \textit{See supra} Part IV.A.
\item \textsuperscript{475} U.N. ENV’T PROGRAMME (UNEP), \textit{ASSET MGMT. WORKING GRP., FIDUCIARY RESPONSIBILITY: LEGAL AND PRACTICAL ASPECTS OF INTEGRATING ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTMENT} (2009).
\item \textsuperscript{476} CLIMATEWISE, ONE YEAR REVIEW 5 (2008) (U.K.).
\item \textsuperscript{477} CLIMATEWISE, SECOND YEAR REVIEW 31 (2009) (U.K.).
\item \textsuperscript{478} \textit{See also} Puri, \textit{supra} note 70, at 435.
\item \textsuperscript{479} CARBON DISCLOSURE PROJECT, \textit{THE CARBON CHASM} 20 app. (2009) (providing an overview of company-specific commitments).
\end{itemize}
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should reduce CO₂ emissions by 80–95% by the year 2050.\textsuperscript{480} CalPERS focuses on the disclosure of climate risks\textsuperscript{481} and, as mentioned above, is in the midst of including climate change into its investment principles; its spring 2012 publication included its first portfolio-wide report on ESG.\textsuperscript{482}

Even the SEC has begun to take the consequences of climate change seriously,\textsuperscript{483} giving in to great pressure from large institutional investors and the US insurance supervisory authority. At the beginning of 2009, the National Association of Insurance Commissioners (“NAIC”) decided to demand that insurance companies with a premium volume of more than $500 million report the environmental risks that could affect them.\textsuperscript{484} The questions to be answered by the insurance companies relate mainly to the impact of climate change on their investment portfolios.\textsuperscript{485} The NAIC has incorporated risk-focused examination questions into the Financial Condition Examiners Handbook, which addresses the impact of climate change.\textsuperscript{486} In Europe, the European Commission launched a proposal to include a statement on

\textsuperscript{480} \textit{Institutional Investors Grp. on Climate Change et al., 2009 Investor Statement on the Urgent Need for a Global Agreement on Climate Change} (2009).

\textsuperscript{481} \textit{CalPERS, Global Principles}, supra note 223, at 63 app. G, 65 app. H.

\textsuperscript{482} \textit{CalPERS, Facts at a Glance: Corporate Governance} 8 (2012).


\textsuperscript{485} NAIC, \textit{Insurer Climate Risk Disclosure Survey} (Mar. 28, 2010), \url{http://www.naic.org/documents/committees_explen_climate_survey_032810.pdf} (“Question 5: Has the company considered the impact of climate change on its investment portfolio? Has it altered its investment strategy in response to these considerations? If so, please summarize steps you have taken.”).

\textsuperscript{486} \textit{See Climate Change and Risk Disclosure, Nat’l Ass’n of Ins. Comm’rs} (Jan, 1, 13), \url{http://www.naic.org/cipr_topics/topic_climate_risk_disclosure.htm}.

For current activities and controversies, see \textit{Anne Obersteadt, NAIC & Ctr. for Ins. Policy and Research, Climate Risk Disclosure Activities} (2012), \textit{available at} \url{http://www.naic.org/documents/cipr_1204_climate_risk_disclosure_activities.pdf}. 
environmental, social and employee matters in the annual report of larger firms.  

CONCLUSION AND OUTLOOK

Labor and pensions in the United States and Germany have significant differences. While German labor and pension law is based on bans of unfair dismissals in labor contracts, employee representation on supervisory boards, and public pensions, the United States provides no such employee rights, yet occupational pension assets equal the US GDP or the pension assets of the other OECD member states. Among the institutional investors who together own half of all equity of US-listed firms, pension funds, particularly state pension funds, are most active in setting corporate governance standards and imposing those standards directly and via proxy advisors. Some of the core principles already implemented involve independent directors, the balancing of director primacy with shareholder rights, long-termism (meaning the creation of long-term shareholder value), and consideration of ESG (especially green investments).

A transatlantic view is constructive for the evaluation of these core corporate governance principles, which are central for pension capitalism. The European Union and the United States apply different standards with respect to significant or majority shareholders. While the EU recommendation—as proposed by the Corporate Governance Commission, and perhaps in the near future by the German Corporate Governance Code as well—provides that significant shareholders are excluded from qualifying as independent directors, such relationships are not mentioned in the United States. This may be relevant since many US technology firms have founder-directors that are significant shareholders.

The inclusion of US corporate law principles in the German Stock Corporation Act of 1937 needs to be mentioned with respect to the balancing of shareholder rights with director primacy. Germany has maintained and tightened central shareholder rights, such as the right to nominate supervisory directors; it also introduced new ones, such as the annual discharge of supervisory and managing directors. Moreover,

director compensation was mandatorily restricted to adequacy, and director liability was sharpened (it played no *de facto* role until the 1990s when US standards were discussed again). Such principles are also relevant for long-termism, and should be sharpened and raised to the top of the institutional investors’ agenda. Pioneering pension funds, such as CalPERS and the UK Hermes Pension Fund, as well as pension fund associations, such as the US CII and the Australian ACSI, should focus on long-term shareholder value and other social issues.