

## THE GERMAN WAY TOWARDS DISCLOSURE

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Any attempt to assess the advantages and disadvantages of disclosure requirements to the individual investor and the capital market as a whole in Germany cannot be anything but superficial. Empirically-based economic cost benefit analyses comparable to those by Benston, Stigler, *et al.*<sup>1</sup> do not exist in Germany. Therefore, the discussion necessarily must be speculative, and cannot weigh facts and evidence. Secondly, rights to information and disclosure requirements in Germany traditionally have been based on a philosophy different from that in the U.S. – the “investor”, *i.e.*, a person who transfers a certain amount of capital to other people or companies in hopes of a good return – was never the center of attention. Rather, these rules were established in the interests of the creditor and the “co-owner”, a person who needs all relevant information in order to exercise his membership rights in the company intelligently. Furthermore, the concept of allocational efficiency was basically foreign to German legal thinking. It has just recently – due to U.S. influences – been introduced into the discussion in Germany and has not, as yet, had any influence on legislation.

Consequently, it is impossible to give a detailed economic analysis like Mendelson’s,<sup>2</sup> but it might be of interest to a non-German audience to discuss the reasons why empirical economic analyses, comparable to those that were conducted in the U.S., do not exist in Germany (section 1), to describe the system and the instruments of disclosure (section 2), to outline the arguments for and against disclosure within their historical contexts (section 3), and to attempt an explanation of why legal provisions and legal reasoning concerning disclosure in Germany differ so much from those developed in the U.S. (section 4).

### 1. Why economists are disinterested

No German economist would ever seriously try to assess the importance of disclosure for the investor as far as *new issues* of stock are concerned. There simply is no need for empirical studies of the subject because new issues of shares almost

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never occur within the organized capital market. The number of shares of German companies listed on the German stock exchanges or admitted to the free market (*Freiverkehr*), which is in fact regulated, has been steadily declining during the past few years.<sup>3</sup> New companies trying to raise capital in the stock market are virtually nonexistent. Admittedly, there have been a few “new” names listed on the Frankfurt, Dusseldorf, and Hamburg exchanges, but virtually none of these companies were German. Most were British, U.S., Japanese, or Dutch “blue chips”, already governed by the as (or even more) strict disclosure requirements of their own jurisdictions.

If, as the majority of authorities insist, disclosure should be beneficial for the individual German investor, then he would be well served by the disclosure regulations of these other countries. British, U.S., Japanese, and Dutch law would give him – or rather his investment advisor (in Germany usually a bank) – all necessary information to evaluate the recent performance and future prospects of ICI, Philips, Ford, Shell, Mitsubishi or IBM. Even if it were true, as Stigler *et al.* claim, that information is useless to the investor, there still would not be any valid reason for serious concern. The additional costs of disclosure incurred through the introduction of a foreign issue into the German capital market would be negligible for companies of this size and for those persons who decided to invest their capital in those enterprises. Serious cost arguments could hardly be raised.

But even without detailed empirical evidence, it can be argued that outside of the stock market, publicity requirements have had very beneficial effects for the investor, at least in a very limited area, where in the words of Brandeis, “sunlight” has proved to be “the best disinfectant”.<sup>4</sup> For quite a number of years, several investment companies based outside Germany – the most prominent being Investors Overseas Service (IOS) – succeeded in reaping substantial amounts of capital from private investors in Germany. They issued glossy advertisements and pamphlets, promised enormous returns and employed an armada of well-trained door-to-door salesmen who were able to attract the interest and money of doctors, dentists, and lawyers. The collapse of IOS eventually prompted the German federal legislature to pass the Foreign Investment Act (*Auslandsinvestmentgesetz*). This Act makes the offering and sale of shares in investment companies based outside Germany illegal unless a prospectus, fulfilling certain minimum requirements, has been submitted to the German federal agency supervising the activities of banks (*Bundesaufsichtsamt für das Kreditwesen/Berlin*). Even though this agency does not have the duty or obligation to check the validity of the data set forth in the prospectus, the threat of civil and criminal liability for misleading statements apparently proved to be strong enough to induce the vast majority of the more than 20 investment companies based outside Germany that were selling shares in that country to discontinue business there. Fraudulent or obviously unsound investment activities were weeded out. One might even venture to say that this legislative effort improved allocational efficiency in the German capital market. No more money was wasted in phony companies based outside Germany, whose major objective con-

sisted in making just one person rich in a short time — the sponsor.<sup>5</sup>

Turning to the benefits of disclosure for the investor as far as *outstanding issues* of stock are concerned, we again have to report that no empirical research has been conducted in Germany.<sup>6</sup> And here it is impossible to claim that such research would be superfluous — shares of outstanding issues are bought and sold by investors in Germany. Nevertheless, this lack of evidence seems to be much less important than in the U.S. Even if some economists should discover that the individual investor and possibly the capital market would not gain substantially from disclosure requirements, or that increased disclosure would even have detrimental effects, this would still be of little concern in Germany. German disclosure regulation, as we have noted, has not been based on market efficiency arguments.

## 2. The German legal framework

### A. General remarks

The difference in attitudes between U.S. and German lawyers towards disclosure is no mere reflection of differences of national business mentality. If rash conclusions or severe misunderstandings are to be avoided, one must bear in mind that the arguments for and against disclosure are put forward to defend or to criticize an existing legal status quo which is itself part of a specific legal system. An idea may prove extremely convincing in one legal frame of reference, while providing few answers to problems generated by a different legal setting. Thus, a short summary of the German legal background concerning disclosure regulation seems indispensable.

One of the most influential arguments used against the extension of actual disclosure requirements in Germany is that they would be contrary to the basic structure of the law governing business organization and commercial associations.<sup>7</sup> Because of tax considerations and specific traditions of doing business, the joint stock company (*Aktiengesellschaft*) is not the natural form for many larger-sized enterprises. A business of the type carried on by a typical U.S. closed corporation would usually not be incorporated in Germany. The law offers the businessman a wide variety of organizational types from which he can choose according to his situation and the various advantages the forms offer with respect to risk propensity, independence, capital needs, familial considerations, etc. There is a general feeling that this freedom of choice has worked well, and that it should not be distorted by imposing disclosure where up to now none has been needed.

The birth of the modern body of law regulating business associations and companies coincided with the industrial revolution in Germany and the entrepreneurial spirit that accompanied it. The emerging legal forms had to be molded in such a way as to coordinate the different interests on which industrial progress relied.<sup>8</sup> These interests were those of innovative entrepreneurs, who by themselves were not

abole financially to set up an independent business, and of investors, who supplied their money but stayed to a greater or lesser extent outside the management. Their diminishing direct involvement with management had to be complemented by mechanisms allowing for influence or at least control from the outside. Another group whose interests had to be provided for were the creditors, e.g., banks or suppliers of goods. Their common interest was directed towards dealing with somebody who would be able to pay his debts.

The different interests mentioned, though contradictory in many respects, had a common goal: the financial success of the enterprise.<sup>9</sup> Also, as it was thought that in a free-market society, this common aim could be realized as long as everybody was given the greatest possible freedom of action, the law did not impose a certain form of enterprise but rather proposed different types: the open commercial partnership (offene Handelsgesellschaft = OHG), the limited partnership (Kommanditgesellschaft = KG), the dormant partnership (stille Gesellschaft = stG), the private limited company (Gesellschaft mit beschränkter Haftung = GmbH), and the joint stock company (Aktiengesellschaft = AG), to name only the most important. Not only are there different types, but businessmen are even free to modify and mix different forms to suit their convenience. A famous example is the now well-established GmbH and Co., KG, a limited partnership whose managing and personally liable partner is a private limited company.<sup>10</sup> The main exception to the hands-off policy of the law was the regulation of the joint stock company, where the main body of rules consists of strict law not modifiable at will. But given the specific structure of the German capital market, the economic need to choose this strictly-regulated form was not as strong as elsewhere. This is shown by Table 1.<sup>11</sup>

### *B. Disclosure by entry in the Commercial Register and publication in the Federal Gazette*

German commercial law provides two basic instruments through which internal business information is disseminated to the public. First there is disclosure by entry

Table 1  
Legal forms of the 1000 biggest enterprises in Germany in the years 1954 and 1960.

Forms of enterprises	1954	1960
Joint stock companies	497	435
Limited private companies	278	299
Limited partnerships	122	159
Open commercial partnerships	30	36
Single businesses	34	38
Others	39	33
<b>Total</b>	<b>1000</b>	<b>1000</b>

in the Commercial Register (Handelsregister). The function of this Register is to convey to the public the names of the local members of the business community to whom commercial law, in most continental countries a specific body of rules, is applicable. The Register also contains information about personal liability and liability limits and the names of the persons with authority to act for the business.

The Register is administered by county courts (Amtsgerichte). Although the magistrate may in case of doubt engage in proceedings to check on the adequacy of an entry petition, he will normally only see to it that the formal requirements are fulfilled. The term "Commercial Register" has also come to signify the department of the court to which the businessman must submit a variety of documents, which then become part of register publicity although they are not formally entered in the register book.

The Commercial Register is available to anyone who wants to inspect it. Whether pertinent information has been registered or not has legal consequences for contractual or quasi-contractual liability towards third parties.

The second main instrument of disclosure is an announcement in the official nationwide "Bundesanzeiger" (Federal Gazette) and in other publications which the contract of association or the company charter may designate.

The *individual firm* must submit the following items for entry in the Commercial Register: <sup>12</sup> the name and the domicile of the business; the name and residence of the proprietor; changes of the firm's and the proprietor's name, and any changes of domicile or residence; the termination of the firm; and the initiation of bankruptcy proceedings. With the exception of the last item, all these entries must be published in the Federal Gazette, <sup>13</sup> if that form of disclosure is used.

The *open commercial partnership* must register the same items as the individual businessman; all partners have to be listed. Additionally, the following information must be given: <sup>14</sup> the date of the beginning of actual business activity; changes of partners; contractual deviations from the rule that each partner has full authority to act for the partnership as a whole; the institution of liquidation proceedings; the continuation of a dissolved partnership in accordance with special provisions of commercial law; in case of liquidation, the name and residence of the liquidators; and the termination of the partnership. The requirements for publication in the Federal Gazette are similar to those for the individual business proprietor. The contract of association, the balance sheet and the profit and loss statement are not disclosed.

The disclosure requirements for the *limited partnership* are quite similar to those of the open commercial partnership, with the exception of some specifics concerning the limited partners. <sup>15</sup> Their names, the amount of their contributions and the limitation of their liability must be entered in the Register, as well as any subsequent changes. The publication in the Federal Gazette and other designated publication organs need not name the limited partners individually, but only state the number of partners.

The *dormant partnership* <sup>16</sup> is neither registered nor published as such. This

institution — which is something in between a loan to a commercial enterprise and a limited partnership — is treated, for registration purposes, as an individual firm of the main partner.

The registration and publication requirements imposed by law have been greatly extended for the *private limited company*. Only the most important will be given here. The following items must be entered in the Commercial Register: <sup>17</sup> the name and the domicile of the company; the nature of the business; the amount of capital; the date of the constitution; the name and the residence of the managers, any subsequent changes therein, and the cancellation of authority to act for the company; changes in the constitution, especially alterations of the company's nominal capital basis as stated in the constitution; and the termination of the company, the name and residence of the liquidators, and their individual authority, if any, to act for the company in liquidation.

In addition, the private limited companies must provide a series of documents which, though not entered in the Commercial Register, become part of the Register files and are thus available to interested persons, principally, of course, present or prospective creditors. As part of the application for registration, the company must submit: <sup>18</sup> the constitution with the minimum content as prescribed by statute, such as the names of the members, object of the business, capital amount, the members' contributions, additional obligations of members, if any (*e.g.*, rendering of services or assignment of a patent) and preferences granted to company founders; the names of the managers, if not listed in the constitution; and a list of company members, including their individual contributions to company capital.

Later, the following information must be submitted: <sup>19</sup> the names and residences of the members of the supervisory council; an annual list of company members; changes in the constitution; changes of managers; and whenever an increase of capital occurs, a list of the persons who subscribed to the increase.

The publication in the Federal Gazette must contain the information entered in the Commercial Register and in addition <sup>20</sup> must list any contributions other than cash payments and the names of the contributors. The private limited company, if not engaged in banking, <sup>21</sup> has no obligation to disclose its balance sheet and profit and loss statement.

The *joint stock company* must fulfill similar legal requirements, though these are, again, vastly expanded. The magistrate of the Commercial Register sees that the formal requirements of company formation are fulfilled. Other items are necessary because the company capital is divided into readily negotiable shares rather than into non-marketable shares as in the case of the limited private company. Thus, in addition to submitting all measures taken to acquire capital, the managing board must record in the Commercial Register the extent to which preemptive shares were issued during the preceding fiscal year.

The most important requirement, though, is that the joint stock company must disclose its annual accounts and annual business report. The latter must give an account of the progress of the company's business and its financial position. Any

event of particular business significance within and after the close of the fiscal year must be reported. The report also must comment on the annual financial statement.

The annual accounts of a company comprise its balance sheet and profit and loss account. The statute defines the detailed forms of the balance sheet and the profit and loss account<sup>22</sup> which the companies, as a rule, must use unless special rules and forms apply as in the case of banks, insurance companies and a few other types of business institutions. The annual accounts and the report are prepared each year by the board of management. They are then audited by qualified professionals<sup>23</sup> and subsequently examined by the supervisory board. Then a shareholders meeting is held, at which it is decided how to dispose of the retained earnings.<sup>24</sup> After the shareholders meeting, the managing board must promptly file with the Commercial Register the annual financial statement, accompanied by the auditors' certification, and the annual business report together with a report of the supervisory board on the results of the audit.<sup>25</sup> The certification accompanying the annual financial statement must be signed by the auditors. If the auditors have refused to certify the annual financial statement, that fact must be explicitly noted on the filed financial statement. Also, the managing board must promptly publish the annual financial statement in the publication organs designated in the company's constitution, and file the publication with the Commercial Register, where it becomes available for public inspection.

A major reform, brought about by the 1965 German Statute on Joint Stock Companies, is the regulation of associated enterprises and groups of companies.<sup>26</sup> The main reason for the attempt to furnish legal structures for this modern business phenomenon has been a strong feeling that group ties disturb the play of forces normally expected between the managements of the companies concerned. The law does not try to forbid a controlling company to impose its will on a subsidiary; what it does is to provide guarantees which, it is hoped, will protect minority shareholders and creditors of the subsidiary companies against losses. This legal aim has also led to consequences for the registration and publication requirements here under review.

Thus, the company's managing board must file certain legally specified enterprise and control agreements with the Commercial Register<sup>27</sup> as well as the name of the other contracting party. The application must be accompanied by the agreement and certify that the necessary approval of the shareholders has been obtained.<sup>28</sup> The agreement is not valid until it is entered in the Commercial Register. Subsequent modifications and the termination of the agreement<sup>29</sup> must also be registered.

Furthermore, German law imposes a duty on a parent joint stock company to submit group accounts, irrespective of the subsidiary's legal form.<sup>30</sup> An introductory law to the statute governing joint stock companies extends this duty to private limited companies having one or more joint stock companies as subsidiaries,<sup>31</sup> although, as we have seen, private limited companies are not normally under such an obligation.

Parent and subsidiary are treated as a single economic unit in group accounts;

debts and liabilities between them cancel each other out. The individual accounts of the enterprises concerned and the group accounts must be given as of the same date, *i.e.*, the respective financial periods must coincide. Like the individual financial statements, the group accounts consist of a consolidated balance sheet, a consolidated profit and loss account, and a consolidated annual business report. The consolidated financial statements must be audited, published and entered in the Commercial Register in the same way as the annual accounts of an individual joint stock company.<sup>32</sup>

For the first time in German legal history, the much-debated<sup>33</sup> Law Governing Financial Statements and Reports of Certain Enterprises and Affiliated Groups of 1969 (*Publizitätsgesetz*)<sup>34</sup> sets forth professional auditing, publication and registration requirements analogous to those prescribed for joint stock companies, irrespective of the legal form of the business. The legal point of reference is size, not form; this has been considered revolutionary by most of the German business community.

The new law makes financial statements and reports obligatory if on the day of the expiration of a fiscal year (closing day) and for the two preceding fiscal years, an enterprise at any time has satisfied two of the following three conditions: (1) the total assets for one of the annual balance sheets, as of the close of the fiscal year, exceeds 125 million Deutsche Marks; (2) the gross income from the sale of goods and services of the enterprise in the twelve months preceding the closing day exceeds 250 million Deutsche Marks; (3) in the twelve months preceding the closing day, the enterprise has employed on the average more than 5,000 workers.<sup>35</sup>

The same law imposes a duty<sup>36</sup> to publish and deliver group accounts to the Commercial Register if the parent enterprise has its head office in Germany and if at the end of a fiscal year and the two preceding fiscal years two of the above-mentioned conditions are satisfied by the group as a whole.

### *C. Capital market oriented disclosure*

The disclosure regulation reviewed up to now has an essentially commercial law background tailored to suit the typical interests of creditors, equity holders, and management. The equity holders enter into the picture as owners or members of a company entitled to various degrees of influence and control. To use these rights properly, information about the actions of the management is necessary.

The interests of the potential investors in the capital market have traditionally been taken care of by a different body of law centered around stock exchange regulation.<sup>37</sup> Its origin dates back to the end of the 19th century. The vast industrial growth of German industry before and after the unification of Germany in 1871 had led to the foundation of a great number of companies. The capital needed was often raised by publishing eye-catching advertisements in the press, conveying inadequate and faulty information about the issuer's business potential. In some cases, investors were lured into placing their money in enterprises on the verge of



bankruptcy, with consequences that are easily imagined. In 1892, a Stock Exchange Investigating Committee (Börsen-Enquete-Kommission) was appointed by the Chancellor of the German Empire to investigate the factual and legal problems of stock exchanges, and to establish the basis for legal regulation. The Stock Exchange Act (Börsengesetz) became effective in 1897. The law was last amended in 1975.<sup>38</sup>

The admission of securities to the stock exchange is regulated in Section III of the Stock Exchange Act. It is complemented by a Notification Concerning the Admission of Securities for Official Quotation (Bekanntmachung betreffend die Zulassung von Wertpapieren zum Börsenhandel) which was adopted in 1910. A revision of this old regulation has been planned for years, but has not been implemented because the E.E.C. Commission in Brussels is working to the same end and trying to harmonize registration requirements in Europe. The Commission has recently issued (January 1976) a proposal that has still to be dealt with by the Council of Ministers.

The Stock Exchange Act requires the publication of a prospectus containing the information necessary to evaluate the securities to be listed. The prospectus must be issued prior to the first listing of the securities on the stock exchange. The same applies to conversions of securities as well as to increases of capital.<sup>39</sup> The prospectus is not published by the issuing company,<sup>40</sup> but by a public credit institution, private bank or bank company, which thus puts its own business reputation at stake.<sup>41</sup> The prospectus must be printed in at least one domestic newspaper determined by the stock exchange's board of admission. A notice concerning the publication must be printed in the Federal Gazette containing the name, the publication date and the issue number of the newspaper.<sup>42</sup>

The main items the prospectus must contain are:<sup>43</sup> the history of the company; the business purposes of the company; development, nominal value and classification of capital stock and special rights vested in securities already issued; outside participations of over 25% and 50% and references to intercompany agreements (particularly as to controlling interests and transfer of profits); composition of the managing board and the supervisory council; provisions of the company's constitution regarding voting powers; appropriation of profits in accordance with the provisions of the company's constitution; data on dividends paid within the last five years; the last annual financial statements of the issuer, or where applicable, the consolidated financial statements; explanations of all major items on the balance sheet and any liabilities not shown on the balance sheet; description of business operations; gross proceeds from sales over the last three years and production and sales data; and present course of business and anticipated trend for the future. For the listing of bonds, there are additional requirements which we will not specify here.

A foreign business company applying for listing on a German stock exchange must commit itself for a period of five years to publish an annual financial report containing a profit and loss statement in a German newspaper designated by the exchange's board of admission.<sup>44</sup>

With the exception of the five-year requirement as to publication of financial statements of foreign companies, the disclosure requirements of the Stock Exchange Act concern new issues. In a period of economic growth and company expansion, this can be almost equivalent to a current disclosure requirement, because every capital increase or new bond issue brings about a new prospectus obligation. But this dissemination of information is only haphazard, and for a long time it has not been considered sufficient.

In May 1968, the Federal Minister of Economics called together a committee of independent experts to discuss this and other matters under the general heading of improving stock exchange trading.<sup>45</sup> This committee recommended that all companies listed on the exchange should submit regular, preferably quarterly, reports about the situation of the enterprise and its prospects for the future so that the average investor would have the gist of the actual business picture. To avoid more stringent legislation, the exchanges and the banks have adopted this policy and are successfully trying to have these interim reports issued by the companies concerned. Companies representing about 90% of the stock listed on German exchanges now submit these interim reports, which are unaudited, to the exchanges, where they are reviewed to see that they contain at least the minimum information desired.

Tougher proposals are being discussed.<sup>46</sup> Although they are not yet laws, they tend to indicate the trend of future developments. These proposals would include in the current disclosure reports information about turn-over, unfilled orders, profits calculated on a half year basis, estimation of corporation income tax, relationships (affiliation or mergers) with other enterprises, or changes in the financial situation of the company or in its market share. For affiliated enterprises and groups of companies having to prepare consolidated financial statements, specific requirements for the interim reports have been envisaged. All this will again be publicly debated when the current E.E.C. harmonization attempts reach the state of legislative enactment.

Another field of capital market disclosure, which was influenced by the U.S. Securities Act of 1933, concerns the regulation of non-German investment companies and the amendment of the law on German investment companies.<sup>47</sup> The law does not shut the door to foreign investment companies, nor does it provide for an examination of the quality of their shares. However, a foreign investment company which intends to distribute its shares in Germany must notify the Federal Supervisory Agency for Banking (Bundesaufsichtsamt für das Kreditwesen). The company's activities can be prohibited if the Agency, in the course of its review, discovers that statutory or administrative rules have been violated.

Great emphasis has been placed in this regulation on disclosure requirements. If statements in a sales prospectus, which must contain all information of material importance for evaluating the foreign investment company shares, are incorrect or incomplete, the person who purchases them on the basis of the prospectus may return them and have his money refunded.<sup>48</sup> As to current disclosure,<sup>49</sup> the

foreign investment company must, *inter alia*, publish periodically in the Federal Gazette a report of its earnings and expenditures; a list of the securities and stock options belonging to the fund, their nominal and their market value, and changes in comparison with the last report, and the difference between the number of shares issued and the number redeemed during the accounting period. Furthermore, the foreign investment company must make the issue and redemption prices for its shares available to the public by publishing them at least once a week in the Federal Gazette and daily in a newspaper with sufficient circulation.

At the same time that the law concerning foreign investment companies went into effect, the law on German investment companies was amended to make a sales prospectus mandatory and to provide for liability in case of false information in roughly the same way as outlined above for foreign investment companies.

Recently, as a reaction to deceptive promotions of tax shelter investments, there has been discussion of whether initial disclosure by an informative prospectus in all cases of public offers of specified types should be required. In this discussion, it was argued that the prospectus should be certified by a qualified auditor and should be submitted to a supervising governmental agency with powers to prohibit offers, sales and distribution if the prospectus does not comply with legal requirements.<sup>50</sup> The Federal Ministers of Finance and Justice are already preparing a legal draft along these lines, and the reaction of the German law community has, on the whole, been positive.

### 3. Policy considerations underlying the disclosure requirements<sup>51</sup>

Ever since the Joint Stock Company Act of 1870 introduced the first disclosure rules for that type of corporation, it was their prime and obvious purpose to force the management to give a full account to the shareholders. Yet even then, the legislature expressly articulated that a second party was entitled to receive information: the "public". Since this Act abolished the old charter system — until then a joint stock company needed a charter granted by the administration at its discretion and was subject to close supervision by the state — it was generally agreed that new provisions were required to insure sound business practices and to protect the public against fraud and deceit.<sup>52</sup> One of the new provisions was the introduction of a rule requiring the publication of the balance sheet in specific newspapers.

The importance of the interests of the public in the performance of the joint stock company was even more clearly expressed in the parliamentary debates. A proposed clause to limit the benefits of disclosure to the shareowners was withdrawn after a discussion made it clear that the majority intended to also protect "the interests of the public, the creditors, third persons, who came into contact with the corporation".<sup>53</sup> This policy has been repeatedly reinforced by court decisions.<sup>54</sup>

Whenever the interests of the "nation" or the "public" are invoked, one has to

be particularly careful. These terms are not only dangerous because of their emotional impact — who could dare to oppose measures in the interest of the “public”? — they also tend to cover up the exact intentions and aims of the speaker because of their ambiguity. If one carefully analyzes the exact meaning of the “interests of the public” and of the “economic life as a whole” in the discussion of the 1870’s, one discovers that the “public” consisted of all those persons who were involved in business relations with the corporation, especially the creditors (who included the workers, according to the prevailing philosophy of the time), the suppliers, and to a lesser degree the customers.<sup>55</sup> By protecting these persons, or rather by enabling them to protect themselves, the Act protected the institution of the joint stock company<sup>56</sup> as a type of company which is indispensable for economic development in its ability to attract and collect anonymous capital for large ventures in the era of industrialization. The arguments were a typical product of classical liberalistic thought, with its strict dichotomy of “public” and “private” areas of life. No government or state interests were involved. Like all economic activity, the existence of joint stock companies and their performance was a matter left to the forces of “society”; the rights and duties of the “state” were limited to providing adequate protection for the honest citizen and the stock corporation as a whole against “fraud”.

During the discussions of the late 1920’s and the early 1930’s preceding the reform of disclosure requirements in the Joint Stock Company Act, the interests of the “public” were again of major concern. The official draft for a revised Joint Stock Company Act stated:

The common rule, well known to every civilized nation, that the administrator of other peoples’ assets is obliged to give an account, is as far as the big enterprises of today are concerned applicable to their relation to the entirety of the citizens of this state. These enterprises have agglomerated national property to such an enormous degree that the nation as a whole has an urgent and legitimate interest to be informed about the performance of the administration as far as this is not detrimental to the company.<sup>57</sup>

Surprisingly parallel to Marxist thinking, the government draft states that the constantly increasing concentration process and the predominance of big corporations is caused by the “natural laws of economic development”.<sup>58</sup> Contrary to orthodox Marxist thinking, however, the draft accepts this development as “rational” and, perhaps because it was influenced by literature advocating a system of “economic democracy”,<sup>59</sup> assumes that the accumulation of “national property” will and eventually must lead towards a “communal economy” (*Gemeinwirtschaft*); *i.e.*, an economic order not dominated by individual profit motivation but by considerations which take the interests of the nation as a whole as their major guideline. Within this ideology, it appeared to be obvious that big companies, as such, are valuable and worthy of protection. The companies were accountable to the people, but only as far as no company secrets were involved.

It is obvious that the “public” in the 1920’s and 1930’s was totally different from that in the 1870’s. The citizen as a part of the “body politic”, in addition to “private persons” who actually or potentially were in contact with the corporation,

had become the center of attention. The rationale for disclosure had moved from the realm of the self-regulating "society" into the area of the "state" which could regulate however it saw fit *politically*.<sup>60</sup> This change of emphasis can be supported by the observation that during this period the interest of the press in publications of joint stock companies increased widely.<sup>61</sup>

This general attitude prevailed during the Nazi era and during the early postwar years. The commission on Enterprise Law, initiated by the most prominent German lawyers association, the Deutsche Juristentag, submitted a report in 1955 which basically was in accordance with the reasoning of the draft of the 1930's. The big "enterprise as such" was of major importance and had to be protected;<sup>62</sup> since this enterprise was a matter of national interest, ways and means had to be devised to assure that the interest of the public was adequately taken into account. While the shift of emphasis from the "private" to the "public" sector was evident, it still remained rather vague as to what exactly the interests of "the public" consisted of, and consequently which measures the state had to take in order to insure that those interests were protected. Not surprisingly, the report proved fruitless as far as legislation was concerned.

The discussion during the intervening decades up to the present has defined the issues more clearly. Today there appears to be wide agreement that big corporations and other big enterprises carry a special responsibility for the well-being of the nation and the economy because of their political importance. These enterprises are the "decisive centers of production and distribution"; they, to a large extent, "determine the investment ratio of a country".<sup>63</sup> They can bargain with communities for tax cuts and subsidies; their decision to build or shut down a plant not only affects the future of the workers but also the ability of cities and counties, possibly even whole states, to fulfill their basic functions, to build roads, schools, kindergartens, etc.<sup>64</sup> Because of this political dimension of management decisions, it seems evident that all relevant information must be provided to allow rational public discussion as the basis for potentially necessary political intervention.

There are two totally different main lines of thought which led to this common result. The Freiburg school of ORDO-liberalism,<sup>65</sup> which exerted a tremendous influence on economic and political thought in postwar West Germany, abandoned the idea that the "big enterprise as such" was worthy of special protection. On the contrary, the dangers caused by oligopolistic market structures were as well-recognized as those of the political power of strong economic units. Concentration and the predominance of large companies was not considered a development based on "natural economic laws" anymore, but as a detrimental occurrence in the course of economic history which would have to be controlled by state intervention. The primary instrument for state intervention was to be an antitrust law through which competition could be reestablished. Competition would then automatically minimize the economic and political power of the big enterprises. Disclosure played an important role for two major reasons: insufficient information about larger companies could conceivably lead to public distrust and eventually to state intervention

even where competition remained intact and such intervention – according to the teachings of ORDO-liberalism – was consequently uncalled for and dangerous; secondly, only publicity could help to avoid mismanagement.<sup>66</sup> The call for more publicity was “not at all a socialistic, but an eminently conservative idea”.<sup>67</sup> It was a safeguard against state involvement.

The other group of advocates for extended disclosure, consisting mainly of the labor unions, the Social Democrats<sup>68</sup> and certain schools of Catholic social philosophy, employed arguments which in many relevant points were diametrically opposed to those of the first group. Reforms in the Joint Stock Company Act or the Stock Exchange Act were considered of minor importance, since both laws focused mainly on the relationship between actual or potential shareholders and the company but neglected other concerned parties, mainly the employees and the “political” public. Furthermore, not even the relationship between the company and the shareholders was adequately regulated as far as corporations with thousands of stockholders were concerned. The split between ownership and control left share-holders powerless and made management independent of them. Company law reform was not called for, but what was needed was a new “constitution for enterprises” – regardless of the particular type of incorporation – which adequately represented the interests of the “owners”, the workers, the labor unions and the political public.<sup>69</sup>

The plea for more disclosure was just the first step in a new direction, one point in a large scale of demands, the most important being the demand for workers’ co-determination on the supervisory board. Ever since the labor unions and the Social Democrats abandoned their plans for the socialization of large parts of the important industries, they have adopted this approach and demanded disclosure for large companies regardless of company type.<sup>70</sup> They considered it “a self-evident ingredient of progressive democracy”.<sup>71</sup>

The most important piece of legislation in the field of disclosure requirements in recent years, the Law Governing Financial Statements and Reports of Certain Enterprises and Affiliated Groups of 1969,<sup>72</sup> was a direct result of this discussion. When the Social Democrats for the first time in postwar history entered government in a coalition with Christian Democrats, they managed to extend disclosure to all big companies without regard to their type of incorporation (at the price of supporting another Act favored by the Christian Democrats, which contained tax cuts for industry).

The government, when it introduced the bill, gave the following reasons, which by now should sound familiar:

The fate of a large enterprise influences not only the private lives of its owners. It affects the interests of a multitude of third persons and often even their existence. The situation of a large enterprise is, *e.g.*, essential for the investment decisions of many other enterprises which are its suppliers or customers. The jobs of so many workers are dependent upon it that its development, for better or for worse, is of essential importance for the regional, sometimes even for the national labor market. The expansion and decline of such enterprises influences the structure

and the financial situation of whole cities; not infrequently, they set data for the economic policies of the government. The legitimate interest of all the concerned parties — defined as current and future suppliers and customers, employees, creditors and all institutions which might have to make political decisions on social or economic issues which might affect the enterprise — in having the opportunity to inform themselves about the situation and the performance of the enterprise, has to be recognized. The interests of all these concerned parties and therefore the *public*<sup>73</sup> in obtaining evidence upon which to base their judgment prevails over the owners possible contrary interests.<sup>74</sup>

The second reason given, which greatly increased the chances for the passage of the bill, was that the most spectacular bankruptcies in the 1960's involved enterprises which were not subject to the requirement that they disclose their annual financial reports. It was presumed that disclosure would have insured orderly management and would have avoided those collapses.<sup>75</sup>

It is interesting and significant for the mainstream of German political and legal thinking in this respect to note that even the strong opponents of the bill hardly dared to deny the interests of "all parties concerned" and the "public." During the parliamentary debate, they criticized as arbitrary the criteria by which it was determined that an enterprise was large and thereby subject to disclosure. They claimed that publicity could not possibly avoid bankruptcies,<sup>76</sup> that the legal harmonization efforts within the E.E.C. might be hindered,<sup>77</sup> and they criticized a long list of the bill's technical details.

The main thrust of the opposing view might be best summarized by a joint memorandum of the leading organizations of industry.<sup>78</sup> In addition to the criticism just mentioned, industry complained that the Act neglected the well-established principle of German company law that all rules should be based on the particular type of incorporation, and that the criteria were dangerously reminiscent of those that the labor unions had proposed for extended workers co-determination.<sup>79</sup> But the main point of criticism was that the existing information requirements already served the same interests at least as well as the proposed bill would and the new law could even be harmful. With respect to the economy as a whole, quite a number of state agencies were well informed, especially the National Bank (Bundesbank) and the tax authorities. The creditors and suppliers could always insist on getting information about the affairs of the enterprise. Banks, in particular, had the legal right to demand the balance sheet whenever a credit amounting to more than 20,000 DM was involved. The National Bank had to be informed whenever a loan over 1,000,000 DM was granted. As far as workers were concerned, their interests were well protected by the co-determination laws. Just as a last weak point, it was argued that the Act might be unconstitutional<sup>80</sup> and that the "public" might be too diffuse a term to be of any relevance. The main thrust of the arguments plainly was that additional information was not needed.

As far as the interests of the employees are concerned, an argument certainly could be made that they already are much better informed through the provisions of labor law than their colleagues in any other nation, and much more efficiently

than they would be through disclosure laws. According to §111 of the Betriebsverfassungsgesetz, a worker council on the plant level has quite a number of co-determination rights concerning hiring and firing and even the closing of a plant; these are supplemented by information rights in economic affairs. On the management level of all sizeable companies, workers representatives make up one-third of the members of the supervisory board. In the steel and coal industry, they even have as many seats on the supervisory boards as the capital owners.<sup>81</sup> With some variations, this model was extended to all companies with more than 2,000 employees in 1976.<sup>82</sup>

One might be tempted to agree with the proposition put forth by the industrial organizations. How could a balance sheet and a report that describes the activities of the past ever be superior to the current information rights enjoyed by the workers representatives in the workers council and on the supervisory board? Nevertheless, parliament was not convinced that disclosure was superfluous. And rightly so. For industry neglected to take into account that on the one hand, the workers representatives are widely bound to secrecy, and secondly, that most of the information rights did not apply to privately-owned enterprises.

The other new laws extending disclosure requirements, the Foreign Investment Act of 1969 and the Investment Act as amended in 1970, followed the traditional policy considerations to prevent fraud. Both Acts proved to be successful within their limited areas of application; they practically eliminated all dishonest or questionable investment companies — possibly even a few others<sup>83</sup> — but they did not prevent fraudulent offers in the capital market as a whole. Shady investment advisors speedily moved on to offering shares of tax shelter companies, which for tax reasons were organized as limited partnerships (KG).<sup>84</sup>

The traditional German approach would have been to concentrate on the elimination of fraud and dishonesty, either by regulating the offerors or by elimination of the tax incentives to invest in areas which, according to the average investor's judgment, were considered not profitable enough and/or too risky. Surprisingly, the debate took a different turn.<sup>85</sup> For once, it was recognized that attempts to stop newly-discovered gaps in the system of investor protection would probably prove futile; inventive investment advisors and promoters would most likely find new loopholes as long as legislation only attempted to check fraud step by step, whenever it became evident. Following the U.S., Belgian, and French examples, it seemed advisable to regulate not only offers of investment company shares, but *all* public offers of investment opportunities.

But even more importantly, fraud and dishonesty were not the only subjects of attention. For the first time in German legal history, a wider community of lawyers<sup>86</sup> discussed the fact that certain mechanisms, which clearly could suppress fraudulent investment activities, might have detrimental effects in other respects; for instance, investments favored by public policy might be hindered by those measures. The already extremely narrow market for venture capital in Germany might be totally shut down, even though that kind of capital is urgently needed by young, ambitious and inventive businessmen, whose plans do not seem safe enough to



obtain loans according to the traditional standards of a paternalistic banking community. The economy as a whole might suffer if all capital were channeled into established lines of business. It seemed that the discussion that is well-known in the U.S. about capital market efficiency had finally begun in Germany. It was generally agreed that the desired goal could best be attained by producing transparency (*i.e.*, maximizing the information available) in the capital market, and that this transparency could best be obtained by the introduction of strict disclosure requirements for every first public offering of an investment opportunity. Interestingly enough, however, all offers made by banks were to be excluded from regulation. As to those offers, transparency and capital market efficiency apparently were irrelevant for the majority of participants and the discussion again centered around "fraud".

The Federal Government is now preparing a draft Act Concerning Public Offerings of Investment Opportunities along these lines, which should be passed by the legislature within the next year.

#### 4. Some speculations on the reasons for the differences in approach

Looking back on the evolution of German disclosure regulation, it is obvious that economic efficiency was definitely not the cornerstone of the debate. Superficially, this could be attributed to the fact that the German legal system has not developed a separate field of the law called securities regulation or capital market regulation. There has been no legal frame of reference from which disclosure regulation could have been analyzed as a coherent policy objective geared to market efficiency. Disclosure rules do exist, but they are tied to different policy traditions and to different legal contexts:<sup>87</sup> Commercial Register publicity is an integral part of commercial law within the field of civil law and disclosure by prospectus as related to stock exchange activity has been viewed as part of governmental regulation of the economy within the public law sector.<sup>88</sup> Disregarding the latest and most recent turn of the discussion, investor protection, as a main element of the efficiency argument, has not been an important policy issue. Some observers,<sup>89</sup> however, influenced and encouraged by U.S. experiences, predict imminent substantial change, using as evidence the new regulation of investment company activity and the reasons put forward to support governmental plans for a statute on public offerings.

To evaluate this optimism, one has to ask why the development in both countries has been so markedly different, and if the forces underlying these differences have actually lost their momentum. It is our view that some skepticism may be in order.

Comparative law as a legal science has lost its innocence of method. It is widely accepted today that it is not necessarily useful to isolate a legal body of rules and to look for equivalents of those rules in other countries. Rather, the social problems of

a country and the particular interests a specific law has been created to serve must be considered; it is then necessary to decide whether or not these same problems and interests have existed beyond one's own national boundaries, and if so, how they were approached in other countries.<sup>90</sup> Also, where legal developments are to be compared, it is important to remember that policy objectives, which eventually became law, are shaped within the context of specific political and economic developments varying from country to country. Thus, in a recent seminar in Frankfurt of the International Faculty to Consider Regulatory Problems arising from Internationalization of Securities Business,<sup>91</sup> it was asked why the securities markets in Germany are much narrower than in the U.S. and Great Britain, why the number of German companies listed on German stock exchanges, which was small from the beginning, is shrinking, and why the German public is so much more reluctant to invest money in shares than the public in other countries. All these questions are pertinent to our subject of investor-oriented disclosure legislation because it may be that capital market problems are not politically and socially relevant enough in Germany to rally the public support necessary for structural change. To put the question this way places it outside of the economist's field and within that of the political scientist.

Several attempts have been made to explain the narrowness of the German capital market,<sup>92</sup> meaning, of course, that compared to the U.S. relatively few persons are seriously concerned about that area.<sup>93</sup> An obvious primary reason for this difference is that in Germany the functions of capital accumulation for personal needs and old age have been for all practical purposes taken over for most people by a very extensive system of social security and obligatory public insurance. This directs huge amounts of money to self-administered public funds which would otherwise have gone into private savings, private insurance, and the securities market. For a resident of the U.S., it may be difficult to realize that about 32% of the German GNP is absorbed by the social security system. Originally, social security legislation was confined to laborers. It was later extended to white-collar workers, and it now includes the self-employed up to a certain limit of income. The claims against these public funds are considered by most as a comparatively reliable investment since the system has actually managed to survive the national catastrophes of German history which most other forms of investment did not.

Another German particularity to be added in this context is that it is a common practice of business enterprises to finance pension obligations owed their own workers and employees with funds that are not segregated from the enterprise's working capital. Of course, there are a great number of instances where these funds are administered by firm-based independent legal entities. However, liquidity is taken away from the securities market.

It has often been remarked that the German mentality is averse to risks. This is said to have a strong impact on the structure of the German capital market. British and U.S. observers also tend to attribute the narrowness of the German securities market to the average investor's underdeveloped state of mind towards more

refined forms of saving. It is questionable, though, that this is an adequate assessment. The overall level of household saving in Germany has been, and still is, comparatively high.<sup>94</sup> It is certainly true that the average German saver nourishes a general distrust of the securities market. After all, a great number of well-to-do Germans twice in one generation lost fortunes that had been invested in industrial securities. The uneasiness is even greater towards forms of savings with continuously wide oscillations in value. Thus, savings invested in the bond market have been far greater than those invested in the stock market. Even more significant for the analysis of the conduct of the average saver is the fact that, for a very long time now, the increase in saving deposits has surpassed the combined sale of stocks and bonds.<sup>95</sup>

It is doubtful whether the comparatively narrow German securities market can be explained solely by investor psychology or the German public's lack of financial sophistication. If these were the true explanations, it would probably be only a question of time until the Germans reach the advanced international standard. The finding that, on the average, the working capital of German companies is self-financed to the extent of less than 30% and is supplied by debt to the extent of more than 70%<sup>96</sup> could be taken as a true expression of the unimpaired aggregate preference of an efficient capital market. However, such an assessment would be oversimplistic because it leaves out the strong influence of tax law, and it is even more seriously misleading because it does not take into account historically rooted structural differences in the organization of markets and the differences in economic and political leverage of various social groups and institutions within a society. Since these structural aspects of a society are closely related to both the structure of the capital market and to the distribution of power within a national economy, an adequate comparative analysis requires the joint efforts of lawyers, economists, and political scientists. The following remarks can do no more than offer some sketchy speculation about the underlying forces that have shaped the German thinking on capital market matters.

The need for capital in a developed and dynamic industry, and the relative lack of direct involvement of the average German investor in the securities market, corresponds with the presence of an overexpanded intermediate business sector. The German capital market is strongly dominated by institutional investors, namely, the German all-purpose banks and other investment institutions which are, to a great extent, managed by the banks.<sup>97</sup> Private insurance companies and pension funds play a minor role in the stock market, but they do have an important stake in the bond market. As a consequence of a liberal political attitude towards foreign capital, there is a strong influence from that source;<sup>98</sup> but it does not amount to anything like restoring the laws of individualistic market competition along the lines of classical economic thinking. Since a functioning non-oligopolistic market is important for the practical relevance of a debate about disclosure in terms of efficiency gains or losses, it becomes apparent why this type of discussion has not taken place in Germany, and why, at the bottom of the German discussion, politi-

cal arguments concerning outside control by non-industrial, non-banking interests played a more decisive role than market economics.

It would be premature to assert that this in itself is a bad thing.<sup>99</sup> On the one side, it has been argued with some strength that the traditional dominance of the banks and their comparatively narrow ties with their industrial debtors has served the German economy well and perhaps even better than more developed capital markets in other countries have served their economies. On the other hand, there is evidence of a serious conflict between the interests the all-purpose bank serves in its roles as holder of equities, creditor, trustee of depository voting rights of a multitude of shareholders, selector of members on a company's supervisory council and intermediary to the capital market. Furthermore, the banks are in a position to offer their clients a wide selection of attractive investment opportunities, including shares, bonds, saving accounts, investment certificates and gold. The customer's choice is often not a matter of indifference to the bank because of the many other interests it has to protect. We do not want to take a definite stand on the question of whether performance, power and control of the German banks are adequately balanced. The point we want to make is that a discussion of the possibility of change in the capital market structure remains futile without an in-depth analysis of the interests of the banks, and without an assessment of the strength of possible countervailing powers.

The same is true of an evaluation of the relevance of the disclosure debate. In Germany, only the government, striving for a coherent and effective economic policy, and to a lesser extent, the trade unions are likely to formulate and pursue interests contrary to those of the banks. In other countries with different industrial and banking traditions, and with different political traditions and ideals, the relevant economic and political interests bearing on the structure of the capital market have been more widely dispersed within various social groups: industry, brokers, banks, institutional investors, and the community of private investors do have divergent interests. In Germany, the polarization of interests that has taken place explains why the disclosure debate was centered around the diffuse interest of the public rather than the efficiency of the capital market.

The argument would be inconclusive if it could not be shown that the banks have no interest in widening existing disclosure requirements for their industrial clients and for themselves. The banks do have other means of acquiring needed information<sup>100</sup> as creditors, members of supervisory boards, shareholders, and trustees of depository voting rights. It is certainly difficult to assess the extent of cooperation between banks with respect to relevant business information, even though it is not to be denied that they compete strongly in most sectors of bank services.

The words of Alfred Marshall in his wide-ranging survey, *Industry and Trade* published in 1919, have lost nothing of their truth. Referring to the situation in Germany, he wrote,<sup>101</sup> "Each of the great banks has representatives in several other banks and in a vast number of industrial enterprises . . . Representatives of

banks have exercised, for two generations at least, a strong control on industrial business which they support". C.H. Wilson<sup>102</sup> describes German banks in the later nineteenth century as being not merely credit organizations but political-economic agencies for converting Germany into an industrial state. And the astute British observer of the German economy Andrew S. Shonfield<sup>103</sup> adds:

The big banks have always seen it as their business to take an overall view of the long term trend in any industry in which they were concerned, and then to press individual firms to conform to certain broad lines of development. They saw themselves essentially as the grand strategists of the nation's industry . . . It would be wrong, however, to cast the German banks in the role of the ringmaster, with the big horses of industry galloping round them and responding to the crack of the whip. The lines of influence between the large bank and the large industrial enterprise are reciprocal. What tends to emerge out of this process is a consensus of big business about the affairs of an industry.

It is quite clear that this alliance throughout German industrial history has never been sympathetic to the dissemination of business information to outside groups and has used its varying but always considerable political influence to this end.

But what about the headway the disclosure philosophy has made recently in the regulation of investment companies? What about the general interest within the law community evidenced at the last session of the Deutsche Juristentag in 1976 towards the idea of a prospectus obligation for all public offerings? Are these not encouraging signs that investor protection, capital market efficiency, and disclosure obligations are gaining momentum in Germany?

Perhaps. It may be argued that the long-run decrease in profits from invested capital, the increasingly unsound size of bank debts in relation to other forms of financing, and the present unwillingness of the public to engage in long-term investment will lead industry to increase its efforts to gain the confidence of the individual investor. But, on the other hand, it is certainly no coincidence that the regulation imposed on foreign investment companies was a reaction to the tremendous original success and later shattering failure of IOS operations which as a whole had bypassed the German banks. The debate on the law concerning public offerings has emerged from large scale misuse of tax shelter quasi-companies,<sup>104</sup> a branch of business which not only has sidestepped the banks but has competed with them most effectively in attracting huge amounts of money.

It is true that the efficiency argument, ably presented by Hopt and Mertens at the Deutsche Juristentag, was well-received at that assembly when it considered the pros and cons of a prospectus obligation for all public offerings. But there was also almost general agreement that investment securities offered for sale by German credit institutions and banks should be exempted. This may be justified on the ground that the German banks' vast expertise in the matter is an even better protection for the individual investor than a prospectus. The proposed exemption would certainly reflect the continuing viability of the German way to disclosure which is to take measures against fraud and deceit at the fringes of the market, backing this up

with efficiency arguments, and to rely on the banks' good judgment as to what is good for the main body of the market. Thus, the oligopolistic structure of the "market" for financial information is accepted as a way of life which has up until now yielded satisfactory results. This, of course, is contrary to the U.S. disclosure philosophy and the theory underlying it. Beyond verbal bridges, the gap between the U.S. and the German approach remains wide.

## Notes

<sup>1</sup> Cited in Mendelson, *Economics and the Assessment of Disclosure Requirements*, which begins at page 49 of this volume of J. Comp. Corp. L. and Sec. Reg.

<sup>2</sup> Mendelson, *op. cit. supra* n. 1.

<sup>3</sup> At the Frankfurt exchange, for example, the number of officially listed domestic stocks dropped from 257 in 1971 to 253 in 1973. The corresponding numbers for officially listed foreign companies: 1971-64; 1973-103. Frankfurt Stock Exchange (ed.), *Frankfurter Wertpapierbörse - History, Organisation, Function* 21 (1974).

<sup>4</sup> Brandeis, *Other Peoples' Money* (1914), here cited after Loss, *Der Schutz der Kapitalanleger*, *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* (= ZHR) 129, 197, 208 (1967).

<sup>5</sup> It should be noted, however, that those clever salesmen and the printers of glossy pictures are not out of business. They simply moved to tax shelter companies, which, as yet, are not subject to any disclosure regulations. For reform proposals which have been taken up by the German federal government, see Kohl, Kübler, Wüstrich and Walz, *Abschreibungsgesellschaften, Kapitalmarkteffizienz und Publizitätswang*, ZHR 138, 1 *et seq.* (1974). See also *infra* nn. 84 and 85 and accompanying text.

<sup>6</sup> Just recently, however, Coenberg and Brandi announced that they are starting an empirical project. See Coenberg and Brandi, *The Information Content of Annual Accounting Income Numbers of German Corporations*, International Working Papers in Corporate Reporting and Control 7 (1976).

<sup>7</sup> Cf. Rittner, *Publizität für alle grossen Unternehmen?* Handelsblatt, May 26-27th, 1967, 25.

<sup>8</sup> Cf. Zöllner, *Die Schranken mitgliedschaftlicher Stimmrechtsmacht* 31 *et seq.* (1964); Teichmann, *Gestaltungsfreiheit in Gesellschaftsverträgen* 96 *et seq.* (1970).

<sup>9</sup> Kübler, *Begriff, Entwicklung und Quellen des Gesellschaftsrechts* 9 (Unpublished manuscript, Konstanz University, 1975).

<sup>10</sup> Cf. Laundry, *The GmbH and Co. Kommanditgesellschaft: German Partnership Vehicle for Joint Ventures*, 23 *The Business Lawyer* 213 (1967).

<sup>11</sup> Bundesamt für gewerbliche Wirtschaft: *Anlagenband zum Bericht über das Ergebnis einer Untersuchung der Konzentration in der Wirtschaft vom 29. Februar 1964*, 524.

<sup>12</sup> Sections 29, 31, 32 of the Handelsgesetzbuch (Commercial Code), §40 of the Handelsregisterverordnung (Ordinance on the Commercial Register, Deutsche Justiz 1937, 1251). Register publicity, excluding joint stock companies, affiliated enterprises and "big-sized enterprises", is summarized in Rittner, *Die handelsrechtliche Publizität ausserhalb der Aktiengesellschaft*, Gutachten für den 45. Deutschen Juristentag 1964.

<sup>13</sup> Commercial Code §10.

<sup>14</sup> Commercial Code §§106, 107, 125, 143, 144, 148, 150, 157.

<sup>15</sup> Commercial Code §§162, 175.

<sup>16</sup> Commercial Code §335.

- <sup>17</sup> Gesetz betreffend die Gesellschaften mit beschränkter Haftung (= GmbHG; Law governing private limited companies) §10.
- <sup>18</sup> GmbHG §8.
- <sup>19</sup> GmbHG §§40, 52, 54, 57.
- <sup>20</sup> GmbHG §10 III.
- <sup>21</sup> GmbHG §41 IV.
- <sup>22</sup> Aktiengesetz (= AktG; Stock Corporation Act) § §151, 157.
- <sup>23</sup> The professional qualifications of official auditors are governed by law (Gesetz über eine Berufsordnung der Wirtschaftsprüfer vom 24. Juli 1961, BGBl. I, 1049).
- <sup>24</sup> AktG §174.
- <sup>25</sup> AktG §177.
- <sup>26</sup> Würdinger, *Aktien- und Konzernrecht*, 2d ed., 241 *et seq.* (1973); Emmerich and Sonnenschein, *Konzernrecht* (1973).
- <sup>27</sup> AktG § §291, 292: agreements as to outside direction and to transfer profits; agreements to pool profits and to transfer a portion of profits; and company lease and company surrender agreements.
- <sup>28</sup> AktG §294.
- <sup>29</sup> AktG § §295, 297.
- <sup>30</sup> AktG §329.
- <sup>31</sup> Einführungsgesetz zum Aktiengesetz (Introductory Law to the AktG) §28.
- <sup>32</sup> AktG § §331–338.
- <sup>33</sup> For more details about the arguments pro and con, see *infra*, section 3.
- <sup>34</sup> Gesetz über die Rechnungslegung von bestimmten Unternehmen und Konzernen vom 15.8.1969 (Publizitätsgesetz = PublG) BGBl. 1969 I, 1189.
- <sup>35</sup> PublG §1.
- <sup>36</sup> PublG § §11–16.
- <sup>37</sup> The following is based on the more detailed account in the introductory parts of Nussbaum, *Kommentar zum Börsengesetz* (1910), and Schwark, *Börsengesetz, Kommentar* (1976).
- <sup>38</sup> BGBl. 1975 I, 1013.
- <sup>39</sup> Börsengesetz (= BörsenG) §38.
- <sup>40</sup> For more details, see Staudt, *Publizität der börsennotierten Aktiengesellschaften in Deutschland und Frankreich* (1972).
- <sup>41</sup> Zulassungsbekanntmachung § §5, 16. This is the reason for the general assumption that few applications of unsound companies will even reach the admission board of the stock exchange.
- <sup>42</sup> Zulassungsbekanntmachung § §12, 16.
- <sup>43</sup> Zulassungsbekanntmachung § §6–8.
- <sup>44</sup> BörsenG §41.
- <sup>45</sup> For the following, see Schwark, *op. cit. supra* n. 37, at 34; Zahn, *Probleme und Reform der deutschen Börsen*, Die Aktiengesellschaft 1975, 169 *et seq.*
- <sup>46</sup> Schwark, *op. cit. supra* n. 37, at 31.
- <sup>47</sup> Gesetz über den Vertrieb ausländischer Investmentanteile und über die Besteuerung ihrer Erträge vom 28. Juli 1969, BGBl. I 986; Foreign Investment Act (= AuslInvG) Amendment to the Kapitalanlagegesellschaftsgesetz (= KAGG; German Investment Company Act) BGBl. 1969 I 986.
- <sup>48</sup> AuslInvG §12.
- <sup>49</sup> AuslInvG §4.
- <sup>50</sup> For more details, see *infra*, sections 3 and 4.
- <sup>51</sup> The following remarks are based mainly on von Caemmerer, *Publizitätsinteressen der Öffentlichkeit und Gesellschaftsrecht* in Das Frankfurter Publizitätsgespräch 141 (1962) and Döllerer, *Zweck der aktienrechtlichen Publizität*, Betriebsberater 1251 (1958).

<sup>52</sup> Motive zur Aktiengesetznovelle von 1870, 651, as cited by von Caemmerer, *op cit. supra* n. 51, and Döllerer, *op. cit. supra* n. 51.

<sup>53</sup> Döllerer, *op cit. supra* n. 51.

<sup>54</sup> See, e.g., RGSt 49, 359, 363, 364, judgment of February 26, 1915: The purpose of true and honest disclosure is not only to commit the management to administer the company in a proper manner or to protect the stock owners; "even more [disclosure intends] to protect the well being of economic life as a whole". For further references, see Döllerer, *op. cit. supra* n. 51, at 1282.

<sup>55</sup> Von Caemmerer, *op. cit. supra* n. 51, at 162; *contra*, Döllerer, *op. cit. supra* n. 51, at 1282.

<sup>56</sup> Cf. Strauss, *Aktienrecht und Wirtschaftspolitik*, in Festschrift für Walter Schmidt 3, 10 (1959).

<sup>57</sup> Entwurf eines Gesetzes über Aktiengesellschaften und Kommanditgesellschaften auf Aktien 94 (published by the Reichsjustizministerium, 1930).

<sup>58</sup> *Id.* at 93 and 94.

<sup>59</sup> Cf., e.g., Naphtali, *Wirtschaftsdemokratie – Ihr Wesen, Weg und Ziel*, 5th ed. (1931).

<sup>60</sup> See Strauss, *op. cit. supra* n. 56, *passim*.

<sup>61</sup> Cf. Döllerer, *op. cit. supra* n. 51, at 1282.

<sup>62</sup> For a report on the discussion and critical remarks about the concept of "the enterprise as such", see, e.g., Wiethölter, *Interessen und Organisation der Aktiengesellschaft im amerikanischen und deutschen Recht* 38 (1961).

<sup>63</sup> Pross, *Manager und Aktionäre in Deutschland* 13 (1965).

<sup>64</sup> Cf., e.g., Kronstein and Claussen, *Publizität und Gewinnverteilung in neuen Aktienrecht* 22 (1960).

<sup>65</sup> The most prominent founders of this school were Eucken, Böhm and Müller-Armack.

<sup>66</sup> Cf., e.g., Kronstein and Claussen, *op. cit. supra* n. 64.

<sup>67</sup> Kronstein and Claussen, *op. cit. supra* n. 64; Silcher, in *Das Frankfurter Publizitätsgespräch* 138; cf. also von Caemmerer, *op. cit. supra* n. 51, at 165. This "eminently conservative" perspective, developed by some academic economists and lawyers as a bulwark against the long term "danger" of socialistic influences on the economy, did not at all convince most legal practitioners and businessmen. On the whole, while paying lip service to the ideas of ORDO-liberalism, they still tended to adhere to a laissez-faire policy and vehemently fought disclosure regulations as an unwarranted intrusion into the "private" affairs of businessmen. This might explain why for a long time disclosure requirements for all enterprises, regardless of their form of incorporation, were rejected by lawyers organizations. See especially the discussion of Deutsche Juristentag in 1964, *Verhandlungen des 45. Deutschen Juristentages*, vol. II, F (1965), and the paper presented to the Juristentag by Rittner, *Die handelsrechtliche Publizität ausserhalb der Aktiengesellschaft*, *Verhandlungen des 45. Deutschen Juristentages*, vol. I, part 4, 63.

<sup>68</sup> It might be noted that originally the conservative Christian Democratic Party shared this notion. In its 1949 program, the party demanded an extension of disclosure in order to (among other aims) "facilitate control of monopoly and provide information about the earnings of the enterprises for employees and the public". Kunz, Maier and Stammen, *Programme der politischen Parteien in der Bundesrepublik* 135 (1975).

<sup>69</sup> Ballerstedt, *Unternehmen und Wirtschaftsverfassung*, *Juristenzeitung* 486 (1951); Köhler, *Unternehmensverfassung und Aktienrechtsreform*, *Juristenzeitung* 137 (1956); Boettcher, Hax, von Neil-Breuning, Ortlieb and Preller, *Unternehmensverfassung als gesellschaftspolitische Forderung* (1968). It should be noted that there were considerable differences among the authors as to the form and content of this new "constitution".

<sup>70</sup> Castan, *Publizitätspflicht für alle Grossunternehmen?*, *Der Betrieb* 515 (1968).

<sup>71</sup> Member of the Bundestag Kurlbaum (Social Democrat), during a parliamentary debate, *Bundestags-Protokolle*, 5th Wahlperiode, 10360.



<sup>72</sup> For details of the law, see text following n. 34, *supra*.

<sup>73</sup> Italics ours.

<sup>74</sup> Bundestags-Drucksache V / 3197, 13.

<sup>75</sup> *Id.*; Cf. also Minz, *Mittler der Publizität*, in *Das Frankfurter Publizitätsgespräch* 258, 266–268 (1962).

<sup>76</sup> Member of Parliament Busse (Free Democrat), Bundestags-Protokolle, cited *supra* n. 71, at 10364.

<sup>77</sup> Member of Parliament van Delden (Christian Democrat), Bundestags-Protokolle, cited *supra* n. 71, at 10360.

<sup>78</sup> Unpublished memorandum of Oct. 30, 1968 by the Federation of German Industry, the Federation of German Banks, the Federation of German Employers' Organizations, the Federation of German Chambers of Commerce and the Federation of German Insurance Companies, presented to the members of the two parliamentary committees concerned with the bill.

<sup>79</sup> The fear that the bill might be just the first step along the road to state control of "big enterprises" was later assuaged by a change of the official name of the Act. When the bill was passed, it was not a "Law Governing Financial Statements and Reports of *Big* Enterprises . . .", as the original proposal had been worded, but merely a "Law Governing Financial Statements and Reports of *Certain* Enterprises . . ."

<sup>80</sup> Obviously a sham argument.

<sup>81</sup> Montan-Mitbestimmungsgesetz of 1951; Montan Holding-Gesetz of 1956.

<sup>82</sup> Mitbestimmungsgesetz of 1976.

<sup>83</sup> Rumors persisted that some smaller foreign investment companies had difficulties finding a German depository bank, as required by the Foreign Investment Act, because all of the German banks that were approached purportedly did not care to create competition for the German investment company they owned or were connected with.

<sup>84</sup> German tax laws allow a deduction from taxable income of artificial losses arising from the participation in certain ventures which are considered to be particularly worthy of support, the most important being housing, investments in developing countries, in West Berlin or structurally weak regions.

<sup>85</sup> The following description is based on: Kohl, Kübler, Walz and Wüstrich, *op. cit. supra* n. 5; Hopt, *Inwieweit empfiehlt sich eine allgemeine gesetzliche Regelung des Anlegerschutzes?* Gutachten zum 51. Deutschen Juristentag (1976); and Mertens, *Inwieweit . . .* (same title as Hopt), *Sitzungsberichte des 51. Deutschen Juristentages* (1977), vol. II part 10 *et seq.*

<sup>86</sup> The Deutsche Juristentag devoted part of its session in 1976 to the debate about the advisability of a law regulating all public offerings.

<sup>87</sup> Cf. Hopt, *Vom Aktien- und Börsenrecht zum Kapitalmarktrecht?* ZHR, *supra* n. 4, at 201 (1976).

<sup>88</sup> Cf. Schwark, *op. cit. supra* n. 37, at 47 *et seq.*; Bremer, *Börse und Staat*, *Betriebsberater* 997 *et seq.* (1965).

<sup>89</sup> Cf. Wiedemann, *Der Kapitalanlegerschutz im deutschen Gesellschaftsrecht*, *Betriebsberater* 1591 *et seq.* (1975); Hopt, *op. cit. supra* n. 85, at 84 *et seq.*; Kübler, *Transparenz am Kapitalmarkt: wirtschaftspolitische Grundfragen aktueller Regelungsprobleme*, *Die Aktiengesellschaft* 1977, 85 *et seq.*

<sup>90</sup> Cf. Drobnič, *Methodenfragen der Rechtsvergleichung im Lichte der "International Encyclopedia of Comparative Law"* in *Ius privatum gentium*, *Festschrift für Max Rheinstein* I, 221 (1969); Zweigert and Kötz, *Einführung in die Rechtsvergleichung I* 27 *et seq.* (1971).

<sup>91</sup> Kohl and Walz, *Kapitalmarktrecht als Aufgabe*, *Die Aktiengesellschaft* 1977, 29.

<sup>92</sup> For the statements in this paragraph, see Häuser, *The German Capital Market* (1976).

<sup>93</sup> According to a poll conducted by Emnid, a private research institute, only 5% of the population are stock owners (*Süddeutsche Zeitung* of March 26–27, 1977, at 32).

<sup>94</sup> OECD Report, *Committee for invisible transactions, the capital market, international*

*capital movements, restrictions on capital operations in Germany* (1969). For recent figures, see *Zahlenübersichten und methodische Erläuterungen zur gesamtwirtschaftlichen Finanzierungsrechnung der deutschen Bundesbank, 1950–1974*, Sonderdrucke der Deutschen Bundesbank; Monatsberichte der Deutschen Bundesbank Mai 1976.

<sup>95</sup> Häuser, *op. cit. supra* n. 92.

<sup>96</sup> This statement is approximate, and must be qualified because different accounting methods, especially the extent to which hidden reserves are legally permissible, tend to bias the ratio in favor of debt financing. Nevertheless, it is interesting to note that more than 50% of total debt obligations are owed to banks. See Möschel, *Das Wirtschaftsrecht der Banken* 40 (1972).

<sup>97</sup> For the German investment companies, see Tormann, *The Investment Institutions* (1973).

<sup>98</sup> See OECD Report 1969, cited *supra* n. 94, at 25; *Foreign Interests in the enterprises in the Federal Republic*, Monthly Report of the Deutsche Bundesbank, vol. 26, n. 11, November 1974.

<sup>99</sup> For an evaluation of the universal bank system, see Hopt, *Der Kapitalanlegerschutz im Recht der Banken* (1975), esp. 190 *et seq.*; Zahn, *op. cit. supra* n. 45.

<sup>100</sup> Möschel, *op. cit. supra* n. 96, at 42 *et seq.*

<sup>101</sup> At 567.

<sup>102</sup> Cited in Shonfield, *Modern Capitalism* (1965), at 261.

<sup>103</sup> *Id.* at 261.

<sup>104</sup> See *supra* n. 5; see also Hopt, *op. cit. supra* n. 85, and Mertens, *op. cit. supra* n. 85.

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