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Change of Governance in Historic Perspective: The German Experience

Law Working Paper N°.28/2005
March 2005

Harald Baum
Max Planck Institute for Private Law and ECGI

ECGI Working Paper Series in Law

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Article prepared for "Corporations, State, Markets, and Intermediaries: Changes of Governance in Europe, Japan, and the U.S.," K. J. Hopt, E. Wymeersch, H. Kanda, H. Baum (eds), Oxford University Press (in preparation for 2005). I am grateful to Patrick C. Leyens and Markus Roth for comments.

Abstract

The shift from the liberal, laissez-faire attitude to the welfare state at the end of the 19th century was accompanied in Germany with an idealized notion of the state that has created a lasting and unfortunate legacy: the persistent and deeply ingrained present-day German belief in a perceived unlimited competence of the state, and a deeply ingrained skepticism against the market mechanism by the general public that has turned out to be the greatest single obstacle obstructing urgent reforms in 21st-century Germany.Nevertheless, the financial overburdening of the modern welfare state has become increasingly visible, and it is confronted with the problem of a growing discrepancy between public expectations and its ability to act. Indicators of change are a large-scale privatization of public utilities and the beginning of a privatization of welfare arrangements. The political economy and corporate governance in Germany are characterized by a corporatist approach. This regime is generally classified as the standard example of an insider-controlled and stakeholder-oriented governance system as opposed to a "modern" capital-marked-based and outsider-controlled system. Various threads of this insider system have started to unravel, and certain elements typically associated with outsider systems seem to be increasing. The structural changes are accompanied by regulatory reforms that are inspired by a regulatory approach typical for a marketoriented governance model. The emphasis has been on the regulation of information: enhanced disclosure duties, stricter liability for insufficient or misleading information, and more efficient means of private enforcement of mandatory disclosure rules by damages suits.

Keywords: welfare state, corporatism, corporate governance, financial market regulation, company law

JEL Classifications: G18, G38, K22

Harald Baum
Max Planck Institute for Private Law
Mittelweg 187
D-20148 Hamburg
Germany
phone: +49-40-419.00-317, fax: +49-40-419.00-288
e-mail: baum@mpipriv-hh.mpg.de

Introduction

It is well known that Germany, the inventor of the Maastricht Treaty's stability criteria, violated these same criteria at least three times in a row between 2002 and 2004. It may be less well known that the average economic growth in 2003 of all countries in the Euro zone would increase by a full percentage point if one excluded the zone's largest economy and worst laggard: Germany. In 2003 the German GNP per capita was some 25 percent lower than the American. These figures are a far cry from the country's superior postwar performance that attracted worldwide admiration – as long as it lasted. However, the figures do correspond with the findings of the 2004 "Economic Freedom Report" published by the Canadian Fraser Institute that show – once again – a strong correlation between prosperity and economic freedom defined by low taxes, freedom of contract, protection of property rights, monetary stability, et al.[1] In the report's overall ranking of 123 countries, Germany has, at least in relative terms, fallen to the 22nd position behind Hong Kong, Singapore, the U.S., Britain, New Zealand, Switzerland, Canada, Australia, and others. With respect to government influence on the economy, the country holds a dismal 107th place due to excessive income transfers and subsidies. Regarding freedom of banking, it scores only 84th because of heavy regulation of the financial industry. These are but a few disturbing examples. Other international comparative studies come to similar dismal evaluations.[2] The worsening has not taken place in absolute but rather in relative terms, so the findings show that some other countries obviously have been significantly swifter than Germany in adapting their governance systems from state to market; put differently, the road ahead may be a longer or a rockier one for Germany.

As of now there is still a general apprehension toward regulatory shock therapies among the German public and hence with its political class – a German Maggie

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[1] *Cf.* www.fraserinstitute.ca.

[2] The World Bank's report "Doing Business in 2005: Removing Obstacles to Growth" does not list the country among the top 20 economies for ease of doing business; *cf.* www.rru.worldbank.org. "The 2005 Index of Economic Freedom" prepared by The Heritage Foundation puts Germany at an unsatisfactory 18th rank; *cf.* www.heritage.org. A biannual study on the international ranking of the 21 leading economies undertaken by the German Bertelsmann Foundation shows that between 1994 and 2004, Germany fell back by eight ranks to the 16th position; during the same time Japan lost seven ranks and now occupies the 11th position; *cf.* BERTELSMANN STIFTUNG (ed.), Internationales Standort-Ranking 2004 (Gütersloh 2004).

Thatcher or Ronald Reagan has yet to enter the stage.[3] However, in the last years a plethora of legislative reforms actually have taken place and many more are underway – some quite courageous and others rather cautious.[4] With the recent blessing of the Constitutional Court, shops may now even stay open on Saturday evenings until 8 p.m. – though, of course, not (yet) 24 hours a day or on Sundays.[5] The debate over opening hours of shops has distracted political minds for several years and is a telling example of the difficulties that attempts to achieve change are (still) likely to meet in Germany.

The following analysis is composed of four parts. To frame the discussion, it begins with a historical overview of the changing perceptions about the role of the state and the proper scope of government in Germany (Part I). From a bird's eye view, it then tries to point out essential structures of the corporatist German governance model and discusses a possible (cautious) shift toward a more market-based regime (Part II). The following section shows how the formation of an independent capital markets (securities) regulation, the new takeover law, and the development of company law mirror these developments; in these areas we observe a "reform in permanence" taking place, as one legislator has aptly put it[6] (Part III). Part IV summarizes the findings.

I. THREE STAGES OF DEVELOPMENT

In the classical understanding, state and society are seen as two different social entities, although this distinction is sometimes – mistakenly – regarded as obsolete in the omnipresence of today's welfare state. The state is usually defined as the unity of three constituent elements – population, territory, and governmental authority – with the state's institutions having the monopoly on the use of force. The term "society" describes all non-state areas and organizational forms of social existence.[7] It is common

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[3] But at least popular books anguishing over the country's decline are starting to appear on bestseller lists, *cf.*, e.g., STEINGART, Deutschland: Der Abstieg eines Superstars ["Germany: Decline of a Super Star"] (Munich 2004).

[4] A harsh critique of the government policies over the past decade – often camouflaged as "reforms" – and the resulting loss in economic growth can be found with HAMM, Staatlich verschuldete Wachstumsstörungen, in: ORDO. Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft 55 (2004) 153.

[5] BVerfG, decision of June 9, 2004, in: Neue Juristische Wochenschrift 2004, 2363.

[6] SEIBERT, Aktienrechtsreform in Permanenz?, in: Die Aktiengesellschaft 2002, 417, 420.

[7] MADER, Regulierung, Deregulierung, Selbstregulierung: Anmerkungen aus legistischer Sicht, in: Zeitschrift für Schweizerisches Recht 2004, 5, 18.

to distinguish between three general stages in the development of the modern conception about the role and tasks the state has to fulfill or – put differently – the proper scope of government, i.e., the shifting balance between state and society, and the corresponding development of regulation:[8] first, the age of liberalism; second, the birth and expansion of the welfare state; and third, its growing crisis.[9]

1. The Liberal Project

The "first" German – i.e., Prussian – welfare state developed under the absolute monarchy in the 18th century. But in the first half of the 19th century – based on the ideas of Immanuel Kant and Wilhelm von Humboldt and strongly influenced by the liberal British tradition and the work of Adam Smith – we see the liberal idea and movement successfully fighting for political and economic freedom against the feudal and mercantilist state. Protection of freedom and realization of law as the liberal state's central and primary tasks gradually replaced the former absolutist public welfare orientation. State intervention was now only accepted as a means to guarantee safety and equality of opportunity; responsibility for welfare was delegated to society. Central to the liberal concept were acknowledgement and protection of civil rights. Modern codifications of civil and commercial law were written. The German Civil Code that went into force on January 1, 1900 – after twenty years of preparation – is probably one of the most prominent examples of a code shaped by the liberal concept of law.[10] A watershed in the attitude toward the freedom of enterprise was the law of June 11, 1870,

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[8] *Cf.*, e.g., OGUS, Regulation. Legal Form and Economic Theory (Oxford 1994) 6 et seq.; MADER, *supra* n. 7, 19 et seq.; GÜNTHER, Der Wandel der Staatsaufgaben und die Krise des regulativen Rechts, in: Grimm (ed.), Wachsende Staatsaufgaben – sinkende Steuerungsfähigkeit des Rechts (Baden-Baden 1990) 51 et seq.; also WILLKE, Supervision des Staates (Frankfurt/M. 1997) 11 et seq.

[9] A complementary study focused on a four stage model of development in Italian corporate governance is FERRARINI, Corporate Governance Changes in the 20th Century: a View from Italy, in: Hopt / Wymeersch / Kanda / Baum (eds.), Corporations, State, Markets, and Intermediaries: Changes of Governance in Europe, Japan, and the U.S. (Oxford, in preparation for 2005).

[10] RGBl 1896, 195 as amended.

the so-called *Aktiennovelle*, that finally abolished the long-disputed requirement to obtain a state concession before establishing a stock corporation.[11]

However, these developments notwithstanding, in the last three decades of the 19th century liberal ideas began to lose influence rapidly as the liberal project came under severe attack from two sides: the socialists as well as the conservatives. The latter especially, in the form of Bismarck's so-called *Staatssozialismus*, proved deadly for German liberalism, with dire long-term consequences for the country.[12]

2. Birth of the Modern Welfare State

From the 1870s onward, the thinking of the so-called Historical School or *Kathedersozialisten* began to dominate the political economy in Germany. The leading figure was the economist Gustav Schmoller. The Historical School became highly influential, dominating academic positions in most (especially Prussian) universities well into the 20th century. This new line of reasoning was highly critical of the laissez-faire concept based on Adam Smith's idea of a market economy that governs itself, disparaging it as "Manchester capitalism." Instead, the school's representatives advocated a decisive role of the state in social policy. Although opinions differed in detail, the core concept shared by most was to overcome the liberal understanding of the state as a necessary evil and replace it with a view of the state as the highest ethical institution for educating mankind. Not the individual but the national community and its noble embodiment in the nation state – in this case, the newly founded German Reich –

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[11] Gesetz, betreffend die Kommanditgesellschaften auf Aktien und die Aktiengesellschaften, BGBl Nordd. Bund 1870, 375; HOPT, Ideelle und wirtschaftliche Grundlagen der Aktien-, Bank- und Börsenrechtsentwicklung im 19. Jahrhundert, in: Coing/Wilhelm (eds.), Wissenschaft und Kodifikation des Privatrechts im 19. Jahrhundert (Frankfurt/M. 1980) 128, 167; for an extensive analysis of the system of state concession and its overcoming, *see* SCHUBEL, Verbandssouveränität und Binnenorganisation der Handelsgesellschaften (Tübingen 2003) 87 et seq., 280 et seq.

[12] A seminal study about the political defeat of German liberalism in the late 19th century can be found with RAICO, Die Partei der Freiheit. Studien zur Geschichte des deutschen Liberalismus (Stuttgart 1999); the classical treatise on liberalism is VON MISES, Liberalismus (Jena 1927, reprint Sankt Augustin 1993); *cf.* VORLÄNDER, The Liberal Tradition in Germany, in: Meadowcroft (ed.), The Liberal Tradition Revisited (Cheltenham 1997); MANOW, The Uneasy Compromise of Liberalism and Corporatism in Postwar Germany, Center for German and European Studies Working Paper (Berkeley 1999).

should be regarded as the righteous center of economic and social life. Accordingly, the bureaucracy was supposed to play a very active role in the economy as in other areas of social life. In other words, in this view the scope of government was to be conceived as broadly as possible. The logical consequence of the adoration of the state was a disdain for the civil (*bourgeois*) society. The notion of a strong state extended well into politics, where the Historical School strongly supported the armament of the Reich and its imperialistic foreign policy.

These lines of thinking corresponded well with the Reich's first chancellor's (and his successor's) policies. In the 1880s, Bismarck initiated a comprehensive social program – namely a social insurance system – based on a paternalistic understanding of an active state's role in social life. Actually, already existing and functioning private insurers and cooperative social insurance institutions were forcefully integrated into the new mandatory state system.[13] While officially fighting against the socialists, his conservative government was de facto promoting their ideas by ruthlessly denigrating economic liberalism and the concept of a free market economy while constantly expanding the scope of government and its interventions in the market.[14] His official policy of helping the working class notwithstanding, Bismarck raised steep tariffs on imports of corn and steel – thus burdening private households with higher costs of living – for protecting the special interests of the influential national farmers and industry to win their consent for his expensive armament program. The development of cartels and associations was allowed and sometimes even promoted. Basically, we already see the well-known pattern of a government doling out all kinds of favors to special interest groups while hiding the costs that have to be borne by society at large. The increase of tasks claimed by the government led not only to more regulation but also to the formation of state monopolies and public enterprises. This resulted in increasing economic activities of the state in public infrastructure projects such as railways or in the postal and telecommunications sector. The nationalization of the various private railways by the state at the end of the 19th century was an important

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[13] MANOW, *supra* n. 12, at 5.

[14] This principle-based critique was voiced by Ludwig Bamberger, one of the leaders of the liberal opposition, in a speech at the German parliament (the *Reichstag*) on April 1, 1881; the speech is (partially) reprinted in: Tamm (ed), Kleines Lesebuch der liberalen Sozialpolitik (Sankt Augustin 2004) 35 et seq.

further step in the gradual shift from the liberal, laissez-faire attitude to the welfare state.[15]

One of the liberal opposition's main concerns about Bismarck's welfare policy was that it would create growing expectations which the state could never fulfill in the long run.[16] This criticism prophetically describes the situation with which the system finds itself confronted one hundred years later at the beginning of the 21st century. However, liberal criticism was not restricted to the expanding state intervention in the market; it was much more fundamental. The opposition perceived the change in policy during the 1880s and 1890s as a disguised return to the discredited 18th-century state paternalism and mercantilism and a betrayal of what they regarded as the most important achievement of the 19th century: the liberation of the citizens and creation of an open society. In their view, Bismarck's aim was not to address actual social shortcomings in the reality of liberalism *within* its framework, but rather to *change* that frame.[17] They observed that by making people dependent on transfers from the state and by the idealization of the nation state, a mentality of blind obedience and trust in government was created. Indeed, it was the deliberate aim of the conservative government's policy not to enable the working class to build up resources of their own to secure their well-being in an independent way, but rather to keep them dependent on the state rents and benevolence to assure their identification with the state and their acceptance of its actions. In the case of the German Reich, this meant a notorious support for a nationalist and increasingly militarized state. But undeniably, at least in the short run, the interventionist welfare-oriented policy produced measurable improvements of life that made opposition against it difficult; however, as the liberals had warned in vain time and again, the price for the paradigmatic shift was to be paid later.[18]

The late 19th-century renunciation of the liberal project in favor of an idealized notion of the state has been presented here in some detail because it is not simply history. It has created a lasting and unfortunate legacy that is highly relevant for today's problems: the persistent and deeply ingrained present-day German belief in a perceived unlimited competence of the state that prompts people to call for the government's

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[15] KÄMMERER, Privatisierung (Tübingen 2001) 64 et seq.
[16] *Cf.* RAICO, *supra* n. 12, at 170 et seq
[17] RAICO, *supra* n. 12, at 172 et seq.
[18] A pointed criticism of interventionist welfare-oriented policy and its disastrous long-term consequences can be found with VON HAYEK, The Fatal Conceit (Chicago / London 1988).

helping hand whenever a social problem arises, a belief which has its roots in the willful discreditation of liberalism a century ago.[19] The director of a leading German economic think tank identified the general public's deeply ingrained skepticism – if not outright rejection – of the market mechanism as the greatest single obstacle obstructing urgent reforms in 21st-century Germany. In his view, no reform of the labor market, the social system, and public finance, however well designed, will ever be successful until the historical misunderstanding of a perceived superiority of governmental and/or collective-corporatist strategies over market-based solutions is corrected and a broader understanding – and general acceptance – of the free market economy as an indispensable correlate of the open society enshrined in our Constitution of 1949 is reached.[20]

3. Crisis of the Welfare State

By the turn of the 19th century, responsibility for public welfare had essentially shifted back from society to the state, and the "second" – the modern – German welfare state was established. The war economy from 1914 to 1918, the economic crisis after the lost war, hyperinflation and the Great Depression, and finally the re-armament under the Nazi regime and then World War II all led to a constant increase of state intervention and growth of regulation. After 1945, at least for a short while, the trust in the authoritative state's guiding hand seemed to have been somewhat shaken. The chance was taken by economists and jurists in the ordo-liberal tradition to create a specific economic and legal order, the "social market economy." Some call it a "complex historical compromise between liberalism and two competing countervailing forces, social democracy and social Catholicism; between traditionalism and two opposed versions of modernism, liberalism and socialism; and of course between capital and labor."[21] But actually, for some time at least, the liberal element was probably the

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[19] WATRIN, Klassischer Liberalismus in Deutschland, in: Raico, *supra* n. 12, at XI; BÖHM, Die Idee des Ordo im Denken Walter Euckens, in: Mestmäcker (ed.), Franz Böhm. Freiheit und Ordnung in der Marktwirtschaft (Baden-Baden 1980), 11, 43 et seq.

[20] HÜTHER, Deutsche Mythen, in: Frankfurter Allgemeine Zeitung, ed. no. 182 of 7 August 2004, p. 11; *cf.* also SPRENGER, Der dressierte Bürger (Frankfurt/M. 2005); fifty years earlier Franz Böhm had articulated similar worries; ID., *supra* n. 19.

[21] STREECK / YAMAMURA, Introduction: Convergence or Diversity? Stability and Change in German and Japanese Capitalism, in: Yamamura/Streeck (eds.), The End of Diversity? Prospects for German and Japanese Capitalism (2003) 11.

decisive aspect of this compromise. Among other reforms, the first large-scale privatization of state enterprises since the early 19th century was initiated.[22] However, even then the foundations of the welfare state were not changed. For example, the mandatory public social insurance system based on (inter-generational) shared financing was not replaced by a private scheme based on accumulation of capital.

In any case, after the economic crisis of 1966/67 and the ensuing formation of the "great coalition" between conservatives and social democrats, priorities shifted again and the old mistrust in free enterprise and market solutions raised its voice once more, this time louder then ever. The slogan of the day was to "test" the economy's ability to shoulder social burdens in the form of ever higher taxes, social duties, and all kinds of restrictive regulations for the sake of promoting the public good.[23] By the mid-1990s, continuous expansion of the scope of government had driven the ratio of public spending to the GNP to more than 50 percent in Germany, and social transfers amounting to 1,000 billion German marks per year equaled the sum of annual exports.[24] Four decades of social and economic policy based on the erroneous assumption that in an open society the repercussions of change for the individual citizen can be neutralized by government intervention have created a "welfare state bubble" that is no longer sustainable.[25] The financial overburdening of the state has become increasingly visible, and the collapse of social security systems has become a real threat in the face of an aging society and persistent long-term unemployment at historical heights. Especially the latter is undermining the specific social cohesion that the institutions of the German political economy had been designed to ensure.[26]

Another consequence of the welfare state in Germany and elsewhere has been a steady and in some areas dramatic increase in regulation, especially in social regulation during most of the last century. Most of it has been restrictive regulation, meaning any

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[22] *Cf.* KÄMMERER, *supra* n. 15, at 74 et seq.

[23] This has been criticized as market socialism by stealth, *cf.* SCHÜLLER, Soziale Marktwirtschaft und Dritte Wege, in: ORDO. Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft 51 (2000) 169, 180 et seq.

[24] MÖSCHEL, Den Staat an die Kette legen – Gegen die Aushöhlung des Wettbewerbs durch den Staat (Bad Homburg 1995); annual transfers from the West to the East German states, the *neue Bundesländer*, accounted "only" for some 10 to 15 percent of that amount.

[25] HÜTHER, *supra* n. 20; *cf.* also HAMM, *surpra* n. 4, at 164 et seq.

[26] STREECK / YAMAMURA, *supra* n. 21, at 13.

kind of restriction decreed or enforced by the state on people's possibilities of action.[27] A corresponding phenomenon has been the increase in people employed in the public sector. From 1950 to 1985 their number more than doubled, while the German population only rose by some 20 percent. This group of the working population is also vastly over-represented in parliament: presently they hold about two-thirds of the seats. Whether – and if so, when – regulatory intensity reached its peak in Germany is difficult to say. Certainly this was not as early as in the United Kingdom, where the increase seemed to have peaked in the mid-1970s and a drive for deregulation had already started by the late 1970s.[28] In Germany, an intensification of the discussion and ensuing deregulatory measures did not start before the 1990s, and then mostly in the context of the privatization of public utilities as required by EC law.[29] In areas such as consumer or investor protection, the surge of new regulation does not seem to have significantly ebbed. In general, things have been delayed by the fact that the decade of the 1990s was partly lost for reforms as attention was focused on the historic task of coping with the (economic and other) consequences of the German unification.[30]

Along with the difficulties of financial sustainability and stifling over-regulation (over-patronization), the modern welfare state sees itself confronted with another fundamental problem: a growing discrepancy between public expectations and the state's ability to act.[31] The state has shouldered an ever greater responsibility, and by now its tasks encompass a comprehensive responsibility for maintenance and development of society in almost every aspect: social, economic, and cultural. In other words, the state's task is no longer restricted to the defense of the given social order

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[27] For a concept of regulation, *cf.* BASEDOW, Economic Regulation in Market Economies, in: Basedow / Baum / Hopt / Kanda / Kono (eds.), Economic Regulation and Competition (The Hague 2002) 2 et seq.

[28] *Cf.* OGUS, *supra* n. 8, at 8 et seq.

[29] *Cf. infra* at 4.

[30] This actually is reminiscent of Japan, where – though for other reasons – the 1990s are called the "lost decade" because of missed chances for reform; *cf.* BAUM, Der japanische "Big Bang" 2001 und das tradierte Regulierungsmodell – Ein regulatorischer Paradigmenwechsel?, in: Rabels Zeitschrift für ausländisches und internationales Privatrecht 64 (2000) 633.

[31] GRIMM, Der Wandel der Staatsaufgaben und die Krise des Rechtsstaates, in: Grimm (ed.), Wachsende Staatsaufgaben – sinkende Steuerungsfähigkeit des Rechts (Baden-Baden 1990) 291, 296 et seq.; GÜNTHER, *supra* n. 7; WILKE, Entzauberung des Staates (Königstein 1983); WILKE, *supra* n. 7; *cf.* also the contributions to the 18th International Seminar on New Institutional Economics – The Proper Scope of Government, in: JITE (157) 2001.

against disturbances; instead, this order itself has become the object of design and transformation by the state.[32] However, the powers of government have not grown in proportion to its expanded tasks. Thus it has increasingly become necessary to involve non-public institutions such as associations in implementing policies by delegating tasks to them and relying on their regulations, or to enter into public-private partnerships. Where traditional imperative regulatory tools are not suited for new tasks, other indirect means and soft instruments are used to implement policies such as financial incentives and disincentives or recommendations.[33] As these devices are non-binding, implementation depends on the cooperation of the ones addressed. This results in the development of a regime characterized as a "cooperative administrative state."[34] At the same time, the use of individual freedom has become increasingly dependent on the prior provision of substantial or organizational means by the state. The pertinent decisions about these are often taken on a very general level in the form of planning and allocative decisions addressed to groups and not to the individual citizen. With the classical instruments of judicial control, protection by the courts is difficult to obtain if the courts are not taking the position of the planning agency, which in turn would undermine the separation between justice and administration.[35]

4. Signs of Change?

Although the attitude of the general public is (still) skeptical if not outright hostile to fundamental systemic changes,[36] the situation has become so critical that at least a partial retreat of the welfare state seems unavoidable. Two developments during the last years stick out, both of which can best be interpreted in accordance with this volume's topic: from state to market.

A first turning point was the previously mentioned large-scale privatization of public utilities from postal and telecommunication systems, railways, airlines, airports,

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[32] GRIMM, *supra* n. 31, at 297.
[33] *Cf.* MADER, *supra* n. 7, at 21 et seq.
[34] KÄMMERER, *supra* n. 15, at 57.
[35] GRIMM, *supra* n. 31, at 300.
[36] And the political parties are correspondingly reluctant to initiate such fundamental changes, HAMM, *supra* n. 4, at 154.

et al., that began in the 1990s and was mostly initiated by EC law.[37] The most prominent example is probably the functional and organizational split of the former Bundespost into three separate entities – at the first stage still subject to public law – each responsible for one of its former services: telecommunication, postal services, and banking (*Postreform I* of 1989). In a second step, those three Bundespost business entities were formally privatized in the *Postreform II* of 1994.[38] As a result, on January 1, 1995, Deutsche Telekom AG, Deutsche Post AG, and Deutsche Postbank AG became private corporations subject to the German Stock Corporation Law (*Aktiengesetz*). All of their shares were initially held by the government but were earmarked to be sold to the investing public.[39] In a third step, one year later Deutsche Telekom AG went public – the largest-ever initial public offering by a European company. After an extensive promotion campaign, the government successfully sold a stake of 25 percent. Some 40 percent of the total issue was placed with German retail investors. Nearly two million Germans subscribed to the offering; some 400,000 of those had never owned shares before.[40] A second tranche of shares was sold to the public in another offering in 2001. Though Deutsche Telekom AG as a listed company is financially independent and accountable for its results, its business activities are regulated under a sector-specific law, the German Telecommunications Act of 1996,[41] and are supervised by a special independent agency set up in 1998. This is an example of how the *qualitative* de-regulation of an industry actually results in more *quantitative* regulation in the form of sector-specific re-regulation, the so-called "new regulatory mix."[42] The difficult question of whether privatized public utilities as former monopolies should be regulated in this way, i.e., by sector-specific laws, or whether by

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[37] *Cf.*, e.g., DEREGULIERUNGSKOMMISSION, Marktöffnung und Wettbewerb (Stuttgart 1991); KREUZER (ed.), Privatisierung von Unternehmen (Baden-Baden 1995); KÄMMERER, *supra* n. 15, at 85 et seq.

[38] For details, *see* KÄMMERER, *supra* n. 15, at 297 et seq.

[39] The government plans to have sold more or less all its shares by the end of 2006; *cf.* report Frankfurter Allgemeine Zeitung, ed. no. 1 of January 3, 2005, p. 11.

[40] For a comprehensive analysis of the privatization of Telekom, *see* GORDON, Convergence on Shareholder Capitalism, in: Milhaupt (ed.), Global Markets, Domestic Institutions (New York 2003) 214, 226-242.

[41] The Act has been replaced by the new *Telekommunikationsgesetz*, Federal Gazette I (2004) p. 1190, in force since June 26, 2004; *cf.* SCHEER, Das neue Telekommunikationsgesetz, in: Neue Juristische Wochenschrift 2004, 3001.

[42] BASEDOW, *supra* n. 27, at 15 et seq.; MADER, *supra* n. 7, at 43.

general competition law is still debated. However, in any case, this discussion is about the *market* regulation.

Even though Deutsche Telekom AG still has a dominant market position in different areas, the privatization was a success: in the year 2000, more than 250 players were offering telecommunication services in Germany; tariffs, especially for long-distance and international calls, dropped significantly by over 90 percent compared to those before liberalization.[43] Less happy were those investors who bought shares in the secondary public offering at a high issue price only to see the share price collapse soon afterward. Between 2001 and summer 2003 (the beginning of limitation), some 15,000 aggrieved shareholders filed damages claims against Deutsche Telekom AG that since then have choked the District Court of Frankfurt.[44] Among other considerations, this in turn prompted the government to present a draft of a new law in 2004, the so-called "Draft Act Regulating Exemplary Investor Suits."[45] The law has four overall aims: to handle mass claims more efficiently, to make it easier and less financially risky for retail investors to pursue their interests, thus promoting private law enforcement of capital market regulation, which in turn should improve Germany's position in the international regulatory competition as a financial market with a modern and efficient legal framework. Obviously, the discussion is once more about *market* regulation.

What had started at the federal level driven mostly by the implications of the evolution toward a Single European Market and corresponding EC laws has developed a momentum of its own, mostly – especially at the local level – driven by fiscal motives. We now see on all three levels of government all kinds of "privatizations," formal as well as substantial ones, delegation of tasks (contracting out), public-private

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[43] *Cf.* SCHEUERLE, in: Basedow / Baum / Hopt / Kanda / Kono (eds.), Economic Regulation and Competition (The Hague 2002) 265 et seq.

[44] Another 17,000 have filed for mediation proceedings (*Güteverfahren*) at a special institution, the *Öffentliche Rechtsauskunft- und Vergleichsstelle Hamburg (ÖRA)*, to suspend the passage of time for purposes of limitation; they are free to join the ordinary proceedings later on.

[45] *Regierungsentwurf eines Gesetzes zur Einführung von Kapitalanleger-Musterverfahren* of November 17, 2004, published in: Neue Zeitschrift für Gesellschaftsrecht, Special Supplement to issue 11/2004; for a comment, *see* REUSCHLE, Ein neuer Weg zur Bündelung und Durchsetzung gleichgerichteter Ansprüche, in: Wertpapier-Mitteilungen 2004, 2334; HESS, Der Regierungsentwurf für ein Kapitalanlegermusterverfahrensgesetz – eine kritische Bestandsaufnahme, in: Wertpapier-Mitteilungen 2004, 2329.

partnerships, and other forms of de-administration.[46] For example, in the spring of 2004, the city of Hamburg held a plebiscite about a possible privatization of the city's public hospitals. A majority voted against it, but the city's government nevertheless sold a large chunk of those to a private company in August. Obviously, the state is gradually retreating from some of its – extensive – former economic activities.[47]

The second turning point may have been the admission that a supplementary private pillar in the public pension system is the only way out of the welfare crisis. The admittance of private provision in 2001 is regarded as a paradigmatic shift in the welfare system that was formerly designed as comprehensive state-organized protection and as the beginning of a "privatization" of welfare arrangements and the rise of "welfare markets."[48] If the development of liberal law was characterized by the shift from status to contract, and the development of the law of the welfare state by the further shift from contract to social role and social capacities, we now possibly see the beginning of a return from there to contract as a consequence of the privatization of welfare. Private law institutions, especially contracts, will regain some of their former relevance as instruments of individual social security.[49] Thus, one might add, by shifting welfare at least partly back to private ordering, the challenge is to solve social problems this time *within* the framework of the liberal model of a contract-based market economy – a chance that was missed in the late 19th century as discussed above. However, success probably depends to a large degree on whether it will be possible to change the

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[46] *Cf.* IMMENGA, Privatisierung im Zielkonflikt – Ein Vergleich der Konzeptionen, in: Kreuzer (ed.), Privatisierung von Unternehmen (Baden-Baden 1995) 9, 44 et seq.

[47] In December 2004 the Social Democratic Party faction of parliament (!) announced a plan to initiate a new law to substantially facilitate public-private partnerships in 2005 as a functioning alternative to state financing for a broad range of public projects; *cf.* report Frankfurter Allgemeine Zeitung, ed. no. 303 of December 28, 2004, p. 11.

[48] BÄUERLE, The Retreat of the Welfare State: Challenges to the German Welfare Regime and the Role of Law, in: Annual of German and European Law 2003, 43, 56 et seq.; the author gives a profound analysis of these developments with extensive further references; the pertinent law is the Federal Law Concerning the Certification of Private Pension Contracts of June 16, 2001 (*Gesetz über die Zertifizierung von Altersvorsorgeverträgen*, Federal Gazette I (2001) p.1310, 1322). The necessity of improving private pensions as supplementary pillar to the public pension system was one of the main topics of the 65th German Lawyers Meeting ("65. Deutscher Juristentag") in Bonn in 2004; for a discussion *see* ROTH, Private und betriebliche Altersvorsorge zwischen Sicherheit und Selbstverantwortung, in: Zeitschrift für Rechtspolitik 2004, 154.

[49] BÄUERLE, *supra* n. 48, at 45, 57 et seq.

general skepticism toward a free market economy that was created during that time. The main task will be to bridge the information asymmetry between the average citizen as an investor in and a consumer of various kinds of financial products by proper – legislative or judicial – regulation of disclosure and other information duties. Again, we are predominantly speaking about regulation that addresses market behavior.

We now turn from the etatist or welfare side of the German role model to its other characteristic: the specifically corporatist and consensus-based structure of its political economy that also has shaped the country's enterprise landscape so far.

II. Moving Toward a Market-Based Regime and Shareholder Capitalism?

1. Corporatism and Consensus-Based Interest Balancing

Not only the welfare state and its interventions substitute markets, but the same is true for corporatism, which can be described as an intermediate layer of decision making located between markets and the political process. The German system of governance is characterized by such a corporatist approach where decision making is delegated to a significant degree to social groups in various areas.[50] As mentioned above, up to a certain degree this is a consequence of the extended welfare state that uses cooperative means instead of mandatory measures, either because of lack of power or as a way to reduce resistance. However, the extent to which corporatist governance prevails in the German economy is not a necessary result of the redistributive aims of the welfare state, let alone the social-market economy as such. Instead, it has historical roots that date back to the 19th century. By sharing power with special interest associations — which usually then profit at the expense of the general public or other groups in society — the government secures the assistance of the players it obviously regards as important for its policies. The most prominent example is the privilege of the unions and business associations to negotiate wages for their members, which are then extended de facto to all those employed, as well as — indirectly — to the unemployed, for legal rules and courts do not allow deviations from the terms agreed upon in the collective wage

[50] For an in-depth analysis, *see* SIEBERT, Corporatist versus Market Approaches to Governance, in: Hopt / Wymeersch / Kanda / Baum (eds.), Corporations, State, Markets, and Intermediaries: Changes of Governance in Europe, Japan, and the U.S. (Oxford, in preparation for 2005).

contract. This setting favors those who are employed at the expense of the unemployed, who may legally not accept lower wages as a trade-off for a job.[51]

The corporatist setting is supplemented by mandatory enterprise co-determination as part of the German corporate governance structure. It was introduced in 1976 and is widely seen as one of the hallmarks of German corporatism.[52] Under this regime, half of the supervisory board seats of large companies (more then 2,000 employees) are filled by labor representatives. As at least two seats are reserved for representatives of trade unions, their continuous influence is stabilized in spite of a shrinking membership base. This gives labor control rights over corporate decisions and leads to a kind of negotiated management where – in the terms of Hirschman – labor has voice as an alternative to exit. The result is a willingness for long-term commitment.[53]

A further aspect has been patient capital generated by high savings and distributed to the firms by bank credit, with the banks usually holding seats on the boards – at least with good customers. Bank loans constituted some 80 percent of long-term external funding to German business in the 1990s.[54] Here, too, relations were obviously rather long term. With committed labor and patient capital, management could take the long view based on stable bargains with and between all those involved.[55] Thus quality-competitive production based on collectively negotiated cooperation could substitute for

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[51] SIEBERT, *op. cit.*

[52] A recent critical analysis can be found, e.g., with DU PLESSIS / SANDROCK, The Rise and Fall of Supervisory Codetermination in Germany?, in: International Company & Commercial Law Review 2005, 67; SCHIESSL, Leitungs- und Kontrollstrukturen im internationalen Wettbewerb, in: Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht 167 (2003) 235. A recent study found that companies with equal representation of employees and shareholders on the supervisory board trade at a 31 percent stock market discount as compared with companies where employees representatives fill only one third of the supervisory board seats, *see* GORTON / SCHMID, Capital, Labor, and the Firm: A Study of German Codetermination, in: Journal of the European Economic Association 2004, 863. The problems caused by trying to adjust the German concept of co-determination to the *Societas Europaea* are discussed by ROTH, Die unternehmerische Mitbestimmung in der monistischen SE, in: Zeitschrift für Arbeitsrecht 35 (2004) 431.

[53] STREECK / YAMAMURA, *supra* n. 21, at 13.

[54] R. H. SCHMIDT, Corporate Governance in Germany: An Economic Perspective in: Krahnen / Schmidt (ed.), The German Financial System (Oxford 2004) 386, 395.

[55] STREECK / YAMAMURA, *supra* n. 21, at 13.

price competition that was no option for German firms because of the high costs of socially regulated labor markets and status protection for various social groups.[56]

The banks' role in corporate governance as so-called "house banks" was enhanced not only by supplying capital and seats on the supervisory boards but also by their voting power – whether because of holding shares of their own or because of depository voting on behalf of mostly disinterested public shareholders (*Depotstimmrecht*).[57] Personal relationships also played a role. Insiders control the supervisory boards when – as is still frequently the case – the former CEO (chairperson of the managing board) changes positions after stepping down from that board by becoming the chairperson of the supervisory board.[58]

Two important additional elements of the corporatist approach to corporate governance should be mentioned. The first is blockholding. As recently as 1996, 64 percent of the voting rights of listed German companies were held by controlling shareholders whose shares in the company amounted to more than 50 percent of the capital; a further 17 percent of the companies had at least one shareholder who controlled more than 25 percent of the voting rights.[59] A large number of listed companies are part of enterprise groups (combined companies) with only a minority of their shares listed. Blockholders are mostly other business enterprises, wealthy families, and banks.[60] This pattern results in a complex web of cross-shareholdings in which two institutions traditionally have played a predominant role: *Deutsche Bank*, the country's biggest bank; and the giant insurer, *Allianz AG*. The web of cross-shareholdings is

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[56] ID at 12.

[57] An extensive analysis of the various elements of corporate governance in Germany and their factual settings can be found with PRIGGE, A Survey of German Corporate Governance, in: Hopt / Kanda / Roe / Wymeersch / Prigge (eds.), Comparative Corporate Governance (Oxford 1998) 943.

[58] In summer 2004 this was (still) true for more than half of the incumbent chairpersons of the supervisory boards of the Dax-30 companies – a recommendation of the German Corporate Governance Code of 2002 to the contrary notwithstanding; *cf.* report Frankfurter Allgemeine Zeitung, ed. no. 195 of August 23, 2004, p. 14.

[59] BARCA / BECHT (eds.), The Control of Corporate Europe (2001) 319; *see* also MCCAHERY / RENNEBOOG / RITTER / HALLER, The Economics of the Proposed European Takeover Directive, in: Ferrarini / Hopt / Winter / Wymeersch (eds.), Reforming Company and Takeover Law in Europe (Oxford 2004) 575, 584 et seq; PRIGGE, *supra* n. 56, at 972 et seq.

[60] R. H. SCHMIDT, *supra* n. 54, at 394.

supplemented by reciprocal seats on supervisory boards. This setting has been somewhat critically labeled *"Deutschland AG"* or "Germany, Inc."[61]

The ownership pattern was reflected in an underdeveloped market for corporate control. Hostile takeovers were a rare exception. Hostile sales of blocks did happen, but again were much less frequent than, e.g., hostile takeovers in the UK or the U.S.[62]

This corporatist corporate governance regime is generally classified as the standard example of an insider-controlled and stakeholder-oriented system as opposed to a "modern" capital-marked-based and outsider-controlled system. However, as has recently been stressed, it has been a system with an inner logic, with complementary and consistent features — in other words, a system that worked.[63] Moreover, it has shown surprising stability for more than three decades. This was interrupted, however, by the successful takeover of Mannesmann AG by Vodafone AirTouch plc in 1999/2000, the biggest of all hostile takeovers so far in Europe. Might this represent the writing on the wall of Germany's corporatist setting?

2. Signs of Change?

Whether a paradigmatic change is underway remains to be seen. Dominant groups with vested interest in the given system — such as the trade unions, for example — will not easily surrender their power. However, various threads of the rough picture sketched above are obviously unraveling. Just a few of those aspects follow:[64] The industrial strategy of broad incremental innovation allowed under the consensus system has ceased to generate sufficient advantages in non-price-competitive markets.[65] Capital has ceased to be patient; instead, it has become mobile and cosmopolitan in the pursuit of

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[61] For a pointed critical analysis, *cf.* BEYER, Deutschland AG a.D.: Deutsche Bank, Allianz und das Verflechtungszentrum des deutschen Kapitalismus, in: Streeck / Höpner (eds.), Alle Macht dem Markt? Fallstudien zur Abwicklung der Deutschland AG (Frankfurt/M. 2003) 118 et seq.

[62] *Cf.* JENKINSON / LJUNGQVIST, The Role of Hostile Stakes in German Corporate Governance, in: J.Corp.Fin. 7 (2001) 397 et seq.

[63] R. H. SCHMIDT, *supra* n. 54, at 397 et seq.

[64] For a comprehensive analysis, *see*, e.g., GORDON, *supra* n. 40; STREECK / YAMAMURA, *supra* n. 21; STREECK / HÖPNER (eds.), Alle Macht dem Markt? Fallstudien zur Abwicklung der Deutschland AG (Frankfurt(M. 2003), and, controversially, R. H. SCHMIDT, *supra* n. 54.

[65] STREECK / YAMAMURA, *supra* n. 21, at 14.

faster and higher profit.[66] Banks are increasingly giving up their role as *Hausbanken* and disposing of their shareholding, turning into Anglo-American-style investment banks.[67] Thus begins the dissolution of the web of cross-shareholding. Furthermore, *Deutsche Bank*, for example, seems to be actively reducing its role in corporate governance. It has given up board seats and has advised its top managers to avoid chairmanships on supervisory boards of other companies.[68]

On the other hand, certain elements typically associated with outsider- or market-based systems seem to be increasing. In particular, the privatization and going public of *Deutsche Telekom* described above has been a major boost for shareholder capitalism in Germany, i.e., public ownership and a strong equity market.[69] Since the mid-1990s the number of stock corporations has more or less quadrupled;[70] there has also been a rise in listings and of market capitalization;[71] and the number of Germans owning shares (directly or indirectly via funds) has nearly doubled.[72] The (initial) success of the *Neuer Markt*, established by the *Deutsche Börse* in 1997 as a Nasdaq competitor for launching initial public offerings of high tech companies, can also be seen in this way.

In addition, a cautious discussion about the advantages and disadvantages of collective bargaining and co-determination has at least begun;[73] both were absolute non-

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[66] ID at 15. A telling example of capital no longer being patient was the spectacular failure of the leading German exchange, Deutsche Börse AG, to takeover the London Stock Exchange (LSE) early in 2005. The management of Deutsche Börse was forced to withdraw its bid because of resistance by its own shareholders to the proposed takeover; *cf.* report Frankfurter Allgemeine Zeitung, ed. no. 58 of March 10, 2005, p. 23.

[67] BEYER, *supra* n. 61, at 126 et seq.

[68] R. H. SCHMIDT, *supra* n. 54, at 416.

[69] *Cf.* GORDON, *supra* n. 40, at 226 et seq.

[70] *Cf.* DEUTSCHES AKTIENINSTITUT, DAI-Factbook 2003 (Frankfurt/M. 2004) 01-1. However, the total number of roughly 15,000 stock corporations still seems modest in an international comparison, and it compares with about one million limited liability companies registered in Germany.

[71] The market capitalization of shares of domestic companies listed at Deutsche Börse has nearly tripled between 1993 and 2003; *cf.* World Federation of Exchanges, Statistics, www.fibv.com.

[72] From 5.6 million in 1997 to 10.4 million in 2004; *cf.* DAI-Kurzstudie 1 / 2005, reprinted in: Die Aktiengesellschaft 2005, R67, R68; but, again, the total number of 833 listed companies (as of 2003) seems modest in an international comparison.

[73] *Cf.*, e.g., the report of a joint commission established in 2004 by the Federation of German Industries (BDI) and the Confederation of German Employers' Associations (BDA): BDA/BDI, Mitbestimmung modernisieren. Bericht der Kommission Mitbestimmung (November 2004) at:

topics until very recently. The same is true for the insider control of supervisory boards by former CEOs mentioned above.

So a gradual and partial de-bundling of the corporatist "*Deutschland AG"* appears to be somewhat probable. However, it is yet another question whether this partial shift toward an outsider- and market-oriented governance model — which may result in a breakdown of the traditional system without having the new one already in place and functioning — will bring an advantage. Possibly, we might end up in the worst of both worlds, at least for some time.[74]

III. Legislative Reactions: Change of Regulatory Model?

The structural developments are accompanied by regulatory changes that seem even more explicit. For many decades, German law basically distinguished only between corporate laws, banking, and exchange regulation – none of it with any specific reference to markets. By now this situation has fundamentally changed.

1. Financial Market Regulation

Although a market-based regulation of financial services in its own right became part of the German legal system only fairly recently, today such an independent and extensive body of financial market regulation is firmly established in addition to the exchange and banking laws.[75] Furthermore, exchange regulation itself has been developed into a modern market-based set of rules. The formation of this regulatory regime shall be briefly summarized.

Not until the early 1990s did the gradual change from bank-based to market-oriented finance and the necessity to implement EC regulation such as the insider trading rules lead to the formation of a specific securities regulation in the Anglo-

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www.bdi-online.de; in October 2004 the liberal faction (FDP) filed a motion in Parliament to reform co-determination: Konzernmitbestimmung neu ordnen – Aufsichtsräte und Eigentümerrechte stärken, BT/Drucks. 15/4039; *cf.* also DU PLESSIS / SANDROCK or SCHIESSL, *supra* n. 52.

[74] This is the expressive warning of R. H. SCHMIDT, *supra* n. 54, 419.

[75] The first German treatise dealing with that subject was HOPT, Der Kapitalanlegerschutz im Recht der Banken (Munich 1975), which initiated the German discussion.

American sense. An additional reason was the fear of an imminent loss of reputation for the *Finanzplatz Deutschland* (Germany as a financial center) because of inferior or non-existent securities regulation. The push for modernization was therefore mainly induced from abroad.

To begin with, the Stock Exchange Act of 1896 (*Börsengesetz*) was amended several times in the last two decades. In 2002 the Act was completely revised as part of the so-called "Fourth Financial Market Promotion Act."[76] In an incremental, path-dependent, stop-and-go progress, the law is slowly developing into a modern market-based regulation of exchanges services to replace the former regulation of a quasi-public monopoly.[77] Today we see a mix of (mostly) state-of-the-art regulations such as §§ 58 - 60 of the Act dealing with alternative trading systems[78] standing beside (some) remaining anachronistic provisions.[79]

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[76] Law of June 21, 2002, Federal Gazette I (2002) p. 2010; the revision of the Exchange Law went into force July 1, 2002, except §§ 58 I, 59, and 60 which went into force February 1, 2003. An overview can be found with MÖLLER, Das Vierte Finanzmarktförderungsgesetz, in: Wertpapier-Mitteilungen 2001, 2405. As the name of the Act indicates, it is the fourth in a series of Financial Market Promotion Acts starting with the First Act in 1990 (Federal Gazette I (1990) p. 266), followed by the Second Act in 1994 (Federal Gazette I (1994) p. 1760), and the Third Act in 1998 (Federal Gazette I (1998) p. 529).

[77] *See* BAUM, Changes in Ownership, Governance, and Regulation of Stock Exchanges in Germany: Path Dependent Progress and an Unfinished Agenda, in: European Business Organization Law Review 5 (2004) 677; MERKT, Empfiehlt es sich, im Interesse des Anlegerschutzes und zur Förderung des Finanzplatzes Deutschland das Kapitalmarkt- und Börsenrecht neu zu regeln? Börsenrechtliches Teilgutachten. Gutachten G., in: Deutscher Juristentag (ed.), Gutachten F + G zum 64. Deutschen Juristentag Berlin 2002 (Munich 2002) pp. G 1 - G 143; *cf.* also FERRARINI, Exchange Governance and Regulation: An Overview, in: Ferrarini (ed.), European Securities Markets: The Investment Services Directive and Beyond (The Hague 1998) 245 et seq; KÖNDGEN, Ownership and Corporate Governance of Stock Exchanges, in: Journal of Institutional and Theoretical Economics (JITE) 154 (1998) 324 et seq.; a comprehensive analysis can be found with HOPT / RUDOLPH / BAUM (eds.), Börsenreform. Eine ökonomische rechtsvergleichende und rechtspolitische Untersuchung (Stuttgart 1997).

[78] Also called (in EU parlance) multilateral trading systems or (elsewhere) electronic communication networks.

[79] A prime example for this is § 1 of the Act. The provision stipulates that a competent state authority must approve the formation of an exchange instead of reserving the pure business decision for the applicant (and the market). When deciding, the state authority – a bureaucracy (!) – has to check whether the market for exchange services "needs" the intended new exchange.

The decisive reform, however, was the enactment of the Securities Trading Act of 1994 (*Wertpapierhandelsgesetz*, hereinafter *WpHG*). This Act was part of the Second Financial Market Promotion Act[80] and has been described as the "basic law" for the German capital market.[81] It transformed the Insider Directive,[82] the Transparency Directive,[83] and (partly) the Investment Services Directive[84] into German law. The law introduced a new era of ordering to the German capital markets because it is not aimed at regulating a special product or participant but the market *as such*. Prior to this, the perspective of regulation could be described as having focused on the institutions and their legal form and, accordingly, the emphasis had been on the law of the stock corporation, exchanges, and banks.

Since its enactment, the WpHG has been repeatedly amended and its scope of application has been broadened. Further reforms are pending as new directives have to be implemented in German law.[85] The WpHG is independent of the Stock Exchange Act and does not regulate exchanges. Whether that distinction makes sense in the age of electronic securities trading on all different types of platforms seems at least questionable.

Along with the enactment of the WpHG, a new supervisory agency, the Federal Securities Trading Supervisory Agency (*Bundesaufsichtsamt für den Wertpapierhandel*), was established. In 2002 it was merged together with the former Federal Banking Supervisory Agency and the Federal Insurance Supervisory Agency into the Federal Financial Services Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, hereinafter *BaFin*).[86] The BaFin is an independent federal administrative agency under the supervision of the Ministry of Finance and thus a governmental authority rather than a self-regulatory body. Its staff consists of public employees.

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[80] Federal Gazette I (1994) p. 1794 / Federal Gazette I (1998) p. 2708.
[81] *Cf.* HOPT, Grundsatz- und Praxisprobleme nach dem Wertpapierhandelsgesetz, in: Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht 159 (1995) 135, 163.
[82] Directive 89/592/EEC, (1989) OJEC L 334/30.
[83] Directive 88/627/EEC, (1988) OJEC L 348/62.
[84] Directive 93/22/EEC, (1993) OJEC L 141/27.
[85] *Cf. infra* n. 88.
[86] An overview of organization and tasks of the new agency can be found with HAGEMEISTER, Die neue Bundesanstalt für Finanzdienstleistungsaufsicht, in: Wertpapier-Mitteilungen 2002, 1773 et seq.

With the WpHG and the BaFin, the cornerstones of a modern market-based regulatory and supervisory regime are in place. A third feature is presently in the making: private law enforcement in the form of damages suits filed by investors.

This kind of private law enforcement begins to supplement the traditional forms of public enforcement by means and sanctions of administrative and criminal law. In this regard three current legislative projects are of specific interest:[87] The "Draft Act Regulating Exemplary Investor Suits" of November 2004 has already been mentioned.[88] In October 2004 the "Act on Improved Investor Protection" went into force.[89] Among other changes, the law predominantly amends the WpHG by reforming the regulations of insider trading and market manipulation and extending the liability for untrue financial statements.[90] The third (and highly controversial) project is the "Draft Act on Liability for Capital Market Information" of October 2004.[91] This law stipulates a personal liability of board members who deceive the capital markets by supplying false information.[92] Recent decisions by the Federal Supreme Court (BGH) dealing with tort liability of board members for inaccurate ad-hoc publicity (disclosure) follow the same venue.[93]

Among other considerations, the legislators justify all the reforms in these areas by the need to create an attractive legal framework so that the German financial market will become or stay attractive for foreign as well as domestic investors. This means that the legislators have (finally) accepted the fact that an international regulatory competition

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[87] For a more extensive English overview, *see* NOACK / ZETZSCHE, Corporate Governance Reform in Germany: The Second Decade, Working Paper on German and International Civil and Business Law (AZW Series), January 2005, at 19 et seq; www.jura.uni-duesseldorf.de/dozenten(noack/azw/.

[88] *Cf. supra* n. 45 and accompanying text.

[89] *Anlegerschutzverbesserungsgesetz* of October 29, 2004, Federal Gazette I (2004) p. 2630.

[90] Parts of the Act are transforming recent EU legislation. For an overview, *see* the contributions by DREYLING, CAHN, SIMON, KIRSCHHÖFER and ERKENS, in: Der Konzern 2005, 1, 5, 13, 22 and 29 respectively.

[91] *Entwurf eines Gesetzes zur Verbesserung der Haftung für falsche Kapitalmarktinformation* of October 7, 2004.

[92] A critical analysis can be found with SPINDLER, Persönliche Haftung der Organmitglieder für Falschinformation des Kapitalmarktes, in: Wertpapier-Mitteilungen 2004, 2089.

[93] These are the so-called "Informatic" decisions of July 19, 2004, in: Neue Zeitschrift für Gesellschaftsrecht 2004, 811; Der Betrieb 2004, 1928; a comment can be found with FLEISCHER, Zur deliktsrechtlichen Haftung der Vorstandsmitglieder für falsche Ad-hoc-Mitteilungen, in: Der Betrieb 2004, 2031.

does exist.[94] The more recent reforms are part of the implementation of a ten-point agenda for strengthening corporate integrity and investor protection that the German government presented on February 23, 2003. If one includes the pending reforms, the emphasis is clearly on the regulation of information: enhanced disclosure duties, stricter liability for insufficient or misleading information, and more efficient means of private enforcement of mandatory disclosure rules by damages suits. The overriding principle is disclose or abstain. Regulation of disclosure is basically market regulation. Here, German legislators are obviously adapting the regulatory model of the capital-market-based and outsider-oriented system.[95] Of course, to a significant degree – but by no means exclusively – reforms are prompted by EU legislation. Whether the regulatory density caused by the accumulation of the various legislative measures is really necessary for – and actually capable of – deterring criminal behavior on the market is yet another question.[96] Given that the heavy costs of compliance burden all firms, the overwhelming majority of which are not prone to criminal activities, a rather skeptical view may be appropriate.[97]

Furthermore, different concepts sometimes are difficult to accommodate: Early in 2005 the BaFin published draft-guidelines aimed at enhancing ad-hoc publicity (disclosure) for listed companies.[98] According to the draft, in case of a multi-step decision process, as a rule, already the first decision should be made public if it qualifies as martial information.[99] This means if the managing board of a listed company takes such a decision it has to make it public immediately afterwards, rather then to wait for advice and, where necessary, approval of the supervisory board first. A supervisory board faced with an already publicly known decision of the managing board will think twice before openly disapproving it. Thus in effect its corporate governance functions are seriously undermined by the proposed disclosure rule – despite the fact that the

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[94] *Cf.* the explanatory comments to Fourth Financial Market Promotion Act by MÖLLER, *supra* n. 76.
[95] *Cf. supra,* text accompanying n. 63.
[96] At least in Germany, (so far) there are next to no major scandals involving large established firms. More or less all the outrageous scandals concerned small, young firms and were caused by owners and/or managers with a surprising amount of criminal energy.
[97] NOACK / ZETZSCHE, *supra* n. 87, at 30.
[98] *Entwurf eines Emittentenleitfadens*, draft of January 3, 2005, at: www.bafin.de./sonstiges/emittenten.pdf.
[99] Id. at V.2.2.5.1.

proposed rule as such does make perfect sense form the perspective of disclosure based capital markets regulation.

2. Market-Oriented Regulatory Approach in Company Law?

As mentioned at the beginning, a "reform in permanence" is taking place, especially in company law.[100] The latest major reform proposal is the "Draft Act on Corporate Integrity and Modernization on Actions to Set Aside Resolutions of the Shareholder Meeting."[101] This Act deals with a variety of issues, namely liability of corporate managers, facilitation of shareholder activism, procedural questions of shareholder meetings, and curbing of abusive shareholder suits. As with earlier reforms of company law, it is safe to assume that the German legislators are once again trying to improve the traditional tools of corporate governance rather then replacing these with a purely market-based-system of corporate control. In other words, and seen in context with the new securities regulations described above, the legislators are obviously continuing to pursue a "dual purpose strategy" in a kind of "hybrid approach," relying on the one hand on the traditional governance devices, and on the other hand enhancing corporate governance through a strengthening of market forces.[102]

However, it cannot be overlooked that even company law as such becomes to some extent market-oriented as we see a growing differentiation between rules for listed and non-listed companies tentatively labeled "*Börsengesellschaftsrecht*" (listed companies'

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[100] SEIBERT, *supra* n. 6, with a short overview of the various reforms till 2002; for a concise in-depth analysis of the development of company law, *see*, e.g., HOPT, Corporate Governance in Germany: Recent Developments in Company Law and Corporate Governance Code, in: Hopt et al. (eds.), European Corporate Governance in Company Law and Codes, Report (The Hague 2004) 23; also HOPT, Gesellschaftsrecht im Wandel, in: FS Wiedemann (Munich 2002) 1013.

[101] *Regierungsentwurf eines Gesetzes zur Unternehmensintegrität und zur Modernisierung des Anfechtunsgrechts* of November 17, 2004, published at: www.bmj.bund.de/ger/service/gesetzgebungsvorhaben; explanatory comments can be found with, e.g., SEIBERT, UMAG und Hauptversammlung, in: Wertpapier-Mitteilungen 2005, 157; SEIBERT / SCHÜTZ, Der Referentenentwurf eines Gesetzes zur Unternehmensintegrität und zur Modernisierung des Anfechtunsgrechts, in: Zeitschrift für Wirtschaftsrecht 2004, 252; FLEISCHER, Die "Business Judgement Rule," in: Zeitschrift für Wirtschaftsrecht 2004, 685; ROTH, Das unternehmerische Ermessen des Vorstands, in: Betriebs-Berater 2004, 1066.

[102] NOACK / ZETZSCHE, *supra* n. 87, at 10.

law).[103] Thus a specific body of law for listed companies is developing within company law and refers to (passive) investor-shareholders without an entrepreneurial interest in the company.[104] A prime example for this differentiation is the German Corporate Governance Code of 2002.[105] The Code itself is a piece of non-mandatory self-regulation. It is based on the modern principle of "comply or explain."[106] But listed companies – and only those – have to explain annually whether or not they adhere to the Code's recommendations.[107]

The "comply or explain" principle is rather new to the traditional German concept of stock corporation law. From a functional perspective, it corresponds with the overriding "disclose-or-abstain" principle of securities regulation and thus correlates with market regulation. From a different perspective, it can also be viewed as part of the trend to replace strict mandatory law with more flexible rules that focus on behavior of corporate managers.[108]

The principle fits with the current general discussion to replace mandatory substantive company law with disclosure regulation. The pertinent claim is to exchange paternalistic and so-called "merit regulation" – based on fair, just, and equitable standards – for disclosure rules.[109] Under the heading of adapting German company law to the needs of modern capital markets and making it fit for international regulatory competition, calls to deregulate the mostly mandatory stock corporation law have been

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[103] FLEISCHER, in: Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht 165 (2001) 513, 514 et seq.

[104] For a basic discussion of the relationship between company law and capital markets regulation, *see* KALSS, Der Anleger im Handlungsdreieck von Vertrag, Verband und Markt (Vienna 2001); MÜLBERT, Aktiengesellschaft, Unternehmensgruppe und Kapitalmarkt (2. ed., Munich 1996).

[105] *Corporate Governance Kodex*; the current version can be found at: www.ebundesanzeiger.de or www.corporate-governance-code.de; for the background of the Code, *see* BAUMS (ed.), Bericht der Regierungskommission Corporate Governance (Cologne 2001); HOMMELHOFF ET AL. (eds.), Corporate Governance (Heidelberg 2002).

[106] A standard commentary is HOMMELHOFF / HOPT (eds.), Handbuch Corporate Governance (Cologne 2003).

[107] This duty to explain is made mandatory by § 161 of the German Stock Corporation Act (AktG).

[108] *Cf.* TIMMERMAN, Das Gesellschaftsrecht im 21. Jahrhundert, in: Doralt/Kalss (eds.), Franz Klein – Vorreiter des modernen Aktien- und GmbH-Rechts (Vienna 2004) 161, 164.

[109] For a fundamental analysis, *see* MERKT, European Company Law Reform: Struggling for a More Liberal Approach, in: European Company and Financial Law Review 1 (2004) 3.

raised for some time.[110] All this can be qualified as a market-oriented approach to company law.

3. The New Takeover Law

One additional recent legal development with significant relevance for the governance regime deserves attention: the new Takeover Act, the *Gesetz zur Regelung von öffentlichen Angeboten zum Erwerb von Wertpapieren und von Unternehmensübernahmen* (hereinafter *WpÜG*)[111] that went into force on January 1, 2002. Once more we see a new piece of legislation that at least predominantly qualifies as market regulation being located at the intersection of capital markets regulation and company law as a form of organizational law. The enactment of the WpÜG was triggered in part by the hostile takeover of Mannesmann AG by Vodafone AirTouch plc in 1999/2000. The legislators obviously accepted that in Germany as elsewhere, a market for corporate control as a means of external corporate governance existed, and it needed effective regulation to work properly. Whether they succeeded in achieving that goal is not as clear as it might appear at first sight, however.

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[110] *Cf.* especially ESCHER-WEINGART, Reform durch Deregulierung im Kapitalgesellschaftsrecht (Tübingen 2001); HIRTE, Die aktienrechtliche Satzungsstrenge: Kapitalmarkt und sonstige Legitimationen versus Gestaltungsfreiheit, in: Lutter/Wiedemann (eds.), Gestaltungsfreiheit im Gesellschaftsrecht (Berlin 1998) 61; SPINDLER, in: Die Aktiengesellschaft 1996, 53; MERTENS, in: Zeitschrift für Unternehmens- und Gesellschaftsrecht 1994, 426. On the tendency toward greater structural flexibility on board level in Europe HOPT / LEYENS, Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy, in: : European Company and Financial Law Review 1 (2004) 135, 162 et seq., and with a comparison of the German Aufsichtsrat to the U.S.-board model LEYENS, Deutscher Aufsichtsrat und U.S.-Board: ein- oder zweistufiges Verwaltungssystem?, in: Rabels Zeitschrift für ausländisches und internationales Privatrecht 67 (2003) 57 et seq., especially 96 et seq.

[111] Law of December 20, 2001, Federal Gazette I (2001) p. 3822; the law was accompanied by four ordinances dating from December 27, 2001, Federal Gazette I (2001) p. 4263 et seq.; a comprehensive legal analysis can be found with HOPT, Grundsatz und Praxisprobleme nach dem Wertpapiererwerbs- und Übernahmegesetz, in: Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht 166 (2002) 383 et seq.; for an economic evaluation, *see* SCHMIDT / PRIGGE, Übernahmekonzeption und Übernahmegesetz, in: Die Betriebswirtschaft 62 (2002) 225 et seq.

The WpÜG was the end of the German self-regulatory takeover regime based on the Takeover Codex of 1995.[112] The Codex mainly failed because it was not accepted by a sufficient number of listed companies. In substance, though not in form and structure, the WpÜG is modeled after the British City Code. A core element is the mandatory offer a bidder has to make if he has gained control of the target company.[113] The relevant threshold is 30 percent of the voting rights. The law thus aims at a protection of minority shareholders by granting an exit in the case of a change of control.

However, not only the mandatory bid but all "public" offers for shares of a listed company are regulated by the law. If an offer stays below the control threshold (and the bidder owns no shares already), the procedural regulations concerning information and an equal opportunity for selling shares apply. The same is true if the bidder already has control. These kinds of offers are regulated in a manner that is somewhat similar to the U.S. concept in the Williams Act that (only) focuses on procedural regulations for all tender offers regardless of whether a change of control is involved.[114] As a result, the WpÜG may be the most coherently structured – and most comprehensive – takeover law so far. It clearly regulates market behavior and is – apart from the mandatory bid rule – predominantly focused on disclosure of information.[115]

Based on the price regulation of the bid – the average share price or a higher price paid by the bidder during the previous three months[116] – minority shareholders participate in a possible control premium. To secure this outcome, the WpÜG – like the City Code – is necessarily characterized by a high regulatory intensity. In this regard it interferes to a much higher degree in the market process than do the alternative U.S. or Japanese models of takeover regulation which "only" try to guarantee a fair and equal treatment of shareholders with respect to information, proceeding, and the chance to sell

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[112] *Übernahmekodex der Börsensachverständigenkommission beim Bundesministerium der Finanzen* of July 14, 1995, amended January 1, 1998.

[113] § 35 WpÜG.

[114] Law of July 29, 1968, codified as part of the Securities and Exchange Act of 1934; 15 U.S.C. §§78m(d)-(e), 78n(d)-(f).

[115] *Cf.* especially §§ 10, 11, 14, 23, and 27 WpÜG stipulate various disclosure duties with respect to the decision to make an offer, form and terms of the offer, its publication, acquisitions of shares in the wake of the offer, and the duty of the target's board to publicly comment on the offer.

[116] § 31 WpÜG, §§ 3 – 7 WpÜG-Angebotsverordnung (Ordinance of December 27, 2001, Federal Gazette I (2001) p. 4263).

in case of a partial bid. Strangely enough, the alternative model was not even discussed as viable during the reform debate in Germany, although the mandatory bid appears to be a somewhat alien concept in the country's corporate law setting. The only discussion was on whether the existing law of combines in the Stock Corporation Act (*Aktienkonzernrecht*) was a functional alternative to the bid. The pull of the British model – helped by the (various) drafts of the Takeover Directive that all contained a mandatory bid as an integral part – was obviously irresistible.

However, the British model was actually not imported as a whole. In fact, only one part, the mandatory bid, was copied without the "checks and balances" inherent to that model.[117] These are, first, a strict neutrality rule for the target's management, and second, a high degree of procedural flexibility made possible by the self-regulatory nature of the City Code. Both are a kind of "functional counterbalance" to the regulatory costs associated with the mandatory bid. Unfortunately, the WpÜG only has a kind of watered-down neutrality rule as a result of active lobbying by parts of the industry and the unions,[118] and, being statutory law, it lacks the flexibility of the City Code. Despite its structural quality, the new takeover regime may thus result in a sub-optimal economic outcome. There is a risk that hostile takeovers as a means of corporate governance could be blocked, and friendly takeovers would not be concluded because of high costs.[119]

IV. SUMMARY

1. As elsewhere, in Germany the balance between state and society – seen as two different entities – and the responsibility for public welfare has shifted over time. During the last decades of the 19th century, a gradual shift occurred from the liberal, laissez-faire attitude to the welfare state. The accompanying renunciation of the liberal project in favor of an idealized notion of the state has created a lasting and unfortunate

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[117] A critical analysis can be found with BAUM, Funktionale Elemente und Komplementaritäten des britischen Übernahmerechts, in: Recht der Internationalen Wirtschaft 2003, 421 et seq.

[118] *Cf.* the instructive criticism from an American perspective with GORDON, Das neue deutsche "Anti"-Übernahmegesetz aus amerikanischer Perspektive, in: Die Aktiengesellschaft 2002, 670 et seq.

[119] There is already anecdotal evidence that planned takeovers as a means of restructuring had to be cancelled because of the rigid price rules of the WpÜG, *cf.* report Frankfurter Allgemeine Zeitung, ed. no. 215 of September 16, 2002, p. 13.

legacy: the persistent and deeply ingrained present-day German belief in a perceived unlimited competence of the state, and a deeply ingrained skepticism toward the market mechanism by the general public that has turned out to be the greatest single obstacle obstructing urgent reforms in 21st-century Germany.

2. Today, the financial overburdening of the welfare state has become increasingly visible, and the collapse of social security systems has become a real threat. Furthermore, the modern welfare state sees itself confronted with another fundamental problem: a growing discrepancy between public expectations and the state's ability to act. A third dismal consequence of the welfare state has been a steady and in some areas dramatic increase in regulation. At least a partial retreat of the welfare state seems unavoidable. Two developments may be indicators of a such a change: the large-scale privatization of public utilities during the 1990s in Germany and the very recent admission that a supplementary private pillar in the public pension system is the only way out of the welfare crisis. The latter can possibly be viewed as the beginning of a privatization of welfare arrangements.

3. The German system of governance is characterized by a specifically corporatist-based structure of its political economy. A corporatist approach has also been characteristic of corporate governance in Germany. Committed labor and patient capital management resulted in a willingness for long-term commitment. This regime is generally classified as the standard example of an insider-controlled and stakeholder-oriented governance system as opposed to a "modern" capital-marked-based and outsider-controlled system. But it has been a functioning system with an inner logic, with complementary and consistent features.

4. However, various threads of this insider system have started to unravel, and certain elements typically associated with outsider systems seem to be increasing. Thus a gradual and partial de-bundling of the corporatist "*Deutschland AG"* appears to be somewhat probable. This raises the question of whether a partial shift toward an outsider- and market-oriented governance model may result in a breakdown of the traditional system without having the new one already in place and functioning.

5. The structural changes are accompanied by regulatory ones. Although most reforms of company law are aimed at modernizing the traditional system of corporate control rather then replacing it with a new one, other legislative reforms are clearly improving corporate governance through strengthening the impact of market forces and are obviously inspired by a regulatory approach typical for an outsider- and market-oriented

governance model. The current general discussion is to what extent mandatory substantive company law can be replaced by disclosure regulation.

6. Since the mid-1990s, an independent and extensive body of financial market regulation in its own right has been built up in addition to the existing exchange and banking laws. The Securities Trading Act of 1994 introduced a new era of ordering to the German capital markets aimed not at regulating a special product or participant but at the market *as such*.

7. The emphasis of various recent reforms has been on the regulation of information: enhanced disclosure duties, stricter liability for insufficient or misleading information, and more efficient means of private enforcement of mandatory disclosure rules by damages suits. The overriding principle is disclose or abstain. In addition, the German Corporate Governance Code of 2002 is based on the modern principle of "comply or explain" that is rather new to the traditional German concept of company law. The new Takeover Act also predominantly qualifies as market regulation.

8. In summary, as market regulation is the cornerstone of a functional outsider- and market-oriented governance model, recent legislative developments may anticipate a change of the traditional governance model rather than a mere supplementation.

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Financial assistance for the services of the editorial assistant of these series is provided by the European Commission through its RTN Programme on European Corporate Governance Training Network (Contract no. MRTN-CT-2004-504799).

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