

Board Models in Europe.
Recent Developments of Internal Corporate
Governance Structures in Germany, the United
Kingdom, France, and Italy.

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January 2004

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Abstract

The struggle for efficient internal management control is the centre of the corporate governance debate in Europe since the incorporation of the Dutch Verenigde Oostindische Compagnie in 1602. Recent developments in Europe illustrate a trend towards specialised rules for listed companies and indicate growing convergence of internal control mechanisms independent of board structure.

The revised Combined Code in the United Kingdom and also the French revised Principles of Corporate Governance, both of 2003, strengthen the presence of independent directors on one-tier boards in Europe. Another systemic break-through for the two-tier board model is the growing tendency to separate the positions of CEO and board chairman. For the German two-tier structure, the strengthening of the strategic role of the supervisory board (Aufsichtsrat) by the new German Corporate Governance Code of 2002 means an attempt to incorporate a key advantage of the one-tier model. Similarly, the control duties of the Italian internal auditing committee (collegio sindacale) were extended by the Testo Unico of 1998 and bring the Italian second board closer to the German supervisory board.

The common trend to stricter standards of independence is challenged in Germany by its rigid concept of co-determination and, to a lesser extent, by the more flexible model of labour participation in France. Director's duties and liabilities and also derivative actions are a focus of the reform debate in Germany since 1998 and are currently under review in the United Kingdom. After the Enron debacle the interplay between internal control devices and independent external auditing has become a major focus of interest in all countries considered. Driven by Anglo-Saxon codes of conduct audit committees today serve as a common denominator for good corporate governance.

Though formal convergence is strong company organs in each country take on their own specific garment. Path dependent system development especially depends on shareholder structures and banking systems. The trend to greater structural flexibility on board level is strongly triggered by the introduction of a threefold board model choice under the French Loi Nouvelle Régulations Economique of 2001 and under the Italian Viotti-Reform that is in force since January 2004.

Keywords: auditing, Aufsichtsrat, banking system, board models, comply or explain, Corporate Governance Codes, directors' duties and liabilities, directors' independence, Higgs Report, internal control, labour co-determination, management and control, path dependency, shareholder activism, supervisory board

JEL Classifications: G3, K22

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Board Models in Europe
– Recent Developments of Internal Corporate Governance Structures
in Germany, the United Kingdom, France, and Italy*

*by Klaus J. Hopt** and Patrick C. Leyens****

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1. The Verenigde Oostindische Compagnie: Early Problems of Company Law

For four hundred years, company law has tried to solve the core problem of corporate governance, the separation of ownership and control. In Europe, corporate governance did not become a research discipline of its own before the end of the last millennium. The analysis of the functioning of management and control under distinct board models was the starting point and still is one of the most important fields of the increasingly comparative and interdisciplinary research agenda¹. The history of the Verenigde Oostindische Compagnie (V.O.C.) impressively illustrates early problems of company law. Its evolution established the first institutional supervisory structure. The V.O.C. goes back to a merger of the early companies, the Voorcompagnieën. Much like modern business amalgamations, it was sought to improve the market position against competitors. Many of the V.O.C.'s features are still characteristic for modern companies. Legal personality, limited liability, listing, and tradable shares are important features discussed in other chapters of this volume.

With its incorporation in 1602, the V.O.C. had an internal structure comparable to what we describe today as a one-tier board model. The board of seventeen directors, elected by the governors of the six chambers,² had universal management power and acted nearly free from any interference by minority shareholders. The board developed the business strategy, set the shipping routes, and issued resolutions that were binding for the chambers. In the course of further business expansion in 1648, an executive committee of the board (The Hague Committee) helped to organise the work of the directors. Committees formed for accounting or specific business matters, were also found at the chamber level.

The major governance problem resulted from the lack of a definition of directors' duties as an alignment of decision making and the company's interest. The governors – the merchants and owners of the early companies – were unaware that an entity with its own interest had emerged as they continued to manage the V.O.C. in the way they had managed their early companies. In particular, the governors' right to prior purchase turned out to be unfortunate, leading to an early form of what we today call self-dealing. With the second dash of regulation in 1623, the license was changed and the governors were permitted to buy from the company only in public auctions under the same conditions as anyone else. Further, they were allowed to supply the company only if they had been granted a license to do so. The major change in the internal structure came with the introduction of the committee of nine in 1623, which can be described as an early form of the modern supervisory board³. Its functions were to give advice to management and to approve the annual report. The control competences included the right to attend board meetings and to inspect the premises and business documents. The involvement of major participants and their strong

¹ On the six buildings blocks of corporate governance research, see Hopt, Klaus J. et al. (eds.), *Comparative Corporate Governance*, Oxford: Clarendon, 1998, at 223 et seq.; reviewed by *John C. Cioffi*, *Am. J. Comp. L.* 48 (2000) 501-34. Cf. further McCahery, Joseph A., et al. (eds.), *Corporate Governance Regimes*, Oxford: Oxford University Press, 2002.

² The six chambers were set up in the cities of the seats of the early companies (Amsterdam, Middelburg, Rotterdam, Delft, Hoorn, and Enkhuizen). At the beginning, the total number of governors was 76.

³ *Lehmann, Karl*, *Die geschichtliche Entwicklung des Aktienrechts bis zum Code de Commerce*, Frankfurt a.M.: Sauer & Auvermann, 1968 (reproduction of edition Berlin 1895), at 65 et seq.

influence explains the later concentration of both management and control in the hands of one single board, as has been predominant in Europe since the 19th century⁴. During the V.O.C. era, market control was almost non-existent. State privileges guaranteed a monopolistic position, and there is no evidence that the term “hostile takeover” had any meaning outside of battles at sea⁵. With growing industrialisation and today’s globalisation triggered by international capital markets, the conditions have changed. Modern corporate governance research seeks to reflect the change of conditions by distinguishing inside control systems – which primarily rely on internal institutionalised control mechanisms – and outside control systems – which are primarily based on external control power of the market⁶.

The recent breakdown of the energy provider Enron, one of the largest publicly traded corporations in the U.S., has revealed major deficiencies in the United States’ mainly market-based corporate governance system⁷. To draw conclusions on the efficiency of the Anglo-Saxon outside corporate governance mechanisms, however, would be short-sighted. It is not easy to state which measures, if any, would have avoided the debacle, since outright fraud happens under all systems. The Enron case involved a high degree of irresponsible and partly criminal conduct, particularly by external auditors. Therefore, improving trustworthy auditing surely would be one measure to implement. However, what is stunning is not only the failure of the auditing control device – which can be classified somewhere in the middle between inside and outside control – but that *all* control mechanisms failed. The Enron case therefore impressively demonstrates that good corporate governance depends on a balanced interplay between the distinct internal and external control devices. To begin with, efficient internal control of management and auditing by the supervisory board or the responsible board committee is indispensable.

2. Board Models in Europe

⁴ *Hopt, Klaus J.*, Ideelle und wirtschaftliche Grundlagen der Aktien-, Bank- und Börsenrechtsentwicklung im 19. Jahrhundert, in: Coing, Helmut/Wilhelm, Walter, (eds.), Wissenschaft und Kodifikation des Privatrechts im 19. Jahrhundert, Bd. V, Geld und Banken, Frankfurt: Klostermann, 1980, 128-168, at 153.

⁵ The V.O.C. was granted a twenty-one-year monopoly on trade to the east of Cape Good Hope and beyond the Strait of Magellan; cf. Art. 34 of the Charter (“octroy opte vereenige der companieën”).

⁶ *Hopt, Klaus J.*, Corporate Governance: Aufsichtsrat oder Markt? Überlegungen zu einem internationalen und interdisziplinären Thema, in: *Hommelhoff, Peter* et al. (ed.), Max Hachenburg: dritte Gedächtnisvorlesung, Heidelberg 1998, 9-47.

⁷ Analysis of the facts is provided by the *Committee on Governmental Affairs*, The Role of the Board of Directors in Enron’s Collapse, Report prepared by the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United States Senate, July 8, 2002, <<http://www.senate.gov>>. Detailed views on the Enron case were delivered by *Hopt* in the Anton Philips Chair Inaugural Lecture at Tilburg University, Netherlands, on September 6, 2002; published: *Modern Company and Capital Market Problems: Improving Corporate Governance After Enron*, (2003) 3 JCLS 221-268. Cf. further *Schwarz, Günter C./Holland, Björn*, Enron, Worldcom... und die Corporate Governance-Diskussion, ZIP 2002, 1661-1672; *Leclercq, Xavier*, Faute D’un acheteur professionnel pour les prestations intellectuelles on obtient... l’affaire Enron!/Paying the price for not using a professional purchaser for intellectual services... the Enron case!, RDAI/IBLJ, N° 6, 2002.

Comparative research has explored the different foundations of company laws in Europe and in the United States⁸. This is one important field, while the analysis of common principles of corporate governance in Europe is another⁹.

2.1 Two-Tier Board Model in Germany

German company law has traditionally relied upon statutory regulation, in which the two-tier board model (including co-determination) is firmly rooted¹⁰. Non-statutory rules became a supplementing regime only very recently in 2002, when the governmental commission Regierungskommission Corporate Governance Kodex presented a consolidated German Corporate Governance Code¹¹. The new code follows the self-regulatory comply-or-explain approach. Companies are obliged by law to publish a statement of their compliance with the code in the annual report¹². The Code is based on the work of a previous governmental commission, the Regierungskommission Corporate Governance, which presented a long list of reform proposals in 2001 after a working period of only fourteen months¹³. Following the international trend, the proposals correctly distinguish between regulatory levels;

⁸ *Leyens, Patrick C.*, Deutscher Aufsichtsrat und U.S.-Board: ein- oder zweistufiges Verwaltungssystem? – Zum Stand der rechtsvergleichenden Corporate Governance-Debatte, *RabelsZ* 67 (2003) 57-105; *Oquendo, Ángel*, Breaking on Through to the Other Side: Understanding Continental European Corporate Governance, *U. Pa. J. Int. Econ. Law* (2002) 975-1027; *Escher-Weingart, Christina*, Corporate Governance Strukturen – ein deutsch-U.S.-amerikanischer Rechtsvergleich, *ZVglRWiss* 99 (2000) 387-409.

⁹ *Arlt, Marie-Agnes et al.*, Die europäische Corporate-Governance-Bewegung (Frankreich, Niederlande, Spanien, Italien), in: Doralt, Peter/Kalss, Susanne (eds.), *Corporate Governance*, *GesRZ* 2002 (special issue), 64-80; *Hopt, Klaus J.*, Common Principles of Corporate Governance in Europe?, in: McCahery, Joseph A. (eds.), *Corporate Governance Regimes, Convergence and Diversity*, Oxford: Oxford University Press, 2002, 175-204, at 176 et seq.; *Davies, Paul L.*, Board Structure in the UK and Germany: Convergence or Continuing Divergence?, [2001] *International and Comparative Corporate Law Journal (I.C.C.L.J.)* 2, 435-456; *Teichmann, Christoph*, Corporate Governance in Europe, *ZGR* 2001, 645-679 (648); *Mülbert, Peter O./Bux, Regina*, Dem Aufsichtsrat vergleichbare in- und ausländische Kontrollgremien von Wirtschaftsunternehmen (§ 125 Abs. 1 Satz 3 2. Halbs. AktG n.F.), *WM* 2000, 1665-1720.

¹⁰ The main body of law is the Aktiengesetz of 1965 (Public Corporations Act 1965). It was repeatedly amended, in particular by the Gesetz zur Kontrolle und Transparenz im Unternehmensbereich of 1998 (Law on Furthering Control and Transparency in Public Corporations 1998), which was focused on internal corporate governance and particularly reformed the supervisory board. For details, see *Feddersen, Dieter*, Neue gesetzliche Anordnungen an den Aufsichtsrat, *AG* 2000, 385-396.

¹¹ Regierungskommission Deutscher Corporate Governance Kodex, 26. February 2002; printed in *NZG* 2002, 75-78; English version: <<http://www.corporate-governance-code.de>>. On the code, see *Bernhardt, Wolfgang*, Der Deutsche Corporate Governance Kodex: Zuwahl (comply) oder Abwahl (explain)? – Unternehmensführung zwischen „muss“, „soll“, „sollte“ und „kann“, *DB* 2002, 1841-1846; *Ulmer, Peter*, Der Deutsche Corporate Governance Kodex – ein neues Regulierungsinstrument für börsennotierte Aktiengesellschaften, *ZHR* 166 (2002) 150-181.

¹² The new § 161 Aktiengesetz (supra n. 10) was introduced by the Transparenz- und Publizitätsgesetz of 2002 (Law on Transparency and Disclosure 2002), printed with comments by *Seibert, Ulrich*, Das „TransPuG“, *NZG* 2002, 608-617. For details, see *Knigge, Dagmar*, Änderungen des Aktiengesetzes durch das Transparenz- und Publizitätsgesetz, *WM* 2002, 1729-1737.

¹³ The commission was set up by the government in May 2000. Its final report of July 2001 is 342 pages long and covers about 130 proposals, about 100 of which are directed to the legislator and about 20 to the succeeding code commission; *Baums, Theodor* (ed.), *Bericht der Regierungskommission Corporate Governance*, Köln: Otto Schmidt, 2001.

unfortunately, however, they only very sporadically consider the important European dimension, and fail to touch upon co-determination¹⁴.

2.1.1 The Role of the Supervisory Board

The central feature of internal corporate governance lies in the organisational and personal division of management and control by a two-tier structure that is mandatory for all public corporations, regardless of size or listing¹⁵. While the clear responsibility of the management board is the running of the business, the role of the supervisory board is not easy to describe. Its legal functions are primarily the appointment, supervision, and removal of members of the management board. Recently its important “soft functions” were highlighted from a comparative perspective¹⁶. Networking with stakeholders and business partners and the balancing of interests within the corporation have been rated as indispensably valuable, particularly for resolving desperate situations. The supervisory board controls the management (not the corporation), its compliance with the law and articles of the corporation, and its business strategies. The supervisory board cannot directly become involved in managing the company, but if articles so provide or the supervisory board so decides, specific types of transactions may become subject to its approval¹⁷.

Its control efficiency and the extent to which the supervisory board exercises its task to advise management is subject to considerable differences, mostly due to size and shareholder structure. In some public corporations the management board de facto picks the supervisory board. In contrast, in family-owned corporations or those owned by major shareholders, approval rights play an important role and are sometimes used to substantially extend the powers of the supervisory board¹⁸. Committees are less common compared with the United Kingdom or the United States. However, a strongly growing tendency towards nomination, remuneration, and audit committees can be observed, and the majority of the larger listed companies has already installed them¹⁹.

The supervisory board is responsible for bringing actions of the company against members of the management board. The approach of the courts – which is welcome in principle – towards the objective liability standard in regard to a breach of the duty of care, is that of a business judgement rule, i.e., directors are not liable if they acted in the interest of the company and on adequate information²⁰. The objective standard,

¹⁴ *Baums*, supra n. 13, at 3 (C. Bericht des Vorsitzenden); *Hopt, Klaus J.*, Unternehmensführung, Unternehmenskontrolle, Modernisierung des Aktienrechts – Zum Bericht der Regierungskommission Corporate Governance, in: *Hommelhoff, Peter* et al. (eds.), *Corporate Governance – Gemeinschaftssymposium der Zeitschriften ZHR/ZGR*, Heidelberg: Verlag Recht und Wirtschaft, 2002 (supplements to ZHR no. 71), at 27-73, at 31 et seq., 42 et seq., 60 et seq.

¹⁵ On the German model, see *Hopt, Klaus J.*, The German Two-Tier Board: Experiences, Theories, Reforms, in: *Hopt, Klaus J.* et al. (eds.), *Comparative Corporate Governance*, Oxford : Clarendon, 1998, 227-258.

¹⁶ *Davies*, supra n. 9, at 450 et seq.

¹⁷ *Berrar, Carsten*, Die zustimmungspflichtigen Geschäfte nach § 111 Abs. 4 AktG im Lichte der Corporate Governance-Diskussion, DB 2001, 2181-2186.

¹⁸ *Hopt, Klaus J.*, Die Haftung von Vorstand und Aufsichtsrat – Zugleich ein Beitrag zur Corporate Governance Debatte, in: *Festschrift für Ernst-Joachim Mestmäcker*, Baden-Baden 1996, 909-931, at 912.

¹⁹ *Feddersen*, supra n. 10, at 393.

²⁰ BGHZ 134, 244 (“ARAG/Garmenbeck”). The proposal of the Regierungskommission to back up the business judgement rule by an amendment of the law is a welcome codification of existing practice. For the proposal see, *Baums*, supra n. 13, para. 70.

however, proves difficult to apply in practice with breaches of the duty of loyalty and with conflicts of interests. Because fiduciary duties in Germany have their foundations in the law of mandate, the issues at the heart of directors' duties – self-dealing, competition with the company, and use of corporate opportunity – are not adequately covered²¹.

Duties and liabilities are one thing, and enforcement is another. First, it is obvious that the supervisory board will be reluctant to bring an action because its members must fear liability for failure in the exercise of control over management. Second, the limited experience with shareholder actions is understandable given the current state of the law²². A minority of five percent, or a shareholding of 500,000 Euro, is required to bring an application to the courts. Only if facts can be proven that imply the urgent suspicion of a breach of duty will the court mandate a neutral representative, who then decides whether to bring action or not²³. In principle, the reform proposals maintain this approach but take a welcome step towards a single shareholder right of action. It is proposed to reduce the threshold to a one percent shareholding and 100,000 Euro²⁴. The special representative scheme is skipped, and informational problems of shareholders are taken into account because the suspicion of a breach of duty alone (not necessarily an urgent one) will suffice. A further improvement concerns the introduction of a two-stage scheme, which takes away the risk of costs from the applicant once the action is admitted by the court.

2.1.2 Board Composition, Independence, and Labour Co-determination

Membership in the supervisory board is incompatible to simultaneous membership in the management board. Further, one person cannot take more than ten parallel supervisory board mandates. However, business relationships are inherent characteristics of the German supervisory board and can involve difficult questions of independence, objectivity, and conflicts of interests²⁵. Many companies make use of their former managers' business knowledge by offering them seats on the supervisory board when they retire. In particular, the chairman of the management board often changes over and takes the chair of the supervisory board. Further seats are offered to representatives of business partners, particularly in cases of cross shareholdings.

An illustrative example for inherent conflicts of interests is the common practice of mandating representatives of banks or of their investment branches. Because of the German universal banking system, the bank then takes on a double position as depository voting rights are to be exercised in the interest of shareholders, and conflicting interests can result from a creditor relationship between bank and

²¹ *Hopt, Klaus J.*, Self-Dealing and Use of Corporate Opportunity and Information: Regulating Directors' Conflict of Interest, in: *Hopt, Klaus J./Teubner, Gunther* (eds.), *Corporate Governance and Directors' Liabilities*, Berlin, New York : de Gruyter, 1985, S. 285-326, at 287 et seq.

²² *Ulmer, Peter*, Die Aktionärsklage als Instrument zur Kontrolle des Vorstands- und Aufsichtsratshandelns, *ZHR* 163 (1999) 290-342, at 292 et seq.

²³ § 147 para. 3 AktG (Public Corporation Act 1965).

²⁴ *Baums*, supra n. 13, para. 73. On the proposals, see *Bayer, Walter*, Aktionärsrechte und Anlegerschutz, in: *Hommelhoff, Peter* et al. (eds.), *Corporate Governance – Gemeinschaftssymposium der Zeitschriften ZHR/ZGR*, Heidelberg: Verlag Recht und Wirtschaft, 2002 (supplements to *ZHR* no. 71), 137-163, at 155 et seq.

²⁵ Empirical evidence is provided by *Prigge, Stefan*, A Survey of German Corporate Governance, in: *Hopt, Klaus J.* et al. (eds.), *Comparative Corporate Governance*, Oxford: Clarendon, 1998, 943-1028, at 957 et seq.

company²⁶. The position is even tripled if the bank holds a participation in the company. The Deutsche Bank AG was the first to address this problem explicitly. Their Corporate Governance Principles of 2001 stated that members of the management board do not, in principle, assume the chairmanship of a supervisory board outside the group²⁷. This principle reflects the clear tendency of German banks to decrease the number of board participations in other corporations.

The German Corporate Governance Code does not provide a general definition of independence. The issue of former managers sitting on the supervisory board is taken up by the recommendation to limit their number to two seats and to not give the chair of the audit committee to a former member of the management board²⁸. Parallel mandates in management or supervisory boards of competitors or advisory functions for such competitors are seen as incompatible²⁹. The issue of business relationships – especially the German system of cross shareholdings – has encountered major criticism by foreign investors³⁰. The recommendation to disclose affiliations of supervisory board members in a report to the general meeting is welcome, but it does not explicitly name cross shareholdings. Further, disclosure is only recommended for the case of existing conflicts of interests, i.e., for affiliations that are classified as such by the supervisory board itself. It is doubtful that such a careful and selective approach towards independence and conflicts of interests will suffice to adequately strengthen market confidence³¹.

A German peculiarity is its strong labour co-determination. Companies with 2,000 workers or more must have half their supervisory board composed of labour representatives; in large enterprises, this amounts to ten of twenty board members (in coal and steel it is twenty-one). The casting vote of the chairman gives slightly more power to shareholders. Labour participation is at the heart of industrial democracy, and it is not surprising that German co-determination finds its roots mainly in the difficult times after World Wars I and II³². It is reinforced by the duty of management to take into account the coalition of interests between shareholders and stakeholders, including those of employees and even the public interest³³.

From the viewpoint of the enterprise, the merit of co-determination is that it has proven to be an early warning system for social conflicts and that it helps to keep down strikes. It further triggers the networking and interest-balancing powers of the supervisory board. However, the implications for internal corporate governance are manifold³⁴. In contrast to the Anglo-Saxon shareholder philosophy, the stakeholder

²⁶ Described by the so-called cumulation theory: For details, see *Hommelhoff, Peter*, Der Einfluß der Banken in der Aktiengesellschaft, in: Festschrift für Wolfgang Zöllner, Köln et al. 1998, 235-252, at 237.

²⁷ Deutsche Bank AG, Corporate Governance Principles, Frankfurt on the Main, March 2001, at 9 para. 8. Subsequent to the enactment of the official German Corporate Governance Code the Deutsche Bank decided to do without individual corporate governance principles.

²⁸ German Corporate Governance Code para. 5.4.2 and 5.3.2.

²⁹ Ibid. para. 5.4.2.

³⁰ CalPERS, International Corporate Governance, German Market Principles, II 7 B: Cross Shareholding, 1999; *Hopt, Klaus J.*, Kontrolle und Transparenz im Unternehmensbereich, in: Assmann, Heinz-Dieter et al. (eds.), Wirtschafts- und Medienrecht in der offenen Demokratie – Freundesgabe für Friedrich Kübler zum 65. Geburtstag, Heidelberg 1997, 435-456, at 445.

³¹ *Hopt*, supra n. 14, at 61.

³² On the history of co-determination, see *Hopt*, supra n. 16, at 229 et seq.

³³ *Mülbert, Peter O.*, Shareholder Value aus rechtlicher Sicht, ZGR 1997, 129-171.

³⁴ *Hopt, Klaus J.*, New Ways in Corporate Governance: European Experiments with Labor Representation on Corporate Boards, 82 Mich. L. Rev. 1338-1363 (1984); reprinted in Wheeler, S.

interest approach to directors' duties does not allow a precise measurement of the value of management decisions³⁵. Further, insider sensitive and control transactions are negotiated without the supervisory board. It remains to be seen whether the now explicit duty of confidentiality can diminish the danger of information leaks that have become well known in the past³⁶. However, the dividing lines within the supervisory board are detrimental to efficient cooperation with the management board. The basic problems of size (up to 21 members) and the inability of the German system to impose adequate qualification standards are further consequences of co-determination³⁷. In the United States, members of audit committees must prove their qualification and experience in accounting and finance. In Germany, it is impossible to set a general standard above a certain level of financial literacy because the workforce and unions would not always be prepared to nominate adequate candidates, and a corresponding strict liability would seem unfair³⁸. For a structural flexibility on the board level and the welcome introduction of an optional one-tier structure, the limits are set by co-determination; shareholders would hardly agree to employees having a voice in all management decisions, a problem to be faced under the statute of the European Public Corporation (*Societas Europaea*, S.E.), which provides an option between the one- and two-tier model³⁹.

The few who name the problems correctly distinguish between the above-mentioned deficiencies of the German supervisory board and the difficulties of German co-determined companies regarding competition and the raising of capital on international capital markets⁴⁰. Foreign investors will be (understandably) reluctant to choose a German co-determined company if global markets offer alternative investments not subject to co-determination. If the workforce takes its tasks seriously, it will seldom be prepared to support cross-border restructurings, which in most cases usher in the danger that jobs will be lost to entities outside the country. It is striking –

(ed.), *Company Law* (The International Library of Essays in Law and Legal Theory), Aldershot: Dartmouth, 1993, at 315-340.

³⁵ *Teichmann*, supra n. 9, at 648; *Hopt*, supra n. 9, at 798 et seq.

³⁶ Art. 1 para. 10 TransPuG (Law on Transparency and Disclosure 2002). On the case of Franz Steinkühler, former president of the metal workers' union (IG Metal), who was involved in extensive insider dealing, see *Hopt, Klaus J.*, Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe, 14 *Int'l Rev. L. & Econ.* 203-214 (1994), at 206.

³⁷ *Lutter, Marcus*, Comparative Corporate Governance: A German Perspective, [2001] *International and Comparative Corporate Law Journal* (I.C.C.L.J.) 2, 423-433, at 426 et seq.

³⁸ *Hopt*, supra n. 14, at 44 et seq.; *Schwark, Eberhard*, Corporate Governance: Vorstand und Aufsichtsrat, in: *Hommelhoff, Peter* et al. (eds.), *Corporate Governance – Gemeinschaftssymposium der Zeitschriften ZHR/ZGR*, Heidelberg: Verlag Recht und Wirtschaft, 2002 (supplements to ZHR no. 71), 75-117, at 106. An important step forward would be to make a clearer distinction between the duty of care and loyalty; for further details, cf. *Hopt*, supra n. 18, at 916 and 930.

³⁹ Council Regulation (EC) No 2157/2001 of 8.10.2001 on the Statute for a European Company (SE), OJ L 294/1, 10.11.2001, Art. 39 para. 5 und Art. 43 para. 4. On the S.E. in detail *Hopt, Klaus J. et al* (eds.), *La Société Européenne, Organisation juridique et fiscale, intérêts, perspectives*, Paris: Dalloz 2003. Cf. further *Teichmann, Christoph*, Die Einführung der Europäischen Aktiengesellschaft – Grundlagen der Ergänzung des europäischen Statuts durch den deutschen Gesetzgeber, ZGR 2002, 383-464.

⁴⁰ *Ulmer, Peter*, Paritätische Arbeitnehmermitbestimmung im Aufsichtsrat von Großunternehmen – noch zeitgemäß?, ZHR 166 (2002) 271-277, at 275 et seq.

and will hardly be understood by an international observer – that the German reform agenda excludes co-determination almost as a matter of political principle⁴¹.

2.1.3 Internal Controls and Auditing

Recent proposals on improving internal control plead for an increase of approval rights of the supervisory board. The success of both stronger involvement in management decisions and the strengthening of control efficiency as a whole depends foremost on the level of information. The functioning of information systems as they exist under the law or as recommended by the German Corporate Governance Code is strongly determined by the two-tier structure. The exclusion of the supervisory board from management and its limited rights to obtain information directly from executives can make it difficult for its members to develop an objective picture of the company's performance⁴².

The interplay of the supervisory board and external auditing is a central point of the corporate governance debate. Under the two-tier system, internal control is an instrument of the management board and confidence must not be undermined by the supervisory board or its committees⁴³. Further, the law does not allow audit committees to take over resolution power in matters reserved for plenary decisions of the supervisory board, as is the case with the approval of the annual accounts⁴⁴. Hence, the primary function of audit committees in German companies is the coordination of control, revision, and auditors⁴⁵. The role of the audit committee is vital, though, as it supervises the independence of the auditor. The German Corporate Governance Code recommends that the auditor deliver a detailed statement of independence to provide the basis for a proper election by the general meeting⁴⁶. By law, an auditor who has earned more than 30% of his or her total earnings exclusively from one company in the last five years is ineligible, and the report cannot be signed more than six times by the same person⁴⁷. Mandatory rotation of the auditing firm itself has been rejected up to now, but it may be a reform discussion again after the Enron case⁴⁸.

The external auditor is elected by the general meeting, and thus primarily serves as a control device of shareholders⁴⁹. However, the role of the auditor as a “partner” of the

⁴¹ Co-determination was excluded from the KonTraG reform 1998 and not part of the mandate conferred to the Regierungskommission Corporate Governance. For criticism, see *Ulmer*, supra n. 40, at 271 et seq.; *Hopt*, supra n. 14, at 42 et seq.

⁴² *Lutter, Marcus/Krieger, Gerd*, Rechte und Pflichten des Aufsichtsrats, 4. Auflage, Köln: Otto Schmidt, 2002, paras. 191-246 and 311 et seq. For a more extensive interpretation of the supervisory board's information rights, see *Roth, Markus*, Möglichkeiten vorstandsunabhängiger Information des Aufsichtsrats, AG 2004 (forthcoming).

⁴³ *Ranzinger, Christoph/Blies, Peter*, Audit Committees im internationalen Kontext, AG 2001, 455-462, at 459 et seq.

⁴⁴ § 107 para. 3, sentence 2 and § 171 AktG (Public Corporations Act 1965).

⁴⁵ *Ranzinger/Blies*, supra n. 43, at 458 et seq. On the pros and cons of audit committees as subcommittees of the German supervisory board, see *Baums*, supra n. 13, para. 313 et seq.

⁴⁶ German Corporate Governance Code para. 7.2.1. For details, see *Pfitzer, Norbert* et al., Die Unabhängigkeitserklärung des Abschlussprüfers gegenüber dem Aufsichtsrat im Sinn des Deutschen Corporate Governance Kodex, DB 2002, 753-755.

⁴⁷ § 319 II 1 Nr. 8 Handelsgesetzbuch (Commercial Code).

⁴⁸ *Baums*, supra n. 13, para. 281.

⁴⁹ With an emphasis on this often ignored aspect, *Bernhardt, Wolfgang*, Vorstand und Aufsichtsrat (unter Einschluß des Verhältnisses zum Abschlussprüfer), in: *Hommelhoff, Peter* et al. (eds.), Corporate Governance – Gemeinschaftssymposium der Zeitschriften ZHR/ZGR, Heidelberg: Verlag Recht und Wirtschaft, 2002 (supplements to ZHR no. 71), 119-130, at 130.

supervisory board has also been strengthened several times.⁵⁰ As a consequence of the KonTraG reform in 1998⁵¹, the supervisory board concludes the auditing contract and confers the auditing mandate, which should cover all matters relevant to the work of the supervisory board⁵². Information flow was triggered by the KonTraG because the auditing report is directly handed over to the supervisory board, and the auditor has the duty of taking part in the meeting on approval of the annual accounts. Further, the auditing mandate was extended; in addition to the checking of the accounts, it now includes the control of the risk management systems. The mere formal check of the statement of compliance appears somewhat toothless, although it has to be noted that the auditor must express doubts in the auditing report should he come across irregularities that question the substance of the statement⁵³. Any further extension of the auditing mandate to business matters was rejected by the Regierungskommission due to the fear that this could lead to a disadvantageous discharge of the supervisory board or even push it away from the exercise of its control duties⁵⁴.

2.2 One-Tier Board Model in the United Kingdom

The regulatory approach in the United Kingdom is somewhat more flexible than in Germany⁵⁵. In June 2001 the final report of the Company Law Review Steering Group was presented⁵⁶, and the answers of the Secretary of State followed in July 2002⁵⁷. In principle, the strong self-regulatory approach will be kept. Important standards for listed companies are set by the Combined Code, which is issued as an appendix to the Listing Rules⁵⁸. Contrary to the “tick box system” of the most famous of its predecessors, the Cadbury Code 1992, the Combined Code primarily provides principles and relies on a comparatively smaller set of specific rules⁵⁹. The Listing Rules require a company to annually state how it has applied the principles and as to

⁵⁰ *Hommelhoff, Peter*, Die neue Position des Abschlußprüfers im Kraftfeld der aktienrechtlichen Organisationsverfassung (Teil I), BB 1998, 2567-2573 and BB 1998, 2625-2632.

⁵¹ Cf. supra n. 10.

⁵² German Corporate Governance Code para. 7.2.3.

⁵³ For details, see *Seibt, Christoph H.*, Deutscher Corporate Governance Kodex und Entsprechenserklärung (§ 161 AktG-E), AG 2002, 249-259, at 257 and the references supra n. 12.

⁵⁴ *Baums*, supra n. 13, para, 285.

⁵⁵ There is virtually nothing on board structure in the Companies Act 1985. According to Companies Act 1985 section 8(1) companies are free to adopt the rules on appointment and remuneration of directors, and proceedings of the board as set out by Companies (Tables A to F) Regulations 1985 (S.I. 1985 No. 805 as amended by S.I. 1985 No. 1052). Mandatory provisions concern removal, disqualification, and powers of directors; cf. *Pettet, Ben*, *Company Law*, Harlow et al.: Longman, 2001, at 158 et seq.

⁵⁶ Company Law Review Steering Group, *Modern Company Law for a Competitive Economy*, Final Report, URN 01/942 and URN 01/943, June 2001.

⁵⁷ Secretary of State for Trade and Industry, *Modernising Company Law*, Presented to Parliament by Command of Her Majesty, July 2002.

⁵⁸ The Listing Rules are now issued by the Financial Services Authority, which as a consequence of the Financial Services and Markets Act 2000 took over the competence of the United Kingdom Listing Authority from the London Stock Exchange; cf. *Alcock, Alastair*, *The Financial Services and Markets Act 2000: A Guide to the New Law*, Bristol: Jordan Publishing, 2000, para. 12.1.

⁵⁹ The Combined Code was first published in 1998. It is the product of the work of three corporate governance committees: the Cadbury Report (Report of The Committee on the Financial Aspects of Corporate Governance, London: Gee, 1992), the Hampel Report (Committee on Corporate Governance, Final Report, London: Gee, January 1998), and the Greenbury Report (Report of a Study Group chaired by Sir Richard Greenbury, London: Gee, 1995); all available at <<http://www.ecgi.org>>. For details, see *Pettet, Ben*, *The Combined Code: A Firm Place for Self-Regulation in Corporate Governance*, [1998] J.I.B.L. 394-400.

whether or not it has complied with the code provisions⁶⁰. As a part of the “Post Enron Initiatives” Derek Higgs undertook a review of the role and effectiveness of non-executive directors⁶¹. The Financial Reporting Council included his recommendations into its revision of the Combined Code. The new Combined Code was published on 23 July 2003 and applies for reporting years beginning on or after 1 November 2003⁶².

2.2.1 The Role of the Board of Directors

The one-tier board model in the United Kingdom entrusts both management and control to the hands of the board of directors, who are vested with universal powers⁶³. In larger companies, managerial power is revocably devolved to groups of directors (committees) or individuals below board level. According to the Combined Code, a formal schedule of matters should be reserved to the board for decision, which is a recommendation not far from that concerning the approval rights of the German supervisory board⁶⁴. To understand the control function, a pivotal distinction has to be made between executive directors who are employed as managers parallel to their directorate and non-executive directors who are not involved in the running of the day-to-day business of the company. There has been considerable debate over the effectiveness of non-executive directors. The revised Combined Code provides the first quasi-official description of their functions⁶⁵. Building on the review undertaken by Higgs it emphasises that non-executives should not only monitor management but also contribute to the development of strategy.⁶⁶ A core element of the Combined Code is its recommendation to compose at least half the board of independent non-executives.⁶⁷ Another is the separation of the positions of board chairman and chief executive officer (CEO).⁶⁸ The effect of both elements taken together is a functional distinction between management (executive directors) and control (non-executive directors led by the chairman).

As all directors have the same powers, non-executive directors can also take the initiative in management decisions, and they are not restricted to post-decision approval like the German supervisory board.

Similarly, all directors – regardless of whether they are executives or non-executives – owe the same duties to the company⁶⁹. Comparing directors’ duties to the situation in Germany, the impression is one of an inverse picture with weak rules on care and skill and strong ones on fiduciary duties. This impression is only true at first glance⁷⁰. In fact, the duty of care and skill was debated because, according to the subjective element it employed, directors could escape liability fairly easily⁷¹. With the

⁶⁰ The Listing Rules para. 12.43A (a) and (b).

⁶¹ *Higgs, Derek*, Review of the role and effectiveness of non-executive directors, Department of Trade and Industry, January 2003.

⁶² Combined Code, preamble, para. 3.

⁶³ On the board of directors, see *Davies, Paul L.*, *Gower and Davies’ Principles of Modern Company Law*, 7. ed., London: Sweet & Maxwell, 2003, at 294 et seq.; *Pettet*, supra n. 55, at 173 et seq.

⁶⁴ Combined Code section A.1.1.

⁶⁵ *Ibid.* section A.1. supporting principles.

⁶⁶ *Ibid.* and *Higgs*, supra n. 61, paras. 6.1 et seq.

⁶⁷ Combined Code section A.3.2.

⁶⁸ *Ibid.* section A.2.1.

⁶⁹ *Percival v Wright* [1902] 2 Ch 421.

⁷⁰ *Davies*, supra n. 63, at 432 et seq..

⁷¹ *Pettet*, supra n. 55, at 174 et seq.

introduction of an objective test by the provisions on wrongful trading in 1986, the approach partly shifted⁷². For fiduciary duties, the no-conflicts rule in principle sets out a strict rule: any situation with an inherent likeliness to lead to a breach of the duty of good faith is automatically to be treated as if the breach had occurred⁷³. However, the difficulties in drawing the line between material conflicts and those where the merits for the company outweigh potential harm have caused the courts to apply a rather lax liability standard. Recent reform proposals led to a draft companies bill, which was presented before Parliament⁷⁴. Both the Company Law Review Steering Group and the answer to it by the Secretary of State plead for an objective standard in the field of care and skill, and make detailed provisions on fiduciary duties and conflicts⁷⁵.

Concerning enforcement, the situation is comparable to Germany, for shareholder actions are seldom brought to solve internal conflicts⁷⁶. The Company Law Review proposes putting the right to derivative actions on an accessible statutory basis⁷⁷. Similar to the relaxation of the factual basis to be proven that was recently proposed in Germany, the Law Commission is arguing for skipping the requirement of a prima facie case⁷⁸. However, the test whether a derivative action should proceed will be whether the minority's views are to the best interest of the company, and the determination of the company's interest will be subject to court discretion⁷⁹. The picture drawn under the present state of the law in the complex area of derivative actions is that the success of a minority in bringing an action very much depends on whether the majority ratifies a director's wrongdoing⁸⁰. On the one hand, minority rights are triggered by the proposals of the Company Law Review Steering Group in that a person with an interest in the relevant wrong will be disqualified from voting⁸¹. On the other hand, according to the Law Commission, majority rights are safeguarded in that an action can be terminated if the views of an independent organ – as, for example, a sub-committee of accountants – indicate that it should be dropped for commercial reasons⁸². It remains to be seen whether the forthcoming reforms will provide a better basis for shareholder activism⁸³.

⁷² Insolvency Act 1986 s. 214.

⁷³ *Pettet*, supra n. 55, at 179 et seq.

⁷⁴ Secretary of State for Trade and Industry, supra n. 57, Vol. I para. 3.6, and Vol. II (“A New Companies Bill: Draft Clauses”). For the proposals, see Company Law Review Steering Group, supra n. 56, Annex C. The proposals are discussed by *Sheikh, Saleem*, *Company Law for the 21st Century – Part 2: Corporate Governance*, [2002] I.C.C.L.R 88-93, at 88 et seq.;

⁷⁵ Company Law Review Steering Group, supra n. 56, Schedule 2, para. 4; Secretary of State for Trade and Industry, supra n. 57, Schedule 2, paras. 4 et seq.

⁷⁶ *Pettet*, supra n. 55, at 244 et seq.

⁷⁷ Company Law Review Steering Group, supra n. 56, paras. 7.46 et seq. The proposals are based on The Law Commission, *Company Directors: Regulating Conflicts of Interests and Formulating A Statement of Duties*, Law Commission Report 261 – jointly with the Scottish Law Commission: Scot Law Com No 173, 22 September 1999.

⁷⁸ *Pettet*, supra n. 55, at 237 and 243.

⁷⁹ Company Law Review Steering Group, supra n. 56, para. 7.48.

⁸⁰ *Pettet*, supra n. 55, at 237 and 243.

⁸¹ Company Law Review Steering Group, supra n. 56, para. 7.54.

⁸² *Smith v Croft* [1987] 3 All ER 909 at 915 and *Prudential Assurance Co. Ltd v Newman Industries Ltd and others* [1982] Ch 204 at 222; cf. *Pettet*, supra n. 55, at 240 and 244.

⁸³ Doubts are expressed by *Davies, Paul L.*, *Corporate Governance from a UK Perspective*, in: Doralt, Peter/Kalss, Susanne (eds.), *Corporate Governance, GesRZ 2002* (special issue), 14-19, at 19. *Pettet*, supra n. 55, at 244 et seq., alludes to the danger that the courts will not detach their judgements from the restrictions set under common law.

The overall assessment leads to the conclusion that corporate governance in the United Kingdom does not so much rely on enforcing managerial care by directors' personal liability, but rather on the danger of removal by ordinary shareholder resolution, and in particular as a consequence of a change of corporate control⁸⁴. In regard to loyalty duties, much weight is given to the outright prevention of conflicts by subtle standards of independence.

2.2.2 Board Composition, Independence, and Outsider Participation

According to the revised Combined Code independence primarily means that there are no "relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement"⁸⁵. In addition to this general definition the revised Combined Code lists the following seven indicators where a director, in principle, should not be deemed independent: employment contract with the company or group within the last five years, a material business relationship within the last three years, additional remuneration apart from the director's fee, close family ties, cross-directorships, representation of a significant shareholder, or a directorship for more than nine years. The board should explain its reasons in the annual report if it determines that a non-executive director is independent although one of the specific examples indicates that he is not. The list of indicators is a new feature of the revised Combined Code. It builds on Higgs' finding that exclusive reliance on a general definition provokes a multitude of individual interpretations in particular by shareholder bodies.⁸⁶ It will be seen whether the new approach can provide, "for the first time, a widely accepted definition of independence"⁸⁷.

At least half the board, excluding the chairman, should comprise independent non-executive directors⁸⁸. Further, the chairman whose role should be separated from that of the CEO should meet the independence test on appointment⁸⁹. Independence is important for the composition of the nomination, remuneration, and audit committee: while a majority of independent non-executive directors is recommended for the nomination committee, the members of the audit and the remuneration committee should all be independent non-executives⁹⁰. The recommendations on committee composition were tightened up in 2003 and reflect the increased awareness of inherent conflicts of interest. A paradigm of independence and of the no-conflict rule is the position of a nominee director, who specifically serves to represent and to protect the interest of some outside party (for example, those of a venture capitalist)⁹¹. There is a developed body of case law, and it is expected that the well-established commercial practice of appointing nominee directors will be kept, though the danger

⁸⁴ Removal by ordinary resolution is provided by Companies Act 1985 s. 303. Cf. *Davies*, supra n. 83, at 19, for support of the overall assessment.

⁸⁵ Combined Code section A.3.1.

⁸⁶ *Higgs*, supra n. 61, para. 9.8.

⁸⁷ *Ibid.* supra n. 61, para. 9.12.

⁸⁸ Combined Code section A.3.2 (formerly: not less than one third non-executive directors and the majority of them being independent).

⁸⁹ *Ibid.* section A.2.1 and A.2.2.

⁹⁰ *Ibid.* sections A.4.1, C.3.1, B.2.1. Except for the remuneration committee the earlier version of the Combined Code took a more relaxed view on committee composition. For the audit committee it recommended a composition by a majority of independent non-executives. For the nomination committee it recommended a majority of non-executives, who did not necessarily have to be independent.

⁹¹ On nominee directors *Crutchfield, Philip*, *Nominee Directors: The Law and Commercial Reality*, (1991) *Company Lawyer* 136-142. Shorter *Pettet*, supra n. 55, at 186 et seq.

of invoking the no-conflict rule is apparent. It should be clear that under the revised Combined Code a nominee director would not be deemed independent and thus will not become a member of the audit or remuneration committee.

Labour participation has not been an issue regarding independence, for a system of employee co-determination comparable to that in Germany is almost unknown to company law in the United Kingdom, and accordingly also the problems of the German system in regard to the size of the supervisory board and the qualification of its members are not subject to it. Post-war full employment pushed labour interest into the centre of debate for only a short period of time. After the failure of the Bullock Committee's proposals on labour representation at the board level in the mid-1970s, English company law continued largely unaffected by employee concerns⁹². Since the government led by Thatcher, the focus has been on strike law. Today, the most important explicit provision on employees' interest is Company Act 1980 section 309. It provides that management must consider employee interests, a provision that the Company Law Review Steering Group describes as "not well recognised and understood"⁹³. The Review affirmed the already predominant interpretation, and has taken the view that the provision tends to increase freedom vis-à-vis shareholders rather than constraining it vis-à-vis employees⁹⁴. The draft statement of directors' duties now clarifies that the interest of the company is meant⁹⁵. It has been noted that the mounting of hostile takeover bids tends to be destructive of established working relationships⁹⁶. The consequence drawn, however, is not the instalment of co-determination but a far more flexible approach, relying foremost on workers' councils at the plant.

2.2.3 Internal Controls and Auditing

The system of internal controls as promoted under the Combined Code includes the group wide supervision of financial, operational, and compliance controls and risk management⁹⁷. Its effectiveness is to be reviewed at least annually, and the results of the review have to be reported to shareholders. The task of the audit committee is to set the scope and to review the results of the audit, its cost effectiveness, and the independence and objectivity of auditors⁹⁸. It further reviews the financial relationship between the company and auditors. Again a flexible approach is sought in that the Combined Code states that if non-audit services are also supplied, the committee must seek to balance objectivity and value for money. The increased awareness of the importance of risk management and auditing is highlighted by the

⁹² On the Bullock proposals, see *Lord Wedderburn of Charlton*, *The Legal Development of Corporate Responsibility: For Whom Will Corporate Managers Be Trustees*, in: Hopt, Klaus J./Teubner, Gunther, 1985, 3-54, at 36 et seq. Cf. also *Davies, Paul L.*, *A Note on Labour and Corporate Governance in the U.K.*, in: Hopt, Klaus J. et al. (eds.), *Comparative Corporate Governance*, Oxford: Clarendon, 1998, 373-386, at 377.

⁹³ Company Law Review Steering Group, *The Strategic Framework*, Consultation Document, February 1999, URN 99/654, para. 5.1.17.

⁹⁴ *Ibid.* para. 5.1.21; *Pettet*, supra n. 55, at 190.

⁹⁵ Company Law Review Steering Group, supra n. 56, Annex C, Draft Statement of Director's Duties, schedule 2, s. 2, notes (1)(b) and (2)(a).

⁹⁶ *Davies*, supra n. 92, at 381.

⁹⁷ Combined Code section C.2.

⁹⁸ *Ibid.* section. D.3.

Turnbull Guidance on Internal Control and the Smith Guidance on Audit Committees; both annexed to the revised Combined Code⁹⁹.

Auditing scandals are not unknown to the United Kingdom. The famous Caparo Case of 1990¹⁰⁰ has become a milestone for auditor liability and, more general, for the tort of negligent misrepresentation¹⁰¹. It is a striking argument for the effectiveness of the self-regulatory approach that the Cadbury Committee was set up with the strong participation of the accounting profession¹⁰². Like their German colleagues, auditors in Britain are elected by the general meeting and thus primarily serve as a control device of the companies' members. A proposal has been made to take up the common practice of directors being authorised to fix auditor's remuneration and to confer the powers from the shareholders to the board¹⁰³. The contents of the auditing mandate follow from the law and primarily include the check of whether the accounts give a true and fair view of the companies' business. An innovation in the field of transparency will be the Operating and Financial Review (OFR), which will be prepared by companies with significant economic power¹⁰⁴. The OFR will contain specific information not only on the past but also on the expected future performance and business strategies of the company. It will thus go beyond the directors' report it replaces, which only covered the past. Similar to the assessment of risk management mechanisms by German auditors, reporting on the OFR does not require auditors to second guess directors' business judgements¹⁰⁵. Instead, they will check whether an appropriate procedure was followed¹⁰⁶. Fears similar to those of the German Regierungskommission were expressed in regard to an extension of the auditing mandate: any additional verification of the discharge of the board's responsibilities might detract from the directors' sense of responsibility¹⁰⁷. It is apparent, however, that the extension of auditing to the future-oriented OFR already goes beyond the mandate of German auditors.

3. Recent Developments in France and Italy

Recent reforms in France and Italy indicate a strong movement towards organisational flexibility at the board level and impressively illustrate the tendency towards a clearer distinction of management and control.

⁹⁹ The report of the committee chaired by Nigel Turnbull was prepared following the first publication of the Combined Code in 1998. It was revised to fit the current version of 2003. The review chaired by Sir Robert Smith is a genuine product of the Post Enron Initiatives.

¹⁰⁰ In *Caparo plc v Dickman* [1990] 2 AC 605, the audited accounts gave an untrue view of the profitability of a company. It was held that the auditors do not owe a duty of care to potential investors. For the facts and discussion see Cadbury Report, supra n. 59, Annex 6. The Company Law Review Steering Group, supra n. 56, paras. 8.127 et seq., argues against legislative intervention and for a development of the Caparo test by courts on a case-by-case basis.

¹⁰¹ The largest claim in a case of auditor liability was brought by the Bank of Credit and Commerce International (BCCI) against Price Waterhouse and Ernst & Whinney (later called Ernst & Young). It was for £ 5.2 billion; *Pettet*, supra n. 55, at 203. For the tort law perspective, see *MacBride, Nicholas J./Bagshaw, Roderick B.*, *Tort law*, Harlow et al.: Longman, 2001, at 129 et seq.

¹⁰² *Pettet*, supra n. 55, at 204.

¹⁰³ Company Law Review Steering Group, supra n. 56, para. 8.118.

¹⁰⁴ Secretary of State for Trade and Industry, supra n. 57, paras. 4.28 et seq.; Company Law Review Steering Group, supra n. 56, para. 8.57.

¹⁰⁵ Secretary of State for Trade and Industry, supra n. 57, para. 4.40; Company Law Review Steering Group, supra n. 56, paras. 8.58 and 8.62.

¹⁰⁶ Secretary of State for Trade and Industry, supra n. 57, Annex D, Clause 81.

¹⁰⁷ Hampel Report, supra n. 59, para. 6.7.

3.1 France: The NRE-Reform and the Introduction of a Third Board Model Option

Already in France in 1966, a choice between the one-tier model with the conseil d'administration on top and the two-tier model with the conseil de surveillance as the second board was introduced. The two-tier structure, which is closely tied to the German supervisory model, is infrequent but not unsuccessful: the two to three percent of all stock corporations that have opted for it make up twenty percent of the CAC 40 companies, and most of them are of international stature¹⁰⁸.

The Loi Nouvelle Régulations Economique (NRE)¹⁰⁹, adopted in 2001, now offers a third option which is the new default structure¹¹⁰. The third model relies on the traditional one-tier structure but breaks with the formerly mandatory concentration of powers in the hands of the Président Directeur Générale (PDG), who took both the position of chairman of the board and of the chief executive officer. The concept of the NRE is a functional division between management and control, regardless of whether both tasks remain accumulated in the hands of a PDG or are split. The indirect influence of the président will remain strong even if the functions are separated, for he continues to decide on the frequency of meetings, sets the agenda, and will probably be the chairman of important committees¹¹¹. The conseil d'administration remains responsible for setting the business strategy and for controlling its implementation in the day-to-day business, which is run by the direction générale. Unlike English directors, their French counterparts are not universally empowered and in particular cannot bind the company by acting as representatives¹¹². Practical differences are not striking, as any business matter might be taken up for decision¹¹³.

The most recent development in the corporate governance of listed companies concerns the Principes de gouvernement d'entreprise (Principles for Corporate Governance) of October 2003¹¹⁴. Similar to the situation in the United Kingdom and in Germany, business matters that require prior approval of the board should be specified¹¹⁵. The code stresses a director's competence and experience as key qualities that should be regarded separately and in addition to independence¹¹⁶.

¹⁰⁸ For example, AXA, Peugeot, Printemps, and Paribas.

¹⁰⁹ Nouvelles Régulations Economiques, no. 2001-420, 15.05.2001, Journal Officiel (J.O.), 16.05.2001, 7776 ff.

¹¹⁰ On the NRE reform, *Colson, Jean-Philippe*, Le Gouvernement D'Entreprise et les nouvelles Régulations Économiques, Petites Affiches, 21.08.2001, No. 166, 4-11, at 8 et seq.; *Le Nabasque, Hervé*, Commentaire des principales dispositions de la loi du 15 Mai sur les nouvelles régulations économiques intéressant le droit des sociétés (1^{ère} partie), Petites Affiches, 05.07.2001, No. 133, 3-15, and 06.07.2001, No. 134, 4-14 ; *Storp, Roger*, Reform des französischen Unternehmensrechts im Rahmen des Gesetzes über „Neue Wirtschaftliche Regulierungen“, RIW 2002, 409-423; *Arlt et al.*, supra n. 9, at 73 et seq.

¹¹¹ *Colson*, supra n. 110, at 9; *Le Nabasque*, supra n. 110, 06.07.2001, at 5 et seq.

¹¹² *Le Nabasque*, supra n. 110, 06.07.2001, at 5.

¹¹³ Art. L 235-35 Code de Commerce (Commercial Code).

¹¹⁴ Principes de gouvernement d'entreprise résultant de la consolidation des rapports conjoints de l'AFEP et du MEDEF de 1995, 1999 et 2002, Paris, Octobre 2003. The code is the product of a joint project of the Association of French Private-Sector Companies (Association Française des Entreprises Privées, AFEP) and the French Business Confederation (Association of Mouvement des Entreprises de France, MEDEF). The joint working group chaired by Daniel Bouton presented its final report on 23.09.2002. English version of code and report: <<http://www.ecgi.de>>.

¹¹⁵ Ibid. para. 4.

¹¹⁶ Ibid. para. 6.4 and 8.2.

Similar to the approach of the Combined Code the general definition of independence is supplemented by specific examples that indicate non-independence. Interestingly for Germany, representatives of banks with which the company is closely tied are explicitly mentioned¹¹⁷. Also the French code lifts the proportion of independent directors from one third to half of the board¹¹⁸. Further, the representation of independent directors in the compensation and audit committee is strengthened but remains below the standard of the Combined Code. For the compensation committee, only a majority of independents is recommended (Combined Code: exclusively independents)¹¹⁹. For the audit committee, the proportion of independent directors should be lifted from one third to two thirds (Combined Code: exclusively independents)¹²⁰. In regard to external auditing, the recommendations envisage meetings of the audit committee and the external auditors without executives¹²¹. Despite its cost intensity, the system of dual auditorship will be kept. Labour participation is secured in that two members of the workers' council attend meetings of the conseil d'administration in an advisory capacity (in two-tier structures they attend the meetings of the conseil de surveillance). Further, companies are obliged to appoint up to three employee representatives for the position of director if the total shareholding of employees exceeds three percent of the corporate capital¹²².

3.2 Italy: Reform of the Collegio Sindacale and the Introduction of Two New Board Model Options

In Italy, the Testo Unico of 1998¹²³ introduced specific rules for listed companies¹²⁴. Following the traditional structure, the company will be run by the consiglio di amministrazione. A mandatory second board, the collegio sindacale, will serve as an internal auditing device. An innovation is the extension of the tasks of the collegio sindacale to the supervision of compliance with laws and articles, of the organisational structure, and the accounting system¹²⁵. Further, the Testo Unico led to a clear distinction between internal and external auditing in that the direct auditing mandate is shifted to the external auditors¹²⁶. The extension of the control duties brings the collegio sindacale close to the German supervisory board. However, its control duties do not include business strategy and thus do not involve a strong advisory function. With internal auditing, the sindaci have a clear advantage compared to their German colleagues because they are still chartered accountants. Further, control competences include the right to issue orders to employees and thus

¹¹⁷ Ibid. para. 8.4.

¹¹⁸ Ibid. para. 8.2.

¹¹⁹ Ibid. para. 15.1. The nomination committee may or may not be distinct from the compensation committee and the chairman of the board should be a member; *ibid.* para. 16.1.

¹²⁰ Ibid. para. 14.1.

¹²¹ Ibid. para. 14.2.2.

¹²² Arts. L.225-22 et seq. and L.225-27 et seq. Code de Commerce (Commercial Code).

¹²³ D.lgs. 24.02.1998, n. 58, Gazz. Uff. 26.03.1998 n. 71; English version: <<http://www.ecgi.de>>.

¹²⁴ *Bruni, Gian B.*, The New Consolidated Act On Companies Listed On The Italian Stock Exchange, *Butterworths Journal of International Banking & Financial Law (B.J.I.B.&F.L.)* (1998) 416-421; *Padovini, Fabio*, Aktueller Stand des italienischen Gesellschaftsrechts: Die neueste Gesetzesnovelle für die Reform, *GesRZ* 2002, 72-76, at 73 et seq.; *Arlt et al.*, *supra* n. 9, at 70 et seq.

¹²⁵ Testo Unico Art. 149.

¹²⁶ Testo Unico Art. 155.

are wider than those of the German supervisory board¹²⁷. As a safeguard for the capital market, the collegio sindacale must notify the responsible authority of irregularities¹²⁸.

Independence primarily means the personal incompatibility of parallel membership in the collegio sindacale and the consiglio di amministrazione¹²⁹. An important distinction in regard to a German co-determined supervisory board follows from the fact that an employee cannot become a member of the collegio sindacale¹³⁰. The Codici di Autodisciplina (Code of Conduct) issued by the Italian Stock Exchange recommends an “adequate” proportion of non-executive directors, the number to be determined by each company, particularly according to shareholder structure¹³¹. The refined rules on independence are comparable to those of the Combined Code and to the French code in that they provide specific examples that indicate non-independence¹³². An internal control committee is recommended with the task of giving advice and making proposals to the board, particularly in the field of risk management¹³³. It should be composed of non-executives, the majority of whom are independent. Participation of the chairman of the collegio sindacale is perceived to be useful, especially because the committees’ tasks involve the assessment of accounting standards together with external auditors.

In January 2003, the Italian government passed a legislative decree that brings into forth a major reform of internal control structures¹³⁴. The so called Vietti-Reform ties in with the proposals of the earlier Mirone Committee¹³⁵. From January 2004, companies will have the choice between three different board models.¹³⁶ The traditional structure will be kept as default¹³⁷. The first new option can be described as a two-tier board structure following the German model with a management board (consiglio di gestione) and a supervisory board (consiglio di sorveglianza)¹³⁸. The second new option is a one-tier structure that ties in with the Anglo-Saxon model¹³⁹. It calls for the board (consiglio di amministrazione) to be composed at least of one third of independent directors and for a control committee (comitato per il controllo sulla gestione) exclusively composed of independent directors.

¹²⁷ Testo Unico Art. 151 (2).

¹²⁸ Testo Unico Art. 149 (3). The responsible authority is the *commissione nazionale per le società e la borsa* (CONSOB).

¹²⁹ Testo Unico Art. 148.

¹³⁰ Testo Unico Art. 148 (3c).

¹³¹ Codici di Autodisciplina, para. 3; English version: <<http://www.ecgi.org>>.

¹³² Codici di Autodisciplina, para. 3.

¹³³ Codici di Autodisciplina, para. 10.

¹³⁴ “Riforma organica della disciplina delle società di capitali e società cooperative, in attuazione della legge 3 ottobre 2001, n. 366”, d.lgs. 17.01.2003 n. 6, Gazz. Uff. 22.01.2003, n. 17, suppl. ord. 8/L; also printed in *Giur. comm.*, supplemento n. 4/03, with further materials and a comment by *Vincenzo Bounocore*.

¹³⁵ The Italian parliament adopted the proposals of the Mirone commission in 2001 and empowered the government to implement the reform by legislative decree (legge 3.10.2001 n. 366, delega al Governo per la riforma del diritto societario, Gazz. Uff. 8.10.2001). On the Mirone proposals, see *Alessi, Riccardo*, *Il Collegio Sindacale nelle Riforme Mirone*, *Giur. Comm.* 2000, 370/I-377/I; *Montalenti, Paolo*, *La riforma del diritto societario nel progetto della Commissione Mirone*, *Giur. Comm.* 2000, 379/I-406/I.

¹³⁶ On the 2003 reform, see *Ambrosini, Stefano*, *L’amministrazione e i controlli nelle società per azioni*, *Giur. comm.* 2003, 308/I-332/I; *Capiello, Stefano/Marano, Gianmaria*, *The Reform of the Legal Framework for Italian Enterprises and the 2003 Reform*, [2003] *I.C.C.L.R.* 216-220.

¹³⁷ Legislative decree, supra n. 134, Art. 2380.

¹³⁸ *Ibid.* Arts. 2409-octies et seq.

¹³⁹ *Ibid.* Arts. 2409-sexiesdecies et seq.

4. Convergence and Divergence

Board models and the improvement of internal controls have been a focus of the reform processes in all countries considered. For a European single market, the interest must be to explore convergences and divergences.

4.1 Convergence of Internal Controls and Path Dependence

4.1.1 Convergence of Internal Controls

The survey shows a striking convergence in the awareness of the distinction between management and control. It is argued by many that the English board of directors has taken a development towards a de facto supervisory board that is close to the German model¹⁴⁰. In fact, the separation of the positions of board chairman and CEO and the growing tendency of appointing non-executive directors can be rated as a systemic breakthrough for the two-tier system. In France, a similar development can be observed concerning the recent turn away from the strong leader idea as formerly embodied in the double position of the PDG. The sharpening of the supervisory functions of the Italian collegio sindacale and the recommendations concerning a balanced board composition including a proportion of non-executive directors are further examples for structural convergence.

Although formal correlation is strong, functional analysis shows that the roles of company organs in each country take on their own specific garment. However, the growing awareness of the distinction between management and control embodies a functional adherence of the internal functions regardless of board structures. A growing tendency towards audit committees – albeit with slightly different powers and functions – can be observed in all systems considered. Triggered by listing requirements of powerful stock exchanges, audit committees today serve as a common denominator in the assessment of good corporate governance by investors¹⁴¹. This is an example for the fact that the demands of capital markets do not stop at formal differences of board structure. One conclusion to be drawn from the Enron case is that good corporate governance depends largely on (independent) directors asking the questions they have to ask and thereafter acting upon the knowledge they have obtained. Law and rules of good conduct cannot do more than provide a framework for efficient cooperation between internal audit committees and external auditors, and the similar efforts on a clearer delimitation reflect the willingness to do so. As an untroubled flow of information is at the heart of efficient control, mandatory meetings of internal and external auditors without executives could be a promising step forward.

4.1.2 Path Dependence, Especially Shareholder Structures and Banking Systems

Convergence is subject to path dependence. Systems develop according to their historical and cultural roots and especially according to the shareholder structure and the capital market environment. The theory of path dependence explains the pronounced risk of welfare losses for the adoption of outside institutional

¹⁴⁰ *Davies*, supra n. 9, at 446 et seq.; *Hopt*, supra n. 9, 783 et seq.

¹⁴¹ For the London Stock Exchange, see the Combined Code, section C.3. For the New York Stock Exchange, see Listed Company Manual, s. 303A.06.

arrangements¹⁴². Examples illustrating roots for market-based path dependence are the distinct banking systems and the different shareholder structures. Shareholder activism clearly is a means of backing up internal controls, and it is surprising that the United Kingdom and Germany are only slowly exploring the potential of derivative actions, which are firmly rooted in the corporate governance concept of the United States¹⁴³. The ongoing discussion on the details of derivative actions illustrates that system development is subject to legal traditions and – as it concerns shareholder activism – by the fear of a misuse of shareholder rights¹⁴⁴. Further examples for rule-driven path dependence are the opposition of shareholder and stakeholder philosophy and the approach towards a comprehensive group law¹⁴⁵. The recently introduced S.E. – regardless of the partly questionable compromises made to finally adopt the statute – is an important step on the way towards a more liberal company law in Europe¹⁴⁶.

4.2 Self-Regulation and Flexibility of Board Structuring

4.2.1 Specialised Rules for Listed Companies

In all the countries considered, the so-called “code movement” has already led to a company law that is to a considerable part determined by soft law. A special body of rules – derived from both hard and soft law – emerges for listed companies¹⁴⁷. It can be expected that the rules applicable to listed companies will sooner or later become a measurement for standards of conduct to be re-imposed on unlisted companies by case law or by rulings of financial authorities. In particular, this could be the case in regard to directors’ duties and conflicts of interests.

The growing importance of codes of conduct, listing rules, and corporate governance ratings leads to a considerable – and at least for Germany – unknown market pressure. The new regulatory level implies difficult questions concerning the regulatory powers of financial authorities and stock exchanges¹⁴⁸. Soft law and the exercise of self-regulatory powers have proven successful in the United Kingdom¹⁴⁹. The most famous example comes from the work of the Panel on Takeovers and Mergers. Scepticism towards self-regulation can be observed in France¹⁵⁰ and Italy¹⁵¹. In Germany, history explains the reluctance towards the exercise of powers on a non-

¹⁴² *Bratton, William W./McCahery, Joseph A.*, Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference, *Colum. J. of Transnat’l L.* 38 (1999), 213-297; *Coffee, John C.*, The Future as a History: The Prospects for Global Corporate Governance and its Implications, *Northw. Univ. L. Rev.* 93 (1999), 641-707.

¹⁴³ *Ulmer*, supra n. 22, at 302 et seq.

¹⁴⁴ *Bayer*, supra n. 24, at 157.

¹⁴⁵ *Forum Europeum Konzernrecht*, Corporate Group Law for Europe, *European Business Organization Law Review (EBOR)* I (2002) 165-264.

¹⁴⁶ *Hopt, Klaus J.*, The European Company (SE) Under the Nice Compromise: Major Breakthrough or Small Coin for Europe?, *Euredia (Revue européenne de droit bancaire et financier/European Banking and Financial Law Journal)* 2000, 465-475, at 468 et seq., for the pros and cons of the S.E.

¹⁴⁷ *Weil, Gotshal & Manges*, Comparative Study of Corporate Governance Codes Relevant to the European Union and Its Member States (Final Report), January 2002, <<http://europa.eu.int>>.

¹⁴⁸ *Hommelhoff, Peter*, The OECD Principles on Corporate Governance: Opportunities and Risks from the Perspective of the German Corporate Governance Movement, [2001] *Int. Comp. Corp. Law J.* 2, 457-480, at 459 et seq.

¹⁴⁹ *Cheffins, Brian*, *Company Law*, Oxford: Clarendon, 1997, 264-420.

¹⁵⁰ *Storp*, supra n. 110, at 409.

¹⁵¹ *Montalenti*, supra n. 135, at 396/I et seq.

statutory basis¹⁵². It remains to be seen whether codes of conduct can defend their position and gain further acceptance. To a considerable extent, the merits of soft law – its adaptability and its power to provide common denominators for investors – depend on the flexibility granted under the national law.

4.2.2 Choice Between Board Models

The tendency in Europe points towards an increase in flexibility. The recently introduced threefold choice for listed companies in France and Italy is the most striking example. In the United Kingdom, the Company Law Review Steering Group pointed out that a two-tier structure is “possible only by very artificial devices, because the duties and functions of all board members are ultimately the same”¹⁵³. However, the development towards a de facto supervisory board demonstrates the impressive adaptability of the Anglo-Saxon one-tier model¹⁵⁴.

The restructuring of the management board of the Deutsche Bank is the most recent German example of the attempt to align management structures to specific business needs¹⁵⁵. The newly introduced executive committee is composed of the five members of the management board and additionally includes seven managers below board level¹⁵⁶. The concentration of powers in the hands of Josef Ackermann, the head of Deutsche Bank who takes both the position of the chairman of the board and of the executive committee, has been rated as a movement towards a strong CEO along the lines of the United States model. Because of the mandatory two-tier structure, the accumulation of powers is not as dramatic as in the States – at least formally – but it is clear that the new structure strains the principles of unitary board power and collegial decision making of directors.

For Germany, the pivotal question is still whether it should continue its tutelage of companies in regard to board structuring. The tendency towards more flexibility as illustrated by reforms in the neighbouring European countries indicates that the German insistence on the mandatory two-tier board model is outdated. The rigidity of German law to a large degree is due to the inflexible position of the government and workers’ unions on co-determination.

4.3 Standards of Independence and Labour Participation

4.3.1 Towards Stricter Independence

Although definitions vary in detail, convergence can be noted in the growing tendency towards stricter standards of independence for board directors¹⁵⁷. Independence is one of the cornerstones for efficient control. However, management knowledge and business relations of the board of directors can be highly useful for

¹⁵² *Hopt, Klaus J.*, Corporate Governance in Europa: Neue Regelungsaufgaben und Soft Law, in: Doralt, Peter/Kalss, Susanne (eds.), Corporate Governance, GesRZ 2002 (special issue), 4-13, at 9. On German experiences with self-regulation in the fields of insider dealing, takeovers, and corporate governance, *Erhardt, Olaf/Nowak, Eric*, Die Durchsetzung von Corporate-Governance-Regeln, AG 2002, 336-345, at 343 et seq.

¹⁵³ Company Law Review Steering Group, supra n. 94, para. 5.1.33.

¹⁵⁴ *Davies*, supra n. 9, at 449.

¹⁵⁵ *Von Hein, Jan*, Vom Vorstandsvorsitzenden zum CEO?, ZHR 166 (2002) 464-502, at 467 et seq.

¹⁵⁶ An organigram which illustrates the new structure is available at <<http://group.deutsche-bank.de>>.

¹⁵⁷ For a comparison of the distinct definitions of independence as of 2002, cf. *Weil, Gotshal & Manges*, supra n. 147, at 55 et seq.

both the running and the control of the company. Provided a minimum set of mandatory rules is kept, it seems most promising to leave the detailed definition of adequate board balance to the discretion of the individual company. Setting the necessary standards of disclosure will be one of the challenges, particularly in regard to cross shareholdings. Anglo-Saxon codes of conduct impressively demonstrate options for providing refined definitions that reveal the differences between mere non-executive independence and higher standards of independence, including other affiliations¹⁵⁸. Continental Europe has been one step behind, but it's making up for lost time. A common standard of independence proves difficult for labour participation. Representatives from workers' unions could qualify as being free from any direct business relationship but they are bound to the interests of the union's members, i.e. the employees of the company.

4.3.2 Towards More Flexible Labour Involvement Models

This leads to the very basic question of whether far-reaching labour participation should be secured by even parity at the board level as German co-determination suggests, or whether other less far-reaching and more flexible forms should be preferred. German co-determination as it is today falls outside the scope of self-regulatory board balance determined by the company. From an investor viewpoint, co-determination implies considerable differences in shareholder influence. No mono-causal links have been evidenced as to control efficiency. Recent scandals in Germany show that co-determination is not a guarantee against excessive remuneration of management¹⁵⁹ or a safeguard against costly strikes¹⁶⁰. It is not clear whether those who argue that co-determination is useful for long-term policies (as opposed to short-term share profits) can make their case¹⁶¹. Instead, it seems apparent that control activity is largely shifted to human resources issues that reveal the inherent conflict between the goals of co-determination and of the control task. For internal controls, at least, it means a slowing down of decision making¹⁶². On the European level, co-determination has proven to be one of the most important reasons for pitfalls of harmonisation. The 5th structure directive in particular has almost been buried, and the S.E. statute could only be reached by leaving the decision to the discretion of the member states as to whether – and if, then how – to implement co-determination¹⁶³. Further European convergence certainly would require a flexible approach. The proposals include a “base solution,” one that would envisage setting a time limit on keeping one's own model of co-determination, or an opening clause following the Dutch model that allows companies of international stature to escape

¹⁵⁸ The Combined Code is discussed supra para. 2.2.2. For earlier efforts in the United States, see The American Law Institute, *Principles of Corporate Governance* (1994), § 3A.01.

¹⁵⁹ Klaus Zwickel, former head of the German metal union (IG Metal) and member of the supervisory board of Mannesmann, is currently facing an action for not having opposed the extraordinary indemnity of Euro 15 million paid to Klaus Esser on his resignation in consequence of the takeover of Mannesmann by Vodafone in 2000. In total, the Mannesmann management received at least Euro 100 million.

¹⁶⁰ Frank Bsirske, head of the United Services Union (Ver.di) and member of the supervisory board of Lufthansa, was harshly criticised for organising a strike of the union members at the expense of the airline in 2002.

¹⁶¹ From an economic viewpoint, *Sadowski, Dieter et al., Gesetzliche Mitbestimmung in Deutschland: Idee, Erfahrungen und Perspektiven aus ökonomischer Sicht*, ZGR 2001, 110-145, at 113 et seq.

¹⁶² *Hopt, Klaus J.*, supra n. 36, at 207 et seq.

¹⁶³ Council Directive 2001/86/EC of 8.10.2001 supplementing the Statute for a European company with regard to the involvement of employees, OJ L 294, 10.11.2001, at 22-32.

the co-determination scheme¹⁶⁴. A voluntary scheme could prove difficult, for – aside from times of crisis – incentives for a single company to start co-determination are hardly imaginable¹⁶⁵. With a view to the developments in neighbouring countries, it could well be argued – also for Germany – that employees’ interests have been adequately recognised at the workplace and sufficiently secured in workers’ councils. Following the reform proposals in the United Kingdom, a special disclosure duty can be imposed to back up labour interests¹⁶⁶.

5. Outlook: What Role for the European Union?

The development of board models since the times of the V.O.C. shows a history split between one-tier structures on the one hand and two-tier structures on the other. Although the basic structural difference remains, today an impressive tendency towards convergence and a number of parallel efforts on improving internal controls can be noted. More than ever, reform projects have to consider the levels of regulation: national or harmonised European rules, statutory or soft law? For Europe, according to the Treaty of Amsterdam, the onus is on those who argue for regulation. For reforms on both the European and the national level, the way will often tend to point towards deregulation or towards disclosure rules. Disclosure is an important interlinkage between internal control by the supervisory board or, in the one-tier board model, by non-executive directors and external controls by capital markets. Common disclosure rules can serve as a basis for further integration of the internal market. This is also a key finding of the High Level Group of Company Law Experts that reported to the European Commission by the end of 2002¹⁶⁷. In its communication to the Council and the European Parliament of 21 May 2003, “Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward”, the European Commission follows closely the recommendations of the High Level Group¹⁶⁸.

Liability for the infringement of market information is the important counterpart to disclosure rules¹⁶⁹. Primary markets and especially prospectus liability are in the centre of the current European reform debate. In its 64th meeting in 2002, the

¹⁶⁴ On the reform proposals, *Ulmer*, supra n. 40, at 275. In detail, *Höland, Armin*, *Mitbestimmung in Europa*, Frankfurt/New York : Campus, 2001, at 139 et seq.

¹⁶⁵ *Gerum, Elmar/Wagner, Helmut*, *Economics of Labor Co-Determination in View of Corporate Governance*, in: Hopt, Klaus J. et al. (eds.), *Comparative Corporate Governance*, Oxford: Clarendon, 1998, S. 341-360, at 346 et seq. Voluntary co-determination happens only very occasionally.

¹⁶⁶ Secretary of State for Trade and Industry, supra n. 57, Vol. II (“A New Companies Bill: Draft Clauses”), s. 75 (1), where it is stated that the impact of management decisions on employees’ interests should be a matter to be considered in the new operating and financial review.

¹⁶⁷ Report of the High Level Group of Company Law Experts on A Modern Regulatory Framework for Company Law in Europe, European Commission, Brussels, 4 November 2002. The members of the group were José Maria Garrido Garcia, Klaus J. Hopt, Jonathan Rickford, Guido Rossi, Jan Schans Christensen, Joëlle Simon, Jaap Winter (chairman).

¹⁶⁸ COM (2003) 284(01). The Synthesis of the responses to the Communication of the Commission to the Council and the European Parliament was published as a Working Document of DG Internal Market on 15.11.2003.

¹⁶⁹ For a profound analysis of the contractual problems, see *Fleischer, Holger*, *Informationsasymmetrie im Vertragsrecht*, München: Beck, 2001. Cf. further the proposals by the Regierungskommission Corporate Governance in *Baums*, supra n. 13, para. 186 et seq. and the comments by *Hopt*, supra n. 14, at 62 et seq.

Association of German Jurists (Deutscher Juristentag)¹⁷⁰ underlined that a comprehensive concept must include secondary markets and continuing disclosure duties¹⁷¹. Liability for false or misleading market information, including secondary market information, is the focus of a research project currently underway at the Max Planck Institute for Foreign Private and Private International Law in Hamburg¹⁷².

Turning to the field of external controls – which was almost non-existent during the V.O.C. era – the differences between the strong capital market in the United Kingdom and the lesser developed markets in continental Europe are apparent today. In the United Kingdom, the market for corporate control, in particular for hostile takeovers, and the corresponding market for managers serve as powerful control devices. In Germany, for example, banks and financial intermediaries still play predominant roles in external control. For the European Union, triggering efficient market control first of all means to facilitate cross-border investment. In its report on “Issues Related to Takeover Bids” of January 2002 the High Level Group singled out the issues at the heart of the long-raging struggle for a 13th directive on takeover bids: minority rights in takeovers, squeeze-outs, and especially anti-takeover devices¹⁷³. State involvement and privileges were the most important cornerstones for the success of the V.O.C. but at the same time they are barriers to competition and market control power. The current debate on golden shares illustrates that not all of the early problems have been overcome. With regard to golden shares, the series of judgements of the European Court of Justice in 2002 and 2003 strongly indicates that we are on our way¹⁷⁴.

¹⁷⁰ The resolutions of the commercial law unit are published in DB 2002, 2037-2038 and at <<http://www.djt.de>>. For a report of the commercial law unit session see *von Hein, Jan*, Tagungsbericht, JZ 2003, 195-199.

¹⁷¹ *Fleischer, Holger*, Gutachten F zu der Frage: „Empfiehl es sich im Interesse des Anlegerschutzes u zur Förderung des Finanzplatzes Deutschland das Kapitalmarkt- und Börsenrecht neu zu regeln?“, in: Ständige Deputation des Deutschen Juristentages, Verhandlungen des 64. Deutschen Juristentages, Band 1, München 2002 : Beck, S. F7-F144, F39 et seq.

¹⁷² The project started with an expert opinion for the German Federal Ministry of Finance on the law of prospectus liability in the EU member states and Switzerland. Subsequently, the focus was expanded to liability for false or misleading secondary market information. The forthcoming publication will also cover the U.S.

¹⁷³ Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids, European Commission, Brussels, 10 January 2002; see also supra n. 167.

¹⁷⁴ European Court of Justice, Judgments of 04.06.2002: C-367/98 (Portugal), C-483/99 (French Republic) and C-503/99 (Belgium). In its judgments of 13.05.2003, C-98/01 (United Kingdom) and C-463/00 (Spain), the court reaffirmed its position against golden shares: the special shares in the BAA plc (British Airports Authority) held by the United Kingdom government and the Spanish special regime for five privatised state enterprises were held to be incompatible with Art. 56 EC. The judgements signalise difficult times for the German Volkswagengesetz that provides the federal state of Lower Saxony with two seats in the supervisory board of the Volkswagen AG and in addition restricts the voting power of other shareholders to 20%.

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