Fordham Law Review

Volume 38 | Issue 4 Article 3

1970

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SHAREHOLDER RIGHTS UNDER THE GERMAN STOCK CORPORATION LAW OF 1965

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I. INTRODUCTION

ON January 1, 1966, a new Stock Corporation Law[1] (*Aktiengesetz*) became effective in West Germany. The reform movement culminating in the adoption of this statute demonstrated the existence of problems in German corporate law similar to those confronting American law.

Undoubtedly, the corporation has become one of the most powerful forces in twentieth century economics.[2] It is "both a method of property tenure and a means of organizing economic life."[3] The corporation's separation of ownership into its component parts, control and beneficial ownership,[4] has brought into sharp focus the fundamental divergence

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1. Law of Sept. 6, 1965, [1965] BGBl. I 1089, Aktiengesetz (C.H. Beck 1965) [hereinafter cited as AktG]. The Aktiengesetz has been published in a bilingual edition. See Aktiengesetz 1965: The German Stock Corporation Law (R. Mueller & E. Galbraith transl. 1966). The Stock Corporation Law pertains only to the Aktiengesellschaft (AG), a form of business association based on freely transferrable shares. The other widely used form of business association in Germany is the Gesellschaft mit beschränkter Haftung (GmbH). This "limited liability company" is also based on share ownership but the shares are not freely transferrable. See Vagts, Reforming the "Modern" Corporation: Perspectives from the German, 80 Harv. L. Rev. 23, 33-34 (1966). See also Haskell, The American Close Corporation and Its West German Counterpart: A Comparative Study, 21 Ala. L. Rev. 287 (1969). The GmbH, which bears close analogy to the American close corporation, is the subject of separate statutory regulation. Law of April 20, 1892, [1892] RGBl. I 447. A movement to reform the law governing limited liability companies has commenced. See, e.g., A. Hueck, Gedanken zur Reform des Aktienrechts und des GmbH-Rechts (1963); Goerdeler, Zur Reform des Aktienrechts und des GmbH-Rechts, 1963 Juristische Rundschau 179.

2. In the United States, corporations have steadily increased in wealth and number. While the increase in number is due mostly to the formation of closely-held corporations, the increase in corporate wealth can be ascribed to the tremendous concentrations of property in a small number of public corporations. This phenomenon can also be observed in Germany where the number of Aktiengesellschaften has steadily decreased from a level of approximately 17,000 in 1926 to only 2,332 in 1960, with the same trend continuing since that time. Simultaneously, the number of limited liability companies has steadily increased, reaching 35,430 in 1960. This does not indicate, however, any diminishing role of the stock corporation in the German economy. Although its number has shrunk, the capital owned and controlled by stock corporations has increased from a total of about 19 billion marks in 1926 to over 30.4 billion marks in 1960. Between 1926 and 1961 the average capital per corporation has increased from 1.1 million marks to 14.5 million marks. In both countries, therefore, the economic impact of the corporate form of business organization has increased in importance not merely because the total wealth controlled by it has increased, but also because this wealth is concentrated in fewer hands. See A. Hueck, supra note 1, at 3-8.

3. A. Berle & G. Means, The Modern Corporation and Private Property 3 (rev. ed. 1968).

4. Id. at 5-8.

between shareholder and management interests. To protect each from being overpowered by the other, limitations have had to be developed. In the past, such limitations were based on the characterization of corporations as artificial persons "who did not have . . . souls or conscience," "had no morals,"[5] and, therefore, were to be feared. The contemporary problem is more delicate. To attract necessary capital, investors' interests must be protected. In the small shareholder's case these interests include his desire to receive dividends and to have some power of decision over the corporation's activities. These interests necessarily conflict with those of management, which encompass retaining a sufficient part of annual profits for expansion, investment and other business purposes. Moreover, management does not not welcome shareholder participation in the management function.

The development of American corporate law illustrates a balancing of these conflicting interests to achieve a result harmonious with a public policy of maximum protection for each without detriment to the economy. No final solution, pleasing to all, has been reached. Perhaps, it is unattainable. Yet, this evolution of respective spheres of action for management and shareholders has been more satisfactory than the attempts to find solutions to similar problems in the civil law system. It is the relatively unsatisfactory treatment of shareholders, especially minority shareholders, in German law which forms the subject of this inquiry.

A. *The Legal Nature of the Shareholder's Interest in the Corporation*

A corporation is a juristic person. It has a legal personality independent of the persons who have created it. This separate legal personality enables the corporation to perform the acts necessary to conduct business by granting to it the legal capacity to assert its rights and allowing it to incur legal liabilities. The personality not only shields the shareholder from individual liability for corporate acts, but it also effectively separates the shareholder-investor from his investment. He neither has direct ownership rights in the capital which he has invested in the corporation, nor ownership of an interest proportionate to his investment in any corporate property. These general statements apply equally to German law.[6]

American law views the shareholder's relationship to the corporation as contractual.[7] The substantive content of the contract is found in the cor-

5. A. Berle, Economic Power and the Free Society 6 (1957). Such early restrictions were: limitations on the amount of property which could be owned, incorporation for a specific number of years only, enforcement of the ultra vires doctrine, and appointment of court "auditors" to inspect corporation operations. Id. at 5.

6. H. Würdinger, Aktien- und Konzernrecht 4-9 (2d ed. 1966).

7. Crocker v. Waltham Watch Co., 315 Mass. 397, 53 N.E.2d 230 (1944).

poration's articles of incorporation, bylaws, resolutions, and stock certificates, as well as in applicable statutory provisions.[8] Title to all corporate property vests in the corporation rather than in the shareholder,[9] who merely has a contractual right to receive his proportionate share of corporate property when it is distributed.[10] Although the terminology differs somewhat, the shareholder of a German corporation has essentially the same limited interest. The corporation (*Aktiengesellschaft*) as a juristic person with an independent legal personality, "owns" corporate property. The shareholders have an interest in corporate property based on their capital contribution, but this interest is limited to the right of proportionate participation in distributions. The fact that, from an economic viewpoint, shareholders collectively are regarded as the corporation's "owners" does not alter the conclusion that the individual shareholder's rights are not equivalent to "ownership" rights, *i.e.*, rights to control and protect the property as well as to assert damage claims.[11]

The absence of shareholder "ownership" rights, however, does not absolve management from the responsibility inherent in handling another's property. In American law, the imposition of fiduciary duties on the corporation seeks to prevent an abuse of the powers given to management. German law, lacking the development of a separate system of equity, attempts to protect shareholder interests through statutory provisions. To a large extent, these provisions are remedial rather than preventive. Since resort to legal process entails procedural and financial burdens, the remedy may turn out to be more burdensome than the injury.

B. *The Reform Movement in Germany*

That "[t]he history of the stock corporation law is the history of its reforms . . . ."[12] is indeed an apt description of the process of revision which, for over a century, has sought to find that elusive balance among the conflicting interests of corporation, management and shareholders in Germany. The penultimate reform movement, reacting against excessive power allocations to management, culminated in the enactment of the 1937 corporate statute.[13] The major objective then was to terminate the

8. Palmer v. Chamberlin, 191 F.2d 532 (5th Cir. 1951); Western Foundry Co. v. Wicker, 403 Ill. 260, 85 N.E.2d 722 (1949); United States Radiator Corp. v. State, 208 N.Y. 144, 101 N.E. 783 (1913); Schaad v. Hotel Easton Co., 369 Pa. 486, 87 A.2d 227 (1952).

9. See Angle v. Chicago, St. P., M. & O. Ry., 151 U.S. 1 (1894).

10. Eisner v. Macomber, 252 U.S. 189, 208 (1920).

11. See E. Mestmäcker, Verwaltung, Konzerngewalt und Rechte der Aktionäre 7-20 (1958); 1 B. Schröder, Deutscher Rechtsspiegel 680, 690-91 (3d ed. 1964); H. Würdinger, supra note 6, at 5, 44-46.

12. Duden, Die Aktienrechtsreform, 3 Juristen-Jahrbuch 69 (1962).

13. Law of Jan. 30, 1937, [1937] RGBl. I 107 [hereinafter cited as AktG (1937)].

abuse of voting rights by management and majority shareholders. The statutorily unrestricted right of corporations to issue shares carrying more than one vote each (*Mehrstimmrechtsaktien*)[14] had been widely used to give corporate control to shareholders having only a relatively small financial investment in the corporation. Single shares that carried as many as one thousand votes were not uncommon in the 1920's.[15] In addition, so-called "management shares" (*Verwaltungsaktien*), *i.e.*, shares owned by the corporation, were voted by management.[16] Although the 1937 statute restricted these practices,[17] it did not strengthen shareholder interests in other areas. In fact, management control over dividend policy was strengthened to the point of excluding shareholders completely.[18] The formulation of business policy, nominally the responsibility of the board of managers, could be given to its chairman who could, if the articles of incorporation did not provide otherwise, cast the deciding vote on all matters regardless of the other board members' contrary votes. This so-called *Führer-prinzip* was a strong emotional factor in the recent reform movement.

Dissatisfaction with the existing scope of shareholder rights and remedies grew during the late 1950's when it became evident that corporate expansion would have to find new sources of capital. To a large extent, the post-war "economic miracle" in Germany was financed by heavy corporate borrowing, an expensive source of capital. In addition, as the Common Market's early success opened new possibilities for corporate expansion, the need to divert the small investor's funds from their traditional destination, savings accounts and bonds, became ever greater. The "popularization" of stock ownership, therefore, became one of the slogans which the advocates of corporation law reform emphasized.

In 1958, the German Ministry of Justice released for public comment the first draft of a new stock corporation law.[19] Later, in 1962, the Ministry submitted an official draft to the German legislature.[20] The reformers' intent to popularize share ownership was expressed in their attempt to furnish greater protection to shareholder interests by achieving a closer harmony between the provisions of the stock corporation law and the

14. See text accompanying note 208 infra.

15. See A. Hueck, Gesellschaftsrecht 109-10 (14th ed. 1968).

16. Id. at 110.

17. See text accompanying notes 208-14 infra.

18. See text accompanying note 115 infra.

19. See Beiträge zur Aktienrechtsreform (R. Hengeler ed. 1959).

20. Entwurf eines Aktiengesetzes, Deutscher Bundestag, 4. Wahlperiode, Drucksache IV/171, Feb. 3, 1962 [hereinafter cited as AktG Draft]. This draft, originally submitted to the legislature in 1960, had to be reintroduced because no final action had been taken by the end of the previous legislative session.

basic principles of the German economic system. As the reformers stated in the draft:

> Our legal and economic order is based on the recognition and protection of private property and the free disposition of private property....
> A corporation law which is in accord with these basic principles of our economic order, must, therefore, be based on the recognition of the shareholders' economic ownership of the enterprise resting on their capital investment, and may only limit the shareholders' right of participation and control to such an extent as is necessary to assure the corporation's ability to function and the realization of the purpose of the union for which the shareholders voluntarily joined together, as well as to assure the safeguarding of superior economic and socio-political goals.[21]

It should be noted that this language refers to the protection of shareholders' rights rather than to shareholder rights themselves. This distinction, reflected concretely in the draft's substantive provisions, as well as in the newly enacted statute, makes characterization of the reform law as a Magna Carta for stockholders[22] a rather undiscerning conclusion. The reform law is primarily concerned with the strengthening of *collective*, rather than individual, shareholder rights.[23]

This article's purpose is to analyze the new statute's provisions with respect to those rights which are of direct concern to most shareholders. To make such an analysis understandable, a short description of the structure of and power allocation in the German stock corporation is essential.[24]

II. Management Structure

Under the *Aktiengesetz*, power to manage the corporation is divided among three institutions: the board of managers (*Vorstand*), the board of supervisors (*Aufsichtsrat*), and the shareholders' meeting (*Hauptversammlung*).

A. *The Board of Managers*

The effective power to formulate corporate policy and to conduct corporate business is vested in the board of managers,[25] an institutionalized counterpart to the officers of the American corporation. The German board, however, has far greater authority than its American counterpart.

21. Id. at 92-93 (author's translation).
22. Time, June 4, 1965, at 82.
23. R. Wiethölter, Interessen und Organisation der Aktiengesellschaft im amerikanischen und deutschen Recht 81 (1961); Gierke, Der Referentenentwurf eines deutschen Aktiengesetzes, 122 Zeitschrift für das gesamte Handelsrecht and Konkursrecht 7 (1959).
24. A more detailed description can be found in Steefel & von Falkenhausen, The New German Stock Corporation Law, 52 Cornell L.Q. 518 (1967). See also Vagts, supra note 1.
25. AktG § 76(1).

1. Appointment, Dismissal and Compensation

The managers are appointed by the board of supervisors for a maximum term of five years, after which they may be reappointed.[26] It is permissible to have only one manager for the corporation instead of a whole board.[27] If a board is appointed, a chairman may be selected from among its members by the board of supervisors. He cannot, however, be elected by the managers themselves.[28] Under the 1937 statute, the so-called *Führer-prinzip* allowed the chairman to cast the deciding vote on all board matters. The new provision,[29] however, provides for board decisions by majority vote.

Managers may be dismissed by the board of supervisors for "important reasons," among which the statute expressly includes serious violations of duty, and incompetence.[30] What other "important reasons" may be is a factual issue determined under the circumstances of each case. No provisions may be made either in the articles of incorporation or in employment contracts to the effect that dismissal shall only occur for specified reasons.[31] Prior case law indicated that where the shareholders' meeting had adopted a resolution expressing lack of confidence in a manager, the board of supervisors *might* regard such resolution as sufficient reason to dismiss him, provided the "no confidence" vote was legally valid. A mere arbitrary vote, one instigated for the sole purpose of securing a manager's dismissal, or one contrary to "good morals," therefore, did not constitute an "important reason" for dismissal by the board of supervisors.[32] For example, where a majority shareholder used his voting power to withdraw confidence from a manager who opposed some transaction or practice desired by that shareholder, dismissal by the board of supervisors was not permissible merely on the basis of the "lack of confidence" resolution.[33] The new statute incorporates prior case law by classifying a lack of confidence vote as an important reason for dismissal, unless the vote is arbitrary.[34]

Compensation for managers may be in the form of a salary, a stated percentage of net profits,[35] or both (as is the usual case). The total compensation received by managers, including all fringe benefits, such as

26. AktG § 84(1).
27. AktG § 76(2).
28. AktG § 84(2).
29. AktG § 77(1).
30. AktG § 84(3).
31. Judgment of Jan. 28, 1953, 8 BGHZ 348, 360-61.
32. Judgment of April 28, 1954, 13 BGHZ 188.
33. See H. Würdinger, supra note 6, at 116.
34. AktG § 84(3).
35. AktG § 86(1).

pension rights and insurance benefits, must be reasonably related to both the tasks performed and the corporation's general financial condition. Enforcement of this limitation rests with the board of supervisors which can, if adverse business conditions cause a substantial decline in the corporation's financial condition, reduce such compensation by an appropriate amount.[36] However, this power applies only to compensation rights of presently employed managers. A reduction of retired managers' pension rights, therefore, is not within the scope of this statutory provision (such reductions may be permitted under Civil Code provisions[37] if pension payments constitute a burden jeopardizing the corporation's financial status *and* are so excessively high compared to general economic conditions in society as to be "unconscionable").[38] Except for the fact that the manager is entitled to submit his resignation, effective at the close of the next calendar quarter, regardless of the period of employment remaining under his contract,[39] no other terms of the employment contract are affected by a reduction in compensation. Since the German bankruptcy statute permits employees to recover damages for the full contractual employment period[40] where their employer goes through bankruptcy proceedings, a manager *could* be entitled to as much as five years damages for loss of compensation. However, this recovery is regarded as excessive in the case of managers, and the stock corporation law consequently limits such recovery to a maximum period of two years.[41]

Any natural person, except a member of the board of supervisors of that corporation,[42] may be a manager. Under the new law it is no longer permissible to have a member of the board of managers of the parent

36. AktG § 87(1)-(2).

37. Bürgerliches Gesetzbuch [BGB] §§ 157, 242 (C.H. Beck 1964).

38. Judgment of April 30, 1935, 148 RGZ 81. The employer is considered to be under a duty to maintain pension payments, once commenced, even when no contractual obligation exists or when he has expressly reserved the right to stop such payments at will. See 1 Soergel, Bürgerliches Gesetzbuch § 242, Anm. E(3)(b)(11) (8th ed. 1952). If the retired employee has a contractual right to pension payments, its reduction because of the employer's economic difficulties depends upon the application of contract principles of frustration. The general principle of "Wegfall der Geschäftsgrundlage" (disappearance of the foundation of the contract) is to the effect that the courts may change the contractual obligation where the factual circumstances surrounding the transaction have changed to such an extent that enforcement of the originally promised performance would violate principles of "good faith." For an analysis of the doctrine and its historical development, see Hay, Frustration and its Solution in German Law, 10 Am. J. Comp. L. 345, 356-66 (1961). See also K. Larenz, Geschäftsgrundlage und Vertragserfüllung (3d ed. 1963).

39. AktG § 87(2).

40. Konkursordnung § 22, Law of Feb. 10, 1877, [1877] RGBl. I 355.

41. AktG § 87(3).

42. AktG § 105(1).

corporation appointed to the board of supervisors of its subsidiary, while having a manager of that subsidiary appointed to the parent corporation's board of supervisors. This very common practice was one of the most controversial points in the discussions pertaining to German corporate law reform. Despite strong pressures from industry, the view regarding this practice as violating conflict of interest principles prevailed.[43]

2. The Standard of Conduct

Since the board of managers is solely responsible for the corporation's conduct and activities, the board must operate the corporation with not only the corporation's best interest in mind, but also with that of its shareholders and employees.[44] In carrying out its duties, the board is held to the standard of conduct of the "ordinary and prudent" businessman. Failure to adhere to this standard results in liability to the corporation for damages caused to it.[45] Such liability may be joint or several. Consequently, while the particular manager who acted irresponsibly may be initially liable for all damages, other board members may incur liability if their failure to notice the transaction or to intervene effectively is a violation of their corporate duty.[46] In a proceeding to recover damages for wrongful acts, the managers bear the burden of proving adherence to the requisite standard of conduct.[47] The statute lists specific actions which are regarded as per se violations of this standard. For example, managers are liable for corporate damages when they, contrary to the stock company law's provisions: give rebates to shareholders on the purchase price of shares, pay illegal dividends, distribute corporate property without formally declaring a dividend, pay debts and obligations (other than current operating expenses) after the corporation becomes insolvent, grant prohibited credits or issue bearer shares prior to receiving full payment therefor.[48]

While the corporation cannot assert the managers' duty to compensate it for damages where the transaction is based on a legally valid shareholders' resolution, it can do so if the transaction is based on a board of supervisors' resolution.

Corporate creditors who are unable to obtain satisfaction from the corporation may, to the extent of their unsatisfied claims, enforce the managers' obligation to the corporation for breach of duty. In such a creditor proceeding neither a shareholders' nor a board of supervisors'

43. AktG § 100(2).
44. AktG § 76(1).
45. AktG § 93(1)-(2).
46. Judgment of Feb. 3, 1920, 98 RGZ 98.
47. AktG § 93(2).
48. AktG § 93(3).

resolution authorizing the transaction will shield the managers from liability.[49] Moreover, unless the transaction for which damages are sought is one of the specific violations listed in the statute, the creditor must establish a prima facie case of "gross violation" of the managers' standdard of conduct. In any event, the burden of proving adherence to the standard remains on the managers.

3. Functions

The board of managers carries out two separate statutory functions in operating the corporation. Specifically, a distinction is made between operation of the business (*Geschäftsführung*) and representation of the corporation (*Vertretungsbefugnis*).

Subject to the liability for damages already discussed, managers have exclusive responsibility for the operation of the business. They are neither bound by instructions from the shareholders' meeting, unless advice was specifically requested,[50] nor can they delegate to the supervisors any tasks which they are supposed to perform.[51] However, sole responsibility for the conduct of corporate business does not indicate an absence of any restraint. This restraint is imposed in several ways. Specifically, the managers' actions must conform to statutory provisions designed to assure the maintenance of corporate assets. In addition, by statute, certain transactions require express shareholder approval.[52] The board is also bound by limitations imposed on it in the articles of incorporation. Of these, the principal limitation is the corporation's stated purpose, which denies internal validity to acts outside the scope of that purpose. The articles of incorporation may also require the supervisors' approval for specific types of transactions.[53]

The power to represent the corporation involves the legal validity of the managers' acts regarding third persons. While the board is again under obligation to the corporation not to exceed the limitations imposed upon it by the articles of incorporation or the board of supervisors, any transaction exceeding such intra-corporate limitation binds the corporation and results in a legal obligation to the third person.[54] This obligation exists even where the transaction is in violation of the purpose clause of the

49. AktG § 93(4)-(5).
50. AktG § 119(2).
51. AktG § 111(4).
52. These include giving creditors promissory notes entitling them to issuance of shares (Wandelschuldverschreibungen) or tying debt payments to the declaration of shareholder dividends (Gewinnschuldverschreibungen), AktG § 221; profit-sharing agreements, AktG § 293; corporate mergers, AktG § 340; see AktG § 119(1).
53. AktG § 111(4).
54. AktG § 82(1)-(2).

articles of incorporation[55] or where the third person dealing with the board had actual notice of the limitation being transgressed.[56] Depending upon the factual circumstances, however, a third person having such actual notice may be left with an unenforceable claim if its enforcement through judicial process would be contrary to good morals.[57] Contrasted with the binding effect of these transactions are managerial transactions which violate *statutory* restrictions. Such statutory violations will not result in corporate liability toward third persons.[58] Thus, action by the managers alone in those areas which, under the stock corporation law, require express shareholder approval do not bind the corporation.

B. The Board of Supervisors

The board of supervisors must consist of at least three members. Additional members, up to a maximum number of twenty-one, can be provided for in the charter depending upon the amount of the corporation's capital. The total number of members must be divisible by three,[59] however, since one-third of the board of supervisors must be elected by the labor force.[60] The first of these labor representatives must be a worker employed by that enterprise. If two are to be elected, the second one must be a white collar employee. If more than two are to be elected, union officials may be elected after the requirements regarding the first two are met. If the majority of the company's employees are women, at least one woman must be elected.[61] Members comprising the other two-thirds of the board of supervisors are elected by the shareholders.[62] The supervisors' term of

55. Judgment of Nov. 19, 1926, 115 RGZ 246, 249.

56. A. Hueck, supra note 15, at 138.

57. BGB § 826 (C.H. Beck 1964). Judgment of Nov. 5, 1934, 145 RGZ 311, 314, denied relief to a plaintiff who had actual notice that the transaction he had entered into exceeded the purposes stated in the corporation's articles of incorporation.

58. See H. Würdinger, supra note 6, at 118-23.

59. AktG § 95.

60. Betriebsverfassungsgesetz, Law of Oct. 11, 1952, [1952] BGBl. I 681 [hereinafter cited as BVG]. This law does not apply to family corporations having less than five hundred employees. For a short descriptive summary of the scope of this law, see E. Steefel, German Commercial Law 103-06 (1963). Special provisions are applicable to corporations in mining, iron and steel industries. Their board of supervisors must consist of eleven members. Five are elected by the shareholders, five by the trade unions, and the last by a majority of the other ten (but such majority must consist of at least three votes from each group). Gesetz über die Mitbestimmung der Arbeitnehmer in den Aufsichtsräten und Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie, Law of May 21, 1951, [1951] BGBl. I 347. See also W. Goertsches, Die Vertetung der Arbeitnehmer im Aufsichtsrat von Aktiengesellschaften innerhalb von Konzernen nach dem Betriebsverfassungsgesetz (1962).

61. BVG § 76.

62. AktG § 101(1).

office is limited by statute to a maximum of four years,[63] but can be reduced to any shorter period by the shareholders or by provision in the articles of incorporation.[64] Labor representatives must be elected for the same term as the other members of the board.[65]

Any natural person may become a member of the board of supervisors, provided he is not a member of the board of managers or an executive officer of the corporation.[66] No supervisor may be a member of more than ten boards of supervisors.[67]

Supervisors may be dismissed without cause before the expiration of their term of office by a vote of seventy-five percent of the shares voted at the meeting. The necessary vote may be reduced to a simple majority by the articles of incorporation, but cannot be increased.[68] Labor representatives can also be recalled without cause by a vote of seventy-five percent of the employees eligible to vote.[69]

The full board of supervisors must meet at least once every six months.[70] From among its membership it must appoint a chairman and at least one deputy.[71]

The board's main function is to supervise the board of managers. For this purpose, the board or any member may, at any time, request from the board of managers written reports about corporate matters. The board of supervisors has the right to inspect fully all corporate books, records and inventories.[72] It has the statutory duty to call a shareholders' meeting whenever the corporation's welfare requires it.[73] While none of the managerial functions may be transferred to the board of supervisors, the board or the articles of incorporation may provide that specific types of transactions require its approval.[74] This power may not be used, how-

63. AktG § 102(1).

64. R. Godin & H. Wilhelmi, Aktiengesetz, Kommentar § 87, Anm. 3 (2d ed. 1950).

65. BVG § 76(2).

66. AktG §§ 100(1), 105(1). However, a board of supervisors member may temporarily take the post of a manager who has been incapacitated. During such a period, the duration of which must be specifically limited in advance and which may not exceed one year, he cannot participate in the board of supervisors' work. AktG § 105(2).

67. AktG § 100(2)1.

68. Aktg § 103(1).

69. BVG § 76(5).

70. AktG § 110(3).

71. AktG § 107(1).

72. AktG § 111(1)-(2).

73. AktG § 111(3).

74. AktG § 111(4). If the board of supervisors refuses to consent to one of these specified transactions, the board of managers may call a shareholders' meeting which, with an affirmative vote of at least seventy-five percent of the shares actually voted, can override the supervisors' decision. Id.

ever, to such an extent as to circumvent the board of managers' statutory power to run the corporation's business operations.

The board of supervisors has also been assigned specific statutory duties. It not only represents the corporation in transactions and legal suits between the corporation and the board of managers,[75] but it also handles the appointment and dismissal of members of the board of managers.[76] In the performance of their duties, for which a compensation reasonably related to the tasks performed may be paid,[77] the supervisors must adhere to the standard of conduct and judgment of a prudent businessman. The supervisors have the burden of proving observance of this standard, and are jointly liable for damages resulting to the corporation by its violation.[78]

C. *The Shareholders' Meeting*

Contrasted with the annual shareholders' meeting of the American corporation, which to a large extent has assumed the characteristics of a social get-together[79] at which management paints a rosy picture and delivers panegyrics to itself and the stockholders, the shareholders' meeting of the German corporation is an *institution* which has statutory powers and restrictions. This institutional character does not, however, result in more extensive shareholder control over management than in the United States. As a matter of fact, under the extensive corporate law reform of 1937, the shareholders' meeting lost some of the power it had previously exercised. Early analysis of the nature of corporations had emphasized their financial aspects, *i.e.*, its accumulation of capital from private investors who expected remuneration, could (within legal limits) do with their property as they wished[80] and should, therefore, have a voice in the use to which their property was put. This view became the basis for the shareholders' meeting's status as the supreme corporate organ. Its decisions on all corporate matters, except those which had been assigned by statute to the exclusive jurisdiction of one of the other two organs, were final and unassailable if legally valid. The board of managers was truly that—it

75. AktG § 112.

76. AktG § 84(1).

77. AktG § 113(1).

78. AktG §§ 93, 116.

79. A. Berle, supra note 5, at 7 stated that: "In the early days, when corporations were still small, the stockholder powerfully influenced the director but today they are so far apart that the stockholder can hardly communicate with management even by megaphone. We go through the ancient forms and it is good that we do, but everyone knows that a stockholders' meeting is a kind of ancient, meaningless ritual like some of the ceremonies that go on with the mace in the House of Lords."

80. BGB § 903 (C.H. Beck 1964).

managed the shareholders' property according to their specific instructions.

Such an allocation of power, while attractive to shareholders, becomes unworkable, or at least difficult or inefficient, in a corporation with many shareholders who are widely dispersed and unfamiliar with the technicalities and problems of daily business operations. This factor, in addition to the twentieth century recognition that the right to use property is subject to limitations based on public policy,[81] led to a reallocation of power. Presently, the statute provides that each corporate organ is supreme within the sphere of activity allocated to it by statutory provisions. Thus, except for the specific tasks given to the shareholders' meeting by statute,[82] it no longer exercises control over the formulation of corporate policy or the conduct of corporate operations. That power, as previously discussed, is now vested in the board of managers, which performs its tasks independently.[83] Consequently, as far as possession of effective power to determine most matters of corporate policy is concerned, the board of managers reigns supreme. It is subject only to the board of supervisors' subsequent inquiry into its conduct.

1. Specific Powers

There are, however, a number of important transactions for which shareholder approval is required by statute. Thus, approval by seventy-five percent of the shares represented at the meeting is necessary: to amend the articles of incorporation,[84] to dissolve or reorganize the corporation,[85] to merge it with another corporation,[86] to transfer corporate assets,[87] and to purchase assets within two years after incorporation, the value of which exceeds ten percent of the capital stock.[88]

Other functions allocated to the shareholders' meeting which require only a simple majority of votes actually cast[89] are: the appointment and dismissal of the board of supervisors,[90] the appointment of annual auditors,[91] and the annual exoneration of managers and supervisors.[92]

81. This restriction is now a constitutional norm in Germany. Grundgesetz art. 14 (1966) (W. Ger.) provides that: "Property imposes duties. Its utilization must also serve for the benefit of society." (author's translation).

82. AktG § 119(1).

83. See H. Würdinger, supra note 6, at 118.

84. AktG § 179(2).

85. AktG §§ 262(2), 293(1), 355(3).

86. AktG § 340(2).

87. AktG § 360; see AktG § 359.

88. AktG § 52.

89. AktG § 133(1).

90. AktG § 101(1).

91. AktG § 163(1).

92. AktG §§ 119(1), 120. The legal effect of such exoneration (Entlastung) has been much

2. Meetings

The regular annual shareholders' meeting can be called by the board of managers[93] after at least one month's notice. This period of notice must be extended to allow deposit of shares if the articles of incorporation require such a deposit as a prerequisite for voting. In the absence of such a requirement, shareholders who give three days notice of their intended participation must be allowed to vote.[94]

Special meetings may be called in accordance with statutory provisions. For example, the board of supervisors must call a special meeting if the corporation's well-being so requires.[95] In addition, the board of managers must call a special meeting upon receiving a written request to do so from shareholders owning five percent or more of the corporation's capital stock.[96] Failure to comply with such a request, which must state the proposed meeting's purpose, may result in the shareholders obtaining court permission to call the meeting.[97]

D. *Summary*

This short summary of the German corporation's structure discloses important similarities and differences between its nucleus of power and that of the American corporation. Noticeable is the fact that both have felt the need to create an organ which is not directly concerned with the routine, daily problems of managing the enterprise. The separation of beneficial ownership and control, therefore, has resulted in the inclusion in the corporate structure of an "outsider" whose function is to check on what is being done. But, beyond this point important divergences occur. The German board of supervisors is truly that—supervisory, *i.e.*, it inquires into the board of managers' conduct, usually *after* action has been

discussed in legal literature. Older writings and cases attributed to it full legal effect, so that no corporate demand for damages could be asserted for injuries arising out of managers' or supervisors' conduct once the exoneration resolution had been adopted. This view has changed substantially over the years. Based on the statutory prohibition against corporate renunciation of the right to compensatory damages within three years of the accrual of such right (AktG § 93(4)), the exoneration resolution is now generally viewed as a "continued confidence" vote which does not affect the corporation's right to assert damages claimed thereafter. This is considered necessary to prevent majority shareholders from obstructing the enforcement of such claims. See A. Baumbach & A. Hueck, Aktiengesetz § 104 Anm. 1-2 (12th ed. 1965); A. Hueck, supra note 15, at 154-55. Prior case law, as stated above, is now expressed in the new statute. It expressly declares that such exoneration does "not" amount to a renunciation of the right to damages. AktG § 120(2).

93. AktG § 121(2).
94. AktG § 123(4).
95. AktG § 111(3).
96. AktG § 122(1).
97. AktG § 122(3).

taken in order to see whether the managers acted *legally*. The adoption of corporate policy for future actions rests with the managers, not with the supervisors or (except in specific instances) with the shareholders. In American law, however, the organ which reviews the conduct of management officers also has the primary responsibility for corporate policy. Therefore, since the board of directors merely delegates management functions to the officers it, not the corporate officers, is principally liable to the corporation for damages resulting from negligent business conduct.

Coupled with this difference in functions is the difference in shareholder control over the corporate policy makers. Having the power to elect the directors, the American shareholder directly selects the men who will determine corporate policy. His German counterpart has no such direct voice; he elects the supervisors who will appoint the managers who will develop corporate policy. The same divergence occurs in the removal of corporate policy makers. The American shareholder can remove the directors of his corporation, but the German shareholder cannot remove the board of managers except by going through the board of supervisors.

These differences give an indication of the general tenor of German corporation law, *i.e.*, the insulation of corporate management from direct shareholder contact. This, of course, does not mean that principles of honesty and fair play are forgotten. Statutory provisions setting limits on management conduct abound. But, the methodology of enforcing observance of legal limitations differs. Consequently, the principal observation to be made with regard to these methods is that they put more obstacles into the path of the shareholder seeking to utilize them than is generally the case under American law. The nature of these obstacles in the enforcement of individual shareholder rights is the subject of subsequent sections.

III. Shareholders' Rights

Since most small shareholders are primarily interested in receiving a return on their investment, our first inquiry is directed to the legal problems surrounding the power to distribute corporate profits in the form of dividends. Another direct incident of share ownership is the right to have a voice in corporate affairs. The extent of shareholders' voting rights, therefore, is the subject of our second inquiry. Before a shareholder can utilize some of the other remedies which are his by virtue of his investment, he must have some means of finding out what management is doing. The scope of his right to be informed about corporate conditions and transactions is, therefore, the subject of our third inquiry.

The discussion of each of these topics under German law will be preceded by a short summary of the same topic under American law. The purpose is to enable the reader to recognize similarities and differences in the two legal systems. Because of this limited objective, the discussion of American law is informational and descriptive rather than analytical.

A. *Dividend Rights*

To the small shareholder one of the most important aspects of corporate share ownership is the payment of dividends. The basic conflict of interest between shareholder and management in this area is obvious. On the one hand, the shareholder wants to receive as high a return on his money as possible; on the other, management wants to utilize corporate profits for business expansion, other investment, higher corporate salaries, etc. This conflict is especially true where ownership of shares is widely scattered, and the officers and directors of the corporation, while not holding any large number of shares of their own, can perpetuate themselves in office through a proxy system. A middle ground is usually established between shareholders and management because each side realizes that putting its own view into practice to the fullest extent will result in eventual harm. "Bleeding" the corporation by excessive dividend payments results in fiscal anemia; starving the shareholder has a depressing effect on the value of corporate shares. Yet, these may be *intended* effects in abnormal situations. It is against the use of such disfavored practices that legal restrictions are directed.

1. The Right to Dividends in American Law

Contrary to early English law which vested the power to declare dividends in the "general court" of shareholders,[98] American law generally vests such power in the board of directors. The grant of this power rests either on a specific statutory authorization[99] or on an inference from the universal statutory provision which gives the board of directors the power to manage corporate business. Although some statutes make this grant of power conditional on the absence of contrary provisions in the articles of incorporation or bylaws,[100] thus raising the possibility of allocating

98. 1 G. Hornstein, Corporation Law and Practice § 461 (1959). Some charters of early American corporations made similar provisions. See D. Kehl, Corporate Dividends § 53 (1941). The English practice persists, subject to the limitation that the amount of the dividend declared by the shareholders may not exceed the amount recommended by the board of directors. The Companies Act, 11 & 12 Geo. 6, c. 38, table A, § 115, sched. 1 (1948).

99. See, e.g., Del. Code Ann. tit. 8, § 170(a) (Supp. 1968), which provides that: "The directors of every corporation . . . may declare and pay dividends upon the shares of its capital stock . . . ."

100. See, e.g., N.J. Stat. Ann. § 14A:7-14(1) (1969), which states that: "A corporation may, from time to time, by action of its board, declare and pay dividends . . . except . . . when the payment or distribution would be contrary to any restrictions contained in the certificate of incorporation."

dividend declaration power to the shareholders, such practice does not seem to occur with any noticeable frequency. Furthermore, the courts do not construe this provision in a liberal fashion.[101]

The "discretionary" power of directors to declare dividends, however, is not free from legal restraint. Protection of creditors requires maintenance of the corporation's financial solvency. Thus, by statute or on general principles of creditors' rights, dividends may only be paid out of funds legally available for that purpose. The standards employed to determine such availability, such as, "earned surplus," "net profits," and "nonimpairment of capital" tests,[102] do not need discussion here, since this inquiry is directed into the shareholder's right to dividends which could legally be declared.

Since the declaration of dividends rests in the directors' discretion, the small shareholder has no effective intra-corporate remedy to overcome a failure to declare a dividend, even though funds are available. His only remedy is to bring a court action to compel a dividend declaration. In most states, this is regarded as an equitable class action[103] and no especially burdensome procedural requirements are put in his path. Three states,[104] however, regard such an action as a shareholder's derivative suit, imposing upon the plaintiff the burdensome prerequisites of that type of action.[105] In both cases, however, the substantive burden carried by the shareholder is great. Courts, reluctant to substitute their own judgment on the feasibility of paying a dividend for the directors' business judgment, a judgment which involves consideration of business activity, expansion, employment policies, investment, and tax consequences, have consistently refused to order the declaration of a dividend in the absence of a showing of abuse of discretion. Such abuse is generally found only where fraud, bad faith, or clear unreasonableness are shown.

101. See L.L. Constantin & Co. v. R.P. Holding Corp., 56 N.J. Super. 411, 421, 153 A.2d 378, 383 (Ch. 1959), where an amendment of the articles of incorporation requiring payment of dividends on preferred stock was not enforced by the court because the corporation's bylaws, which gave the directors the discretion to declare dividends, had not been amended. This led to an "inconsistency" which was resolved in the directors' favor despite the fact that, generally, the articles of incorporation take priority over the bylaws.

102. See 11 W. Fletcher, Private Corporations §§ 5335-48 (rev. ed. 1958); H. Henn, Handbook of the Law of Corporations and Other Business Enterprises § 320-23 (1961); D. Kehl, supra note 98, at § 25-30; Weiner, Theory of Anglo-American Dividend Law: American Statutes and Cases, 29 Colum. L. Rev. 461 (1929).

103. Knapp v. Bankers Sec. Corp., 230 F.2d 717 (3d Cir. 1956); Whittemore v. Continental Mills, 98 F. Supp. 387 (D. Me. 1951).

104. Lydia E. Pinkham Medicine Co. v. Gove, 303 Mass. 1, 20 N.E.2d 482 (1939); Gordon v. Elliman, 306 N.Y. 456, 119 N.E.2d 331 (1954); Thompson v. Thompson, 214 S.C. 61, 51 S.E.2d 169 (1948).

105. See H. Henn, supra note 102, at 352-53.

The factual situation which must exist to indicate fraud or bad faith is generally not too difficult to ascertain. Failing to declare dividends in order to pay corporate officers excessive salaries or bonuses, to drive down the purchase price of shares, to force shareholders to sell out, or to give tax advantages to high income bracket shareholders are recognizable examples. The real problem faced by the plaintiff shareholder in this area is the difficulty of proving that these reasons are the motivating forces behind the directors' refusal to declare a dividend. Combined with judicial reluctance[106] to get involved in corporate policy decisions, the further requirement of "clear and satisfactory proof" of fraud or bad faith[107] is a difficult burden to sustain.

In situations not involving fraud or bad faith, the shareholders' difficulty is even greater because of the elusive nature of unreasonableness. Such a charge is mainly directed against the directors' wisdom and judgment in refusing to declare a dividend, and consequently, asks the court to do exactly what it does not want to do—evaluate corporate business policy. Courts give great weight to a director's *duty* to refrain from declaring a dividend where he has any honest doubt as to the wisdom of doing so.[108] The most frequently advanced argument is that the directors are "unreasonably" accumulating surplus funds instead of declaring dividends. Such a charge is generally overcome by showing the courts that present or future business needs require retention of such surplus funds.[109] But there are limits beyond which accumulation of surplus funds, especially if in liquid form, may not go without being designated as unreasonable.[110]

106. "In view of the varied economic, 'political' and taxing incidents that must be considered in making a decision of whether funds should be retained or distributed, the rule [of directorial discretion] is a wise one. But as a brake upon directorial discretion, a principle recognizing the right of participation by the shareholders in all the net earnings of the company not reasonably needed for legitimate corporate purposes ought to have equal weight. . . . The rule of directorial discretion has frequently, perhaps generally, been too sacredly respected by the courts." N. Lattin, The Law of Corporations ch. 10, § 1, at 459 (1959).

107. Bickel v. Henry Bickel Co., 184 Ky. 582, 584, 212 S.W. 602, 603 (1919).

108. See, e.g., id. at 584-85, 212 S.W. at 603-04.

109. City Bank Farmers Trust Co. v. Hewitt Realty Co., 257 N.Y. 62, 67, 177 N.E. 309, 311 (1931).

110. Whittemore v. Continental Mills, 98 F. Supp. 387 (D. Me. 1951). Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919) is often cited as the leading case for the proposition that accumulation of surplus funds beyond the corporation's reasonable needs is an abuse of directorial discretion. In this case, the defendant corporation was ordered to pay out nearly twenty million dollars in dividends despite its contention that shareholders should be satisfied with "average" dividends while the corporation used surplus funds for capital improvements to better its products' technical qualities. It should be noted, however, that this action also involved aspects of a power struggle within the (then) closely held

A factor which should be considered in determining the permissibility of accumulating surplus funds is the imposition of accumulated earnings taxes. By definition, this tax is assessed only on funds not reasonably necessary for the corporation's anticipated needs.[111]

Thus, while the remedy to compel dividend declarations exists, its effective use is hindered by judicial deference to directorial discretion and judicial imposition of a heavy burden of proof on the plaintiff. As a matter of actual practice, however, it should be pointed out that the large American corporation's record of dividend policies shows few instances of arbitrary abuse of discretion. Court actions to compel declarations of dividends almost exclusively involve closely held corporations.

2. The Right to Dividends in German Law

Early German corporation law did not contain any substantive rules regarding the power to declare dividends, although usually the power was given to management under the articles of incorporation.[112] Only in the late nineteenth century did an amendment to the Commercial Code require shareholder approval of the annual financial statement,[113] a policy consonant with the growing recognition of shareholders as economic "owners" of the corporation. This policy found its fullest expression in the 1931 provision allocating to the shareholders' meeting, rather than to management, the actual formulation of the annual financial statements instead of merely their approval.[114] The practical difficulties encountered in having shareholders prepare and adopt a corporation's financial statements resulted in a rapid change in this procedure. Under the 1937 reform of the stock corporation law, a reform largely designed to strengthen the board of managers' powers, shareholders were virtually eliminated from any participation in the formulation of dividend policies. Although the shareholders' meeting was given the power to *declare* dividends by express statutory provision,[115] the actual *control* over whether or not dividends would be declared, and in what amounts, was given to the board of managers. This was assured, except in a very unusual situation,

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corporation. Henry Ford, possessing effective control of management, attempted to "squeeze out" Dodge's minority interest.

111. Int. Rev. Code of 1954, §§ 531-37. See United States v. Donruss Co., 393 U.S. 297, rehearing denied, 393 U.S. 1112 (1969).

112. H. Kronstein & C. Claussen, Publizität und Gewinnverteilung im neuen Aktienrecht 121 (1960).

113. Handelsgesetzbuch [HBG] § 239(b) (C.H. Beck 1964). Law of July 18, 1884, [1884] RGBl. I 123, 162.

114. Law of Sept. 19, 1931, [1931] RGBl. I 493.

115. AktG § 126 (1937).

by giving to the board managers exclusive power to prepare the annual financial statements, and by limiting the source of dividend declarations to funds made available for this purpose by management.

a. The Process of Dividend Policy Formulation Under the *Aktiengesetz* of 1937

Putting the process of dividend policy formulation into statutory terminology, the board of managers had to prepare annually, within the first three months of the corporation's business year, a balance sheet and a profit and loss statement.[116] Only those funds designated in the financial statements as "net profits" were available for dividend purposes.[117] The most important management power with respect to dividend policy was the board of managers' practically unlimited discretion to keep profits out of the "net profits" figure by allocating such sums to reserve accounts. German law differentiates among three types of reserve funds: "legal reserves" (*Gesetzliche Rücklagen*), "free reserves" (*Freie Rücklagen*), and "silent" or "hidden reserves" (*Stille Rücklagen*). The first two types of reserve accounts are also called "open reserves," since they are itemized and visible figures in the annual financial statement, whereas "hidden reserves" are not indicated therein by a specific entry.

The statutory provisions relating to *legal reserves*[118] required that at least five percent of the corporation's annual profit be allocated to this specific reserve account until its total amount equaled ten percent of the corporation's capital stock. The articles of incorporation could increase the percentage of annual profits required to be put into the legal reserves account and could also provide that such annual allocations continue until a percentage of the capital stock higher than the statutory minimum of ten percent was reached. These were two very effective ways to keep part of the corporation's profits from being distributed as dividends. The accumulated legal reserves could be used only for specific purposes designated by statute, the most important of which was the coverage of business losses.[119]

Free reserves[120] could be accumulated out of annual profits either on the basis of provisions in the articles of incorporation, or, lacking such specific regulation, on the basis of a board of managers' decision. If the articles specified the purposes for which such reserves were to be retained, allocations in excess of reasonable requirements to accomplish such pur-

116. AktG § 125 I (1937). This period could be extended by an additional two months by a provision in the articles of incorporation.

117. AktG § 126 I (1937).

118. AktG § 130 (1937).

119. AktG § 130 III (1937).

120. AktG §§ 125, 131B II (1937).

poses were *probably* illegal.[121] In the absence of an express statement of specific purposes, however, the board of managers had unlimited power to accumulate free reserves. The accumulation of free reserves under these circumstances was not limited by any concept corresponding to the American "abuse of discretion" doctrine. It was, therefore, a most effective control over the corporation's dividend policy.

Hidden reserves were not actual accumulated reserve funds appearing in the financial statements, but represented the difference between specific itemizations as they appeared in those statements and their actual value. The purpose of the statutory regulations pertaining to the annual financial statements was to protect creditors by publicizing the corporation's financial condition. Consequently, on the theory that creditors were not affected thereby, there was no prohibition against understating assets and overstating liabilities.[122] Through these two practices management could again prevent actually realized profits from reaching the "net profits" entry.

Although the board of managers had practically unlimited power to employ these methods of reserve accumulations, there was one procedural limitation which could prevent abuse of the power. The annual financial statements, prepared by the board of managers and examined by auditors selected by the shareholders' meeting,[123] had to be submitted to the board of supervisors. In addition, accompanying these financial statements had to be a recommendation for a dividend declaration. The board of supervisors then had three alternatives—it could approve the statements, disapprove them, or could call for shareholder action thereon.

If the board of supervisors approved the financial report it became final. The shareholders' meeting had no power to change it and was limited for

121. See H. Würdinger, Aktienrecht 68-69 (1959).

122. "Shareholders studying the financial statements may be fairly sure that net worth and earnings of their company are not below the reported figures. Since understatements of assets and overstatements of liabilities are both legal and common the real figures, however, are largely a matter of guessing." von Falkenhausen & Steefel, Shareholders' Rights in German Corporations, 10 Am. J. Comp. L. 407, 427 (1961). "Most German corporations thus have two different sets of financial statements: one for the shareholders and one for the tax collector." Id. at n.94.

123. AktG § 136 I (1937). The auditors' examination of the financial statements was limited in scope. It checked for compliance with statutory requirements, but did not affect the board of managers' decisions with respect to the formulation of free or hidden reserves. AktG § 135 (1937). Minority shareholders who owned ten percent of the capital stock for at least three months could contest the selection of auditors on grounds of personal disqualification, such as, incompetence or loss of "independence" because of long association with the corporation, or on grounds of failure to observe procedural requirements. If the court found for the contesting shareholders, it had to appoint acceptable new auditors. AktG § 136 II-III (1937).

dividend purposes to net profits as given in the report. Moreover, shareholders could not initiate legal proceedings to invalidate the approved financial report, except for specific defects designated by statute. These defects were limited to the following situations: (1) the required audit did not occur, (2) procedural regulations were not observed, (3) the report was in violation of regulations adopted in the public interest or to protect creditors, and (4) the report was in violation of "good morals."[124] The narrow interpretation of these prerequisites was demonstrated by the fact that not one court action since 1937 was successful in declaring void a financial report approved by the managers and supervisors.[125] Thus, an intentional accumulation of excessive reserves, even if contrary to the articles of incorporation,[126] could not be contested by legal action. One writer[127] expressed the opinion that even the intentional accumulation of excessive reserves for the admitted purpose of "starving" minority shareholders would not be sufficiently opposed to "good morals" to justify invalidating the financial report. Although such a result may seem rather severe when compared to American corporate law, it must be remembered that German law has no doctrine of fiduciary duties. Instead of declaring the whole financial report void, the German approach is to leave the shareholder injured by malicious management action to his tort remedy under the Civil Code.[128] As a policy judgment, this may serve to avoid complications in intra-corporate functioning, but it sets no limit whatever to attempts to "squeeze out" small shareholders.

The board of supervisors had no power to make changes in the financial report. Its disagreement could be expressed by outright disapproval, in which case the board of managers had to call a shareholders' meeting. Rather than disapprove the report formally, the supervisors, in conjunction with the managers, could call a shareholders' meeting for the purpose of adopting the financial report.[129] In both cases, the preparation and and approval of the report would be in the hands of the shareholders who could decide independently, without regard to management recommendations, on allocations to reserve funds. However, in practice, such shareholder determination of the financial report was extremely rare.

b. Reform Proposals

One of the most important reasons for reforming the German stock company law was to make the purchase of corporate shares more attrac-

124. AktG § 202 (1937).

125. Barz, Die Feststellung der Bilanz, in R. Hengeler, supra note 19, at 61, 62.

126. See von Falkenhausen & Steefel, supra note 122, at 420.

127. Barz, supra note 125, at 62. See also A. Baumbach & A. Hueck, Aktiengesetz § 202, Anm. 2, § 195, Anm. 3 F (12th ed. 1965).

128. BGB § 826 (C.H. Beck 1964).

129. AktG § 125 III-IV (1937).

tive to small investors. The first draft of the new corporation law, therefore, proposed that the power to draw up the annual financial report be returned to the shareholders' meeting. This power would give the shareholders more control over the formulation of dividend policies. The procedure designed to accomplish this, however, was hardly more than a change in statutory terminology.

The draft proposed[130] that the board of managers initially prepare the balance sheet and profit and loss statement, leaving out all allocations to reserve funds. This would have meant that the financial report no longer determined the corporation's net profit, but only the "annual surplus" of assets over liabilities. Attached to this report would have been a special report listing allocations to reserve funds required by statute or by the articles of incorporation, and *recommending* the allocation of the remaining surplus between free reserves and dividends. If the board of supervisors gave its approval to both of these reports, the shareholders' meeting would have been bound by their entire content, *i.e.*, valuation of assets, liabilities, required reserve allocations and the "recommended" allocation between free reserves and dividends. The only discretionary power given to the shareholders' meeting would have been to allocate more than the recommended amount to free reserves. To prevent attempts by majority shareholders to "starve" minority shareholders, such increases could not have gone beyond an amount "necessary for corporate conditions" and could not have reduced the annual dividend below four percent. It should be noted, however, that this limitation would have applied only to shareholder attempts to increase reserve allocations and *not* to management's initial power to recommend reserve allocations. The net effect of this proposal would have been twofold. First, shareholders would have had the additional power to increase reserve allocations beyond those suggested by management, but could not have decreased management's recommendation. Second, *formal* approval of the financial report as determined by managers and supervisors would have been by means of a shareholder resolution. Since the content of management's report would have been binding on the shareholders' meeting, however, this procedural change from the then existing law (which provided for formal approval by the board of supervisors) would have been a rather meaningless formality.

Widespread public criticism of this superficial change resulted in the adoption of new provisions in the 1962 draft law.[131] These provisions attempted to give to the shareholders a more effective voice in the deter-

130. This discussion of the detailed provisions of the 1958 draft is based on Barz, supra note 125, at 64-69.

131. See AktG Draft at 92.

mination of dividend policies without sacrificing those management powers necessary to assure the maintenance of sound business practices. The explanatory text supporting these proposed changes analyzed the conflicting considerations fully:

> This solution [present law] is unsatisfactory. It does not sufficiently take into consideration that shareholders, from an economic viewpoint, are the owners of the enterprise. They bear the economic risk of their participation, through their investment they have furnished the basis for the enterprise and the realization of profits. It is, therefore, not permissible to limit their power of decision to what management in its discretion decides to leave them.
>
> On the other hand, it is not advantageous to return to the law of the Commercial Code and to give to the shareholders' meeting the complete power to prepare and adopt the annual financial report. . . . The questions arising in that process are so complicated that they cannot be discussed fully and decided properly by a multitude of shareholders. Such a decision requires an extensive business background. A meeting of numerous shareholders who are not acquainted with these problems is not equipped to decide on the annual financial report. Such a decision realistically can only be reached by a small group of experts. . . . The draft, therefore, envisions a compromise solution.[132]

Under the proposed solution, the board of managers still had the responsibility for preparing the financial report which, after being examined by the auditors, would be submitted to the board of supervisors for examination and approval. If approval were given, the report would be final and could not be changed by the shareholders' meeting.[133] The changes proposed were not, however, reflected in this procedural regulation. Rather, limitations imposed on the managers' power to build up reserves were added to the statute to assure greater protection of shareholder interest. Thus, whereas the accumulation of free reserves was formerly within management's unlimited power, the draft statute transferred this power to the shareholders because "shareholders as investors . . . must decide what to do with profits which were earned with capital supplied by them."[134]

It was left up to the shareholders' meeting, therefore, to decide not only whether and to what extent the corporation's profits were to be put into free reserves, but also how much was to be paid out in dividends. Such decision was to be reached by the usual shareholders' resolution requiring only a simple majority vote for approval. To prevent abuse of this power, the draft statute provided for a special remedy.[135] Where the reserve allocation was not needed to assure the corporation's sound financial condition in the near future, as determined by reasonable business judgment,

132. AktG Draft at 165-66 (author's translation).
133. AktG Draft §§ 141, 150, 158, 160.
134. AktG Draft § 55, and explanation at 113.
135. AktG Draft § 246.

and where it would have prevented the payment of a dividend of at least four percent, shareholders owning five percent of the capital stock or shares worth one million marks would have been allowed to contest the resolution in court.

Since the corporation had to be assured of some reserves to cover future needs, however, there had to be a way to keep shareholders from "bleeding" it. This the draft law sought to accomplish by permitting provisions in the articles of incorporation calling for specified allocations to free reserves or empowering management to make such reserve allocations provided that the total accumulation of free reserves did not exceed fifty percent of the corporation's capital stock. As soon as that level had been reached the provision in the articles empowering management to make reserve allocations would have been suspended.[136] The shareholders' meeting, however, could thereafter have resolved to pay additional profits into the free reserve account by a simple majority vote, subject to the minority shareholders' right to contest the resolution on the grounds discussed earlier.

In addition to transferring management's control over free reserves to the shareholders' meeting, the draft law also limited the managers' power over hidden reserves. These, as described above, result from understatements of assets or overstatements of liabilities. The draft law recognized that such practices do not injure creditors, but concluded that they can be used to withhold funds from dividend sources and prevent the preparation of accurate financial reports. Concluding that such reserves as were necessary for future corporate needs could be accumulated as free reserves,[137] the draft, nevertheless, did not prohibit the formation of hidden reserves. Instead, it merely attempted to prevent abuse thereof by providing that such reserves could be formed only to such an extent as "reasonable business judgment" considered them necessary to maintain the corporation's financial conditions in the near future.[138] While the aim was praiseworthy, the effectiveness of this limitation seems doubtful. It incorporated concepts which had no clearly recognizable substance and which were likely to have been interpreted by courts, traditionally adverse to giving shareholder rights a broad scope, to favor management.

The draft law retained the 1937 law's provisions which permitted the board of supervisors to refer the submitted financial report to the shareholders for approval either directly or after having disapproved it. New, however, was the limitation that where such a submission occurred the shareholders' meeting could only allocate those sums to open reserves

136. See note 134 supra.

137. AktG Draft, explanation at 175.

138. AktG Draft § 146 II-III.

which were required by law or by the articles of incorporation. The shareholders could not exceed these specifications by any discretionary reserve allocation.[139] However, the draft, by providing that a shareholders' allocation of *hidden* reserves which exceeded limits set by law or the articles did not constitute sufficient ground to contest the annual report,[140] in effect, would have permitted the unlimited accumulation of hidden reserves—a defect which would probably have been kept from becoming oppressive only because referral of the financial report to the shareholders' meeting is a rare practice.

c. Dividend Declarations Under the *Aktiengesetz* of 1965

The basic procedure of the 1937 law and the 1962 draft is retained in the new statute.[141] The board of managers, therefore, must prepare during the first three months of the corporation's new business year the annual financial report, consisting of a balance sheet and a profit and loss statement.[142] The financial report must follow standard bookkeeping methods and must be as accurate a reflection of the corporation's true financial condition as it is possible to give within the board's statutory power to evaluate corporate assets and liabilities.[143] Under the new statute, since the scope of this power, which is the basis for the formation of hidden reserves, is restricted somewhat, some improvement in the reliability of corporate financial reports may be expected. The report must be submitted to the auditors elected by the shareholders' meeting. They must examine it for compliance with statutory provisions and with the articles of incorporation.[144] The financial report, accompanied by the auditor's report and the board of managers' recommendations as to dividend payments and the allocation of profits to reserve accounts, must then be submitted to the board of supervisors.[145] Unless both boards decide to submit the report to the shareholders' meeting for final determination, the board of supervisors must adopt or reject the submitted report.[146] The supervisors' failure to act on the report within two months constitutes a rejection thereof, which requires submission of the report to the shareholders' meeting for final determination and adop-

139. AktG Draft § 161 I-II.
140. AktG Draft § 244.
141. See note 1 supra.
142. AktG § 148.
143. AktG § 149(1).
144. AktG § 162(1)-(2).
145. AktG § 170(1).
146. AktG § 172.

tion.[147] If the supervisors approve the report it is considered adopted and not subject to modification by the shareholders' meeting.[148]

Although not accomplished in exactly the same way as the draft proposed, management's power over the accumulation of reserves (and thus, over dividends) is restricted under the new law. Where managers and supervisors alone adopt the financial report, as is, and undoubtedly will remain the usual case, they may allocate up to fifty percent of the annual profit to free reserves, unless the articles of incorporation permit a higher reserve allocation. Even where such a provision is present in the articles, however, it becomes suspended totally as soon as the accumulated free reserve fund exceeds fifty percent of the corporation's share capital, or partially, to the extent it would exceed such limit.[149] Significantly, in the absence of such a provision, there is no limitation on the accumulation of free reserves. As a result, management may allocate up to fifty percent of annual profits to the free reserve account regardless of the total accumulation therein. Furthermore, reserve allocations beyond those that management can legally make may be decided upon at the shareholders' meeting by a simple majority vote.[150] Since the individual shareholder's right to a dividend distribution pertains only to net profits which have not been legally allocated to other uses on the basis of statutory provisions, the articles of incorporation, or shareholder resolutions,[151] this power of the majority shareholders is liable to abuse. The statute, therefore, provides remedial relief by permitting shareholders owning at least five percent of the corporation's capital stock or whose stock's par value amounts to at least one million marks to bring an action to contest a shareholder reserve allocation.[152] The allocation complained of, however, must violate two standards before judicial relief can be granted. First, in "reasonable business judgment," it must be unnecessary for the maintenance of the company's vitality during a period for which its economic needs can be determined, and second, it must reduce whatever dividend is actually declared below the four percent level. The first prerequisite seems to be even hazier than the comparable American concept of abuse of discretion, and will probably receive the same restricted application by German courts which, like American courts, are reluctant to upset business policy decisions.

Compared to the 1962 draft, however, the substantive provisions of the new statute, seem more effective and far reaching in restraining *manage-*

147. AktG §§ 171(3), 173(1).
148. AktG § 172.
149. AktG § 58(2).
150. AktG §§ 58(3), 133(1).
151. AktG § 58(4).
152. AktG § 254.

ment control over dividends. The individual shareholder, absent any resolution for additional reserve allocations, is guaranteed a dividend through the mandatory limitation on free reserve allocations. Although this maximum limit may be raised by the articles of incorporation, such a provision automatically loses its effectiveness when the accumulated reserves reach the statutory maximum level. Of course, a reserve accumulation of fifty percent of the corporation's capital stock takes a long time to build up, and it is possible that this provision will be used to withhold dividends from shareholders for an extended period. It would seem, however, that this statutory limitation is fairly effective in the one situation where it is needed most, *i.e.*, the deliberate withholding of dividends to "starve" minority shareholders. Since in order to be effective such an intentional plan requires allocation of practically all available profits to reserves, the fifty percent limit would probably be reached in a relatively short period.

The beneficial effects of this statutory check could have been easily undone if management's present power to understate assets and to overstate liabilities was not curbed. The 1962 draft sought to restrict this power by prohibiting the formation of hidden reserves which as a matter of reasonable business judgment were not necessary to maintain the corporation's financial condition in the near future. The drafters of the new statute found two faults with this standard. First, it was too general to furnish any reasonable guidelines to management. Second, it still would not have informed shareholders of the company's real financial condition. The legislative committees[153] deemed this second consideration too basic a factor in the public's distrust of corporate investment to be permitted any longer. Consequently, the statute, in additional provisions,[154] prescribes in detail how each type of corporate property must be assessed or depreciated. Thus, the legislators, by combining these limitations with the statutory obligation to furnish an accurate financial report,[155] may have achieved the desired goal. The assurance of greater accuracy is strengthened by the fact that the auditors who examine the report must determine whether it meets statutory requirements, a task now made easier because the new statute incorporates specific requirements, not the more general test of reasonableness.

As enacted, the new statutory provisions allocating partial power to both management and shareholders are a definite improvement over the former system and both the 1958 and 1962 drafts. Whether this attempt

153. See Bericht des Abgeordneten Dr. Wilhelmi, Deutscher Bundestag, 4. Wahlperiode, Drucksache IV/3296, 30-31 (1962).

154. AktG §§ 152-56.

155. AktG § 149(1).

to strike a workable balance between these two conflicting groups will be effective and not subject to abuse remains to be seen.

B. *The Shareholder's Right to Vote*

In American, as well as in German law, the primary responsibility for the formulation of corporate business policy and the transaction of corporate business rests with management. Both legal systems, however, reserve for shareholder decision statutorily specified matters of policy, or transactions, such as amending the articles of incorporation, selling substantial parts of corporate assets, merging with another corporation or dissolving the corporation. In these matters, and others, the individual shareholder participates in the management process by expressing his decision through his voting power. Since his exercise of his voting power, though infrequent, involves the most fundamental aspects of corporate policy, the scope of that power becomes of primary importance.

1. Voting Rights Under American Law

Early common law applied many non-stock corporation rules to stock corporations. Consequently, the right to vote was for a long time regarded as a personal right allowing each shareholder one vote regardless of the number of shares he owned. Even in the United States, some of the early corporate charters placed a maximum limit on the number of votes allowed each shareholder.[156] Today, however, the right to vote is regarded as an inherent part of stock ownership, and, therefore, as a property right.[157] As a result, the shareholder is entitled, by statute[158] or as a matter of general law,[159] to one vote per share. Although some statutes would permit per capita voting by appropriate provisions in the articles of incorporation,[160] such practice seems to be almost unknown in stock corporations.[161]

Statutes generally permit the issuance of nonvoting shares provided

156. The charter of the Union Bank, incorporated in Massachusetts in 1792, allowed a maximum of ten votes to each shareholder. E. Dodd, American Business Corporations until 1860, at 203 (1954).

157. Brown v. McLanahan, 148 F.2d 703 (4th Cir. 1945).

158. Cal. Corp. Code § 2215 (West Supp. 1969); Del. Code Ann. tit. 8, § 212 (Supp. 1968); N.J. Stat. Ann. § 14A:5-10 (1969).

159. Brooks v. State ex rel. Richards, 3 Boyce 1 (Del.), 79 A. 790 (1911).

160. See, e.g., Cal. Corp. Code § 2215 (West Supp. 1969) which states that: "In the absence of any contrary provision in the articles or in any statute relating to the election of directors or to other particular matters, each [shareholder] is entitled to one vote for each share."; Del. Code Ann. tit. 8, § 212(a) (Supp. 1968) states that: "Unless otherwise provided in the certificate of incorporation . . . each stockholder shall . . . be entitled to one vote for each share . . . ."

161. See H. Henn, supra note 102, at § 191.

there is at least one other class of shares which carries voting rights.[162] Even absent such statutory authorization, articles of incorporation which permit such issuance have been upheld as valid.[163] In some states, however, there are constitutional and statutory limitations on the issuance of nonvoting shares. These statutes either prohibit such shares or give to those shareholders the right to vote on matters which would adversely affect them.[164]

a. Cumulative Voting

In many states, shareholders are given more than one vote per share for the election of corporate directors. This "cumulative voting" system[165] is designed to allow minority shareholders to be represented on the board of directors. Basically, it gives each share as many votes as there are director vacancies to be filled, and permits the shareholder to cast all votes for one director or to distribute them among as many candidates as he wishes. Thus, if there are five directors to be elected, a shareholder owning one hundred shares could either cast five hundred votes for one candidate or divide his vote as he pleases. Despite criticism of the system to the effect that it results in the election of partisan directors and causes abuse "by persons who are motivated by narrow, selfish interests" and "by opposition groups [who] use cumulative voting to secure a toe-hold in a long-run fight for control of the company,"[166] the fact that it permits minority shareholders to express viewpoints has led to widespread consti-

162. E.g., Cal. Corp. Code § 2216 (West 1955).

163. People ex rel. Browne v. Keonig, 133 App. Div. 756, 118 N.Y.S. 136 (1st Dep't 1909); Saint Regis Candies, Inc. v. Hovas, 117 Tex. 313, 3 S.W.2d 429 (1928).

164. In Illinois, nonvoting shares are unconstitutional, People ex rel. Watseka Tel. Co. v. Emmerson, 302 Ill. 300, 134 N.E. 707 (1922). A similar holding by the West Virginia court, State ex rel. Dewey Portland Cement Co. v. O'Brien, 142 W. Va. 451, 96 S.E.2d 171 (1956), was overruled by amending the state constitution, W. Va. Const. art. 11, § 4. Even where permitted, nonvoting shares may be entitled to vote under special circumstances. Del. Code Ann. tit. 8, § 242(d)(2) (Supp. 1968) provides that: "If any proposed amendment would alter or change the preferences, special rights or powers given to any one or more classes of stock by the certificate of incorporation, so as to affect such class or classes of stock adversely, or would increase or decrease the number of authorized shares of any class or classes of stock, or would increase or decrease the par value thereof, then the holders of the stock of each class of stock so affected by the amendment shall be entitled to vote as a class upon such amendment, whether by the terms of the certificate of incorporation such class be entitled to vote or not; and the affirmative vote of a majority in interest of each such class of stock so affected by the amendment shall be necessary to the adoption thereof . . . ."; cf. N.Y. Bus. Corp. Law § 804 (1963). See also ABA-ALI Model Bus. Corp. Act §§ 60, 73, 80, 84, 89 (rev. ed. 1969).

165. See C. Williams, Cumulative Voting for Directors (1951); Cole, Legal and Mathematical Aspects of Cumulative Voting, 2 S.C.L.Q. 225 (1950).

166. W. Carey, Cases and Materials on Corporations 288 (4th ed. unabr. 1969).

tutional and legislative prescription of the system.[167] However, except for California, the states having the largest number of corporations only permit, but do not require, cumulative voting.[168] To weaken the effect of cumulative voting, many corporations in their articles of incorporation provide for the election of "staggered" or "classified" boards of directors. This results in the election of only part of the board each year. Whether such practice is unconstitutional in states making cumulative voting mandatory has been the subject of conflicting decisions and much argument.[169] In at least two states statutory provisions have resolved the conflict by providing that all directors must be elected annually.[170] Where directors are subject to removal without cause by a simple majority vote, the director elected by minority shareholders through cumulative voting could easily be removed. To prevent such nullification of minority rights, some states[171] have enacted statutes allowing the removal of an individual director only if the number of cumulated votes opposing his removal are insufficient to elect him.

b. The Proxy System

Early common law required shareholders to attend the shareholders' meeting in person in order to vote.[172] Today, since a quorum of shareholders must be present at a shareholders' meeting in order to conduct

167. Cumulative voting is required in the following states: Alaska, Arizona, Arkansas, California, Hawaii, Idaho, Illinois, Kansas, Kentucky, Michigan, Mississippi, Missouri, Montana, Nebraska, North Carolina, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Washington, West Virginia and Wyoming. See H. Henn, supra note 102, at 293 nn.13 & 14.

168. E.g., Del. Code Ann. tit. 8, § 214 (Supp. 1968); N.Y. Bus. Corp. Law § 618 (1963). If the articles of incorporation do not prohibit cumulative voting, Minnesota, (Minn. Stat. Ann. § 301.26(3) (1969)) permits shareholders who notify the corporation's president or secretary not less than 24 hours before the election that they intend to cumulate their votes to engage in such voting for the election of directors.

169. Classified boards are unconstitutional: Wolfson v. Avery, 6 Ill. 2d 78, 126 N.E.2d 701 (1955); State ex rel. Syphers v. McCune, 143 W. Va. 315, 101 S.E.2d 834 (1958). Contra, Bohannan v. Corporation Comm'n, 82 Ariz. 299, 313 P.2d 379 (1957); Janney v. Philadelphia Transp. Co., 387 Pa. 282, 128 A.2d 76 (1956); see Sell & Fuge, Impact of Classified Corporate Directorates on the Constitutional Right of Cumulative Voting, 17 U. Pitt. L. Rev. 151 (1956); 69 Harv. L. Rev. 380 (1955).

170. Cal. Corp. Code §§ 805, 2201 (West 1955); Wyo. Stat. Ann. § 17-36.34 (1965).

171. E.g., Cal. Corp. Code § 810 (West 1955) states that: "[U]nless the entire board is removed, an individual director shall not be removed if the number of shares voted against the resolution for his removal exceeds the quotient arrived at when the total number of outstanding shares entitled to vote is divided by one plus the authorized number of directors." See Mich. Comp. Laws Ann. § 450.13 (1967); Minn. Stat. Ann. § 301.29 (1969); Pa. Stat. Ann. tit. 15, § 1405 (1967); 51 Mich. L. Rev. 744 (1953).

172. W. Carey, supra note 166, at 254.

business,[173] it would be practically impossible for most large corporations to convene a legally constituted meeting. Corporate shares are widely dispersed among small shareholders who have no desire to attend such a meeting. Although the common law rule still persists absent any contrary provision, present statutes generally permit voting by proxy.[174] Even without such statutory permission, proxy voting may be validated by provisions in the articles of incorporation or bylaws.[175] Proxies are usually required to be in writing and their duration is normally specified by statute, although the proxy itself may specify a different duration not exceeding a stated maximum period.[176]

c. Federal Regulation of Proxy Solicitations

Because in large corporations the proxy system has lent itself so well to the self-perpetuation of management, it is regulated by a federal statute[177] administered by the Securities and Exchange Commission (SEC). The literature[178] concerned with the legal problems of federal regulation of proxies is as voluminous as the problems themselves, and only a very brief description of the regulatory process is attempted here.

The basic provision giving the SEC power to regulate proxies also defines the scope of that power. Section 14(a) of the Securities Exchange Act provides that:

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any

173. What constitutes a quorum is usually determined by statutory provisions. These may specifically designate what percentage of the corporation's voting shares is sufficient for a quorum, Cal. Corp. Code § 2211 (West Supp. 1969), or may permit corporate articles of incorporation or bylaws to specify a percentage differing from the statutory one, Minn. Stat. Ann. § 301.25(7) (1969), provided such percentage is not set below a specified minimum, Mo. Ann. Stat. § 351.265 (1966).

174. See ABA-ALI Model Bus. Corp. Act § 33 (rev. ed. 1969) which states that: "A shareholder may vote either in person or by proxy . . . ."

175. Worth Mfg. Co. v. Bingham, 116 F. 785, 791 (4th Cir. 1902); see Axe, Corporate Proxies, 41 Mich. L Rev. 38 (1942).

176. E.g., Cal. Corp. Code § 2226 (West 1955) ("A proxy is not valid after the expiration of eleven (11) months from the date of its execution unless the person executing it specifies therein the length of time for which it is to continue in force, which in no case shall exceed seven (7) years from the date of its execution."); Del. Code Ann. tit. 8, § 212(b) (Supp. 1968) ("[N]o such proxy shall be voted or acted upon after three years from its date, unless the proxy provides for a longer period."); N.J. Stat. Ann. § 14A:5-19 (1969) ("[I]n no event shall a proxy be valid after 3 years from the date of execution.").

177. Securities Exchange Act of 1934 § 14(a), 15 U.S.C. § 78n (1964, Supp. IV, 1969).

178. See, e.g., 2 L. Loss, Securities Regulation 857-1036 (2d ed. 1960, Supp. 1962).

proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to Section 78*l* of this title.[179]

To implement this statutory power, the SEC has promulgated Regulation X-14.[180] This regulation consists of eleven rules which are applicable to every proxy solicitation sent to holders of shares listed with the SEC as required by law. In addition to the rules, Schedules 14A and 14B specify the information required to be included in the *proxy statement* which, together with the actual solicitation, must be furnished to every shareholder.[181] The required information covers such items as: the proxy's revocability; the identity and share interest of the person or persons making the solicitation; who bears the solicitation costs; the identification of the various classes of shares entitled to vote and the number of outstanding shares in each class; the details on bonus, profit sharing, pension, retirement and other remuneration plans which will be voted on at the meeting; full information about planned issuance of securities requiring shareholder approval; the details of planned mergers, consolidations and other acquisitions; and full information about nominees for director posts, including their activities for the last five years, their share interest, salaries, bonuses and other remuneration received or to be received. If the proxy solicitation relates to a meeting at which directors are to be elected, the proxy statement must be accompanied by an annual report containing "such financial statements for the last two fiscal years . . . as will in the opinion of the management adequately reflect the financial position . . . and results of . . . operations" of the corporation.[182] The proxy form, which is to be signed by the solicited shareholder, must clearly indicate the matters upon which action is to be taken at the meeting, and must be so organized that the person solicited can make a choice "between approval or disapproval of each matter or group of related matters."[183] Preliminary copies of the proxy statements and proxy forms must be submitted to the SEC at least ten days before they are to be sent out to the shareholders.[184] These filed materials are examined by the Commision staff for accuracy, clarity and fullness of disclosure. Defects are sought to be corrected through letters of comment and informal conferences. Thereafter, copies of the materials actually sent out to the shareholders must be submitted to the SEC and to the security exchange on which the stock is listed.[185]

179. Securities Exchange Act of 1934 § 14(a), 15 U.S.C. § 78n(a) (1964).
180. 17 C.F.R. § 240.14a (1969).
181. 17 C.F.R. § 240.14a-3(a) (1969).
182. 17 C.F.R. § 240.14a-3(b) (1969).
183. 17 C.F.R. § 240.14a-4 (1969).
184. 17 C.F.R. § 240.14a-6 (1969).
185. Id.

Such "definitive" materials are again examined by the SEC and false or misleading statements found therein may result in actions to enjoin the corporation from soliciting proxies through the mails or other methods of interstate communications, or may result in criminal prosecution.[186]

The proxy rules have greatly improved a situation which had afforded shareholders little opportunity to participate meaningfully in corporate affairs. As the leading writer on the subject has concluded:

> The proxy rules are very likely the most effective disclosure device in the SEC scheme of things. The proxy literature, unlike the application for registration and the statutory reports, gets into the hands of investors. Unlike the Securities Act prospectus, it gets there in time. It is more readable than any of these other documents. And it gets to a great many people who *never* see a prospectus. Moreover, there are indications . . . that the indirect influence of the proxy rules, through their infiltration of the general law of notice to security holders, may in the long run be more significant than their direct impact.[187]

The last statement in the above quotation reflects the feeling of frustration prevalent for many years because the proxy rules' *direct* effect was limited to those corporations which listed their shares on national stock exchanges. Since the great majority of corporations were not so registered, most of the nation's stockholders did not receive the benefit of this legislation. Almost since the original enactment of the Securities Exchange Act, efforts to amend it in order to widen its scope were numerous and fervent.[188] Not until 1964, however, were these efforts rewarded with success.

The long awaited amendment attempts to cure two defects in the proxy rules' applicability. First, it greatly enlarges the number of companies affected by the proxy rules. It provides that every corporation not listed on a national exchange, which is "engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded by use of the mails or any means or instrumentality of interstate commerce" *must* register such security with the SEC if its total assets exceed $1,000,000 and if its shares are held by 500 or more shareholders.[189]

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186. 17 C.F.R. § 240.14a-9 (1969) states that: "No solicitation . . . shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication . . . containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

187. 2 L. Loss, supra note 178, at 1027.

188. For a detailed account of such amendment proposals and their fate, see id. at 1149-64.

189. 15 U.S.C. § 78l(g)(1)(B) (1964); see Kennedy, Proxy Regulation, 20 Bus. Law. 273 (1965).

Thus, the determining factor is no longer listing on a national stock exchange, but registration with the SEC under a law directing registration for companies of a specified size. Second, under prior law even a company listed on a national exchange could evade the proxy rules by simply not soliciting any proxies, a practice followed as late as 1961 by 19% of the companies listed on national exchanges.[190] Since 1955, the New York Stock Exchange has exerted its influence to reduce this percentage, informing recalcitrant companies that delisting would be considered for those corporations which did not solicit proxies after 1961.[191] The 1964 amendment seeks to eliminate, or to compensate for, the failure to solicit proxies by requiring every corporation which is registered with the SEC and does not solicit proxies to file with the Commission and transmit to stockholders "information substantially equivalent to the information which would be required to be transmitted if a solicitation were made."[192]

d. Preemptive Rights

An unlimited management power to issue additional shares of stock not only would reduce the individual shareholder's proportionate interest in dividends and corporate assets, but would also effectively dilute the shareholder's vote and, consequently, his only means of control over management. Regarding such a practice as a violation of management's duty of fairness to *all* shareholders, early court decisions[193] developed the doctrine of preemptive rights. This doctrine necessitates that management give present shareholders the opportunity to purchase that part of a new issue of shares which is proportionate to their existing share interest before such shares are either offered to outsiders or are sold to other present shareholders in excess of their proportionate interest. The preemptive right extends both to the issuance of newly authorized shares,[194] which normally requires shareholder approval and amendment of the articles of incorporation, and to additional issues of originally authorized shares.[195] The right applies to the last at least where the interval between the original authorization and the contemplated issue has been so long as to give present shareholders an equitable right to preserve their long

190. 27 SEC Ann. Rep. 73 (1961).

191. 2 L. Loss, supra note 178, at 1028.

192. 15 U.S.C. § 78n(c) (1964).

193. Eidman v. Bowman, 58 Ill. 444 (1871); Gray v. Portland Bank, 3 Mass. 363 (1807). For commentary see Drinker, The Preëmptive Right of Shareholders to Subscribe to New Shares, 43 Harv. L. Rev. 586 (1930); Frey, Shareholders' Pre-emptive Rights, 38 Yale L.J. 563 (1929); Morawetz, The Preemptive Right of Shareholders, 42 Harv. L. Rev. 186 (1928).

194. Stokes v. Continental Trust Co., 186 N.Y. 285, 78 N.E. 1090 (1906).

195. Titus v. Paul State Bank, 32 Idaho 23, 179 P. 514 (1919); Glenn v. Kittanning Brewing Co., 259 Pa. 510, 103 A. 340 (1918).

maintained proportionate interest unchanged.[196] Although early cases[197] held that the preemptive right required management to offer shares to shareholders at par value, later cases took the more realistic view that shareholders must pay the market value for such shares.[198]

Today shareholders' preemptive rights are regulated by statute in practically all states. Some provide for the right, but permit its abrogation through provisions in the articles of incorporation or bylaws.[199] Others deny the right unless affirmative provisions in the articles expressly grant it.[200] A few statutes grant the right but incorporate the exceptions developed at common law.[201] These exceptions generally pertain to shares issued in exchange for property or services, treasury shares, shares issued to satisfy conversion or option rights and shares issued in connection with a merger or consolidation. It should be noted, however, that even where preemptive rights are not granted, general equitable principles of fiduciary duties are still applicable to new or additional issues of shares and may be enforced against directors or majority shareholders. Therefore, attempts to dilute the minority shareholders' voting power may be resisted by relying on the doctrine of "equitable limitations."[202]

e. The Exercise of Voting Rights

The mere fact that a shareholder has an interest in the matter being voted upon is not a sufficient reason to disqualify him from voting. Therefore, he can vote to ratify contracts or business transactions between himself and the corporation from which he would derive an economic benefit, provided such transactions are fair and concluded in "good faith."[203] Just as majority shareholders, however, minority and individual

196. The court in Carlson v. Ringgold County Mut. Tel. Co., 252 Iowa 748, 108 N.W.2d 478 (1961) enforced the preemptive right where shares originally authorized but not issued were offered for sale to outsiders 40 years later. See also Thurmond v. Paragon Colliery Co., 82 W. Va. 49, 95 S.E. 816 (1918). Where no unreasonable time has elapsed between the original authorization and the presently contemplated issue of shares, the existence of preemptive rights may be denied because of the implied understanding among shareholders and management that all shares would be issued. Dunlay v. Avenue M. Garage & Repair Co., 253 N.Y. 274, 170 N.E. 917 (1930).

197. Hammond v. Edison Illuminating Co., 131 Mich. 79, 90 N.W. 1040 (1902); Cunningham's Appeal, 108 Pa. 546 (1885).

198. McClanahan v. Heidelberg Brewing Co., 303 Ky. 739, 199 S.W.2d 127 (1947); Stokes v. Continental Trust Co., 186 N.Y. 285, 78 N.E. 1090 (1906).

199. See, e.g., N.Y. Bus. Corp. Law §§ 505 (Supp. 1969), 622 (1963).

200. E.g., Cal. Corp. Code § 1106 (West 1955).

201. E.g., Ohio Rev. Code Ann § 1701.15 (Page 1964).

202. See W. Carey, supra note 166, at 1133.

203. Gamble v. Queens County Water Co., 123 N.Y. 91, 25 N.E. 201 (1890).

shareholders have a fiduciary duty to the corporation, and, perhaps, to the majority shareholder, not to use their voting power for their own benefit where principles of fairness and good faith would be violated.

2. Voting Rights Under German Law

Under German law the right to vote is regarded as an "inherent part of membership"[204] in the corporation and, as such, may not be restricted except as expressly permitted by law. Every share,[205] except preferred shares (*Vorzugsaktien*),[206] carries voting rights. The new statute provides two permissible methods for altering the normal ratio of one vote per share.[207]

One method is to allocate to each share more than one vote (*Mehrstimmrechtsaktien*). Permitted prior to the 1937 reform of the German corporation law, this practice was widely abused. It was used mainly to retain corporate control in the hands of the family shareholders who originally founded the corporation but needed outside capital to keep it going. It was also employed by corporations to get effective control of other companies with a minimum outlay of capital. For example, a corporation would buy a controlling interest in another company, use its voting power to give multiple votes to part of the shares it owned, and then sell the other shares to the public. It thereby recouped most of its investment, and through the retained multiple-vote shares, maintained effective control of the subsidiary. The 1937 law,[208] however, basically

204. H. Würdinger, supra note 121, at 72.

205. AktG § 12(1).

206. The issuance of preferred shares is relatively rare and is strictly regulated by statute. Preferred shareholders have cumulative dividend rights unless the articles of incorporation provide differently. Judgment of April 22, 1953, 9 BGHZ 279. The total par value of preferred shares may not exceed the par value of all other shares issued. AktG § 139(2). Except for the fact that preferred shareholders have no voting rights, they are given all other rights inherent in share ownership. AktG § 140(1). Where preferred shareholders do not receive their annual dividend, and the full dividend for two years is not paid by the end of the following business year, preferred shareholders automatically have full voting rights until all cumulated preferred dividends are paid. AktG § 140(2). Although, under normal circumstances, preferred shareholders cannot vote on amendments to the articles of incorporation, any amendment which limits or seeks to abolish any of their rights requires an affirmative vote of seventy-five percent of the preferred shares voted at a special meeting called for that purpose. AktG § 141. The same applies if the corporation seeks to issue additional preferred shares, unless such a plan is expressly reserved to the corporation when the original preferred shares are issued. Id.

207. Shares must have a par value. AktG § 6. Despite proposals to permit no-par shares, the new law retains this provision. A corporation may have a series of shares with different par values, however, as long as the value is in multiples of one hundred marks. AktG § 8(2). This is necessary in order to equalize voting power.

208. AktG § 12 II (1937).

prohibited the issuance of shares with disproportionate voting rights, but provided for exceptions through express permission by the Ministers of Economics and Justice.

Under the 1937 statute, multiple-vote shares, even if permitted, were given effect only in those situations requiring merely a majority vote of shares. Matters which by statute required approval of a specific part of the *capital investment* were, therefore, not affected. Consequently, since the amendment of the articles of incorporation, the increase in capital stock, mergers and other matters of fundamental corporate concern had to be approved by seventy-five percent of the capital stock, holders of multiple vote shares could, in these cases, only cast votes proportionate to their actual investment interest.

A traditional argument for the retention of multiple-vote shares has been that it is a useful and necessary device to prevent "foreign domination" of corporations. In this context, the term "foreign" refers both to citizens of other countries and to domestic competitors who could be prevented from taking over corporations by giving disproportionate voting power to "insiders." The draft law, however, emphatically rejected this device, maintaining that, where necessary, outside domination could be prevented by means equally effective yet less amenable to abuse. In eliminating even the exceptional utilization of multiple-vote shares, the drafters pointed out that the issuance of registered instead of bearer shares, or the conversion of bearer into registered shares, could prevent outside domination if the subsequent transfer of registered shares were made subject to corporate approval.[209] Another method of preventing undesired domination was the issuance of preferred shares which carried no voting rights. Despite these arguments, however, the Bundestag retained the law permitting multiple-vote shares where the appropriate state government in which the corporation has its principal office gives its approval. The new statute delegates to the states the power to give such permission for the protection of predominant economic needs.[210]

Another permissible method of changing the basic ratio of one vote per share is to limit by provisions in the articles of incorporation the number of votes which any one shareholder may cast.[211] This may be done by

209. AktG Draft § 12, and explanation at 98. Bearer shares can be transferred merely by delivery and the right to transfer them cannot be restricted. Registered shares, however, are transferred by endorsement (AktG § 68(1)) and the transferee must give evidence of possession and transfer before his name will be entered on corporate records as the owner of the shares (AktG § 68(3)). The articles of incorporation may make the transfer of registered shares conditional on corporate approval which, if no contrary provision is made, must be obtained from the board of managers. The articles also may specify the reasons for which a transfer of such shares may be denied. AktG § 68(2).

210. AktG § 12(2).

211. AktG § 134(1).

restricting each shareholder, regardless of the value of his total investment, to a maximum number of votes, or by providing that shares held by any one person in excess of a certain number carry only limited voting rights. (For example, after the first 100 shares, each 10 shares may carry only one vote). Although the 1937 statute originally required that such authorization be contained in the articles of incorporation, a subsequent amendment of the corporation law required that the Ministers of Economics and Justice approve any such plan.[212] The new law retains the 1937 statute's method of limiting voting rights specifying, however, that the plan used may not be applied only to a *specific* shareholder. The necessity of obtaining ministerial approval for such limitations has been eliminated, thus leaving the decision to adopt them entirely within the corporation.[213] With regard to a vote which, by statute or the articles of incorporation, requires a majority of the capital shares of the corporation, a limitation of voting rights adopted under this statutory section is not effective.[214]

As under American law, German law does not prevent a shareholder from voting his shares on a matter merely because he would derive a benefit therefrom. Instead, protection against possible abuse is provided by allowing one to bring a court action to contest a resolution's validity on the ground that the purpose of the shareholder's vote was to obtain special advantages for himself or a third person to the detriment of the corporation or the other shareholders.[215] In addition, the statute prohibits the casting of shareholder votes in two specific cases.[216] In the first, neither a manager nor a supervisor may vote his shares on a resolution which would result in his exoneration from liability to the corporation, and similarly, in the second, no shareholder can vote his shares when the resolution is directed toward absolving him from any corporate obligation. This statutory prohibition of voting is exhaustive. Consequently, shareholders may vote to elect themselves supervisors and to grant benefits to themselves on their own retirement.[217]

a. Exercise of Voting Rights Through Agents

Except for corporate matters which require approval of at least seventy-five percent of the corporation's capital stock represented at the meeting, all other resolutions are decided by simple majority vote.[218]

212. Dritte Durchführungsverorodnung zum Aktiengesetz § 13, Law of Dec. 21, 1938, [1938] RGBl. I 1839.
213. AktG § 134(1).
214. Id.
215. AktG § 243(2).
216. AktG § 136(1).
217. Judgment of Sept. 29, 1955, 18 BGHZ 205.
218. AktG § 133(1).

There is no quorum requirement, and management's interest in shareholder participation in the annual meeting is not strong. This lack of necessary shareholder participation is no doubt one of the basic reasons why a proxy system similar to that found in the United States and several other European countries has not developed in Germany. Because of the same practical circumstances, *i.e.*, the dispersal of shares among large numbers of shareholders who cannot attend meetings, but who want to have their votes counted, the new statute[219] provides two ways by which absent shareholders can vote on corporate resolutions.

First, a shareholder may give to another person a power of attorney (*Vollmacht*) to vote his shares at the meeting. This power must be in writing, signed by the shareholder, and deposited with the corporation. Consequently, a telegraphic power of attorney is not valid.[220] The corporation's articles of incorporation may not prohibit the use of such powers,[221] but may restrict their use by providing that they can only be given to persons meeting specified qualifications, for example, other shareholders.[222] Such qualifications, however, may not be drawn so narrowly as to prevent the shareholder from executing a power because he cannot find a person competent to exercise it.

Second, because most shareholders deposit their shares with their bank, the more practical and most widely used method for absent shareholders to vote is to give the bank authorization (*Ermächtigung*) to vote the shares. This well established system of "depositary voting" (*Depotstimmrecht*) has recently come under severe attack. Due to its great importance, a detailed analysis of its scope under prior law is necessary.

The bank's authorization had to be in writing. It was valid for fifteen months, but could be revoked at any time. The standard authorization permitted the bank to vote the deposited shares in its own name rather than in the name of their legal owner.[223] Although the authorization had to identify specifically the particular bank which was authorized to vote the shares, the fact that the instrument commonly used was an authorization rather than a power of attorney meant that the bank could thereafter, without the shareowner's permission, authorize a third person to vote the shares. This practice was widely followed by banks which "lent" votes to other banks.[224] The authorization normally covered all shares on deposit with the bank. Separate authorizations were, therefore, not needed for shares of each corporation in a diversified portfolio. Where

219. AktG §§ 134(3), 135.

220. BGB § 126 (C.H. Beck 1964); Judgment of May 27, 1957, 24 BGHZ 297.

221. Judgment of May 23, 1903, 55 RGZ 41.

222. AktG § 134(4).

223. AktG § 114 IV (1937).

224. See A. Hueck, Gesellschaftsrecht 149-50 (11th ed. 1963).

the shareholder informed the bank of the manner in which to vote his shares, his instructions were binding under Civil Code provisions.[225] The bank, however, was not legally obligated to ask for specific instructions, and the authorization forms which the bank normally furnished made no provision therefor.[226]

To realize the full implications of this process, it must be remembered that the great majority of shares in Germany are bearer shares, the holders of which are unidentified. Consequently, there was no direct means of making available to shareholders information pertaining to the annual meeting's agenda. The 1937 *Aktiengesetz* merely required that notice of the meeting be published,[227] and that shareholders who asked to be informed be furnished copies of the agenda.[228] Other shareholders could obtain this information at the bank which held their shares, since corporations customarily furnished such copies to all the banks. Needless to say, the majority of small shareholders would sign the authorization furnished by the bank without inquiring into the nature of the resolutions which their shares would support or reject. To silence criticism of this practice, the banks themselves drafted a set of general rules[229] regulating the exercise of their authority to vote such shares. These rules required banks to follow shareholder instructions when given, and to exercise the voting right in the shareholder's interest when instructions were lacking. In addition, banks had to notify shareholders and ask for instructions on how to vote their shares if on the meeting's agenda were any resolutions which would amend the articles of incorporation or which, by statute, required an affirmative vote of seventy-five percent of the corporation's capital stock voted at the meeting. Also, if the bank received notice of any expressed opposition to particular resolutions at least two weeks before the meeting (an unlikely situation because of the notice requirements discussed earlier), it had to notify the shareholder and inform him, absent contrary instructions from him, of how the bank intended to vote his shares.

These self-imposed rules neither stilled criticism nor prevented abuse.

225. BGB § 665 (C.H. Beck 1964) would permit the bank to deviate from the shareholder's instructions if it thought that under the particular circumstances the shareholder would permit such deviation. Notice of intended deviation and answer from the shareholder should precede the bank's deviation from instructions unless danger could result from such a delay.

226. See Heinsius, Die Vertretung bei der Ausübung des Stimmrechtes nach amerikanischem Aktienrecht, 17 Betriebs-Berater 824 (1962).

227. AktG § 105 II (1937).

228. AktG §§ 108, 109 (1937).

229. "'Grundsätze für die Ausübung des Stimmrechts auf Grund einer Ermächtigung nach § 114 Abs. 4 AktG.'" Heinsius, supra note 226, at 826.

The traditional close alliance between banks and large corporations remained the basis for strong protests against use of such votes to further bank interests or to support management over shareholders. Such conflicts of interest could hardly be avoided since German banks not only provided large and numerous loans to corporations because other sources of capital were scarce after the currency devaluation of 1948,[230] but also because they frequently were large corporate shareholders themselves. Although many writers expressed differing opinions on the extent of bank abuse of their voting power,[231] it is true that banks normally would vote for management proposals.[232]

b. Reform Proposals

It is not surprising, therefore, that the law reform drafters' attempt to improve this system received from legal writers extensive analysis, comment and criticism.[233] The justification for the proposed change is noteworthy because it did not establish that actual abuses required reform, but that change was justified because of the persistent arguments about abuses:

> The [present] rules have not been able to end the arguments about the need for and the administration of the exercise of voting rights through banks. Time and again it is maintained that the system of allowing banks to vote shares conceals conflicts of interest. In cases of doubt, the bank would have a tendency to give preference to its own interests in the corporation not to those of the shareholder. . . . Not shareholders, but the banks decide in their discretion how to vote. Corporate management is, therefore, no longer under the shareholders' supervision. It is not accountable to anyone. Regardless of whether and how far these assertions have substance, it is not possible to maintain the depositary voting system as one of the foundations of the corporate system on a permanent basis in this opinion struggle. Corporations, as well as banks, must be protected from the disturbances created by it.[234]

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230. While German savers invested a total of over $44,000,000,000 in savings accounts and bonds since 1948, their investment in new shares of stock in that same period amounted to only $4,000,000,000. Time, June 4, 1965, at 82.

231. For two extensive analyses and recapitulations of different viewpoints, see R. Wiethölter, supra note 23, at 322-31; Klug, Die Neuordnung des Bankenstimmrechts, in Aktuelle Probleme aus dem Gesellschaftsrecht und anderen Rechtsgebieten, Festschrift für Walter Schmidt 39 (1959).

232. R. Wiethölter, supra note 23, at 334.

233. E.g., A. Hueck, supra not 224, at 149-50; H. Rasch, Richtige und falsche Wege der Aktienrechtsreform 9-13 (1960); R. Wiethölter, supra note 23, at 322-38; Mohring, Die Ausübung des Stimmrechtes durch Kreditinstitute im Referentenwurf eines Aktiengesetzes, in R. Hengeler, supra note 19, at 86 (1959); Garbers, Börsenmakler, Banken und Nominees —Ihre Bedeutung für die Aktionärsvertretung im nordamerischen Recht, 18 Betr.-Berater 212 (1963); Heinsius, supra note 226; Klug, supra note 231; Koehler, der Referentenentwurf eines Aktiengesetzes, 14 Juristenzeitung 73, 110 (1959); Schutz, Rationalisierung und Recht, 16 Juris. Zeit. 105 (1961).

234. AktG Draft, explanation to § 129, at 157.

This desire to protect corporations and banks from disturbances, rather than to devise a more effective method of enforcing shareholder interests, may be one of the reasons why the draft proposal not only aroused even more disturbance-creating opposition, but also would have had a practical effect opposite to the reform's purpose as a whole.

The basic procedure which allowed banks to vote shares which had been deposited with them was retained in the draft law.[235] However, to point out that these shares were not owned by the bank, the provision permitting banks to vote such shares in their own name was eliminated. Instead, the votes were to be cast in the name of the shareholder who actually owned the shares, or, if that shareholder wanted to remain anonymous, they could be voted "in the name of the one concerned." The written instrument required to permit the exercise of the shareholder's voting rights had to be a power of attorney that complied with the statutory sample, rather than the former bank-drafted "authorization." As before, the power of attorney had to designate by name the specific bank which was to cast the votes. Unless the shareholder specifically authorized the bank to do so, however, it was no longer permissible for the bank to authorize another bank to vote these shares. Even if such authorization were given, the bank having the power of attorney had to vote the shares itself if it had an office in the locality where the shareholders' meeting was to take place.

The power of attorney, as envisioned by the draft law, was no longer a general authorization to the bank to vote all the shareholder's deposited shares. It would have permitted the bank to vote at the specifically designated meeting only the shares of one corporation. Thus, the power would have had to be renewed annually for regular meetings, and a new form executed for any special shareholders' meetings. Most important in its practical implications was the fact that holders of diversified portfolios would have had to execute a power of attorney for each corporation in which they owned shares. The formal execution of the power, however, would not have authorized the bank to vote shares. To overcome the 1937 law's defect which put on each shareholder the burden of learning the meeting's purpose and of instructing the bank on how to vote, the draft required the *bank* to furnish the shareholder with complete information about the meeting's agenda. This information would have had to cover not only management and shareholder proposals, but also matters which the bank intended to propose at the meeting. Also, the bank would have had to inform the shareholder of how it intended to vote on each item on the agenda. The statutorily prescribed power of attorney form would have set aside space in which the shareholder could designate how he wanted

235. AktG Draft § 129.

the bank to vote. Only if the shareholder had not given contrary instructions would the bank have been able to vote the shares according to its own decision. The form would also have expressly incorporated the Civil Code[236] provision allowing the bank to deviate from the shareholder's voting instructions if it believed that the shareholder, had he knowledge of the particular circumstances requiring deviation, would have consented thereto.

Obviously, the purpose of this change was to compel the furnishing of information to shareholders so that they could specify the manner in which their shares were to be voted. At first glance, this purpose seemed to have been accomplished by providing that banks could not vote deposited shares unless they had supplied the shareholder with the required information. In this respect, the proposal resembled the federally regulated proxy system in the United States which mandated the furnishing of information to the shareholders. However, the essential difference which weakened the German system was that the wrong institution would have been charged with the duty of furnishing the information. Under the German practice, the exercise of voting rights through depositaries is a service provided by the bank for which it is compensated by the shareholder through an annual fee. The institution of the new proposal had been estimated to increase the annual fee threefold because the procedure would have required much heavier expenditures by the banks. As one writer stated:

> [T]he extensive paper war which will necessarily result from this procedure will cause very high costs, which the banks must shift to its customers by means of higher deposit fees. The detailed answers and instructions would have to be carefully registered and evaluated if the banks are to avoid unpermitted use of the powers of attorney. This would require considerable personnel, apart from the resulting costs for postage, printing and paper.[237]

A small shareholder who owned a few shares in several corporations, or even in just one corporation, would undoubtedly have been reluctant to sign the power of attorney since the costs of the voting process would have been thereby transferred to him. The likely result, therefore, would have been that small shareholders would not have returned the power of attorney to the bank, and thus, would have been disenfranchised. Majority shareholders and management would then have had an even freer hand in running the corporation than under the former system.

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236. BGB § 665 (C.H. Beck 1964).

237. Koehler, supra note 233, at 76.

c. Provisions in the New Law

The legislative committees[238] recognized the almost universal criticism[239] of these proposals, and thus, partially restored the former system in the final statute. As now enacted,[240] banks can vote deposited shares on the basis of a written power of attorney from the owner. The shares must be voted, however, in the owner's name or "in the name of the one concerned," rather than in the bank's own name. As under the former system, the power of attorney covers all the shares deposited with the bank by that shareholder regardless of the fact that he has diversified holdings. The new law provides that the power of attorney is a general authorization to the bank to vote all shares at any meeting during the time for which it is issued—fifteen months. Only the shareholder's express authorization permits the bank to authorize someone else to vote the shares. Such authorization cannot be utilized, however, if the bank has an office in the locality where the meeting is taking place.

Eliminated from the statute is the provision contained in the draft that banks may only vote shares after they have furnished complete information to the shareholder and received his instructions on how to vote his shares. The bank is now required to send to each depositor-shareholder information about the meeting's agenda immediately upon receipt of such information from the corporation.[241] This information must be accompanied by an indication of how the bank, considering the shareholder's interests, thinks the shareholder's shares should be voted.[242] In addition, the bank must specifically ask the shareholder to send his voting instructions to the bank. For this purpose, the statute empowers the Ministers of Justice and Economics to prescribe a form which the banks must use.[243] In addition, the bank must expressly inform the shareholder that the bank's voting suggestion will be followed unless the shareholder sends instructions to the contrary.[244] To prevent the banks from transferring the costs resulting from this procedure to the shareholder, the statute empowers the Ministers of Justice and Economics to publish regulations imposing upon the *corporation* the duty to reimburse the bank for the costs resulting from the preparation and mailing of

238. Bericht des Abgeordneten Dr. Wilhelmi, Deutscher Bundestag, 4. Wahlperiode, Drucksache IV/3296, 24-25 (1962).

239. See note 233 supra.

240. AktG § 135.

241. AktG § 128(1).

242. AktG § 128(2).

243. AktG § 128(6).

244. AktG § 128(2).

materials to the shareholders.[245] Apparently, not included within this duty of reimbursement are the bank's labor costs which result from sorting and tabulating the instruction forms returned by shareholders.

By imposing these costs on the corporation, and by making the furnishing of information about the agenda mandatory, the new procedure incorporates the basic features of the American proxy system. Whether or not shareholders will read the furnished material, make their own decisions and communicate them to the bank is a problem which will be as difficult to solve in Germany as it has been in the United States. This, however, is not a legal problem, but a matter of individual shareholder initiative. One possible legal problem which could arise under the new statute is the extent to which detailed information must be furnished to the shareholders. The anticipated beneficial effect of the new system may very well not be realized if corporations and banks are allowed to furnish information which does not give the shareholder enough knowledge to decide intelligently.

d. Shareholders' Preemptive Rights

Shareholders in a German stock corporation have a statutory preemptive right (*Bezugsrecht*)[246] to purchase new shares in proportion to their existing investment. Although this right may not be restricted in the articles of incorporation, it can be denied or restricted with respect to a particular issue of new shares if the resolution which authorizes the new issue expressly provides for such denial or restriction.[247] An affirmative vote of seventy-five percent of the capital shares voted at that meeting is required for the approval of the restriction or denial of the right. While such denial of preemptive rights is discretionary, it may not violate "good morals"[248] and it may not be discriminatory, *i.e.*, it cannot deny the right to some shareholders but give it to others.[249] However, exclusion of particular shareholders from the right to purchase new shares is permissible if it can be justified under the circumstances and is not arbitrary. Thus, if a shareholder is trying to get control of a corporation in order to destroy it, it becomes management's duty to exclude him and to see to it that only "loyal" shareholders receive new shares.[250] With the approval of the requisite number of shareholder votes, denial of the preemptive right may also be permitted for valid corporate purposes, such

245. AktG § 128(6).

246. AktG § 186(1).

247. AktG § 186(3); Judgment of Sept. 16, 1927, 118 RGZ 67; Judgment of June 19, 1923, 107 RGZ 67.

248. Judgment of March 30, 1926, 113 RGZ 188.

249. Judgment of Oct. 6, 1960, 33 BGHZ 175.

250. Id. at 186.

as the purchase of property or services which cannot otherwise be obtained. The shares must be offered at par value unless the resolution authorizing the increase in capital stock designates a higher price.[251]

In addition to shareholder authorization to increase the corporation's capital stock, management can issue additional shares[252] within the limits of a prior authorization given by the shareholders' meeting. Such authorization is given by adding to the articles of incorporation a provision empowering the board of managers, during a maximum period of five years, to issue additional shares up to a certain amount. This "authorized capital" (*genehmigtes Kapital*) may not exceed fifty percent of the corporation's capital stock at the time the authorization is given. The provision may be renewed at the end of the five year period by amending the articles of incorporation. Both the original authorization and subsequent amendments require an affirmative vote of seventy-five percent of the shares voted at the meeting. The preemptive right of shareholders applies to these shares, but may be excluded by the articles of incorporation or by the board of managers together with the board of supervisors. Again, no discrimination among shareholders is permitted except where circumstances justify the exclusion of particular shareholders because of their intent to injure the corporation.[253]

C. *The Right to be Informed About Corporate Affairs*

To be informed about corporate conditions and transactions is a necessary prerequisite to the effective exercise of shareholder rights. But in this area, too, limits must be set to prevent injury to the corporation resulting from the revelation of business information which might be used by competitors. An additional danger to management's effective functioning is also posed by the possibility that too extensive an exercise of the shareholder's informational right may consume the unjustified time and energy of corporate personnel.

1. American Law

Shareholders as collective owners of the corporation have a justifiable natural curiosity in the company's general condition. This interest is satisfied, in most cases, by imposing on management periodic reporting requirements. Such reports must be regarded as an important shareholder device in exerting control over management. Information contained in reports may arouse a shareholder's interest in or suspicion about a specific transaction. Generally, however, such information will not

251. AktG § 182(3); Judgment of Oct. 6, 1960, 33 BGHZ 175, 178.

252. AktG § 202.

253. Judgment of Oct. 6, 1960, 33 BHGZ 175.

be sufficient to form the basis for decisive shareholder action. To assure the availability of more detailed information, American shareholders are given power to inspect corporate books and records.

a. Required Corporate Reports

Corporations listed on a national securities exchange or subject to the mandatory registration provisions of the Securities Exchange Act are legally required to submit annual reports to their shareholders.[254] As a prerequisite for listing its shares, such a requirement may also be imposed on the corporation by the stock exchange's internal regulations.[255] In addition, all states require the filing of annual reports, usually with the secretary of state. The mandatory content of these reports varies from the mere listing of corporate directors, officers and outstanding stock,[256] to information equivalent to that required under federal securities legislation.[257] Such reports need not be sent to shareholders,[258] but as a general rule, they become public documents and shareholders may inspect them.[259]

b. Right to Inspect Corporate Books and Records

Shareholders also have a common law right to inspect corporate books and records.[260] It is a limited right, however, exercisable only at proper times and places, and for proper purposes. It covers all corporate books and records, including intra-corporate correspondence.[261] Although the English view, requiring as a prerequisite for inspection the existence of a disputed matter or controversy, has generally been rejected in the United States,[262] courts do require that the inspection be in connection with the exercise of a valid shareholder right.[263] Thus, the inspection of books to ascertain the company's condition before voting at a shareholders' meet-

254. 17 C.F.R. § 240.14a-3 (1969).

255. N.Y. Stock Exchange, Company Manual § A-4, at 64-65.

256. Del. Code Ann. tit. 8, § 502(a) (Supp. 1968).

257. ABA-ALI Model Bus. Corp. Act §§ 125-26 (rev. ed. 1969).

258. Cal. Corp. Code §§ 3006-07 (West 1955) requires the corporation to send an annual report consisting of a balance sheet and a profit and loss statement to every shareholder unless the bylaws expressly dispense with such report. Even where this is the case, however, shareholders owning at least ten percent of the corporation's outstanding shares have a right, upon request, to receive a report of the corporation's financial condition. Id. at § 3011. See 1 H. Ballantine & G. Sterling, California Corporation Laws §§ 266, 269 (4th ed. 1969).

259. See generally 5 W. Fletcher, Private Corporations §§ 2258-2323 (rev. ed. 1967).

260. In re Steinway, 159 N.Y. 250, 53 N.E. 1103 (1899).

261. Otis-Hidden Co. v. Scheirich, 187 Ky. 423, 219 S.W. 191 (1920).

262. Id. at 428-29, 219 S.W. at 194.

263. Slay v. Polonia Publishing Co., 249 Mich. 609, 229 N.W. 434 (1930).

ing or to obtain information to be used in litigation against the corporation or in a shareholder's derivative suit is a proper exercise of the right and must be permitted.[264] Moreover, the corporation's stock list must be made available for inspection to allow a shareholder to contact other shareholders in connection with proxy contests or matters appearing on the corporate meeting's agenda.[265] Inspection may be justifiably denied if it is motivated by improper purposes, such as, harassing corporate management,[266] or securing business prospects or advertising lists,[267] or obtaining business secrets or information for a competitor.[268] Since it is presumed that the shareholder's exercise of the right is proper, the burden of establishing the impropriety of the shareholder's purpose rests on the corporation.[269]

Almost all states have enacted statutory provisions establishing and regulating the right to inspection of corporate books and records. These statutes generally incorporate the substance of the rules evolved at common law.

2. German Law

Each shareholder has the statutory right to inspect the stock ledger which indicates the name, address, and profession of every shareholder.[270] However, since most shares in Germany are bearer shares, this is not an important right. German law does not otherwise provide for any inspection of corporate books and records. Instead, shareholders have a statutory right to obtain desired information at the shareholders' meeting. In addition, the corporation law has provisions requiring the preparation of annual reports which are available to shareholders.

a. The Requirement to Prepare Reports

During the first three months of the corporation's business year, the board of managers must prepare the annual financial report, consisting of a balance sheet and a profit and loss statement.[271] Although in the past the itemized figures in these reports have not necessarily reflected the corporation's true financial condition, the revision of the dividend declaration provisions will hopefully result in the preparation of more reliable financial reports.

264. 5 W. Fletcher, supra note 259, at §§ 2223, 2225.

265. See ABA-ALI Model Bus. Corp. Act § 31 (rev. ed. 1969).

266. See Sawers v. American Phenolic Corp., 404 Ill. 440, 89 N.E.2d 374 (1949).

267. Eaton v. Manter, 114 Me. 259, 95 A. 948 (1915).

268. Dines v. Harris, 88 Colo. 22, 291 P. 1024 (1930).

269. Slay v. Polonia Publishing Co., 249 Mich. 609, 612, 229 N.W. 434, 435 (1930); H. Henn, supra note 102, at § 201.

270. AktG §§ 67(1)(5).

271. AktG § 148.

In addition, the board of managers must also prepare an annual business report (*Geschäftsbericht*) which is submitted with the financial report to the auditors for examination.[272] The business report is subsequently transmitted to the board of supervisors which must examine it and make a written report about the business report's conclusions.[273] Then the financial, business, auditor's and supervisor's reports are all submitted to the shareholders' meeting. Upon conclusion of the meeting, the financial report must be published in the official government publication *Bundesanzeiger*.[274] All the reports, accompanied by a notice of such publication, must subsequently be submitted to the local court which keeps the official Commercial Register.[275] Copies of the submitted reports must be made and given to anyone who asks for them, provided his request is based on "justifiable interest." Interpretation of the statutory language supports the conclusion that every shareholder has such an interest because of his investment, and that the motive for which he seeks the information is not a valid ground for refusing his demand for information.[276]

The business report's content is prescribed by statute.[277] It must describe both the corporation's general activities during the preceding year and its present condition. It must also explain the financial report, with special emphasis on the methods used to determine the value of assets and liabilities. Any substantial differences between the new and the preceding financial report must be explained. Furthermore, the relationship between the corporation and its subsidiaries must be revealed. Compensation paid to managers and supervisors must be specified, including salary, bonuses, and all fringe benefits. In addition to these specific items, the report must give an account of all important corporate matters in order to satisfy the overriding mandate that it be a "conscientious and trustworthy accounting." Violation of this standard, either through false statements or through the omission of material matters, may result in criminal liability involving a fine, imprisonment of up to three years, or both.[278]

272. Id.

273. AktG § 171.

274. AktG §§ 25, 177(2).

275. AktG § 177(1). The local Amtsgericht, nominally a state court of first instance whose jurisdiction and procedure are nevertheless regulated by federal law, keeps the Commercial Register and acts as Registergericht. HGB § 8 (C.H. Beck 1964); Gesetz über die Angelegenheiten der freiwilligen Gerichtsbarkeit § 215, Law of May 17, 1898, [1898] RGBl. I 189, as amended [hereinafter cited as FGG]. See also Kaplan, von Mehren & Schaefer, Phases of German Civil Procedure I, 71 Harv. L. Rev. 1193, 1194-99 (1958).

276. HGB § 9 (C.H. Beck 1964). See 7 H. Würdinger, Handelsgesetzbuch, Kommentar § 9, Anm. 2, 3 (2d ed. 1953).

277. AktG § 160.

278. AktG § 400.

b. The Shareholder's Right to Obtain Information at the Annual Meeting

Every shareholder, regardless of the size of his investment, has a statutory right to ask for information at the shareholders' meeting.[279] The right extends to all matters reasonably connected with topics under discussion at the meeting. For example, in connection with the annual resolution exonerating management, all corporate transactions and management decisions of the previous year come within the scope of this right.[280] Specifically made the subject of proper inquiry are relations between the corporation and any "connected enterprise." This encompasses not only subsidiaries but also contractually associated companies.[281] Members of the board of managers who conduct the meeting must answer "fully and truthfully" all questions which fall into this proper sphere.

In addition, the statute specifies an exhaustive list of reasons that justify a denial of requested information. The most important of these is the right to withhold information which, according to "reasonable business judgment," would cause "not inconsiderable damage to the association or to a connected enterprise . . . ."[282] This wording reflects an important change, both substantively and remedially, from the 1937 statute. Under that statute, the denial of information because of possible injury to the corporation was left to management's "discretion."[283] Criticism of this discretionary power used to be answered by pointing out that a denial of requested information was judicially reviewable. This argument disregarded the limited scope of such judicial review, however, and ignored the fact that, as a practical matter, "judicial review is not a sufficient assurance that the Board of Managers is not acting arbitrarily."[284] As in American law, German law limits judicial review of a discretionary act to the issue of abuse of that discretion. The court has no power, therefore, to enforce its own view of the correctness of the action taken. Thus, German courts asked to overrule a refusal to disclose information were not permitted to balance shareholder against corporate interests to determine which ought to prevail under the particular circumstances of the case. A further procedural difficulty was that the shareholder, as plaintiff, had the burden of proving a violation of his

279. AktG § 131(1).

280. See A. Baumbach & A. Hueck, Aktiengesetz, Kommentar § 131, Anm. II(4) (13th ed. 1968); R. Godin & H. Wilhelmi, supra note 64, at § 112, Anm. 3.

281. See Reinicke, Das Auskunftsrechts des Aktionärs, in R. Hengeler, supra note 19, at 117, 126-27.

282. AktG § 131(3).

283. AktG § 112 (1937). For an exhaustive study of the shareholder's right to information under this section, see H. Scheu, Das Auskunftsrecht des Aktionärs (1959).

284. H. Scheu, supra note 283, at 51.

right to information, whereas management needed only to explain its reasons for refusing the disclosure. Management, of course, was not required to explain why the information would injure the corporation, since that would necessarily have resulted in the revelation of the information.[285] The judge was thus made to consider the question of abuse without any evidence, except in the rare case where the shareholder could substantiate allegations of illegal motivation on management's part. Even if the shareholder were successful in his suit, the practical benefit of his victory was questionable. The right to ask for information could only be exercised at the corporate meeting. It did not extend to obtaining written or oral replies to questions at any other time. Consequently, a refusal at one meeting to answer a question which was reversed by the court only entitled the shareholder to receive an answer at the following shareholders' meeting.

To eliminate the board of manager's power to act as "judge in its own case,"[286] the new statute includes a test of reasonable business judgment. The expectation is that the court will now need to inquire into the factual circumstances to determine whether the refusal to disclose information to the shareholders is legally justifiable. Thus, "judicial review is not limited to a determination of whether the board of managers abused its discretion, but is directed towards determining whether the board of managers must reveal the information."[287] It is questionable, however, whether this change can alleviate the difficulty facing the court in deciding whether possible corporate injury is outweighed by resulting shareholder benefit. This balancing cannot be done except by forcing the board of managers to reveal the information which allegedly will injure the corporation. To prevent such injury, the new statute[288] provides that the "Law Pertaining to Non-Contentious Litigation"[289] applies to such a proceeding. This statutory procedure excludes the public from court actions.[290] While use of the revealed information by third persons, therefore, is prevented, this device does not keep the information

285. A. Baumbach & A. Hueck, Aktiengesetz, Kommentar § 112, Anm. 4 (12th ed. 1965); R. Godin & H. Wilhelmi, supra note 64, at § 112, Anm. 7.

286. AktG Draft, explanation to § 125, at 154.

287. Id. See also Gierke, supra note 23; Wernicke, Die Auskunftsverweigerung im Referentenentwurf eines Aktiengesetzes, 14 Betr.-Berater 99 (1959), for a discussion of the 1958 draft proposals.

288. AktG § 132(3).

289. FGG. For table of amendments, see F. Keidel, Freiwillige Gerichtsbarkeit, Kommentar § 41-42 (8th ed. 1963). This special procedure applies mostly to matters involving personal status, guardianship proceedings, inheritance and property divisions. It is more flexible than regular court procedure. See Kaplan, von Mehren & Schaefer, supra note 275, at 1196.

290. FGG § 8. F. Keidel, supra note 289, at § 8, Vorb. 7.

from the complaining plaintiff who has a constitutional right[291] to attend court proceedings when the opposing party presents its evidence.[292] Even if the court should determine that the board of managers were justified in its original denial of the information request, the shareholder would have discovered what he is now not supposed to know. Under these circumstances, the new provision that a judgment in favor of the shareholder entitles him to immediate access to the information, rather than requiring him to wait until the next meeting, is really, as a practical matter, superfluous. The new statute, therefore, has brought greater protection to the shareholder, but has failed to retain sufficient protection for the valid corporate interest of keeping business information secret. Only where the denial of the information request was unjustified can the new procedure be regarded as fulfilling its purpose.

The new statute[293] lists specific subject matter about which no information need be given. For example, details about corporate taxes need not be presented beyond those contained in the financial report. And, since the formation of hidden reserves is now more closely regulated by other statutory provisions, requests for more detailed information than given in the financial report may also be denied. These provisions attempt to prevent unnecessary delays in the progress of the shareholders' meeting. Another ground justifying a refusal to divulge information is the possibility that the managers would thereby subject themselves to criminal liability. Significantly, the draft's explanatory text[294] refers not to the protection of management, but to the necessary protection of "state secrets," the revelation of which results in criminal liability. The statute, therefore, does not intend to classify the denial of information as justifiable because revelation may self-incriminate the managers and result in their criminal liability for wrongful conduct.

The statute expressly provides that an information request may not be denied for any reason other than the ones specified. It is doubtful, however, whether this provision will be literally enforced. The 1937 statute had a similar provision to which courts and legal writers developed two exceptions. These will undoubtedly continue to be enforced. The first results from the application of Civil Code § 226,[295] which pro-

291. Grundgesetz art. 103 (1966) (W. Ger.).

292. Judgment of Oct. 25, 1956, 6 BVerfG 12.

293. AktG § 131(3).

294. AktG Draft, explanation to § 125, at 155.

295. BGB § 266 (C.H. Beck 1964) states that: "The exercise of a right which can only have the purpose of causing injury to another is unlawful." The concept that possession of a legal right imposes duties upon the possessor in exercising it is especially strong in German law. Under the principle "qui iure suo utitur neminem laedit" the exercise of a legal right must take into consideration its impact on other persons' interests and on society

hibits the "misuse" of legal rights. Because of this statute, the board of managers has been allowed to refuse information on the grounds that the shareholder was simply trying to harass management or was pursuing "exclusively selfish interests."[296] The second exception provides that since the shareholder's right may only be exercised at the meeting, an answer may be refused because the papers or documents needed to give the information are not presently available and can only be obtained with "excessive expense."[297] However, notice to the board of managers before the meeting that certain information will be requested may obligate it to have the necessary books and records on hand.[298]

c. The Appointment of Special Auditors

A special procedure involving the disclosure of information is available to minority shareholders. Specifically, the shareholders' meeting has the statutory right to appoint special auditors to investigate a particular matter or transaction.[299] Under this provision, therefore, an individual shareholder can request the shareholders' meeting to appoint auditors. Of course, this request may not be voted upon by the board members whose conduct is to be investigated. Nevertheless, if the shareholder's request is denied, resort to legal process in the form of a petition to court for the judicial appointment of auditors[300] can be had if certain prerequisites are met. For example, this petition must be granted if brought by shareholders owning ten percent of the corporation's capital stock or whose stock has a par value of two million marks. These shareholders must be able to show, however, "justified suspicion" that the particular transaction was fraught with dishonesty or constituted a gross violation of the law or the corporation's articles of incorporation. Moreover, the conduct to be investigated must have occurred in connection with the incorporation or within the last five years. While the petition is pending, the complaining shareholders must deposit their shares with the court after showing that they owned the shares at least three months before the date of the meeting at which their request for the appointment of auditors was denied.

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as a whole. See H. Mitteis, Deutsches Privatrecht 28-29 (3d ed. 1959). In French law, the doctrine of "abus des droits" serves a similar function. See R. Schlesinger, Comparative Law 372-76 (2d ed. 1959).

296. Judgment of June 12, 1941, 167 RGZ 151.

297. Id. at 169.

298. R. Godin & H. Wilhelmi, supra note 64, at § 112, Anm. 2.

299. AktG § 142(1). This provision does not authorize the appointment of auditors to investigate management conduct in general. Judgment of Jan. 22, 1935, 146 RGZ 385.

300. AktG § 142(2).

IV. Conclusion

This inquiry into the legal status and rights of German shareholders commenced with the assertion that assurance of shareholder as well as corporate interest required a compromise. The legal framework designed to protect these inherently conflicting spheres of interest must balance them in order to arrive at a solution which is fair to both, while taking into consideration the impact of the legal norms on society.

This weighing and balancing has been done more realistically and more efficiently in the United States than in Germany. The factors responsible for this are not to be credited solely to greater American ingenuity or even better understanding of the problem. American corporation law has benefited greatly from the flexibility of the legal system of which it is a part. Common law and statutory damage remedies provide for compensatory relief for wrongful conduct, while the equitable injunction prevents its occurrence. Where these approaches have proven inadequate, comprehensive governmental regulation and control have intervened to protect investors. German corporation law is much more rigid. Generally, only remedial relief is available, and even that is circumscribed by procedural and financial burdens which the small shareholder usually cannot sustain.[301] While the new German corporation statute has eliminated some of these obstacles, too many remain. Thus, as long as corporations almost exclusively issue bearer shares and a minimum share interest remains a prerequisite to the availability of relief, the small shareholder of a large corporation virtually has been denied a remedy because he has no means of contacting other small shareholders to solicit their support. Another factor which renders the enforcement of management's responsibility more difficult is that the corporate organ empowered to formulate policy and to transact business is responsible only to a weak supervisory board, and does not have to account directly to the shareholders for its conduct.

In one sense, German corporation law is paradoxical. It shows great concern for the employer-employee relationship, as the mandatory representation of workers on the board of supervisors demonstrates. Yet, the law's traditional conservatism with respect to shareholder rights remains largely unabated. The shareholder is still regarded as a "saver" who should be satisfied with receiving interest payments, and not as an investor to whom management owes an accounting for its conduct.

The reform of legal norms which are based on historical tradition cannot be accomplished overnight. Recognition of the inadequacy of the

301. The subject of procedural remedies and their obstacles in German corporation law is too complex to be treated in this article. The author is presently preparing a separate article on this topic.

rules is a prerequisite to change. While the new German corporation statute retains provisions which do not adequately protect the rights of small shareholders, continued economic expansion in Germany and other Common Market countries can be expected to demonstrate these inadequacies and the need for further reform.