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COMPARING THE ANNUAL SHAREHOLDERS MEETING IN THE UNITED STATES WITH THAT IN GERMANY - USE OF YANKEE CONCEPTS OF DuE PROCESS DISCERNED BY ALEXIS DE TOCQUEVILLE

Robert G. Miller

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*Robert G. Miller**

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* The author served for 15 years as vice president and chief legal officer with a U.S. Securities and Exchange Commission ("SEC")-registered investment adviser subsidiary of a major bank holding company. In that capacity, the author viewed commercial corporations from the perspective of a fiduciary investor — a perspective that he feels has been useful for this article. Also, throughout this time period, he was a secretary, vice president, and chief administrative officer for an SEC-registered closed-end investment company, regulated under the United States' Investment Company Act of 1940. This company, organized as a corporation, was sponsored and managed by the above investment adviser. In his capacity with this investment company, the author was able to view that corporation from the perspective of a corporate secretary and chief administrative officer; in addition, for a period of 28 years, the author has been an active member of the San Francisco chapter of the American Society of Corporate Secretaries and has served on its advisory committee for the part 8 years. The author also feels that he gained a comparative law perspective by virtue of being, for a time, a secretary and chief legal officer for a London, England subsidiary of the above investment adviser, this subsidiary itself being an SEC-registered investment adviser. Lastly, contributing, he feels, to all the various perspectives mentioned above, the author was, for a time, chief compliance officer for the entirety of the domestic and international trust operations of the same bank holding company.

On the other hand, the author wishes it noted that his construction of a German model is based entirely on secondary sources relative to German law written in, or translated into, English. The author is not a practitioner of German law. In some instances, the author's construction of a German model has had to be based on reasoned elaboration of what his research has disclosed as to the actual present German law. In short, the author's position has been that, for purposes of this article, a "German model" requires a conscientiously-constructed overview of the German position but not necessarily accurate details in all respects.

Lastly, the author gratefully acknowledges the help that he has received from attorneys who have read over his manuscript and offered suggestions and, in addition, the unstinting help of librarians in the law library at Boalt Hall, University of California at Berkeley and in the Monadnock law library of the San Francisco Bar Association in San Francisco.

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I. INTRODUCTION

Governance rules pertaining to issuers whose shares are widely traded (hereinafter "widely traded issuers")[1] in the United States have been a subject of much controversy recently, and the controversy continues even after enactment of changes after opportunity for public participation.[2] As shown in Appendix A, the controversy has been characterized by differing views of the principal objective of corporate governance regulation and, in particular, of the primary purpose served by the annual meeting of shareholders of publicly-traded corporations.

A principal objective of this article is to examine how peculiarly New England, or "Yankee," concepts of due process, as discerned by Alexis de Tocqueville in his famous work, *Democracy in America*, underlie what this article contends is the main purpose of United States (hereinafter "U.S.") regulation of corporate governance — protecting the interest of the citizen shareholder with investment intent. This shareholder is referred to as a "citizen capitalist."

The concept of a citizen capitalist in U.S. law is by and large not explicit and therefore must be regarded as implied. The only actual express reference to it is a requirement under U.S. federal law that management needs to include a proposal by a shareholder only on certain conditions in its proxy statement for an annual meeting. These conditions are that (1) the shareholder have over a threshold amount of share ownership (currently the lesser of $2,000 of cost and 1% of voting power), and (2) this ownership interest be held for at least a threshold amount of time (currently one year).[3] For purposes of this article, a shareholder with such investment intent that is not otherwise a "financial aristocrat" as discussed below, is a "citizen capitalist" regardless of nationality. The annual meeting, undergirded by concepts of Yankee due process, is the main way of protecting the citizen capitalist's interest and, consequently, of protecting the ability of industry (whether U.S. or foreign) to raise capital.

The author of *Democracy in America* was a French aristocrat of the early 19th Century concerned about the *unruliness* of the development of "democracy" in the Europe of his day. He visited the United States over an

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1. For U.S. purposes, such issuers are those whose shares are either listed on an SEC-registered stock exchange or whose shares are registered with the SEC by virtue of having an extensive trading market. *See* Securities Exchange Act of 1934 § 12, 15 U.S.C. § 781 (1994).

2. Shareholder Communication, Exchange Act Release No. 3-326, Fed. Sec. L. Rep. (CCH) ¶ 85,051 (Oct. 22, 1992).

3. 17 C.F.R. § 240.14a-8(b) (1998).

extended period in the 1830's. His book holds up American democracy as he found it, after an exhaustive study, as a useful model for Europeans concerned with an *orderly* unfolding of democratic principles in Europe. Thus, he portrayed American democracy as having been developed in a relatively calm and safe environment. This form of democracy developed slowly, from the grassroots, but with European traditions in mind. This made American political democracy — particularly as exemplified in New England — a useful model for Europe.[4] It is the same for American *corporate* democracy as a model for the foreign observer today.

A foreign observer should not necessarily accept the U.S. model as applicable in every detail to his own country without a careful comparison of the de Tocqueville concepts (hereinafter "Yankee concepts of due process") with those concepts of due process that constitute mores of his own country. For purposes of stimulating debate, this article compares what the author regards as the approach of a German model vis-a-vis the governance of widely traded issuers with the U.S.[5] This comparison is in light of Yankee concepts of due process, with deference to special mores of this counterpart country.

The heritage that, the author believes, suggests special mores that pertain to Germany is found in a "living" book. The book is "living"

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4. *See* ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 18–20, 57 (J.P. Mayer ed., George Lawrence trans. 1966) (1969).

5. For purposes of Germany, such issuers are those whose shares have an extensive trading market. There are several parts to this definition, which takes into account three laws in Germany: The Law of Stock Corporations, the Stock Exchange Law, and the Co-Determination Law. The components of an issuer with "an extensive trading market," for purposes of this article, are as follows: (i) the issuer has more than 2,000 employees under the Co-Determination Law; (ii) the issuer is a stock corporation under the the Law of Stock Corporations, that is an "Aktiengesellschaft" in German; and (iii) the stock corporation is registered for trading on one or more of Germany's eight national stock exchanges under the Stock Exchange Law.

This three-component definition includes a comparatively small percentage of companies in Germany. Most companies are either "companies of limited liability" rather than stock corporations, whose shares are not publicly traded or do not have shares outstanding that are listed for trading on a national stock exchange if the company is in the form of a stock corporation. Rather, if publicly-traded at all, the shares of most German companies are traded either (1) on a national stock exchange as an unlisted stock with limited trading privileges, or (2) solely in the over-the-counter market. In both of these two cases, the environment is unregulated compared to the U.S. equivalent and therefore, is not covered in detail in this article. For an overview of the German capital markets, *see* Joseph Blum, *The Regulation of Insider Trading in Germany: Who's Afraid of Self-Restraint?*, 7 NW. J. INT'L L. & BUS. 507, 507–12 (1986). For a commentary on the small number of issuers in Germany that have an extensive trading market, *see* Theodor Baums, *Corporate Governance in Germany: The Role of the Banks,* 40 AM. J. COMP. L. 503, 503–04 (1992).

because it (1) is popular while at the same time scholarly, (2) purports to discuss mores as well as heritages that underlie such mores, (3) is written in or translated into English, (4) is written by an author who, like de Tocqueville, has a substantial connection with both the U.S. and the country he has written about, and (5) is not particularly out of the mainstream in its approach, given commentaries of other respected scholars. The author selected is a contemporary one, Gordon A. Craig, a professor in German history at Princeton and Stanford Universities in the U.S., as well as in German universities. The "living book" is THE GERMANS,[6] written in 1981. This book seeks to assess the various roots of the "good" and "bad" aspects of German culture as it stood at the beginning of World War II. It then assesses the steps taken since the end of the war in then "West Germany" (as well as in East Germany) that are designed to counteract the bad aspects.

Craig suggests that German lawmakers perceive that a main source of volatility in Germany has been a frustrated and stifled middle class. For various reasons listed in Appendix B, members of this class do not have a heritage of being free and responsible as a result of the Enlightenment in Europe during past centuries. This stands in contrast to the middle class in other European countries. Craig suggests that current governmental efforts in Germany include keeping the middle class "under wraps" by fostering various "institutions" as directors of society.[7] These institutions, whose members include those in the middle class, are each deemed to have charters that evince a cohesive and cooperative spirit. The German model is a useful one in countries where the middle class is large but perceived to be too politically immature and volatile to be given responsibility on its own. In short, Germany is selected in contrast to the U.S. for corporate governance purposes, as an example of a country whose *disadvantage* is the heritage of a politically immature middle class, but whose *advantage* is a heritage of strong institutions.

U.S. corporate governance law is discussed critically in this article. The article suggests ways in which methods of corporate governance in the U.S. should change, on the basis that the approach should more stringently discern and apply Yankee concepts of due process in order to protect the interests of the citizen capitalist. The article then turns to the law pertaining to widely-traded issuers based on the German model. First, the extent to which the German model can be said to apply the various Yankee (or "de Tocqueville") approaches discussed earlier in the article is assessed.

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6. GORDON A. CRAIG, THE GERMANS (1983).

7. *Id.*

Second, a sequential overview of the approach of the German model is evaluated.

II. INTRODUCTION TO THE U.S. SYSTEM OF CORPORATE GOVERNANCE

A. The Primary Purpose of U.S. Regulation

The United States has corporate governance rules that are detailed and multi-faceted. They represent a combination of the efforts of the federal government, the various states, and of various essentially private entities. To restate, it is the thesis of this article, first, that the current scheme of U.S. regulation of corporate governance as it pertains to the annual meeting in particular, is designed for the primary purpose of insuring the ability of industry (U.S. or foreign) to raise capital by favoring the interest of the citizen capitalist.[8] Second, the scheme of regulation employed in the U.S. is justified by a form of deductive reasoning. This entails the use of "first principles" derived from human experience rather than by inductive reasoning derived from use by experts of a scientific method. Thus, to a large extent by unconscious accretion over the years, the scheme of regulation applies various Yankee concepts of due process that were apparent in the de Tocqueville era. These concepts would seem largely beneficent and, as in the arena of *political* democracy, preferable to application of a scientific method to see what best enables industry to raise capital.[9] Third, when and if U.S. corporate governance regulations are more clearly articulated in terms of Yankee concepts, there will not only be continued but also a more sophisticated application of them. Certainly such articulation is preferable to that of subjective predilections on the part of individual regulators.[10] This part of the article dedicated to the U.S., suggests changes to solidify U.S. protection of the citizen capitalist by means of the application of Yankee concepts.

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8. The purpose of the most relevant U.S. statute, the Securities Exchange Act, is, in fact, to promote "interstate commerce, the national credit, the Federal taxing power, . . . the national banking system, the Federal Reserve System, and . . . fair and honest markets in [stock] transactions." Securities Exchange Act of 1934 § 2, 15 U.S.C. § 78b (1994).

9. The scientific method approach, which this article does *not* espouse, has been urged by various authors in the Winter 1993 edition of the JOURNAL OF APPLIED CORPORATE FINANCE, published by the Continental Bank. *See, e.g.*, Joseph A. Grundfest, *Zen and the Art of Securities Regulation*, 5 CONTINENTAL BANK J. OF APPLIED CORP. FIN. 4 (1993).

10. *See id.*

B. The Annual Meeting as a Centerpiece

In light of the costs of an annual meeting, U.S. corporate governance rules recognize the availability of alternatives as a means of supervising the management of an enterprise.[11] However, the scheme of U.S. regulation favors the annual meeting method of supervision by citizen capitalists for several reasons.

First, there is a Yankee concept regarding due process of public adherence to duties minutely-divided among several government officials in the performance of an overall governmental function. Each official has a personal responsibility to comply with his or her ("his") own specific duties. Performance is characterized by formality and publicity. If an official fails to perform the duties assigned him, he is subject to personal liability. This reliance on "public performance of minutely divided ministerial duties" is seen, from the perspective of human experience, as a deterrence to "despotism" in connection with performance of the overall function.[12] If one includes "corporate officials" as a species of "government officials" responsible for the process that leads to an annual meeting, the holding of an annual meeting in the U.S takes advantage of the ministerial duties concept to provide a check and balance in favor of the citizen capitalist against any "despotism" on the part of management.[13]

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11. One alternative, even in states that normally require the holding of an annual meeting, is that a majority of the voting shares consent, in writing, to the taking of the particular annual meeting action, such as election of directors, without a meeting. *See* DEL. CODE. ANN. tit. 8, § 228 (1997). As another alternative, an annual meeting can be dispensed with, subject to the risk that, on application of a shareholder or director, a court will summarily require the holding of one. *See* DEL. CODE ANN. tit. 8, § 211 (1997). A third alternative, which exists in Massachusetts and provides for a "business trust," is that the concept of "trustees," as equivalent to directors who are subject to court supervision, be substituted for the discipline of an annual meeting. *See* MASS. GEN. LAWS ANN. ch. 182, § 1-14 (Law. Co-op. 1994). A fourth alternative, in states that provide for the concept of business being conducted by "limited partnerships," is that the discipline of an annual meeting be substituted with the self interest of a limited partner and his ability to enforce contractual provisions against the managing, or "general," partner. *See* CAL. CORP. CODE § 15501-33 (West 1994). Finally, a fifth alternative, in the case of a federally registered investment company, is that total reliance be placed on the discipline of independent directors taking annual meeting-type actions. An example is the selection of management for the upcoming year, with holding an annual meeting of shareholders dispensed with if that omission is permitted by the relevant state law. *See* Investment Company Act of 1940, 15 U.S.C. § 80a-15(b)(1),(c) (1994).

12. *See* DE TOCQUEVILLE, *supra* note 4, at 64–66, 74–78.

13. For the genesis of federal rules providing for adherence to publicized performance of minutely-divided ministerial duties in the context of solicitation of proxies for voting at

A second justification for the U.S. annual meeting is that it provides a focal point for taking advantage of another Yankee concept which is being able to rely on a *fact-oriented*, rather than an issue-oriented press. This is characterized by many newspapers circulating in every corner of the land. This "press" does not have as its primary role that of espousing important principles unlike its European counterpart at least in de Tocqueville's day. Rather it attempts to enable citizens to pursue their own *financial interests* in accordance with their instincts and informed by full knowledge of the facts.[14] The press enables important debate preceding an annual meeting, reflected in SEC filings,[15] to be brought to the attention of citizen capitalists as well as the general public. The same is true of the meeting itself since its time and place are to be announced in SEC filings open to the press and the results of the meeting are to be publicized.[16]

A third justification is that the U.S. annual meeting makes use of two additional useful Yankee concepts of due process. One concept is that when a government official intervenes in his proper sphere, every citizen is expected to guide, support, and sustain him rather than regard him as an enemy in his midst, which is the European approach.[17] In the conduct of an annual meeting, the citizen capitalists can be regarded as "citizen sustainers." Thus, the report card of the citizen capitalists at an annual meeting can have a useful public application. The report card is similar to the opinion asked of the "independent public accountant" retained by a corporation for annual reporting purposes.

Thus, the opinion of the public accountant addresses the fairness of management's presentation of the corporation's publicly disseminated *financial statements* for past periods.[18] Although, in a sense it is adversarial, the public accountant is not likely to be unduly hostile to management since it is management who retains the accountant. Similarly, the report card of the citizen capitalists addresses the adequacy of the publicly disseminated *performance* of management for past periods. These shareholders, as a group, are also not likely to be unduly hostile to management since the

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an annual shareholders meeting, *see Shareholder Rights: The Role of the Federal Proxy Regulatory System Before the Subcomm. on Sec. of the Senate Comm. on Banking, Hous. and Urban Affairs*, 102[d] Cong.16-24 (1991) [hereinafter *Hearings*] (testimony of Richard C. Breeden, Chairman, U.S. Securities and Exchange Commission).

14. *See* DE TOCQUEVILLE, *supra* note 4, at 184–88.

15. *See infra* pp. 20–29.

16. 17 C.F.R. § 240.14(c)-101 (1998).

17. DE TOCQUEVILLE, *supra* note 4, at 95.

18. For guidelines with respect to assuring the fairness of this presentation, *see* Securities Exchange Act of 1934 Regulation S-X, 17 C.F.R. pt. 210 (1998).

value of their shares depends on the market's perception of the adequacy of management performance which is influenced by their perception. Similar to the case of the independent public accountant,[19] shareholders in the U.S. have never been held answerable for damages to members of the public for their good faith opinion.

The question for the citizen capitalists is the nature of the opinion.[20] Should it be an *unqualified* one, as indicated by a highly favorable vote that the performance has been adequate? Should it be a *qualified* one as indicated by a favorable majority vote qualified by a significant negative one? Should the report card signify a crisis of confidence as indicated by a refusal to re-elect management for the upcoming year? Finally, should this signification of a crisis of confidence be confirmed by overthrowing those responsible for operation of the corporation through election of new management after an election contest?

The second relevant Yankee concept of due process is that of egalitarianism in compensation for government officials.[21] In the New England of de Tocqueville's day, the gap between compensation paid to government officials performing higher-level duties and those performing lower-level ones, was smaller than in Europe. Assuming that the right to vote is a form of compensation for purchasing shares, and that all shareholders, not just citizen capitalists, are capable of fulfilling the role of a "government official" who is a citizen sustainer, *all* shareholders "of record" are to participate in the opinion process.

A fourth U.S. justification for an annual meeting is that it enables the shareholders as a whole to enjoy the *satisfaction* of providing a "report card" on the performance of management. The human factor of sensitivity of management about the nature of the "grade" that it receives, as well as to other events that transpire at the meeting, give the individual shareholder a means of registering his concerns by means other than selling his shares. This safety valve avoids unnecessary transaction costs and undue volatility in the price of shares.[22]

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19. *See, e.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).

20. Management is of course concerned about the percentage of favorable votes for election of directors and for other management proposals that are received at shareholder meetings. *See* Eugene J. T. Flanagan, *Corporate Governance Issue: Shareholder Voting Rights*, N.Y.L.J. (Sept. 16, 1987) at 21.

21. *See* DE TOCQUEVILLE, *supra* note 4, at 212–14.

22. *See* Pegging, Fixing and Stabilizing Security Prices, Exchange Act Release No. 34-2446, Fed. Sec. L. Rep. (CCH) ¶ 22,512 (Mar. 18, 1940), regarding the perplexing subject of artificial pegging, fixing and stabilizing securities' prices for a good cause from management's perspective, even in the face of "natural" market volatility.

A fifth reason relates to the Yankee concept that sober virtues, such as thrift (as opposed to speculation), are to be encouraged in a citizenry.[23] As demonstrated below, it is the intent of U.S. law to assure that shareholder opinion on the performance of management is motivated by considerations of "thrift." The process leading up to an annual meeting provides an opportunity for information, bearing on issues of thrift, to be introduced into the public marketplace. And the date of the annual meeting is a publicly-announced occasion calling for advance disclosures, not just to selected securities analysts, but to the public at large.[24]

A sixth justification relates to the Yankee concept that places reliance on the degree of education of the ordinary citizen. This concept reflects the U.S. assumption, prevalent in the New England of de Tocqueville's day, that every voting citizen has received a basic formal education as well as a thoroughly practical one. In short, every ordinary citizen in de Tocqueville's day was assumed to be a man-of-the-world capable of fulfilling magisterial responsibilities.[25] Disclosure to such a presumably educated citizen is prompted by the upcoming event of an annual meeting.

A seventh U.S. reason for favoring the annual meeting relates to the Yankee concept that the citizen is to remain master in matters that concern him alone.[26] A protected "citizen-as-master" for purposes of the annual

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23. DE TOCQUEVILLE, *supra* note 4, at 34–6.

24. *See infra* pp.13–28.

25. *See* DE TOCQUEVILLE, *supra* note 4, at 36. The qualifications for being on the jury list were electoral rights and good reputation. *Id.* at 206. Electoral rights during the time of de Tocqueville, in Massachusetts for instance, were accorded to all men aged 21 and over, resident in the particular district for a particular length of time ranging from 3 months to 10 years, and having at least a threshold level of annual income, three pounds sterling, or capital, sixty pounds sterling. *Id.* at 722. An example of a role for the educated citizen is a justice of the peace in a New England township, who is halfway between a man of the world and a magistrate. For such an official, good sense and integrity are more important than knowledge. *Id.* at 75.

26. According to de Tocqueville:

> [I]n all matters concerning the duties of citizens toward each other [the citizen] is subordinate. In all matters that concern himself alone he remains the master; he is free and owes an account of his actions to God alone. From this derives the maxim that the individual is the best and only judge of his own interest and that society has no right to direct his behavior unless it feels harmed by him or unless it needs his concurrence.

Id. at 66.

> [The citizen] has conceived an opinion of himself which is often exaggerated but almost always salutary. He trusts fearlessly in his own powers, which seem to him to be sufficient for everything. Suppose that

meeting may be a three-part "entrepreneurial unit" of the corporation. This unit is deemed to constitute the corporation's driving force. One part of this trinity is the deemed provider of capital to the corporation on a "seed-capital" basis, that is, the citizen capitalist.[27] The other two parts of the trinity are the executive officers and the directors. Together the executive officers and the directors comprise what is known as "management." As demonstrated below, the citizen-as-master concept justifies the annual meeting because it provides an occasion for "representative" citizen capitalists to provide guidance to management through the medium of a shareholder proposal.[28]

An eighth reason is that the U.S. annual meeting provides an occasion to replace the existing operators of the corporation if such a step is warranted. A related Yankee concept is that on the one hand, freedom of association for political ends involves a risk to public order in a democracy and such freedom of association gives rise to a second, non-elected policy-making body, a "dissident faction." On the other hand, such a faction, if publicized, is preferable to the type of "secret society" found in the Europe of de Tocqueville's day. Such a secret society, officially precluded from government, acts as a rival government. It therefore necessarily has a sole purpose of undermining public order rather than providing a "loyal opposition."[29] The annual meeting provides an opportunity for a dissident faction, as otherwise loyal opposition, to attain power. However, there is a requirement that beyond a certain point of "testing the waters," its efforts to attain power must be made known to all the shareholders.

A ninth justification is that the U.S. annual meeting reflects a Yankee concept that government procedures that are "judicial" in form characterize government decision-making that is *not* judicial in substance.[30] A process is judicial in substance if it pertains to elaboration of established principles

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> an individual thinks of some enterprise, and that enterprise has a direct bearing on the welfare of society; it does not come into his head to appeal to public authority for its help. He publishes his plan, offers to carry it out, summons other individuals to aid in his efforts, and personally struggles against all obstacles. No doubt he is often less successful than the state would have been in his place, but in the long run the sum of all private undertakings far surpasses anything the government might have done.

Id. at 95.

27. *See infra* pp. 17-18.

28. 17 C.F.R. § 240.14a-8(a)(1) (1998).

29. DE TOCQUEVILLE, *supra* note 4, at 190-93.

30. *See* DE TOCQUEVILLE, *supra* note 4, at 75-77.

to an individual fact situation. In contrast, a process is "legislative" if it pertains to establishment of new principles based on new facts and is "executive" if it pertains to enforcement of established principles. Reflecting such "judicial-form procedures," the process leading up to an annual meeting can be said to consist of (1) publicly disseminated disclosure documents and a form of proxy, as the "pleadings" in a judicial context (hereinafter "pleading documents"), and (2) the annual meeting itself including the determination and announcement of results, as the "hearing." All of this transpires while the substance of the process is not judicial but a combination of the legislative and the executive.

C. Overview of Subjects Covered as to the U.S. System

Part II of this article evaluates the overlapping statutory schemes relating to the annual meeting process from the perspective of citizen capitalists. Part III evaluates the roles of various types of participants, including the citizen capitalists, in the U.S. annual meeting process. The disclosure involved in the process that leads up to the annual meeting is evaluated in Part IV. The disclosure described in this part assumes an uncontested setting in which there is no formal opposition to management proposals. Part V evaluates the integrity of the voting process on behalf of citizen capitalists that culminates in the annual meeting. Part VI evaluates the U.S. approach towards the added complication to and vindication of the annual meeting which is a counter-proposal by a dissident faction that seeks not merely a negative grade for management, but also an overthrow of the current operators of the corporation, all to the ostensible benefit of the citizen capitalists.

Parts VII through IX evaluate various threshold assurances of a foundation for evaluation on behalf of the citizen capitalists. It will be seen from Part IV that the disclosure that leads up to an annual meeting falls into three categories: (1) any changes in the overall business, or "enterprise" objectives of the corporation; (2) long-term corporate operating performance measured against these objectives, including the subject of management compensation; and (3) the corporation's short-term share price performance as measured against enterprise objectives. The foundation for the first category, the meeting of enterprise objectives, is addressed in Part IX discussing the prior prevention of clearly misguided management decisions as to enterprise objectives. As to a foundation to the second category, long-term performance, Part VIII addresses the prior prevention of clearly misguided management decisions affecting long-term corporate operating performance. Lastly, as to a foundation for the third category, protection as to liquidity, Part VII addresses the prior prevention of clearly

self-interested management interference, to the detriment of liquidity objectives, in the market price for the corporation's shares.

III. USE OF OVERLAPPING STATUTORY SCHEMES IN THE U.S. FOR EVALUATION OF MANAGEMENT

The *right* of citizen-capitalists to have management performance of publicly-traded corporations evaluated annually by *some* means, not necessarily an annual meeting, is protected by U.S. law. Although principles of dispersion of power and flexibility prevent an annual meeting from being the exclusive means for an evaluation, the annual meeting *is* favored in the U.S. as seen below.

A. Limited Intra-Government Competition

A Yankee concept of due process is that the control of an otherwise all-powerful government unit is to be rendered non-absolute by control of an overlapping area by one or more other government units independent of the first. This concept of "limited intra-government competition," present in de Tocqueville's day, protected against despotism in the performance of an overall government function.[31] In addition, it also provides an opportunity for experimentation today.

Thus, *federal* law does not require that an evaluation of management performance in the case of a widely-traded issuer be made by means of an annual meeting on behalf of citizen-capitalists. Rather, it is the law of the issuer's domicile for governance purposes, its "home state,"[32] that determines any such need. It is the "citizen-as-master" trinity of the issuer that determines the identity of this "home state." This right to choose applies regardless of the nature of the distribution of the issuer's shareholders among the various states.[33] As discussed above,[34] a home state may dispense with an annual meeting requirement for an issuer. It may rely, for instance, on publicized performance of ministerial duties to assure that

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31. *See id.* at 72. An example of the dispersion of the power of a *state* is that the collection of state taxes was a *township* function. *Id.* at 73–74, 84, 89–90. For the inherent weakness of centralized *power*, *see id.* at 15, 89–90.

32. *See* citations *supra* note 11 and accompanying text, *see also Hearings*, *supra* note 13, at 6–7 (testimony of Richard C. Breeden, Chairman, U.S. Securities and Exchange Commission).

33. *See, e.g.*, DEL. CODE ANN. tit. 8, § 101 (1996).

34. *See supra* note 11 and accompanying text.

management is evaluated.[35] Federal law, however, clearly favors the use of a corporate annual meeting. As a citizen sustainer of federal efforts, the New York Stock Exchange requires that such a meeting be held as a condition of granting an issuer's application to have its shares listed on the exchange for trading.[36] Also favoring the holding of an annual meeting is the U.S. constitutional principle that even if the home state does not require it, another state may, if the issuer has substantial contact with the non-home state in terms of shareholders resident and/or business done.[37]

Once a U.S. issuer is required to hold corporate annual meetings on behalf of citizen-capitalists as a means of evaluation, federal rules, for the professed purpose of protecting the ability of industry to raise capital,[38] mandate that the publicly-disseminated pleading documents have integrity.[39]

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35. Federal rules require that disclosure be made of "voting rights," to prospective purchasers of securities in a new offering. *See* Registration Statement Under the Securities Act of 1933, Item 9, 17 C.F.R. § 232.S-1 (1998); Securities Act of 1933, Reg. S-K, 17 C.F.R. § 229.202(a)(5) (1998); Securities Exchange Act, General Form of Registration of Securities Form 10, 17 C.F.R. § 2409.210 (1998).

36. NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL ¶¶ 301.00, 302.00 and 306.00; *see Hearings*, *supra* note 13, at 26–28 (testimony of Richard C. Breeden, Chairman, U.S. Securities and Exchange Commission). The New York Stock Exchange and the National Association of Securities Dealers Automated Quotation Systems, are themselves regulated by the SEC as securities market citizen sustainers. *See* Securities Exchange Act of 1934 § 19, 15 U.S.C. § 78s(b),(c) (1994). They are also empowered to enact requirements for the listing of the corporation's shares for trading by federal law. *Id.* These requirements can be more rigorous than those insisted upon by the corporation's home state for its own purposes as well as those required by federal law for its own purposes. *Id.*

See also The Business Roundtable v. Sec. Exch. Comm'n., 905 F.2d 407 (D.C. Cir. 1990). This case involved Rule 19c-4 under the Securities Exchange Act of 1934, which requires exchanges to enact rules providing for fair corporate suffrage as a condition of the listing of shares, that is, the rules were to prohibit disparate voting right plans tending to disenfranchise shareholders. The court overturned the SEC rule on the basis that it encroached on a role allocated to the states. However, stock exchanges have been able to span this difference and have voluntarily enacted rules providing for such fair corporate suffrage. NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL ¶ 310.00.

37. For example, the State of California requires that if a corporation has more than half of its shareholders, as well as more than half of business factors bearing on operations, in California, the law of the latter must be met on certain corporate governance subjects notwithstanding less stringent requirements of the home state. *See* CAL. CORP. CODE § 2115 (West 1994). On the other hand, if the home state requires an annual meeting but a stock exchange where shares are traded does not, the requirements of the home state, under case law, prevail over those of the stock exchange. *See The Business Roundtable*, 905 F.2d 407.

38. *See Hearings*, *supra* note 13, at 16 (testimony of Richard C. Breeden, Chairman, U.S. Securities and Exchange Commission).

39. *See infra* Parts IV, V, and VI. This requirement of adherence to federal rules in the pleading phase applies whether or not management of the corporation technically chooses

These include forms of proxy preceding the annual meeting. Regulation of the annual meeting itself, that is, the "hearing," is left to the home state or, if applicable, to the foreign country domicile.

B. Suggested Change as to the U.S. Statutory Scheme

It is noteworthy that the federal pleading rules apply to annual meetings of *foreign* corporations only to a limited degree . Thus, they apply only to those whose shares are listed for trading on a U.S. stock exchange. Foreign "home state" law is to govern the hearing phase for such a foreign corporation. This is the case even if a substantial number of citizen-capitalists of the foreign corporation are of *U.S.* nationality. However, those foreign corporations whose shares trade "over-the-counter" rather than on any exchange, are excluded from the need to comply with U.S. federal *pleading* phase rules with respect to their annual meetings. This is true even though the over-the-counter market may represent an important source of shares that have been purchased in these corporations by citizen-capitalists.[40] This state of affairs creates a vacuum in which the foreign law pertaining to the hearing phase of the annual meeting has no intra-government competition from a separate promulgator of pleading phase rules.

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to "plead" its case in the sense of soliciting proxies for voting at the annual meeting. If it chooses to plead, it is governed by rules under section 14(a) of the Securities Exchange Act of 1934, which regulates the contents of "proxy statements." If it chooses not to plead, it is subject to the rules under section 14(c) of that Act, which involves the regulation of "information statements" containing essentially the same information as proxy statements. *See* 15 U.S.C. § 78n.

40. There need not be compliance with federal pleading rules even if the securities trade on the widely-used National Association of Securities Dealers Automated Quotation System ("NASDAQ"), as opposed to such lightly regulated over-the-counter markets as the Electronic Bulletin Board or the "Pink Sheets." *See* Franklin R. Edward, *Listing of Foreign Securities on U.S. Exchanges*, 5 CONTINENTAL BANK J. OF APPLIED CORP. FIN. 28, 32 (1993). This exemption from federal pleading phase rules is by virtue of a "temporary exemption." Securities Exchange Act of 1934, Rule 12g3-2, 17 C.F.R. § 240.12g3-2 (1998). By virtue of this temporary exemption, foreign corporations not listed for trading on a U.S. stock exchange are exempted from the need to register their shares with the SEC under the Securities Exchange Act of 1934. Thus, they are exempted from the need to provide annual and other reports on its operations to the SEC and self-regulatory organizations as well as to comply with federal pleading phase requirements. The exemption is subject to certain conditions. These, however, do not assure the detail and readability that is required of domestic U.S. corporations and of foreign corporations listed for trading on a U.S. stock exchange. Moreover, the relevant information need be furnished only to the SEC where it is subject to review and reporting by the press, although not directly provided to security holders.

Further, the concept that a federal treaty preempts state law might preclude any *state* with which such a foreign corporation has substantial contacts from providing the intra-government competition in the form of requiring an annual meeting even though foreign law may not. This absence of competition can be said to detract from the overall U.S. scheme of regulating corporate governance, in particular that of protecting the citizen capitalist investing in a foreign corporation. A change would seem warranted.[41]

IV. THE U.S. ANNUAL MEETING PARTICIPANTS

This part will show that public performance of ministerial duties, keyed to various participants, including the citizen capitalist, helps insure the integrity of the U.S. corporate annual meeting process. These duties, in turn, take advantage of a variety of Yankee concepts of due process. The key participants, together with applicable concepts, are discussed below.

A. The Participants

The first participant is the citizen capitalist. The parts of the citizen-as-master trinity of a corporation derive from what transpires when a corporate enterprise is formed. It is the author's contention that federal "pleading phase" rules seek to preserve, in a "mature corporation," the same dynamism that exists in a "young corporation." Under federal rules, the parts of the trinity, in order of "dynamism" priority, consists of:

— one or more founders of a young corporation, the "men with the idea," translated into the original enterprise objectives of the corporation. Federal rules equate the *executive officers* of a mature corporation with these "founders."
— For a young corporation, the venture capitalist or the provider of seed capital. Such a capitalist provides general guidance to the founders, both directly and through a board

41. A possible solution would be for Congress to grant the President authority to negotiate a treaty pursuant to a division of authority between the Congress and the President along the lines of the one approved in the U.S. Supreme Court case of United States v. Curtis-Wright Export Co., 229 U.S. 304 (1935). In our case, this treaty could eliminate intra-government competition from the U.S. or its states with respect to exempted non-listed foreign shares traded in the U.S. In return, the rules of the foreign country that is the home state for the shares would eliminate intra-government competition from its own regulatory authority with respect to exempted non-listed U.S. shares traded in that foreign country.

of directors that he helps elect.[42] In the spirit of the concept that citizens are presumed to be educated, the federal rules can be said to equate any shareholder owning over a threshold amount in a mature corporation with the venture capitalist, if the shares have been held for a minimum period of one year, indicative of an investment intent, that is, the citizen capitalist.[43]

— Lastly, for a young corporation, the board of directors as elected by the venture capitalists and, for a mature corporation, the board of directors as elected by all the citizen shareholders with a leadership role given to the citizen-capitalists.

The executive officers, who are perhaps the most dynamic and most entrepreneurial of the three parts of the trinity, and the directors, perhaps the least dynamic and most cautious, constitute "*management*." Providing a counterpoint to management is the part of the trinity whose dynamism ranks in the middle, the citizen capitalist(s).

A second participant is the "plebe shareholder," who is subordinate to the citizen capitalist. The plebe is a shareholder that either owns less than the threshold amount of shares required to become a "citizen capitalist" or, if he satisfies the threshold amount, has achieved this status recently so he does not to have an established investment intent. The plebe shareholder, unlike the citizen capitalist, has no right to seek to guide management through inclusion of a proposal of his in the corporate pleading phase.[44] Nor has the plebe holder been notified by the corporation of the expected date of management's dissemination of its next pleading document. Thus, this announcement having occurred in the pleading phase of the *last* annual meeting for which, by definition, the shareholder was not a shareholder of record, the plebe shareholder is precluded from taking anticipatory action.

A third participant is the "citizen shareholder." This is the shareholder, whether citizen capitalist or plebe shareholder, who is deemed to provide thrift-oriented input as opposed to speculative or other "marred" input to the market price for the corporation's shares. This shareholder differs from and counterbalances various kinds of shareholders who are

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42. A true venture-type citizen capitalist for a mature corporation would be a "leveraged buy-out association." *See* Susan Woodward, *Shadow SEC Roundtable on the New Disclosure of Executive Pay*, 5 CONTINENTAL BANK J. OF APPLIED CORP. FIN. 62, 66 (1993).

43. *See* Securities Exchange Act of 1934, Rule 14a-8(a)(1), 17 C.F.R. § 240.14a-8(a)(1) (1998).

44. *Id.*

more specialized in terms of experience and training or, perhaps for the best of reasons, are otherwise not primarily motivated by thrift. These shareholders are called "financial aristocrats," "oversized investors," or "counter-entrepreneurs" in this article.

The fourth participant is the "financial aristocrat." An applicable Yankee concept of due process is that the creation of an aristocracy is to be avoided. In de Tocqueville's day, the target was a *landed* aristocracy. A main drawback of such an aristocracy was that its use of the land was not economically productive, that is, motivated by thrift.[45] Remaining participants in the annual meeting process described below can be said to be somewhat disfavored "*financial* aristocrats." These are "oversized shareholders" and "counter-entrepreneurs." Federal rules can be said to guide these aristocrats into economic productivity as follows.

One financial aristocrat is the "abdicating oversized shareholder." The "*oversized* shareholder"[46] is defined here as a wealth-controlling shareholder that often owes a "fiduciary duty" to beneficiaries and, in some cases, is subject to the discipline of public performance of ministerial duties. At least until the 1990s,[47]the oversized shareholder has *not* been disposed to take pains in exercising voting power.[48] Examples of such a typically passive, and in the U.S. annual meeting sense arguably unproductive shareholder, have been the investment company such as the "mutual fund,"[49] the employee benefit plan trust, the large personal trust,

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45. For instance, the creation of a landed aristocracy was discouraged by abolishing "primogeniture" succession by the oldest son to all land, a concept prevalent in England from which most original U.S. colonists came. This abolition precipitated the break-up of landed estates. *See* DE TOCQUEVILLE, *supra* note 4, at 51–54. On the other hand, de Tocqueville recognized that an aristocracy has its uses, as a "defender" of the people from the "excesses of despotism." *Id.* at 96.

46. For a study arguing that concentrations of share ownership are *per se* productive as the only feasible counter-weight to management, *see* Michael Ryngaert, *An Appropriate Federal Role in the Market for Corporate Control*, 5 CONTINENTAL BANK J. OF APPLIED CORP. FIN. 44 (1993). Commentators note that the institutional shareholder, even if disfavored, has progressively become a bigger player in U.S. corporate governance. *See Hearings*, *supra* note 13, at 10 (testimony of Richard C. Breeden, Chairman, U.S. Securities and Exchange Commission).

47. *See* James A. White, *Calpers to Halt its Proxy Efforts — Pension Fund to Try Quiet Approach to Influence Business,* S.F. EXAM., Oct. 8, 1991, at D1; *but see* James A. White, *New York's Regan to Pensions: Hands Off*, WALL ST. J., Sept. 13, 1991, at C1.

48. *See* Curzan & Pelesh, *Revitalizing Corporate Democracy; Control of Investment Managers' Voting on Social Responsibility Proxy Issues*, 93 HARV. L. REV. 670, 686 (1980).

49. For an article on the statutory bases for the passive role of mutual funds in corporate governance, *see* Mark J. Roe, *Mutual Funds in the Board Room*, 5 CONTINENTAL BANK J.

and any other institutional account as managed by the typical SEC-registered U.S. investment manager. Typically, for such a shareholder, it has not been desirable to incur the expense of participating, in a careful thrift-oriented way in a myriad of annual meeting opinions on performance. Rather, the typical approach of such an investor if the price of one stock in the portfolio behaves poorly due to inept management performance, is that he accepts the ineptitude as an investment risk to be met by the instrumentality of the purchase or sale transaction.[50]

An important aspect of the reasoning has been that if the ineptitude is reflected in a lower stock price, this will tend to attract a tender offer from another stock market professional displaying a willingness to pay a premium over the current market price for control.[51] In any event, the effect of the ineptitude on the market price may well be offset by appreciation in the price of shares that the institution holds in a competitor corporation or industry.[52] Lastly, the reasoning continues, at least if the size of the holding is relatively small in comparison to the depth of the market for the shares of the corporation, the institution can sell the investment at low transactional and other cost to the portfolio. This cost will be lower than the expense of careful voting.[53] All of these reasons for passivity in the U.S., even if justifiable from a portfolio management standpoint, deprive the citizen-capitalists as a whole, as well as the public, of a source of strength in the U.S. annual meeting process.

Guiding this passive investment manager into economic productivity and thus favoring the citizen-capitalists, federal rules governing management of certain portfolios forbid an investment manager to cause its passivity to amount to actual relinquishment of the right to vote. A conscious decision by the institution on issues to be voted on is required even if that decision is to fail to exercise the power to vote and thereby threaten the attainment of a quorum.[54] Moreover, should the passive

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OF APPLIED CORP. FIN. 56 (1993).

50. *See* Flanagan, *supra* note 20, at 21-22.

51. *Cf.* Alex M. Azar, *FIRREA: Controlling Savings and Loan Association Credit Risk Through Capital Standards and Asset Restrictions*, 100 YALE L.J. 149 (1990).

52. *See id.* For a critique of a common application of this concept of portfolio diversification, *see* Bernard Black, *Next Steps in Corporate Governance Reform: 13(d) Rules and Control Personal Liability*, 5 CONTINENTAL BANK J. OF APPLIED CORP. FIN. 49-50 (1993).

53. *See generally* Azar, *supra* note 51.

54. For instance, an investment company that "lends" portfolio securities, consisting of voting common stock, to another securities professional, is required to demand return of the stock in time for the company to be of record for an important shareholder vote. Salomon

oversized shareholder also have a large interest in the corporation, and seek to realize speculative profits as a substitute for voting, it will be thwarted in extreme cases. Thus, the federal "short-swing profits" rule limits the degree to which such a shareholder can retain profits from "investment" transactions realized within a particularly short time span of each other. This rule provides that a shareholder with more than a 10% equity voting position in a corporation must relinquish to the latter any profits derived from his purchase and sale, or sale and purchase, of shares that occur within six months of each other.[55]

Another financial aristocrat participant is the Delegating Oversized Investor who is a participant. A common approach among oversized investors that are somewhat more active than the passive shareholders has been to follow the "Wall Street Rule." This "Rule" is that if a shareholder does not sell his or her shares, he or she always votes in accordance with the recommendations of management.[56] This approach bears the Yankee due process justification of a delegation to "management" which, as seen above, compromises a two-thirds of the citizen-as-master trinity. The disadvantage of following this Rule is if institutions investing in a large portion of shares of the corporation disenfranchise themselves by following the Rule, a substantial portion of shares are removed as a source of strength for the citizen-capitalists in the voting process.

Certain federal requirements assure that the diligence of the press can put the shareholders, as a whole, on notice of potential disenfranchisement of shares held by large concentrations of institutional investors likely to follow the Wall Street Rule. First, the smallest amount of ownership in a widely-traded corporation, if held by a sufficiently large *institutional* shareholder, becomes a matter for the public record by virtue of a "Form 13F" filing required of the latter by law. This filing must occur within 45 days of the end of each calendar *quarter*. This serves to give aggregate information to citizen-capitalists on institutional ownership in advance of the annual meeting.[57] Second, the details of a purchase of five to ten percent of the publicly-traded shares of a corporation, if by an institutional shareholder, is made a matter for the public record by virtue of a "Form 13G" filing required of the shareholder. This is the case even if the

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Bros., Fed Sec. L. Rep. (CCH) ¶ 79,056 (May 23, 1972). With respect to voting by employee benefit plan trusts, *see* Morton Klevan, *Fiduciary Duty and Proxy Voting*,7 ANN. REV. BANKING L. 229 (1988).

55. *See* Securities Exchange Act of 1934 § 16, 15 U.S.C. § 78p(a), (b) (1994).

56. *See* Curzan & Pelesh, *supra* note 48, at 686.

57. Securities Exchange Act of 1934 § 13, 15 U.S.C. § 78m(f) (1994) and Rule 13f-1, 17 C.F.R. § 240.13f-1 (1998).

purchase by the shareholder is in the ordinary course of its business with neither the purpose nor the effect of influencing management. This filing must occur within 45 days of the end of the calendar year.[58] As demonstrated below, this filing may give less than timely information to citizen-capitalists of a large individual holding by an institutional investor in advance of the annual meeting.[59]

Another type of oversized shareholder is the "reactive" oversized shareholder. An oversized shareholder as managed by a U.S. investment manager can be rendered economically unproductive insofar as diversification of the investment manager"s business subjects him to business pressure from management of a corporation in whose shares the manager has invested the oversized shareholder's funds.[60] For instance, management of an issuer that is invested in through the trust department of a commercial bank may simultaneously retain the commercial department of the same bank to provide lending services to the issuer. Because of the trust and commercial departments report to the same senior bank management there is a special risk to the integrity of the bank's participation in the annual meeting process on behalf of oversized shareholders. This risk is that senior management of the bank will seek to influence the trust department managers to cause the trust department to vote the shares held by the oversized shareholders in favor of issuer management at the annual meeting.[61] This may all be to the detriment of citizen capitalist investors in the issuer.

To avert this special risk, U.S. corporate governance rules, first, make use of the protocol of public performance of minutely divided ministerial duties to maintain the independence of the trust department from the commercial department.[62] As a second deterrent, every effort by management of a corporation to influence any shareholder, if it amounts to

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58. 17 C.F.R. §§ 240.13d-1(b), 240.13d-2, 240.13d-3.

59. A shareholder will likely not learn of this ownership interest until it appears in the corporation's pleading document for the upcoming annual meeting. Securities Exchange Act of 1934, Schedule 14A, Item 6(d), 17 C.F.R. § 240.14a-101 (1998) and Securities Act of 1933, Regulation S-K, Item 403(a), 17 C.F.R. § 229.301 (1998).

60. That institutional shareholders succumb to management pressure is the conclusion of a study by the Investor Responsibility Research Center sponsored by the United Shareholders Association, spearheaded by T. Boone Pickens. *See* Flanagan, *supra* note 20, at 22.

61. *See* Curzan & Pelesh, *supra* note 48, at 687.

62. *Cf.* Broker-Dealer Policies and Procedures Designed to Segment the Flow and Prevent the Use of Material Non-Public Information [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,520 (Mar. 1990).

an effort to assemble an annual meeting voting "faction" even of one shareholder, is to be disclosed to the shareholders.[63] This is the case whether the voting by the faction is to be by proxy or in person.[64] Again, the disclosure amounts to timely publicity if it is of enough interest to the press, and enables the citizen-capitalists to marshal forces against the management faction.

The last oversized shareholder is the "pro-active shareholder." There is a problem to the citizen capitalist even in the case of the oversized shareholder that takes its responsibilities seriously as a source of strength in the voting process. The problem is that this oversized investor is still a "financial aristocrat."[65] The question arises whether, given the large amount of wealth that it controls[66] and hence the opportunities it has for diversification, it has the mind-set to be a fully productive participant in the annual meeting process. The approach of federal regulation in the U.S. is that the *optimal mind-set* for an investor is not that of the oversized investor, but that of the *educated citizen*.[67] This applies, for instance, to the entrepreneurial undertaking of electing a board of directors that, in turn, will select the executive officers.[68]

Federal rules seek to counter-balance any ill effects of the non-entrepreneurial mind-set of the active institutional investor. First, through the vehicle of disclosure, the rules seek to enable the press to publicize to

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63. *See* Securities Exchange Act Rule 14a-2(b)(2), 17 C.F.R. § 240.14a-2(b)(2) (1998).

64. The pleading disclosure obligation still exists if management has decided to dispense with proxy solicitation and to rely on personal attendance of certain investors at the annual meeting, such as institutional shareholders. Disclosure in this case is in the form of a "information statement" rather an a proxy statement. A dissident faction can resort to soliciting proxies for the meeting even if the corporation limits itself to an information statement. Securities Exchange Act of 1934 Rule 14c-1-5, 17 C.F.R. § 240.14c-1-240.14c-5 (1998) and 17 C.F.R. § 240. 14c-101.

65. For suggested causes of the emergence of the assertive institutional investor, *see* Flanagan, *supra* note 20, at 22–23.

66. *See* Curzan & Pelesh, *supra* note 48, at 683–84.

67. *See* James A. White, *CALPERS to Halt its Proxy Efforts — Pension Fund to Try Quiet Approach to Influencing Business*, S.F. EXAMINER, Oct. 8, 1991, at D1. In this article, Regan, New York's Comptroller, is quoted as saying he "believes that pension funds are not qualified to tell companies how much they should pay their executives or how to run other aspects of their business . . . we should not be involved." Contrast this approach with that of Germany where, according to a recent analysis, "capitalism has been built on relationship with commercial banks rather than on equity capital and . . . concentration of equity rather than dispersion of such ownership is favored." *See Learning to Love Equity*, THE ECONOMIST 71 (U.K. July 3, 1991).

68. For a counter-argument in favor of the large institutional shareholder as a "cost-effective means" for standing up against management, *see* Black, *supra* note 52.

citizen-capitalists large holdings in a corporation where any investor, such as an oversized one, is likely to seek to influence management. Thus, once the amount of voting power control by an investor exceeds 10% of total voting power, there must be prompt public disclosure. There must also be disclosure if voting power is less than that and the investor discloses his investment intent to seek to influence management.[69] Second, federal rules have the effect of curtailing an active oversized shareholder's involvement in the process of nominating directors, thus leaving more room in the process for the citizen capitalist. Management's pleading statement must disclose every arrangement or understanding that any shareholder, such as an oversized one, has with a nominee for director relating to his candidacy.[70] Third, the rules have the effect of requiring disclosure of any management bias towards the recommendations of oversized shareholders. Thus, if the board has a nominating committee, management's pleading document must state that fact and set forth the ministerial duties, on the part of the committee, to be performed in arriving at its nominees for director, having the effect of disclosing any preference for the recommendations of oversized shareholders.[71] Fourth, while permitting citizen shareholders to test the waters, without publicity, for purposes of forming a dissident faction,[72] a U.S. rule requires that wealth-controlling shareholders, such as oversized investors, publicize their efforts. The rule defines such a shareholder as one owning over $5 million in market value of the corporation's shares.[73]

Finally, U.S. federal law curtails the power, vis-a-vis the citizen capitalist, of the financial aristocrat who is a "counter-entrepreneur." *Secret* exercise of significant voting power is denied to the financial aristocrat who affirmatively seeks to use voting power to influence management for his own entrepreneurial purposes.[74] A concern is that the mind-set of a counter-entrepreneur may be opposed to that of the citizen capitalist. This

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69. *See* Securities Exchange Act of 1934 Rule 13d-1(b)(2), 14 C.F.R. § 240.13d-1(b)(2) (1998).

70. *See* Securities Exchange Act of 1934 Schedule 14A Item 7, 17 C.F.R. § 240.14a-101 (1998) and Securities Act of 1933 Regulation S-K, Item 401, 17 C.F.R.§ 229.401 (1998).

71. The pleading document, whether a proxy statement or information statement, must divulge whether the nominating committee will consider nominees recommended by shareholders and, if so, the procedures to be followed in submitting recommendations. 17 C.F.R. § 240.14a-101.

72. *See* discussion *infra* Part VI.A.B.

73. *See* Securities Exchange Act of 1934 Rule 14a-6(g), 17 C.F.R. § 240.14a-6(g) (1998).

74. *See* 17 C.F.R. § 240.13d-1(a).

professional's mind-set, a benefit to secondary markets if adequately constrained, may be one of speculation for the short-term granted that the speculation might well be of the controlled, sophisticated variety. Federal and state rules in the U.S. seek to guide the holdings of counter-entrepreneur shareholders into economic productivity for several voting purposes as follows.

First, once any *non-institution*, whether or not with a motive of influencing management, acquires five percent or more of a corporation's shares, he must, under federal law, promptly make public disclosure and thereafter keep that disclosure current.[75] The public disclosure must describe his background, source of funds and intentions relating to any change in the enterprise objectives of the corporation in which he has acquired that interest.[76] If he owns ten percent or more of the voting power, his interest in any current corporate transaction must be disclosed in management's pleading document.[77] Supplementing the federal requirements, state laws go beyond disclosure and expressly curtail the counter-entrepreneur's voting power. Some enable the citizen-capitalists to amend the corporate charter to provide for a freeze on this counter-entrepreneur's exercise of voting power.[78] Some provide for the granting of additional offsetting voting power to the citizen-capitalists.[79] Lastly,

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75. Once the ownership interest of an investor exceeds ten percent, his purchases and sales of shares of the corporation in one month become a matter for the public record in the next month. 17 C.F.R. § 240.13d-2(a). This provision has been criticized because it increases the cost of monitoring of management by institutional investors that have assumed large positions. *See* Ryngaert, *supra* note 46, at 46–47.

76. *See* 17 C.F.R. § 240.13d-101.

77. 17 C.F.R. § 240.14a-101 at Item 7(b) and Securities Act of 1933, Regulation S-K Item 404(a), 17 C.F.R. § 229.404(a) (1998).

78. *See* IND.CODE ANN. § 23-1-42-9 (Michie 1994); BNS Inc. v. Coppers Co. Inc., 683 F. Supp. 58, 463–64 (D. Del. 1988); CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987). *See also* 805 ILL. COMP. STAT. § 7.85 (West 1978); NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL ¶ 312.00 (1983) and AMERICAN STOCK EXCHANGE GUIDE § 713 (1983) which required that charters of listed companies preclude exercise of the privilege of converting preferred stock into common stock without shareholder approval if the resulting acquisition amounts to more than eighteen and one-half and twenty percent of common stock respectively. *See also* Financial Accounting Standards Board Interpretation No. 35, CRITERIA FOR APPLYING THE EQUITY METHOD OF ACCOUNTING FOR INVESTMENT IN COMMON STOCK (May 1981).

79. For instance, Delaware law provides that a large shareholder, unless he has acquired eighty-five percent or more voting power, may not vote in favor of merging the corporation with an entity controlled by that large shareholder unless the prior board of directors had approved the transaction, or the other shareholders approve the transaction and there is a sixty-six and two-thirds percent vote by independent shareholders in favor of the transaction.

some laws provide that, once an investment by a shareholder exceeds a certain voting power threshold, he is deemed to have assumed special duties toward the corporation along the lines of those of management.[80] This would be without having the benefit of certain protections accorded management such as liability insurance[81] and the protection of having adhered to public performance of minutely-divided ministerial duties in the course of the making of difficult business decisions on the corporation's behalf.[82]

B. Suggested Changes as to U.S. Regulation of the Annual Meeting Participants

1. Compromises with Oversized Shareholders

Of particular interest to the citizen capitalist is any "compromise" agreed to by management with an oversized investor owning a significant stake in the corporation having the effect of modifying *enterprise objectives*. Such a significant compromise may be agreed to by management in order to gain an oversized shareholder's vote. Any compromise should be disclosed in management's pleading document if the compromise, first, amounts to a change in enterprise objectives and, second, is brought about through the efforts of an oversized investor having over a threshold amount of ownership, that is, one percent of the corporation's voting securities.

See DEL. GEN. CORP. LAW § 203(a) (1994) and BNS Inc. v. Koppers Co., Inc., 683 F. Supp. 458.

80. If a shareholder has acquired more than ten percent of a corporation's voting power, he is personally liable for violation by the corporation of certain of the securities laws unless he had "no knowledge of or reasonable ground to believe in, the existence of the facts [which created the liability] and he acted in good faith in not directly or indirectly inducing the . . . violation." Securities Exchange Act of 1934 § 15, 15 U.S.C. § 78o (1994). For a critique of this degree of answerability, *see* Black, *supra* note 52, at 49–50.

If the shareholder's acquisition of shares has been such that he has become a majority shareholder, he may not vote in favor of a corporate reorganization with impunity if, on the entire record, the reorganization is not fair to the minority shareholders. *See* Singer v. Magnovox Co., 380 A.2d 969 (1977) and Weinberger v. UOP, Inc., 458 A.2d 701 (1983). Lastly, federal law precludes a species of investment company, the management investment company, from owning a concentration of a corporation's voting securities. *See* Roe, *supra* note 49, at 56.

81. *See* DEL. CODE ANN. tit. 8, § 145 (1994).

82. *See id.* at § 102(c)(7) and Appendix B.

2. Disclosure about Institutions and Oversized Shareholder Voting Policies

The information on "Form 13G" as filed by institutions is not disseminated frequently enough to assure timely disclosure to citizen-capitalists of a large holding in the hands of an oversized investor. Divulgence should occur, as in the case of Form 13F, within 45 days after the end of each calendar *quarter* rather than calendar year. A rule change should be made requiring that information on Form 13G set forth, by category, the policy of the institutional investor as to the exercise of its right to vote. The categories might be: (1) abstain from voting, which is an undesirable development from the standpoint of the citizen capitalist; (2) vote in accordance with the tally of the citizen shareholders as a whole, that is, engage in "echo voting," which is desirable; (3) observe the Wall Street Rule, an undesirable change; (4) request voting instructions from the institution's own beneficiaries, themselves perhaps "citizens," which is desirable;[83] (5) restrict activities solely to voting in the institution's judgment in the interest of fulfilling the corporation's current enterprise objectives, a desirable change; (6) seek to influence management without restraint but only in ways that do not directly affect current enterprise objectives, which is questionable; and (7) seek to influence management without restraint and without subject matter limitation, which is undesirable.

In addition, the definition of a "citizen capitalist" should be changed. One year is too short a time period to have held shares to be considered a "citizen capitalist" for shareholder proposal and other purposes. Consistent with the criteria for investment intent in other contexts,[84] the rules should

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83. Curzan & Pelesh, *supra* note 48, at 694–98.

84. In one context, a criterion for investment intent on the part of public shareholders of corporations on the verge on combining with each other is that the corporations have been independent of each other and autonomous for at least *two years* before effectuation of the combination. Without this *prior* stance of investment intent, the combination cannot be viewed as a "pooling of interests" for accounting purposes. Further, a criterion of investment intent for the acquiring corporation is that it not dispose of a significant portion of the assets of the acquired corporation within *two years* of the combination. Without, too, this stance of *current* investment intent, the combination cannot be viewed as a "pooling of interests." *See* Accounting Principles Board. Opinion No. 16 (Aug. 1970).

In another context, a SEC-suggested criterion for *lack* of investment intent, for purposes of defining a "greenmailer" intent on short-term profit, has been that he have held shares for less than *two years*. The SEC has been in favor of a requirement that, for a corporation to repurchase shares held by such a short-term shareholder at a premium over its fair market price, approval of the shareholders of the corporation as a whole have been obtained first. *See Recommendation of the SEC Advisory Committee on Tender Offers, 1984: Hearings on Tender Offers Before the House Subcom. on Telecomm., Consumer Protection,*

be amended to make the minimum holding period two years.

V. THE DISCLOSURE THAT LEADS UP TO AN UNCONTESTED U.S. ANNUAL MEETING

A. Catering to the Citizen Capitalist

In its disclosure requirements, U.S. federal law governing the pleading phase of an annual meeting assumes that the shareholder who receives disclosure is a "citizen" motivated by thrift and willing to exercise his instincts of thrift, that is, is an actual or potential citizen capitalist. The law assumes that the information that such a citizen desires includes several categories of information.

The first category is business and services. It must be asked: what is the nature and scope of the corporation's *business and services*?[85] Has the nature and scope undergone a recent change? "Services" are, in the sense of industry segments, classes of products and services and foreign and domestic operations and sales.[86]

A second category is the enterprise objectives. Although U.S. federal law does not refer to "enterprise objectives" in so many words, they consist of three components. The first is the mind-set of the citizen-capitalists as a group that are deemed to "control" the corporation, determined by their "average" investment objective. This mind-set is implemented through representatives of the citizen-capitalists who are able to insist that their proposals be included in management's pleading document. The pursuit of enterprise objectives is a requirement of the corporation's capital structure, that is, the requirements impinging on the means whereby the average citizen capitalist shares in the success or lack thereof, of the second component.

The third component is the corporation's overall business plan. The plan relates to the achievement of market share, the meeting of social and other long-term economic objectives, and the enhancing of shares of special cash recoveries for both management, which are bonuses, and the citizen-capitalists, which are dividends. The citizen capitalist asks whether the corporation is still pursuing *enterprise objectives* that coincide reasonably

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and Fin., Fed. Sec. L. Rep. (CCH) ¶ 83,511 (April 4, 1984) (statement of John S.R. Shad, Chairman of the SEC).

85. Securities Exchange Act of 1934 Rule 14a-3(b)(6), 17 C.F.R. § 240.14a-3(b)(6) (1998).

86. 17 C.F.R. § 240.14a-3(b)(7).

well with his own long-term investment objectives and short-term liquidity needs.[87] U.S. federal law assumes that the citizen capitalist intends to hold onto his shares until his forecasted need for cash. The law therefore requires that he receive, in advance of the annual meeting, an "annual report" of the corporation touching on the nature of the enterprise objectives and the achievement of them. The annual report is to touch on any change, or proposed change, in objectives.[88]

A further question is: What has the *long-term operating performance* been in comparison with enterprise objectives? This performance is the result of deploying assets, monitoring liabilities, and taking advantage of opportunities to raise "equity" capital in essentially the same manner as the citizen capitalist manages his own household affairs.[89] For this purpose, in explaining operating performance for larger, mature corporations, the annual report must contain very specific objective information for the near term, of the past two years. In addition, fairly specific information must be given for the middle term, the past three years. If the corporation falls into

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87. Some commentators, however, believe that disclosure of financial information to the financial markets is relevant only to the pricing of shares and is superfluous for corporate governance purposes. *See* Baumol & Malkiel, *Redundant Regulation of Foreign Security Trading and U.S. Competitiveness*, 5 CONTINENTAL BANK J. OF APPLIED CORP. FIN. 19 (1993).

88. Deemed material to this issue are:

- Disposal of a segment of a business. This can be said to suggest early fruition or abandonment of an aspect of enterprise objectives. *See* 17 C.F.R. § 240.14a-3(b)(3); *see also* Securities Act of 1933 Regulation S-K Item 302(a)(3), 17 C.F.R. § 229.302(a)(3) (1998);
- Change in control of the corporation. This suggests modification of the corporation's enterprise objectives in order to pay off debt and other obligations incurred by the acquirer of control. 17 C.F.R. § 240.14a-101 and 17 C.F.R. § 229.403(c);
- Any proposed modification or exchange of securities of the corporation, to be presented to the shareholders for their approval. 17 C.F.R. § 240.14a-101 at Item 12. This suggests a substantive change in the methodology whereby the investor can expect to share in the success or failure of the corporation in its pursuit of enterprise objectives; and
- Any proposed merger of the corporation into, or consolidation with, another corporation. 17 C.F.R. § 240.14a-101 at Item 14(a)(3). This suggests both a possible change in enterprise objectives and a change in the methodology whereby an investor can expect to share in results.

89. The raising of money from family members and neighbors in the conduct of household affairs, at least in the time of de Tocqueville, can be comparable to raising equity capital by corporations. The expectation, in each case, is that the investor will receive reciprocal treatment at the appropriate time, including a fair share of any return derived from these transfer payments.

a particularly mature category, general results must be provided over the longer term of the past five years.[90] For corporations that do not fit the category of such a mature "larger corporation," the requirement is less rigorous.[91] Only fairly specific results need be given and then only for the shorter term, of the past two years. Hence, the more mature the corporation, the less its obvious entrepreneurial dynamism, the more is its deemed *public* accountability and the greater the degree of disclosure required to citizen-capitalists.

Another question is: How effectively has management assured a fair market price for the shares and deterred undue volatility, as by appropriate and timely public disclosure? Thus, the citizen capitalist needs knowledge as to the interim marketability of his shares in the event he must sell them to meet his household emergencies. Controversially, there are recent, rigorous U.S. federal requirements to display stock market performance with apparently little emphasis on measurement of the *fairness* of that performance in light of actual long-term operating performance.[92]

The citizen capitalist is also concerned with what management's assessment is concerning long-term operating and short-term share price performances compared with the corporation's enterprise objectives. For this purpose, the annual report must contain management's "discussion and analysis" of the corporation's financial condition, "material changes" in that condition, and "material changes in results of operations."[93] Reflective of the "citizen," for U.S. purposes, being half-way between a man-of-the-

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90. The *very specific* information consists of a past two-year quarterly analysis focusing on net operating income. 17 C.F.R. § 240.14a-3(b)(3); *see also* 17 C.F.R. § 229.302 at Item 302(a).

The *fairly specific* information consists of:

- last two-year balance sheets of the corporation. 17 C.F.R. § 20.14a-3(b)(1);
- last three-year statements of changes in financial position;
- last three-year statements of income; and
- past three-year analysis of the impact of inflation and changing prices on net operating income.

17 C.F.R. § 240.14a-3(b)(5)(ii); *see also* 17 C.F.R. § 229.303(a)(3)(iv). The *general information* consists of a past five-year summary focused on the relationship of net operating income to debt and equity capital. 17 C.F.R. § 240.14a-3(b)(5)(I); *see also* 17 C.F.R. § 229.301.

91. The theory is apparently that in the case of these smaller corporations, the shareholders are less dependent on the diligence of the press and have more first-hand knowledge.

92. *See* 17 C.F.R. § 240.14a-3(b)(9); *see also* 17 C.F.R. § 229.201.

93. 17 C.F.R. § 240.149-3(b);17 C.F.R. § 229.303.

world and a magistrate,[94] federal regulations give the citizen capitalist the right to request that the corporation, at its expense, send him a copy of its report of relevant performances filed with the SEC. This is its report on "Form 10K" which is subject to U.S. requirements of detail not found in the requirements for annual reports to shareholders.[95]

Another question is: How do the corporation's long-term operating and short-term share price performances, in light of enterprise objectives, compare with the results for competitors? Federal rules require that the annual report contain written assurances that the financial information conveyed by the report, relative to long-term operating performance, is consistent with "generally accepted accounting principles," so that comparisons can be made with competitors. This requirement draws on the Yankee concept of judicial-form procedures. Thus, "generally accepted accounting principles," as applied to specific situations, have evolved through combined efforts of the SEC, employing its own judicial-form procedures,[96] and of various citizen sustainers, such as the "Financial Accounting Standards Board," which employs its own judicial-form procedures.[97]

Lastly, the citizen capitalist asks: What are the corporation's personnel policies and internal controls? This information, which he is deemed particularly capable of assessing, relates to the performance of individual directors and executive officers. An example is a description of significant contributors to corporate operating performance that are not yet directors or executive officers. This is indicative of an ability on the part of the officers to delegate successfully.[98]

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94. *See supra* note 25 and accompanying text.

95. 17 C.F.R. § 240.14a-3(b)(10).

96. *See* Securities Act of 1933 Regulation S-X, 17 C.F.R. §§ 210.4, 210.6 (1998).

97. *See* Donald E. Kiesco & Jerry J. Weygandt, INTERMEDIATE ACCOUNTING 10-12 (4th ed. 1983).

98. Examples would be production managers, sales managers, and research scientists. 17 C.F.R. § 240.149-101 at Item 7(b); and 17 C.F.R. § 229.401(c). Also, on the subject of personnel policies and internal controls, the corporation in its annual report must:

1. inform the shareholder if there are any standing audit, nominating, and compensation committees of the board and, if so, their functions 17 C.F.R. § 240.149-101;
2. disclose any director who, in the past year, has attended fewer than a threshold number of meetings, *Id.;* and
3. summarize any disagreements or reservations of a resigning or dismissed independent accountant or of a resigning director. *See infra* note 192 and accompanying text.

B. Compensation

Most importantly, the citizen capitalist is deemed to ask whether "compensation" paid to executive officers and directors is warranted by such factors as the nature of the corporation's overall enterprise objectives, long-term operating and short-term share price performances, as well as by the specific duties assigned to these officers and directors. Materials furnished in advance of U.S. annual meetings must, by federal requirement, provide detailed information on "compensation." This expense is given far more attention in the U.S. than other expenses of the corporation. It is an emphasis that has been heightened by recent amendments to the corporate governance rules.[99] The implication is that compensation is regarded by the SEC as a lynch-pin determinant, for citizen-capitalists to consider regarding the "grade" to be given in the annual meeting opinion.[100] This subject of "compensation," which was a favorite topic for the U.S. citizen in de Tocqueville's day as well as our own, is therefore covered below in some detail. Applying various Yankee concepts of due process, three separate *components* of compensation and two overriding *principles* of compensation apply to corporate officials in the U.S.

1. The "Wage" Element

One element of compensation for disclosure purposes is a *wage,* which is an objectively determined amount. A "wage" could encompass not only cash as a method of compensation but also deferred compensation accrued as retirement benefits. A relevant Yankee concept is that *government* officials are to be paid a wage on a piecework basis, that is, measured and paid after work has actually been performed.[101] Assuming that a corporate executive officer or director is the equivalent of a "government" official, he would logically be paid only after proof that work has actually been performed, thereby warranting a wage. In some cases, the value of the work could be in terms of the intrinsic value of the individual's performance of *ministerial* duties. This is the case with the corporate treasurer or secretary. In other cases, such as that of the chief executive officer, it could be in terms of the value of the individual's performance of *executive* duties. The

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99. *See* Executive Compensation Disclosure; Securityholder List and Mailing Requests, Exchange Act Release No. 34,32723, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,051 (Aug. 6, 1993).

100. For a discussion on compensation as such a lynch-pin determinant, *see* Woodward, *supra* note 42, at 66.

101. *See* DE TOCQUEVILLE, *supra* note 4, at 66.

valuation of this performance requires measurement of actual added value to long-term operating performance and short-term share price performance of the corporation brought about by the work performed by the executive officer. Under U.S. federal requirements regarding pleading documents:

> a. Note must be taken not only of the wages paid in the last year to executive officers and directors, but also of what this article regards as *potential wages* to be derived from contingencies occurring in that year that might, in the future, give rise to the equivalent of a wage paid. An example would be an executive officer's or director's financial interest in an annual meeting proposal[102] or in a pending corporate transaction.[103]
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> b. The corporation's long-term *operating performance* over a three-year period must be set forth.[104] However, there is no requirement that the corporation's enterprise objectives be disclosed to the citizen-capitalists in any degree. Therefore the operating performance can barely be compared to those objectives in ascertaining any value added by the work of the chief executive officer.
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> c. The work that *contributed* to the added value above, in the case of "highly compensated" executive officers, is suggested, without more, by a requirement that the five-year business histories of all executive officers be shown.[105] This is in addition to the five-year business histories of individuals to whom work has been delegated by these executive officers. These individuals are considered "significant contributors" to the business.[106]

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102. *See* Securities Exchange Act of 1934 Schedule 14A, 17 C.F.R. § 240-14a-101 (1998).

103. *Id.*; *see also* 17 C.F.R. § 229.404(a).

104. *See* 17 C.F.R. § 240.14a-3(b)(1).

105. 17 C.F.R. § 240.14a-101; *see also* 17 C.F.R.§ 229.401(e). Under recent amendments, a compensation committee must provide a justification of the level of compensation. For the practical issues involved in complying with this and other newly enacted requirements bearing on disclosure of compensation, *see* Executive Compensation Disclosure; Security Holder List and Mailing Request, Exchange Act Release No. 34,32723 [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,209 (Aug. 6, 1993).

106. *Id*; *see also* 17 C.F.R. § 229.401(c).

2. The "Job Security" Element of Compensation

A second element of compensation in the U.S. is to be determined largely by the demands of the recipient. This element is derived from a combination of the Yankee concept of thrift and two other concepts. One of these other concepts views a citizen as "drafted" into government service. Thus, he is not regarded as contending for the privilege of providing that service but as being drafted into it on the basis that he is not being forced to work for *free*.[107] A citizen is drafted into service as a corporate *director* by his fellow citizens when elected to that position by the citizen-capitalists. He *must* be compensated for this "compulsory service." Technically, there need not be substantive formal proof that he actually performed the requisite services. This is because a failure to serve warrants a sanction which is an *in terrorem* assurance that performance will substantiate the compensation.[108] In short, a director can be regarded as *not* receiving a wage but rather only "job security" related compensation.

A second observation concerns the board of directors' primary function, which is the designation and compensation of executive officers. A relevant Yankee concept is that a special species of elected officials have the unfettered discretion to designate and compensate certain subordinate officials. In de Tocqueville's day, the elected officials were the "selectmen" of a township and the subordinate officials were those selected for the grand and petit jury lists.[109] Under U.S. corporate governance law, the equivalent to "selectmen" are the directors of a corporation. The equivalent to grand and petit jurors are the corporate executive officers.[110] The power of the directors to designate carries the "discretion to terminate

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107. DE TOCQUEVILLE, *supra* note 4, at 66.

108. Management's pleading document must set forth indices of due diligence on the part of the board *as a whole*. This is, (a) number of meetings held by the board over the past year, (b) existence or non-existence of audit, nominating, and/or compensation committees, and (c) if the particular committee exists, its specific functions and number of meetings held over the past year. 17 C.F.R. § 240.14a-101.

Management's pleading document need only suggest the individual director involvements in these activities such as each committee membership and whether or not the director has attended at least seventy-five percent of meetings over the past year. *Id.* Disclosure of the *quality* of a director's involvement is only intimated at by his "business experience" over the past five years. *Id.* There is no requirement of disclosure as to whether or not the nominating committee has performed a peer review of director performance.

109. *See* DE TOCQUEVILLE, *supra* note 4, at 64–65.

110. Thus, the grand jury managed the affairs of a township in much the same way as executive officers manage the affairs of a corporation. DE TOCQUEVILLE, supra note 4, at 80, 206.

at will." An executive officer motivated by thrift is deemed to insist that a portion of his compensation is for assuming the risk that his employment may be terminated at the will of the board. This can be regarded as "job security compensation", determined largely by the demands of the executive officer. U.S. federal pleading rules require disclosure of job security compensation under the category "all other compensation."[111] Again, no formal proof of *performance* is required to receive this compensation.

One form of job security compensation, called a "golden parachute," is typically triggered by a takeover of the corporation by another corporation likely to result in a decision by a new board to terminate the current executive officers. Another form of job security compensation consists of deferred payments contingent on the executive remaining with the company. The arrangement for this compensation is called a "golden handcuff." Federal disclosure rules currently do not require that management discuss, for the benefit of citizen-capitalists, the amount of compensation that falls into the "job security" category. This compensation is measured by the extent to which total compensation exceeds the sum of "wages" and "bonuses." Compensation that is, in reality, "job-security compensation" has been a controversial subject in the U.S.

3. The "Bonus" Element of Compensation

A third element of compensation in the U.S. is largely at the discretion of the corporation. This element deals with the Yankee concept of due process that permits government officials to share in special cash recoveries that they have brought about for the benefit of the government.[112] As applied to a corporation, federal law recognizes that directors and executive officers may "share in special cash recoveries" that they have brought about for the benefit of the corporation. Federal law requires disclosure to the citizen-capitalists of such a "bonus."[113] The bonus is comparable to what a shareholder receives in the form of a dividend. In both cases, the sharing occurs not only when long-term operating and short-term share price performances satisfy enterprise objectives, but, also, when interim cash flow goals are exceeded. Federal rules require disclosure to the citizen capitalist of "bonuses" to directors and executive officers, but do not

111. *See* 17 C.F.R. § 240.14a-101; *see also* 17 C.F.R. § 229-402(b).

112. For instance, in the form of a share of a fine assessed against a private citizen. *See* DE TOCQUEVILLE, *supra* note 4, at 80.

113. *See* 17 C.F.R. § 240.14a-101; *see also* 17 C.F.R. § 229-402(b).

require discussion as to the circumstances justifying the payment of bonuses.[114]

4. The Overall Amount of Compensation

Two Yankee concepts of due process are relevant to the overall amount of compensation in the U.S. These concepts are "no work for free" and "egalitarianism." The "no work for free" concept serves to require that the compensation be reasonably generous, so there are no ulterior motives.[115]

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114. A typical bonus would either be a cash bonus or what this article will call "an equity participation bonus."

No explanation is needed for a "cash bonus" since the points of awarding the bonus and sharing of cash recoveries will have occurred at the same time. An "equity participation bonus" can be explained in terms of the de Tocqueville "bonus" concept as follows. An "equity participation bonus" would involve the awarding of a stock option by the corporation to an executive officer, or the equivalent of a stock option. This would create only an expectancy of a *payment of* a bonus in the mind of the executive officer. No bonus is realized as of the time of awarding of the option. The bonus will be received, that is, the expectancy will materialize, only after two conditions are satisfied.

First, interim cash flow goals of the corporation would have to be exceeded. This would only occur when (1) the market price of the stock exceeds the exercise price of the stock, signifying that a cash flow goal of the corporation has been subjectively exceeded in terms of the price at which the corporation could raise equity capital, and (2) the executive officer objectively acknowledges this favorable performance by exercising the option. However, the expectancy of the bonus will not yet have been *fully* materialized, since long-term operating and short-term share price performances must also be exceeded both subjectively and objectively.

Second, therefore, the corporate performances will have been exceeded. A *subjective* determination would be involved in determining whether this has occurred. Such an occurrence would be at the point when the executive officer has held the shares for two years after grant of the option. This would signify his subjective determination, starting from the end of the two-year period, that the long-term operating performance and short-term share price performances of the corporation, have in fact, satisfied enterprise objectives since the point that he was awarded the stock option. An *objective* determination will have occurred when the executive officer sells the stock so that he can realize the bonus.

If this sale occurs within two years of the *exercise* of the option, the exercise is deemed to have constituted compensation in the form of an equity participation bonus. If the stock is held for more than two years after exercise, then no bonus would need to be disclosed; an investment intent rather than an intent to realize cash, that is to realize a bonus, would be presumed. Between exercise of the option and sale of the stock, only an appropriate notation as to the executive officer having a *confluence of interest* with the corporation by virtue of his holding the stock would need to be disclosed. This holding of stock would serve as an explanation only if the reader should regard the executive officer's level of compensation as comparatively low under the circumstances. Otherwise, the notation would be gratuitous and emphasis on such disclosure would not seem warranted.

115. *See* DE TOCQUEVILLE, *supra* note 4, at 66.

Federal rules, as the result of recent changes, require extensive disclosure that are pertinent to this concept of due process. The citizen capitalist is entitled to know whether or not compensation of at least a minimum amount, now $100,000 per year, is being paid to the chief executive officer.[116] The regulations require that outside agendas of executive officers and directors be brought into the open so that ulterior motives may be considered along with the level of compensation that is possibly too low.[117] New requirements require extensive disclosure of arrangements that provide directors and officers with an entrepreneurial stake (identities of interest), serving to show the absence of ulterior motives assuming compensation is on the low side.[118] These arrangements include stock options, performance shares, and restricted stock awarded to executive officers.[119] However, these arrangements, although accrued to the recipient as a gift from the corporation, are typically not realizable by the recipient in terms of a cash payment until attainment of enterprise objectives.[120]

A second Yankee concept of due process relevant to the overall amount of compensation is that of egalitarianism. U.S. federal rules reflect this concept by omitting any need for disclosure of compensation that is shared equally with lower level officers or other employees of the corporation to citizen-capitalists.[121] This egalitarianism finds expression in the recent extreme detail and precision required of disclosure of arrangements that

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116. 17 C.F.R. § 240.14a-101; *see also* 17 C.F.R. § 229-402.

117. Pleading documents must disclose as to each director, or nominee for director, and as to each executive officer:

> 1. any holding of the position of both executive officer and director of the corporation, 17 C.F.R. § 240.14a-101; *see also* 17 C.F.R. § 229-402(a);
> 2. any special arrangement or understanding between him and any other individual or entity if the arrangement or understanding is to be implemented by his being a director or executive officer; and
> 3. any material indebtedness to the corporation of a director, executive officer, or immediate family member.

17 C.F.R. § 240.14a-101; *see also* 17 C.F.R. § 229-402(c).

118. *See* 17 C.F.R. § 240.14a-101; *see also* 17 C.F.R. § 229-402(b).

119. The NYSE Listed Company Manual, recognizes a "widespread endorsement of director share ownership." NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL ¶ 309.00.

120. *See supra* note 114 and accompanying text.

121. *See* DE TOCQUEVILLE, *supra* note 4, at 212-14; 17 C.F.R. § 240 14a-101; and 17 C.F.R. § 229.401(d). The New York Stock Exchange states in its manual for listed companies that it specially encourages those stock options and employee stock purchase plans that include all or a large portion of the company's employees. Listing of new shares for "key officer"-only plans requires the approval of shareholders. NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL ¶ 309.00, 312.03.

provide higher level employees with *entrepreneurial stakes*. This detail persists even though the main purpose of disclosure would seem to only justify lower cash compensation than would otherwise be expected.[122]

C. Suggested Changes as to Disclosure in the U.S.

The disclosure to citizen-capitalists required in a non-contested annual meeting basically fulfills the main opinion-related purposes of an annual meeting. However, changes should be made.

The first change is in long-term corporate operating performance. In various other contexts, the SEC has concluded that the performance of any "long-term" investment is to be gauged by shareholders over a full "business cycle" of ten years.[123] Yet, as seen above, the objective results of the performance of management in terms of "long-term" operating performance need be disclosed only over a period of five years at the longest. A ten-year discussion would seem warranted.

The second change is to make disclosure understandable to the citizen. The operating results are required in the U.S. to be given in accordance with a technical format[124] in terms of accounting principles "generally accepted" by accountants. However, generally accepted accounting principles take time to formulate because of the need to adhere to judicial-form procedures.[125] As a result, varying interpretations of accounting principles are permitted until "generally accepted" ones are formulated.[126] There is no U.S. requirement that a "management discussion and analysis" give an overview of performance in terms of long-term operating and short-term share price performances in light of enterprise objectives.[127] Such an analysis would seem warranted. This analysis should be in terms that a "man-of-the-world" experienced in managing his own household affairs can understand. This includes the deployment of assets, control of liabilities,

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122. *See* 17 C.F.R. § 240.14a-101; and 17 C.F.R. § 229.401(d). *See also* Woodward, *supra* note 42.

123. For instance, investment company performance advertising. *See* 17 C.F.R. § 229.482(e)(3).

124. 17 C.F.R. § 240.14a-3(b)(1). *See generally* Securities Act of 1933, Regulation S-X, 17 C.F.R. § 210.01(1998). According to one commentator, the format is so technical that foreign corporations are reluctant to list their shares for trading in the U.S. because of the requirement that their financial statements be reconciled to U.S. generally-accepted accounting principles. *See* Edward, *supra* note 40, at 28.

125. *See* Kieso & Weygandt, *supra* note 97.

126. *See generally* 17 C.F.R. § 210.01.

127. *See, e.g.*,17 C.F.R. § 240.13a-3(a)(5)(ii); and 17 C.F.R.§ 229-303.

raising of equity capital, and selection of, and delegation to, duly-compensated personnel.

A third change is in enterprise objectives. There is currently no requirement in the U.S. that management discussion and analysis describe the corporation's enterprise objectives. The objectives serve as a bogey against which the citizen capitalist can measure long-term operating, and short-term, share price performances. In addition, with a statement of enterprise objectives in mind, the citizen capitalist is assured that they are consistent with his own long-term investment objectives.[128] A firmer indication of enterprise objectives would seem warranted, granted that world-wide agreement on the detail of disclosure of enterprise objectives would seem desirable so corporations subject to U.S. requirements are not placed at an undue competitive disadvantage.[129]

The fourth change is in short-term share price performance. As seen above, there is a recent requirement that share price performance over past periods be disclosed to citizen-capitalists.[130] However, there is no requirement that management discuss and analyze material developments relevant to "*fair* share price performance," that is, avoidance of undue volatility in the price of shares. This should be the focus in recognition that exercise of thrift, rather than speculation, is the first concern of the citizen capitalist. The U.S. requires extreme detail on the subject of compensation, in particular of executive officers.[131] However, there is no requirement to

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128. It has been held that disclosure of "long-term corporate operating objectives" is not actionable. Krim v. BancTexas Group, Inc., 989 F.2d 1435 (5th Cir. 1993).

129. It is noteworthy that the recent Private Securities Litigation Reform Act of 1995 specifically provides protection for "forward-looking statements" against litigation instituted by private parties, as a species of disclosure of enterprise objectives. These statements would be in prospectuses and registration statements for new issues regulated under the Securities Act of 1933. The protected statements would be by issuers whose shares are widely-traded enough to be regulated under the Securities Exchange Act of 1934. The protected statements would include both (1) "a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer" and (2) "a statement of future performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the SEC." Specified cautionary language would have to be used in either of these statements in order for there to be protection. Securities Exchange Act of 1934 § 27A(c), 15 U.S.C. § 78aa-1(c)(1994).

130. For discussion of this requirement, *see* Executive Compensation Disclosure; Security Holder List and Mailing Request, Exchange Act Release No. 34,32723 [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,209 (Aug. 6, 1993).

131. *See* Woodward, *supra* note 42, for a critique of the detail from the standpoint of costs associated with disclosure.

discuss, for the benefit of the citizen capitalist, the factors upon which each of the three basic elements of compensation are based: wages, job security payments, and bonuses. If Yankee concepts of due process are to be honored, such a breakdown would seem warranted.[132]

Extreme detail and precision is required regarding the provision of entrepreneurial stakes, as well as other management prerequisites, as if these elements equaled cash compensation in all respects. As suggested above, in fact, they do not. Rather, their disclosure is not only to measure factors that may counterbalance a level of compensation that is possibly too low and a conflict of interest, but also to suggest a degree of participation in the entrepreneurial unit serving to give the corporation a citizen-as-master dynamism that is a confluence of interest.[133] There should be a relaxation of the detail on disclosure of entrepreneurial stakes.

Other changes to be made involve "wage" and "bonus" triggering events. It is yet to be made clear, in the scheme of U.S. regulation, that certain amounts are to be considered an element of "wage," requiring disclosure and justification as triggering events. Thus, any profit that an executive officer is permitted to retain that is derived from materialization of a *potential conflict-of-interest situation* disclosed to the citizen-capitalists should be considered an element of wage to be justified as such. Further, any profit derived from a *non-thrift motivated conversion* of a stock option into cash by an executive officer, should be considered as an element of "wage."[134] For instance, the rules might be modified to require that an element of wage occurs if the executive officer realizes a profit within two years of the grant of a stock option.

It also is unclear whether an executive officer who realizes a profit by selling stock more than two years after grant of a stock option but within

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132. *See id.* at 68–69 for a critique as to the current system of discussion of compensation by a compensation committee, which is without any such breakdown.

133. *See* Securities Exchange Act of 1934 Schedule 14A Item 8, 17 C.F.R. § 240.14a-101 (1998); and Securities Act of 1933 Regulation S-K Item 402(b), 17 C.F.R. § 229.401(d) (1998).

134. *See supra* note 117 and accompanying text. Compare this recommendation on the part of the author with Securities Exchange Act of 1934 § 16(a),(b), 15 U.S.C. § 78p(a),(b) (1994). As to the avoidance of wage-triggering events that may amount to insider trading, *see generally* NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL. Woodward discusses the current system of regarding all options, on date of award, as compensation. *See* Woodward, *supra* note 42, at 25. *See also* Ross L. Watts, *Accounting for Executive Compensation*, 5 CONTINENTAL BANK J. OF APPLIED CORP. FIN. 83 (1993).

two years of exercise of the option, should be retroactively deemed to have been paid a bonus as of the date of exercise of the option. This element of bonus should have to be justified in accordance with "bonus" criteria.[135]

The periods covered by performances, performers, and wages paid to performers are not comparable under the current rules, making it difficult for citizen-capitalists to make an assessment.[136] For instance, all measuring elements described above, long-term operating performance, short-term share price performance, enterprise objectives, work done by the respective executive officers, and value added by these executive officers, *for the same measurement period* are not set forth. To make understanding of the adequacy of compensation easier for the citizen capitalist, such an ease of comparison should be required.[137] Finally, a requirement of at least an average compensation figure would seem warranted for *all* executive officers, as well as for highly-compensated executive officers.

VI. INTEGRITY OF THE U.S. EVALUATION—THE "GRADE"

The integrity of the mechanics of the annual meeting process becomes a U.S. issue once the objectives of assuring a willing and able electorate, as well as full disclosure, have been achieved for the benefit of the citizen capitalist.

As suggested above,[138] integrity is assured by the due process concept of judicial-form procedures. The meeting has a "pleading" phase and a "hearing" phase. Management and the shareholders are parties to these procedures. The latter comprise every variety of shareholder,[139] but the leader is the citizen capitalist.[140] The right of shareholders to be involved in these procedures, once vested, cannot be diminished. Thus it is impermissible for stock exchanges to provide for the listing of new shares that have stronger voting rights than those of existing shareholders.[141] The judicial-form procedures to which we refer have three facets that protect the

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135. *See supra* note 114 and accompanying text.

136. *See* Smith v. Van Gorkum, 488 A.2d 858 (Del. 1985).

137. For an argument in favor of facilitating comparisons of performances, performers, and wages, *see* Woodward, *supra* note 42, at 66.

138. *See supra* note 30 and accompanying text.

139. Citizen capitalist, plebe shareholder, citizen shareholder, oversized shareholder, and counter-entrepreneur. *See supra* notes 42–82 and accompanying text.

140. *See supra* notes 42–82 and accompanying text.

141. *See* Securities Exchange Act of 1934 Rule 19c-4, 17 C.F.R. § 240.19c-4 (1998).

interests of the citizen capitalist. The first seeks to protect a citizen-as-master dynamism, the second a participatory democracy vigor, and third a public-performance-of-ministerial-duties dependability.

A. The Seeking of Citizen-as-Master Dynamism

The annual meeting in the U.S. has the important core role of providing a forum whereby management and the shareholders draft a board of directors in addition to the opinion-seeking role. The shareholders have the important selectman role, out of a *legally unlimited* universe of potential draftees. The choice of directors is unconstrained by mandatory qualifications.[142] Protections against excess are provided to the federal and state governments by modification of the "draft" concept by certain concessions to human nature,[143] disclosures to the citizen-capitalists as "men-of-the-world,"[144] and by a standard of conduct expected of the directors[145] once they are elected. This dynamic *independent second purpose* of the annual meeting, the draft out of an unlimited universe, requiring alertness on the part of the "drafters," gives integrity to the entirety of the annual meeting process, including the grade process.

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142. The U.S. does not require that a director have an identity of interest with the corporation. He need not be a U.S. citizen. No educational or professional attainments are prescribed and they need not even be disclosed. Conflicts of interest are not a basis for automatic disqualification.

143. A nominee must have consented to being named in the pleading document representing his willingness to serve if drafted. He is presumed to have consented if a majority of the directors mentioned in the pleading document are part of the board that he had in mind when indicating his willingness to be drafted. *See* Securities Exchange Act Rule 14a-4(d); 17 C.F.R. § 240.14a-4(d)(4) (1998); Sch. 14A, Item 7(b), 17 C.F.R. § 240.14a-101, and Securities Act of 1933, Reg. S-K, Item 401(a), 17 C.F.R. § 229.401(d) (1998).

144. The pleading document proposing the nominee must give the number of shares of the corporation that he owns "beneficially." 17 C.F.R. § 240.14a-101; and 17 C.F.R. § 229.403(b). Also, conflicts of interest must be disclosed. The pleading document is to set forth any material relationship that the director or officer has with a business or professional entity that conducted over a threshold amount of business with the corporation. *See* 17 C.F.R. § 240.14a-101; and 17 C.F.R. § 229.404(b)(1)-(6). The pleading document is to indicate any family relationship between an existing and/or proposed director and another existing/proposed member of management. 17 C.F.R.
§ 240.14a-101; and 17 C.F.R. § 229.401(d).

145. A nominee will be precluded from realizing "short-swing profits" while he is a director. He will be required to return to the corporation profits that he has derived from opening and closing transactions in the corporation's stock for his own account that occur within six months of each other. Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p(b) (1994).

B. The Seeking of Participatory Democracy Vigor

A relevant Yankee concept is that strongly-held varying viewpoints be reconciled in township-type meetings conducted in accordance with principles of a participatory democracy.[146] This participatory democracy session, monitored by the press even if it occurs *after* the vote has been announced at the physical aspect of a corporate annual meeting, gives vigor to the annual meeting and protects the integrity of the grade process conducted *before* the vote is announced. For example, the shareholder who attends the meeting is given the right by U.S. law to hear first-hand, management's assessment of the vote, as well as of its performances and objectives. Management hears, first-hand, the shareholders' assessment of the vote in light of their investment objectives.

U.S. law takes pains to protect the integrity of this participatory democracy session. Management is required to involve *all* shareholders in the physical meeting. Thus, by law, it has access not only to shareholders "of record" on the corporate register of shareowners, but also the potential access to "beneficial", not of record or not "street-name," shareowners who have power to direct how the record owners vote. Management's access is derived from the right to be informed by the street name holder of the name, address, and number of shares of each beneficial owner. An exception to deemed access exists only if the beneficial owner has expressly objected to disclosure of this information.[147] Having this access, management must inform *both* record owners and non-objecting beneficial owners of the date, time and place of the meeting[148] and important attendees.[149] Armed with information derived from SEC filings,[150] citizen-

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146. *See* DE TOCQUEVILLE, *supra* note 4, at 44, 64–65.

147. 17 C.F.R.§ 240.14b-2.

148. Management's pleading document must also contain the complete mailing address of the corporation's principal executive office. 17 C.F.R. § 240.14a-101; *see* 17 C.F.R. § 240.14a-13.

149. Attendees of importance would include the independent accountant(s) for the current year as well as those for the last year if they are different. If they will be present, the pleading document must say whether they will be able to make a statement and/or be on hand to answer questions. 17 C.F.R. § 240.14a-101.

150. The relevant SEC filings include: (1) an annual report to the SEC on the performance of the corporation; *see* 17 C.F.R. § 249.310; (2) an annual report to shareholders; *see* 17 C.F.R. § 240.14a-3; (3) initial and follow-up pleading documents, *see* 17 C.F.R. § 240.14a-2, and 17 C.F.R.§ 240.14a-11; (4) filings by "institutional investors" as to their ownership of shares in the corporation, *see supra* note 57 and accompanying text; (5) filings by investors acquiring holdings in the corporation including subsequent purchases and sales, *see supra* notes 58, 69 and 76; and (6) filings by members of

capitalists are given, by state law, a limited right in which to meet and confer among themselves in advance of the meeting.[151]

C. The Seeking of Ministerial Duties Dependability

Taking into account the size and untested nature of the shareholder component of the electorate, the voting process adds to the integrity of the annual meeting grade process through applying the concept of public performance of minutely-divided ministerial duties. Those officials involved in administering the voting process have a duty to see that a shareholder is permitted to change his voting instructions to any proxy holder. Election inspectors have a duty to assure that a shareholder's wishes are recorded with accuracy and precision.[152] The shareholder has a "duty,"

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management relative to their personal transactions in the corporation's stock. *See* Securities Exchange Act § 16(a), 15 U.S.C. § 78p(a) (1994).

151. Under state law, a corporation must make a complete list of the record shareholders as of the record date available for inspection by any other shareholder. This must be done a short-time before the meeting, typically ten days. DEL. CODE ANN. tit. 8, § 291 (1994).

152. A shareholder is to be given a wide range of options reflective perhaps of what public opinion would require in the participatory democracy of a township meeting. These options are:

> (1) The right to vote for directors individually and with particularity, that is, "approve," "withhold," or, if state law permits, "against";
> (2) Absent special circumstances, the shareholder retains discretion over how his proxy is to be voted. Only on his instructions can his proxy not be voted once it is given. 17 C.F.R.§ 240-14a-4;
> (3) The proxy holder has authority to vote on issues not reasonably foreseen at the time of the proxy solicitation. This is only if the shareholder is made aware of that possibility when his proxy is solicited. The proxy holder cannot vote for a nominee not named in the pleading document unless a bona fide named nominee is unable to serve or will not serve for good cause. *Id.*;
> (4) The proxy holder can vote, without instruction, on "routine" matters not included in the pleading document even if the stand taken is opposed by management;
> (5) He can vote on proposals of shareholders that have been excluded from the corporation's pleading document. *Id.*;
> (6) A proxy holder is permitted to attend annual meetings on behalf of the beneficial owner of the shares that he is voting. The holder need not be a shareholder himself. Therefore, the beneficial shareholder, by choosing his proxy holder carefully, can assure that his vote is counted on unforeseeable matters in accordance with the judgment of a carefully-chosen representative. *See* 17 C.F.R.§ 240.14a-4(c); and

if his vote is to be counted, to contribute "man-of-the-world" sophistication to the voting process.[153] Management has the duty to protect the shareholders as a whole from more unconstrained fellow shareholders.[154] Management also has the duty to protect shareholders from the emergence of corporate uncertainty which may occur in the event the shareholders decline to ratify the proposed slate of directors and also fail to elect a board of directors.[155]

VII. INTEGRITY OF THE U.S. EVALUATION—THE ELECTION CONTEST

A feature of the U.S. annual meeting process is that citizen-capitalists have the ability to replace management. Such a replacement could lead to a possible restructuring of the corporation or termination of enterprise objectives if warranted by poor performances. Reflecting the Yankee concept of the "dissident faction," U.S. corporate governance rules encourage the emergence, on a controlled basis, of the self-financed corporate dissident faction whether or not a counter-entrepreneur[156] to contest the election of directors. This is on a "controlled basis" because of the perils posed by the "secret society". There is to be full publicity to the citizen-capitalists as soon as a faction constitutes a "rival legislature." This legislature comes into existence as soon as (1) the faction reaches a

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(7) Reflecting perhaps the Yankee protocol that in a participatory democracy each citizen is willing to take a public stand, there is typically no requirement that the shareholder vote be conducted by secret ballot.

153. Thus, according to one court decision, if a shareholder gives facially conflicting proxies and these are irreconcilable from the books and records of the corporation, the proxies are not to be reconciled by "extrinsic evidence" and are not to be counted. An investor is required to use "reasonable care" in exercising his right to vote by proxy. *See* Concord Financial Corp. v. Tri-State Motor Transit Co., 567 A.2d 1, 5 (Del. Ch. 1989).

154. Thus management determines the time and place of each meeting, when the polls are to be opened and closed, and whether any shareholder proposals made for the first time in the actual hearing phase are in order. Lastly, management, as a holder of proxies given it by shareholders, has discretion to vote on shareholder proposals made for the first time at the hearing phase of the meeting.

155. Even though the law of a home state may require that an annual meeting agenda item be the election of directors for the upcoming year, the law of such a state typically does not necessarily limit directors to one-year terms. Charter documents of corporations usually make it clear that the term of a director does not end "*until* his successor is elected and qualifies."

156. Under federal securities rules, anyone who furnishes a communication to shareholders "under circumstances reasonably calculated to result in the procurement, withholding, or revocation of a proxy," is deemed in this article an organizer of a faction. *See* 17 C.F.R.§ 240.14(a)(1).

threshold size and (2) the organizer seeks either an immediate or eventual instruction, that is, proxy, from the members.[157] After this point is reached, publicity must be given as to the membership, financing, and intentions of the organizer of the rival legislature.[158] To permit initial testing of the waters in a private manner before a "legislature" is publicly announced, *any* proponent of a faction is allowed to contact up to ten other shareholders[159] "independent" of himself[160] without publicizing[161] his efforts even if seeking an immediate proxy.

A. "Citizen" Shareholder Organizers

After this threshold is reached, the citizen shareholder organizer, whether citizen capitalist or plebe shareholder, is given greater scope to act without publicity than shareholders comprising financial aristocrats, such as oversized shareholders and counter-entrepreneurs. Once a *citizen shareholder organizer* has contacted ten persons, he is permitted to seek to have a free-ranging discussion with an unlimited number of shareholders without announcing a rival legislature so long as he is not seeking an *immediate* proxy. This is despite the fact that his efforts are calculated to win *eventual* proxy support for his position in the form of a proxy naming

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157. *See id.*

158. *See id.*

159. This latitude is not permitted to management as a prospective faction organizer. Unless it gives publicity to its efforts, it cannot "furnish a communication" to any shareholder under circumstances reasonably calculated to lead to a proxy decision by the shareholder. *See* 17 C.F.R. § 240.14a-2(b)(1). An interesting question relates to the circumstances under which taking the initiative to meet and confer with a shareholder constitutes "furnishing a communication" to a shareholder. *See supra* notes 63-64 and accompanying text.

160. If the faction organizer is contacting other shareholders that are "dependent" on him because of a preexisting relationship, the ten-person limit does not apply. For instance, an investment adviser already being paid by his clients for disinterested corporate governance advice is allowed to contact an unlimited number of his clients that are shareholders. 17 C.F.R. § 240.14a(b)(2). A trustee shareholder with voting power is allowed, using channels permitted in the trust instrument, to contact an unlimited number of the trust's beneficial shareowners. 17 C.F.R. § 240.14a(b)(2). Finally, provided there is full disclosure afterwards, shared readership of a newspaper having an unlimited number of subscribers, enables an organizer to place a "tombstone advertisement" announcing his desire to organize a faction and inviting indications of interest. 17 C.F.R. § 240.14a-2(a)(6).

161. Publicity would include the filing with the SEC of (1) a proxy statement, (2) a form of proxy, (3) written follow-up efforts to obtain proxies, (4) the corporation's annual report to shareholders and, (5) if a proxy statement is not supplied, the corporation's information statement.

himself as holder.[162] There is ample time for a "citizen shareholder" who happens to be a "citizen capitalist" to secretly test the waters in this manner. Thus, for the previous annual meeting, the SEC required that the corporation announce the likely date of commencement of the current year's pleading process in its disclosure pleading.[163]

Any would-be organizer of a faction in the U.S. can enlist the help of the corporation to assist him in his efforts to have a free-ranging discussion with other shareholders before forming a rival "legislature." If he can demonstrate a proper corporate purpose, and the corporation itself is in the process of soliciting proxies, the corporation must, at the would-be organizer's expense, either mail materials that he furnishes to both record owners and non-objecting beneficial owners, or provide names and addresses of these owners to the would-be organizer so that he himself can do the mailing at the option of the corporation.[164] Once the applicable alternative-legislature threshold is reached, the faction organizer is subject to requirements of publicity and pleading disclosures to citizen-capitalists. These are similar to those to which management is subject in "pleading" its case for the annual meeting.[165]

Until recent changes were made, federal rules assured a collegial atmosphere in the course of the exchange of rival election contest disclosure documents. Thus, the SEC, as a neutral party, reviewed preliminary copies of the disclosure documents of both sides in secret. Thus, the SEC served to tone down the more contentious parts, by commenting on the disclosure documents.[166] However, the timeliness of debating rejoinders was hampered in this process. Recent rule changes have therefore lessened the SEC's role as preserver of the "bon homme" deemed inherent in a participatory democracy session.

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162. *See* 17 C.F.R. § 240.14a-2(b)(1).

163. This date is 120 days in advance of the anniversary date of the mailing of the first pleading document for the last meeting. *See* 17 C.F.R. § 240.14a-8(a)(3)(I), 5(e).

The typical state law provides for a record date and notice no more than sixty days, and no less than ten days, before the meeting. Therefore, if a shareholder wishes to organize a faction, he has at least a sixty day head-start, that is 120 days minus sixty days, and could conceivably have as many as 110 days (120 days minus ten days) to test the waters before giving publicity.

164. *See* 17 C.F.R. § 240.14a-7(a). However, for some reason, corporate assistance is not required for would-be organizers wishing to form a rival legislature, if management is seeking not proxies but rather the favorable vote of shareholders planning to attend the meeting *in person*. *See* 17 C.F.R. § 240.14a-2.

165. 17 C.F.R. §§ 240.14a-3, 240.14a-4, 240.14a-101.

166. 17 C.F.R.§ 240.14a-8(a)(10).

B. The Organizer that Is a Counter-Entrepreneur

If the organizer is a counter-entrepreneur and intent on affecting enterprise objectives, U.S. corporate governance rules require full publicity as to the faction's existence. Thus, there is an announcement of the legislature, (1) as soon as the ten-person threshold is exceeded and (2) if the organizer's efforts are calculated to win *eventual* support for his own position in the form of a proxy to himself.[167] A secret free-ranging discussion among faction members, if initiated by a counter-entrepreneur, is not permitted if it is beyond a ten-person threshold. A problem, of course, is that any purportedly free-ranging discussion will have had its vigor dampened because it is encumbered by the indirect presence of third parties and the public, if a rival "legislature" is announced.

Moreover, federal rules assure that a dissident faction organized by a counter-entrepreneur incurs expense and other costs before it acts as a rival legislature and seeks to prevail in an election contest. All capital-contributing "sponsors" in the faction must be disclosed on the announcement of the rival legislature, as well as the identity and compensation of service providers like proxy solicitors.[168] All of this has the benefit of assuring that such an enterprising-objective-changing faction has entrepreneurial dynamism. However, no such disclosure on announcement of the legislature is required of special consultants such as legal counsel and financial experts unless they are "financing" the solicitation of proxies.[169]

C. Oversized Investor Organizers

Publicity by filing with the SEC must be given to certain *written* organizing efforts of any shareholder whose voting share ownership of the corporation exceeds $5 million in market value.[170] Thus, publicity as to the

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167. 17 C.F.R. § 240.14a-2. This rule defines a counter-entrepreneur, as referred to in this article, as (a) any nominee for director proposing his own election, (b) anyone intending to propose an alternative to a management proposal to change the corporation's enterprise objectives, (c) any person who has acquired five percent or more of the corporation's common shares with an intent to exert control, and (d) anyone else with a substantial financial interest in the success of his own organizing efforts.

168. There is one exception. This is when the session is to address a publicized proposal by a *rival* counter-entrepreneur in an election contest. 17 C.F.R.§ 240.14a-11.

169. *See* 17 C.F.R. §§ 240.14a-101, 240.14a-11.

170. Such an organizer must make a filing with the SEC disclosing his identity, background, and intentions. He must otherwise publicize his efforts but need not provide a written disclosure statement to each shareholder that he seeks to win over. 17 C.F.R. § 240.14a-6(g).

existence of a rival "legislature" must occur as soon as the ten-person threshold is exceeded if the written efforts, even though not seeking an immediate proxy, are reasonably calculated to result in a proxy decision in favor of the *position* of the faction organizer. In this case, the *personal* furnishing of a prescribed disclosure statement to shareholders who are urged in person to join the faction is not necessary. This is as long as any eventual proxy decision in favor of the cause advocated by the organizer does not result in receiving a proxy himself.[171] This last condition of non-receipt of a proxy assures that a "sales meeting" does not occur, but rather a truly free-ranging discussion.

D. Suggested Changes as to Election Contests

First, the rules should be changed to provide greater latitude to the counter-entrepreneur organizer of a dissident faction in an election contest to have a free-ranging discussion with other shareholders. This should be done without the dampening effect of full publicity of the existence of a legislature. Recognition should be given that it is this organizer who may be the vehicle for a *change* in the corporation's enterprise objectives, that is, it is he who provides the means whereby shareholders can act on a poor "grade." The change could be a change in management, a restructuring, or a termination of enterprise objectives.[172] Similarly, "oversized investors" and other shareholders that have achieved a voting share ownership of the corporation exceeding $5 million should be given a circumscribed right to have a free-ranging discussion with other shareholders without full publicity of the rival existence of a legislature, *if* these shareholders have held their shares for over a threshold amount of time.

In both of these cases, the rules could be made to reflect the rules that apply to small offerings of securities. Thus, these two types of would-be organizer, the counter-entrepreneur and the oversized investor, could be enabled to have a free-ranging discussion without full publicity with no more than 35 other shareholders representing a maximum of $5 million in market value of the corporation's shares.[173] The would-be organizer of such a dissident faction should not be permitted to seek an *immediate* proxy. However, his efforts should be able to be calculated to win *eventual* support

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171. *See* 17 C.F.R.§ 240.14a-2(b)(1).

172. However, management should not be required to cooperate with a not-yet-publicized counter-entrepreneur trying to make initial contact with other shareholders before mailing of the corporation's own pleading documents, unless the counter-entrepreneur has held shares for at least two years.

173. *See* Securities Exchange Act Rule 505, 17 C.F.R. § 230.505 (1998).

for his position in the form of a proxy. To assure that the purportedly free-ranging discussion is not merely a sales meeting, the would-be organizer should be required to disclose to contacted shareholders his address, his telephone and fax numbers, and his "e-mail" address.[174]

The second suggested change concerns contingent compensation to consultant experts. As seen above, a faction is required to disclose the identity of, and compensation paid to, tactical participants such as proxy solicitors, even if the latter are not "financing" the solicitation. However, current rules do not require that a faction organizer disclose the identity of, and compensation paid to, consultants regarding the viability of a proposed change in enterprise objectives if the consultants are not disclosed as experts. Disclosure is only required if they *are* financing the solicitation. This non-disclosure exists even though the consultant advises on the tactics to be followed in achieving the pre-condition of the change in enterprise objectives, a victory in the election contest for a substantial fee. A reconsideration is warranted. Any change would be in light of the important role of the legal and other advice, as well as the large amount of compensation paid. This was particularly true over the course of the 1980's. This change should also reflect the Yankee concepts of emphasis on the importance of compensation and of reliance on the citizen.

Part IV has discussed *disclosure* with respect to annual meeting issues in the U.S. Parts V and VI have discussed the integrity of the holding of the meeting, at which issues are resolved and the opportunity for alternatives to existing management as one method of resolution are presented. Parts VII through IX will show ways in which the issues voted on at a U.S. annual meeting have been made concrete and manageable for the citizen capitalist. This narrowing of issues serves to assure that the opinion of the citizen-capitalists can be relied on by the public in furtherance of the policy to encourage capital raising efforts by industry.

VIII. AN UNDERPINNING—ASSURING A THRESHOLD LEVEL OF SHORT-TERM (SHARING PRICE) PERFORMANCE IN THE U.S.

As the annual meeting approaches, the U.S. citizen capitalist can have confidence that patently self-interested interference with the market price of shares by insiders has been limited.[175] This interference creates undue

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174. *Compare* 17 C.F.R. §240.14a-8(b)(2) *with* 17 C.F.R. § 230.505, which applies to identification of the maker of a shareholder proposal.

175. Typically, the insider, in causing such interference, will have either purchased shares at a price that is lower or sold shares at a price that is higher than would be the case if insider information that he has were to have been disclosed to the public first. His goal,

volatility affecting short-term, share price, performance. First, U.S. federal law requires that significant information be accurately disseminated in a timely manner to the public market.[176] Second, insiders are subject to federal sanction insofar as they take advantage of a temporary lack of accuracy or timeliness by achieving short-term profits in their corporation's shares on the basis of "insider information."[177] The following will explain

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typically, would not be long-term investment return but rather short-term profits to be realized *after* disclosure of the information to the public. He would typically realize these profits by means of an off-setting transaction within a short period of time of the original transaction, that is, a sale after the purchase or a repurchase after the sale.

One undesirable effect of such insider trading is "undue volatility" in the price of the shares held by citizen-capitalists. This is in the sense of prices, while shares are being held pending consummation of investment objectives, that are not fixed primarily by available public information but rather are fixed primarily by the speculation of the insiders. The undesirability of such interference with fair pricing of shares is or particular concern to stock exchanges. *See* NEW STOCK EXCHANGE LISTED COMPANY MANUAL ¶ 303.00.

176. The requirements include: (1) that the shareholders receive annual reports and that these be filed for information purposes with the SEC so as to be available for public inspection; (2) that the SEC receive annual reports, up-dating quarterly reports, and ad hoc reports of significant developments, Securities Exchange Act of 1934 § 12(a), 15 U.S.C. § 78l(a); and (3) that, if management is to avoid sanction for facilitating insider trading, significant developments be disseminated to the public in a timely manner. *See infra* note 180 and accompanying text.

As to this last item, the de Tocqueville concept of separate ministerial duties is employed to protect management and the corporation from inadvertent inaccuracies on hindsight, in forward-looking statements, including those pertaining to enterprise objectives and a comparison of long-term performance with enterprise objectives. *See infra* note 180 and accompanying text.

177. This is only a main protection against undue stock market volatility. Three other protections against volatility likewise involve a sanction in the form of civil penalty exacted by the SEC and, in certain cases, exposure to a civil lawsuit brought by a private party. The first protection involves the failure of management to follow internal control rules regarding the measurement of long-term performance. 15 U.S.C. § 78m(b)(2). The second protection involves failure of management to meet certain safe-harbors, a form of performance of ministerial duties, in publicizing forward-looking statements. 15 U.S.C. § 78au-1(A)(c). The third protection involves failure of management to establish internal controls to prevent trading on material inside information. 15 U.S.C. § 78u-4(g). These three protections supplement the one covered above, the protection against actual trading by insiders on the basis of inside information.

The existing citizen shareholder, embarked on giving an evaluation at an upcoming annual meeting, has a particular need for assurance that each of the above four violations of law are protected against. First, if the violation involves inappropriate lowering, for a time, of the value of his shares via false propagation of bearish information which is later corrected, the shareholder is potentially deprived of a good price at which to sell his shares if a household emergency arises during the "lowering" period. Second, if the violation involves inappropriate raising of the value of his shares in the same manner as the first

these protections.

A. Dissemination of Accurate Information

A relevant Yankee concept of due process is that a governing body employing judicial-form procedures guides the activities of even elected government officials. In de Tocqueville's day, an example of the governing body is a court of general sessions. An example of elected government officials subject to guidance would be selectmen. The guidance for the governing body was by means of the issuance of broad "writs" rather than continual supervision similiar to an employer supervising an employee.[178] Writs were issued after judicial-form procedures.

The SEC employs this concept of "writs" in governing the activities of the elected board of directors of corporations, as well as officers indirectly appointed by the directors. By legislative writ of mandamus, commanding an act not otherwise contemplated by an elected official, the SEC commands the elected board of directors to assure that the corporation has a system of internal controls in place. These must meet specific congressionally-mandated objectives to further accurate and prompt public disclosure.[179] In response to this writ, corporate boards of directors, in turn, appoint a variety of administrative officials of a publicly disclosed nature to assure compliance with the writ. Each official is to adhere to public performance of minutely-divided ministerial duties to assure that the writ is obeyed.[180] The officials, answerable to the elected governing body and the SEC, by virtue of the writ of the SEC, typically include a corporate secretary,[181] a compliance official,[182] a corporate treasurer,[183] a principal

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violation, there are two problems. For one thing, the shareholder is potentially deprived, during the "raising" period, of a good price at which to cover any short sale, against the box, that he may have made for "household emergency" tax reasons. This is to achieve a gain in an advantageous taxable year during the period before the raising period. For another thing, an individual, buying in the market at the inappropriately high price on the basis of unduly bullish projections, might sue the *corporation* for one or more of the violations. This lawsuit might itself cause the value of the corporation's shares to drop unduly.

178. *See* DE TOCQUEVILLE, *supra* note 4, at 78–79.

179. *See* 15 U.S.C. § 78m(b)(2). These directives are elaborated by citizen-sustainer stock exchanges. *See* NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 2.

180. For a comprehensive description of the duties placed upon officials involved in corporate governance, *see* James Hamilton, James Motley and Andrew Turner, *Responsibilities of Corporate Officers and Directors under Federal Securities Laws*, Fed. Sec. L. Rep. (CCH), Feb. 12, 1997.

181. *See* DEL. CODE ANN. tit. 8, §§ 142, 103(a)(2), 158 (1994).

182. This individual is responsible for assuring the adequacy of administrative controls,

accounting officer,[184] an internal auditor,[185] a current independent public accountant,[186] any former independent public accountant,[187] the directors of the corporation and, by federal regulation, members of the SEC staff.[188] With the exception of SEC staff members, the sanctions against an official who fails to fulfill his duties includes personal liability for damages caused to the corporation subject to the writ.[189]

To illustrate how the performance of ministerial duties operates, we will consider the preparation of management disclosure documents preparatory to the annual meeting. In the process, the independent public accountant, elected by the corporation's "entrepreneurial unit"consisting of management and the citizen-capitalists, audits the books and records of the corporation kept by the corporate treasurer. The independent public accountant performs these ministerial duties in accordance with generally accepted *auditing* standards. The treasurer, for his part, has performed his duties in accordance with generally accepted *accounting* principles.[190] In performing his audit, the independent public accountant tests the corporation's internal accounting controls as monitored by the internal auditor. The latter relies on *internal controls* in performing his duties. The financial statements are approved by the corporation's principal accounting officer. He performs his duties in accordance with generally accepted *accounting* principles. The independent public accountant, as one of his duties, offers comments on these statements to the audit committee of the

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that is, internal controls other than accounting controls. He is either a compliance officer employed by the corporation itself or a compliance professional employed by an investment banker retained by the corporation for capital-raising purposes. To assure management integrity, federal law spells out in detail the nature of administrative and accounting controls that are the responsibility of a compliance official. *See* 15 U.S.C. § 78m(b)(2).

183. The home state typically requires that the corporation have a corporate treasurer or controller who is personally responsible for supervising safe custody of assets. *See* CORPORATE CONTROLLER'S MANUAL, Part I (Paul J. Wendell ed. 1981).

184. *See* 15 U.S.C. § 78f(a).

185. *See* CORPORATE CONTROLLER'S MANUAL, *supra* note 183, at 1-3, 19.2-10, 20.1-2.

186. Securities Exchange Act of 1934 Rule 14a-3(b)(1), 17 C.F.R. § 240.14a-3(b)(l) (1998).

187. *See supra* note 149 and accompanying text.

188. *See* "Informal and Other Procedures" specified in Regulation 202.3 of the Rules of Practice of the Securities and Exchange Commission ("Processing of Filings"), 17 C.F.R. § 202.3.

189. *See* 15 U.S.C. § 78r.

190. For a commentary in favor of eliminating the touchstone of generally-accepted accounting principles if accurate information has been disseminated with respect to foreign corporations trading in the U.S., *see* Baumol & Malkiel, *supra* note 87.

board of directors.[191] The views of the audit committee are forwarded by the corporate secretary in a formal, recorded manner, to the full board of directors. If the financial statements are approved, the corporate secretary has the duty of assuring that ministerial duties of other officials leading up to the annual meeting are performed. Members of the SEC staff have minutely-divided ministerial duties to assist in the timely dissemination of information as the annual meeting approaches.

If a former independent accountant has recently been relieved of his duties by management, SEC rules require the use of a formal, recorded process to bring any disagreement between this accountant and management to the attention of the citizen-capitalists.[192] If a director has recently resigned, the SEC rules provide that the director has the option of bringing to the attention of the citizen-capitalists any financial statement-related disagreements he has with the rest of management.[193]

B. Dissemination of Timely Information

By legislative writ of mandamus, the SEC commands the board of directors to disseminate material information to the marketplace in a timely manner before insiders can illegally act on it prior to dissemination. At the same time, SEC rules, by virtue of a legislative writ of prohibition on elected directors, constrain insiders from interfering with that writ by trading on inside information that is material.[194]

Another Yankee concept of due process is that a court of general sessions, the SEC, be advised by a *grand jury* as to whether or not it should

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191. Citizen sustainer stock exchanges such as the New York Stock Exchange require that there be an audit committee composed solely of directors independent of "management". NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL ¶ 303.00.

192. If the former independent public accountant believes that management has interfered with his ability to perform his duties and has caused him to be terminated, the accountant can require the corporate secretary to publicize the reasons for his termination. Thus, the accountant can request the secretary to disclose in the corporation's disclosure pleading: (a) in connection with his audits going back two years, a summary of any specified disagreement or expressed concern on the part of the accountant; (b) if the accountant believes the secretary's summary is inaccurate or incomplete, a brief statement of his own views; and (c) a brief statement as to the likelihood that the accountant will be able to be present at the annual meeting and to make a statement and answer questions. 17 C.F.R.§ 240.14a-101 at Item 9d.

193. 17 C.F.R. § 240.14a-101 at Item 7(g).

194. 17 C.F.R. § 240.10b-5. *See* Sec. Exch. Comm. v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 978 (1968), 404 U.S. 1005 (1971), *petition for reh'g denied*, 404 U.S. 1064 (1972).

issue an executive writ in order to enforce a legislative writ in a particular case. In the case of an executive writ, the "grand jury's" main resource is a public prosecutor. The latter would have access only to the general public rather than a public prosecutor with an investigative staff especially assigned to him.[195] For purposes of SEC enforcement in the form of an executive writ, the "grand jury" functions as a hearing officer. The "public prosecutor" assigned to the grand jury is from the division of enforcement of the SEC.[196] The division of enforcement has no investigative staff. The general public receives encouragement to assist this public prosecutor in the form of a possible bounty, a share of any "civil penalty" realized by the SEC.[197]

Another Yankee concept relevant to applying sanctions, by virtue of interference with an executive or legislative writ, is that *political* rather than judicial agencies are relied on to impose executive writ remedies. These remedies include "impeachment," that is, removal of a public official from

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195. DE TOCQUEVILLE, *supra* note 4, at 79.

196. SEC procedures can be described as follows in terms of the "writ," "grand jury," and "judicial procedure" Yankee concepts of due process:

The investor provides information to the hearing examiner, the "grand jury," concerning an alleged failure of disclosure in violation of a legislative writ issued by the SEC. The information includes the role of the corporate official in that failure. If the hearing examiner decides to conduct an inquiry, he publishes information concerning the possible violation in order to obtain further information from the public. *See* Securities Exchange Act of 1934 § 21(a)(1), 15 U.S.C.§ 78u(a)(1) (1994). He subpoenas witnesses, compels their attendance, takes evidence, and requires the production of records. 15 U.S.C.§ 78u(b) and 17 C.F.R. § 201.14.

If he concludes that the corporate official has violated legal requirements of full disclosure contrary to the legislative writ, he issues an "initial decision." See 17 C.F.R. § 201.17(a). The initial decision may recommend that the commissioners of the SEC issue an executive writ ordering that the board cause the offending corporate official to pay a civil penalty, that is, avoiding undue formality, itself issue an executive writ ordering the offending official to pay the penalty. 15 U.S.C. § 78u(b).

The initial decision will automatically be adopted by the commissioners of the SEC as their own, unless there is a petition for review on proper grounds. If there is a petition, a similar judicial procedure before the commissioners will be held in order to reach a definitive finding on whether or not a writ should be issued. *See* 17 C.F.R. § 201.17.

197. There is an interplay of two Yankee concepts here. First, under that of "private litigants in the public interest" discussed below, *private* citizens, by receiving a share of any fine as a "bonus" discussed above, are encouraged to stand up and act as accusers of those *public* entities and officials that fail to fulfill administrative duties. *See* DE TOCQUEVILLE, *supra* note 4, at 79–80. Conversely, *public* officials, by receiving a share of any fine, are encouraged to stand up and prosecute *private* citizens that shirk public duties. *See id.* at 80, 86.

office for interference with a writ.[198] The political process to issue an executive writ of impeachment is to be bifurcated. One political agency decides whether or not to issue a bill of impeachment as a form of executive writ and another decides whether or not to impeach.[199]

The SEC, having issued a legislative writ to the elected board of directors that has been interfered with by the offending corporate official insider, is empowered to issue an executive bill of impeachment. This bill is issued on behalf of the citizen-capitalists and the public. However, contrary to Yankee concepts of due process, the entity in a position to impose the executive writ of *impeachment* under the current rules is not another political agency but rather a *court* applying disqualification from holding office as a criminal sanction rather than an administrative remedy such as an executive writ.[200] In its mildest form, the criminal sanction imposed by court order is merely a finding that the insider is guilty of a "violation of the securities laws."[201] This merely requires disclosures to citizen-capitalists and the public for subsequent annual meetings.[202] This sanction is therefore consistent with the above Yankee concept. In its most drastic form, a court-imposed criminal sanction can prohibit the insider from serving as an officer or director of any publicly-traded corporation ever again.[203] This would appear inconsistent with the above Yankee concept of *administrative* impeachment.

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198. *See id.* at 106–10. According to the author, such dismissal, so easy to pronounce because in a sense so mild, makes U.S. law particularly formidable. For ordinary men, dismissal from office "destroys their status, stains their honor, and condemns them to a disgraceful leisure worse than death." *Id.* at 110.

199. The process is brought into play, for one thing, when a government official is suspected of "high crimes and misdemeanors." *See* U.S. CONST. art. I, §§ 3(6), 3(7), art. II, § 4. A mild form of executive writ is found in the case of a director or executive officer of the corporation, or a large holder of shares, who is found to have failed in his duty as an "insider" to publicly announce, through a filing with the SEC, any purchase or sale he has made of shares in the corporation. This finding is made on a "bill of impeachment" issued by the corporate secretary. The omission automatically brings into play an executive writ requiring announcement of the omission in the next pleading document relating to an annual meeting and thus provides an opportunity for a sort of public impeachment by the shareholders. Securities Exchange Act of 1934 Schedule 14A Item 7(b), 17 C.F.R. § 240.14a-101 (1998), and Securities Act of 1933 Regulation S-K Item 405, 17 C.F.R. § 229.405 (1998).

200. This concept was employed in the Europe of de Tocqueville's day where *one body* could impose both criminal and administrative sanctions in the event of malfeasance of office. DE TOCQUEVILLE, *supra* note 4, at 106–10.

201. Securities Exchange Act of 1934 § 21(d)(1), 15 U.S.C.§ 78u(d)(1) (1994).

202. *See* 17 C.F.R. § 240-14a-101 and 17 C.F.R. § 229.401.

203. 15 U.S.C. § 78u(d)(2) (1994).

Further deterring insiders from trading on inside information to the detriment of citizen-capitalists is another Yankee concept which allots a "private-litigant in the public interest" a share of the monetary penalty exacted against *public* officials that violate a legislative writ.[204] This concept also regards the attorney representing the private litigant as a co-private litigant in the public interest.[205] To elaborate, the procedural rules of the U.S. courts allow a shareholder to assert the rights of all similarly situated shareholders, and thus the public, by bringing a "class action" in court against an offending insider who is a corporate official. A class action is a suit brought by plaintiffs who are similarly situated. The fee of the attorney representing the class is permitted to consist of an agreed-to portion of any recovery. The private litigant and his attorney, if acting in good faith, are not required to pay legal expenses of the corporate-official insider in defending against the suit if they lose.[206] Also, if the private litigant-in-the-public-interest wins, he is to have the opportunity to recover not only compensatory, but also *punitive* damages. He also has the right to have both forms of damage set by a jury of citizen peers, as "educated citizens," rather than by a court.[207]

C. Suggested U.S. Changes as to Short-Term, Share Price, Performance

First, as seen above, the SEC staff is to adhere to public performance of ministerial duties as part of the controls assuring accuracy of publicly-disclosed financial information to the benefit of citizen-capitalists. Performance of these duties is a personal responsibility of staff members. A failure to perform the duties is an offense for which there is a remedy enforceable by members of the public.[208] However, of possible detriment to the interests of citizen-capitalists, there is no remedy in the form of personal liability for money damages caused to the corporation by failure to fulfill *ministerial* duties. If the current SEC were not such a praiseworthy government agency, this "oversight" would be questionable in light of the current debate on how to improve the performance of government bureaucracy. In any event, serious consideration regarding the question whether members of the SEC staff who are not fulfilling their ministerial

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204. DE TOCQUEVILLE, *supra* note 4, at 80.

205. *See* CAL. CIV. PROC. CODE § 1021.5e (West 1994).

206. *See, e.g.*, CAL. CIV. PROC. CODE §§102.1, 128.5 (West 1994).

207. *See* Pac. Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 16 (1991).

208. *See* 28 U.S.C. § 1361 (1994).

duties should be made liable in damages for any such non-fulfillment, is warranted.[209]

Second, the private-litigant-in-the-public-interest concept would not seem to apply against private citizens but rather only *public* officials. For purposes of the annual meeting opinion, the concept accords private citizens, that is, the citizen-capitalists, the privilege of achieving monetary recoveries against *quasi*-public officials, the corporate insiders. However, the statutory bounty concept is inconsistent with this private litigant concept insofar as it enables citizens to earn a share of a civil penalty exacted by government against a purely *private* citizen. In contrast, the *special cash recovery* concept, is properly only available to *public* officials in the performance of *their* duties vis-a-vis private citizens. Receipt of a statutory bounty by a private citizen for informing on another private citizen, therefore, can be justified only as an extreme application of citizen sustainership.[210] This extreme application has been misused in Europe and even in the U.S. The statutory bounty should be retained as a means of avoiding the need for large prosecutorial investigative staffs. But this retention should be limited only to the case of SEC recovery against "*public*," or quasi-public, officials.

Third, the SEC and a court can bar an offending corporate official insider from serving as a director or officer of any publicly-traded corporation ever again. As seen above, this is inconsistent with the Yankee concept of impeachment as an executive writ, that is, as an administrative remedy. The use of a court, rather than a second political agency, to complete the impeachment process involves the formality and expense of court proceedings. This means the use, on the one hand, of a jury of citizens to decide questions of "fact" and, on the other hand, of a judge to decide questions of "law." Avoiding this expensive formality is a main goal of accused corporate official insiders who agree to consent decrees. This result may not be in the best interest of the citizen capitalist, particularly in the case of an overall exemplary corporate official.[211] Therefore a second *political* agency should complete the executive writ of removal from office. The second political agency could be the principal stock exchange on which

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209. *See* DE TOCQUEVILLE, *supra* note 4, at 66, 77–78.

210. In de Tocqueville's day, it was considered appropriate for citizen committees to be formed to catch suspected criminals and hand them over to the police. *See* DE TOCQUEVILLE, *supra* note 4, at 96.

211. For articles critical of exacting by the SEC of consent decrees resulting in stepping down from office, *see* George Gilder, *The Victim of His Virtues*, WALL ST. J., Apr. 18, 1989, at A24; *cf. View & Outlook, The Milken Indictment*, WALL ST. J., Mar. 31, 1989, at A12.

shares of the corporation are listed for trading. The principal stock exchange would function as a citizen-sustainer in the process.[212]

Fourth, in spite of recent federal legislation, it is certainly arguable that the scales in class action suits for violation of the prohibition against insider training are weighted too heavily in favor of the private litigant in the public interest in the U.S. There is concern that the burden of the expense and delay of engaging in technically-oriented proceedings in over-worked courts tends to fall too heavily on defendants that are natural persons. Also of concern is the risk that a particular jury might not reflect the wisdom expected of citizens. This is particularly the case insofar as a jury is randomly selected from voters' registers rather than at the discretion of an elected "selectman," which was the case in de Tocqueville's day. The U.S. judicial system might inquire into re-inventing the elected "selectman" to assure that jurors qualify as worldly "citizens" in the context of complex cases like insider trading. *Arbitration* is currently widely advocated as a less expensive substitute for court proceedings in securities cases.[213] However, there is uncertainty in some states as to whether or not arbitrators can award punitive damages if plaintiffs have previously waived the right to claim punitive damages.[214] As a means of curtailing the risk and delay of court proceedings in the future, arbitrators might uniformly be regarded as having the power to award punitive damages to plaintiffs irrespective of a prior waiver. The private litigants in the public interest would share in a monetary benefit to the public. Arbitrators should have the ability to permit this sharing.

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212. Using the impeachment of the U.S. President as an analogy, the SEC could be regarded as the equivalent of the U.S. House of Representatives, as the entity that would issue any bill of impeachment against a sitting U.S. President. Thus the SEC, like the House, would be acting as the representative of the people as a whole, with that wholeness's diverse interests.

The relevant stock exchange could be regarded as the equivalent of the U.S. Senate, as the entity that would act on the House's bill of impeachment and, if warranted, impeach the President and thus remove him from office. Just as the Senate represents the interests of the states in particular, as well as, the public as a whole, the relevant stock exchange would represent the interests of the investing public and the companies listed for trading on the exchange in particular, as well as the public as a whole. This public-as-a-whole facet of the role of the relevant stock exchange will have been assured by SEC general oversight of the stock exchange.

213. There is even a publication covering significant issues and events in securities and commodities arbitration—THE SECURITIES ARBITRATION COMMENTATOR (Richard P. Ryder, ed.).

214. *See Post-Awars Proceedings: "It's Not Over 'til It's Over"*, 4 SEC. ARB. COMMENTATOR 12, 1 (1992).

IX. AN UNDERPINNING—ASSURING A THRESHOLD LEVEL OF LONG-TERM OPERATING PERFORMANCE IN THE U.S.

As the annual meeting approaches, the U.S. citizen capitalist can have confidence that patently misguided decisions bearing on long-term operating performance have been limited by a creative tension that provides dynamism in decision making. This tension is given by a provision for participatory democracy sessions (hereinafter "free-ranging discussions") at upper levels of corporate deliberations.

A. Examples of Participatory Democracy Sessions

First, although it is a subject of controversy,[215] U.S. corporate governance law currently allows[216] more than one executive officer to be a member of the corporation's board of directors. This allowance has beneficial effects from the standpoint of the citizen-capitalists because it serves to prevent one executive officer who is given board member status to the exclusion of others from having only his viewpoint presented at board meetings even if other executive officers strongly disagree with him. Allowing more than one director to be an executive officer enhances collegiality in the form of a free-ranging discussion among executive officers in advance of the formal proposal at a board meeting.

Second, the board of directors constitutes a body of elected citizens with the primary role of hiring, firing and compensating executive officers on the basis of relevant facts presented by the executive officers. The executive officers have an obligation to respond to a request for information regarding the issues.[217] The board meeting provides a forum in which the executive officers and board of directors can have wide-ranging discussions before the board takes formal action affecting the hiring, firing or compensating of executive officers. Only after the parties have satisfied their obligations to discuss and to act in good faith, is the resulting

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215. *See* Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Sec. Exch. Act, Release No. 34,15384, 43 Fed. Reg. 58522 (1978).

216. *See id.*

217. *See* Aronson v. Lewis, 473 A.2d 805 (Del. 1984); Moran v. Household, 500 A.2d 1346 (Del. 1985); *In Re* J.P. Stevens & Co., Inc. Shareholder Litigation, 542 A.2d 770 (Del. Ch. 1988); Smith v. Van Gorkum, 488 A.2d 858 (Del. 1985); City Capital Assoc. Ltd. Partnership v. Interca, Inc., 551 A. 2d 787 (Del. Ch. 1988); Robert M. Bass Group v. Evans, 552 A.2d 1227 (Del. Ch. 1988). *Cf.* Investment Company Act of 1940 § 15(c), 15 U.S.C. § 80-15 (1994).

"management" decision protected from lawsuit by a "business judgment" rule. This rule gives management broad latitude to pursue business plans in order to fulfill enterprise objectives, notwithstanding the objections of shareholders who, unlike the citizen capitalist, have a short-term orientation with respect to operating performance.[218]

Third, as a matter of form, board decisions must be reached at meetings where a majority of director members are present and a majority of those present vote in favor of the decision in order to be valid.[219] As a matter of substance, stock exchanges seek to assure a true free-ranging discussion at board meetings of their listed companies by requiring that at least two directors be "independent."[220] The presence of independent directors not only serves to take advantage of the broad universe of candidates for director permissible under the concept of the "draft," but also of any special qualifications that the independent director might have, giving him the property of a "catalyst" to discussion. This catalytic quality helps assure that formal, substantive action is taken by the board only after a true free-ranging discussion in which the special qualifications of the independent directors, including those bearing on the general community's interests, are taken into account.[221] If a director has disagreed with a decision, he has the option of having his disagreement recorded in disclosure to the citizen-

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218. It is permissible for the pursuit of enterprise objectives to be *inconsistent* with short-term returns to shareholders in the form of dividends or in the form of short-term stock market performance. Thus, management is entitled to follow a social policy objective so long as consistent with enterprise objectives. *See City Capital Assoc. Ltd. Partnership*, 551 A.2d 787. Further, under a *federal* requirement, enacted in 1977, a corporation is required to adhere to internal controls to assure management integrity irrespective of lack of immediate effect on financial statements. Securities Exchange Act of 1934 § 13(b)(2), 15 U.S.C. § 78m(b)(2) (1994). Similarly, SEC rules permit management to omit from the corporation's disclosure statement any citizen capitalist proposal calling for the corporation to *violate* a statute. *See* Securities Exchange Act of 1934 Rule 14a-8(c)(2), 17 C.F.R. § 240.14a-8(c)(2) (1998).

219. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141 (1994).

220. The New York Stock Exchange requires that there be a committee "composed solely of directors independent of management and that the board itself have at least two independent directors." NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL ¶ 303.00.

221. Many state laws permit a director or executive officer to be protected from liability for actions taken, even if he may, on hindsight, have failed to display man-of-the-world sophistication. This potential protection would apply so long as he has acted in good faith. Many state laws permit the board to cause the corporation to purchase insurance as to any such obligation to indemnify a director or officer. In a few states, the corporation itself, including the shareholders, is permitted to agree in advance to absolve the director or executive officer from any personal liability on condition that he shall have acted in good faith. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (1994).

capitalists before an annual meeting which further assures a true participatory democracy session.

Fourth, the U.S. gives immense power to the "citizen-as-master trinity" of a corporation consisting of management, the executive officers and the board of directors, and the citizen-capitalists. It is this element that has determined how work of the corporation is divided,[222] the state in which the corporation is to be "domiciled,"[223] the stock exchange on which its shares are to be traded, and procedures that it is to use in governing itself and its enterprise objectives as set forth in articles and bylaws.

U.S. regulations pertaining to the wielding of this power require that the management side have free-ranging discussions with qualified representatives of the citizen capitalist side. The applicable Yankee concept of due process is that the township meeting provide a forum for the exercise of political ambition by any citizen *who has achieved a modest level of eminence in the community*.[224] By virtue of SEC rules, "opportunity to exercise ambition" is accorded to the shareholder who qualifies as a citizen capitalist and has gone though the effort of formulating a relevant[225]

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222. The division of duties among executive officers is largely a matter of unfettered board discretion. Executive officers typically are required to include a president who is senior executive officer in charge of operations, at least one vice president, and a principal accounting officer whose primary *policy-making* function is to assure that the corporation's financial statements are consistent with enterprise objectives. State law typically permits the corporate charter to provide for the selection of a chairman of the board or the senior executive officer presiding at board meetings. DEL. CODE ANN. tit. 8, § 142,103(a)(2),158 (1994). It is federal law that requires that a publicly-traded corporation have a principal accounting officer. 15 U.S.C. § 78f(a).

223. The only requirement is that the chosen state accept the designation of home state. Usually a state accepts even where the corporation has only a minimal contact with it. At least one commentator has criticized this ability of the citizen-as-master trinity unit to choose the domicile of the corporation. The criticism is that management thereby dominates the corporation. *See* Ryngaert, *supra* note 46, at 44, 47-48.

The home state determines principles that govern the rights of shareholders as a whole, as compared to those of executive officers and directors. The home state provides for any super majority vote on transactions involving a change in the corporation's enterprise objectives. *See* DEL. CODE ANN., tit. 8, § 203 (1994). The home state permits any staggering of terms for directors. *See* DEL. CODE ANN., tit. 8, § 141(d).

224. DE TOCQUEVILLE, *supra* note 4, at 69.

225. Management may exclude proposals by citizen-capitalists that it finds, after a meet-and-confer with the SEC staff, to have as their thrust "irrelevant" objectives. These are: (1) conduct of *ordinary* business operations of the corporation, *See* Securities Exchange Act of 1934 Rules 14a-8(c)(7), 17 C.F.R. § 240.14a-8(c)(7) (1998); (2) a shareholder's personal claim or grievance, 17 C.F.R. § 240.14a-8(c)(4); (3) specific amounts of cash or stock dividends, 17 C.F.R. § 14a-8240.(c)(13); (4) moot proposals, 17 C.F.R. § 240.14a-8(c)(10); (5) proposals duplicative of other proposals, 17 C.F.R. § 240.14a-8(c)(11); (6) proposals

"shareholder" proposal that he proposes to include in the corporation's pleading documents.[226] The shareholder must have demonstrated staying power through his conduct if a prior proposal of his was included in a management document.[227] Further, the shareholder's ambition must be disciplined so the discussion will be relevant.[228] Management is given the opportunity to oppose the "ambitious" citizen capitalist's proposal in the pleading document, thus encouraging a discussion with the capitalist in advance of publication. On the other hand, no ambitious citizen capitalist has the right to have a discussion with management in respect to a planned *management* proposal that the citizen capitalist will conceivably oppose. Thus, there is no ability on the part of an ambitious citizen capitalist to publicly register opposition to a published management proposal at corporate expense.[229]

Fifth, free-ranging discussions among citizen-capitalists as a prelude to formal action of presenting a shareholder proposal to management is enhanced by a requirement that share ownership of directors, and nominees for director, be disclosed to shareholders in advance of the annual meeting. Insofar as any of these directors satisfy the qualifications of a citizen capitalist, they are in an ideal position to have a free-ranging discussion with each other as representatives of the citizen capitalist community before the taking of formal action by the board or by a committee thereof. One ideal opportunity for such a discussion is a committee of the board of directors charged with nominating directors.[230] In addition, by virtue of a

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that the shareholders have, previously and decisively voted down, 17 C.F.R. § 240.14a-8(c)(12); (7) matters not significantly related to the corporation's business, 17 C.F.R. § 240.14a-8(c)(5) or (8) matters that the corporation is powerless to have an influence over, 17 C.F.R. § 240.14a-8(c)(6).

226. 17 C.F.R. § 240.14a-8(a).

227. The representative of the citizen capitalist side is expected to be present at the annual meeting, as still a shareholder, to defend his proposal. 17 C.F.R. § 240.14a-8(a)(2).

228. Thus, management need include in a corporation pleading document only *one proposal* from a particular representative of the citizen capitalist side. The length of the proposal, together with any argument in favor of it, cannot exceed 500 words. Inclusion of the proposal is subject to the right of management to include a statement in opposition. 17 C.F.R. § 240.14a-8.

229. *See* 17 C.F.R. § 240.14a-8(e).

230. Another alternative which has so far been defeated in the courts as impermissibly detracting from the role assigned by state law to the board of directors is that of a shareholder-elected "shareholder advisory committee" consisting solely of citizen capitalist members. *See* Charles F. Richards and Anne C. Foster, *Exxon Revisited: The SEC Allows Penzoil to Exclude both Mandatory and Precatory Proposals Seeking to Create a Shareholder Advisory Committee in Accordance with the Usual Convention*, 48 BUS. LAW.

particular SEC disclosure rule, shareholders who qualify as citizen-capitalists but are not directors, have a special window of opportunity to have a free-ranging discussion with the *nominating committee* before it takes formal action.[231]

B. Suggested Changes as to Long-Term Performance

The requirements that management have a free-ranging discussion with representative citizen-capitalists should be strengthened. One possibility is that "ambitious" citizen-capitalists be given an opportunity to provide a statement in opposition to a management proposal. For instance, management could invite ambitious citizen-capitalists to convey a subject of interest to them with the purpose of allowing management to have a free-ranging discussion with them in advance of publishing a proposal on the subject.

Currently a corporation's disclosure statements need not disclose whether or not a *director* qualifies as a "citizen capitalist." This should be changed. The length of time that a director has held his shares should be disclosed, as well as the value of his investment. Management's discussion and analysis should disclose the opportunities for the citizen capitalist directors to have free-ranging discussions with other directors as well as each other. A possibility would be a discussion between citizen capitalist directors as members of the compensation committee, which has an important role in the continued retention of *executive officers*. Another possibility would be a discussion between citizen capitalist directors as members of the nominating committee.

Assurances that citizen-capitalists with different viewpoints will have an opportunity to have a free-ranging discussion before publication of an ambitious citizen capitalist's proposal in the corporation pleading documents should be tightened. This will serve to temper the exercise of ambition by one individual and assure input from his "peers." Management's "discussion and analysis" should disclose whether any special opportunities for exercise of ambition are to be given to citizen-capitalists to have free-ranging discussions with other citizen-capitalists. The citizen-capitalists to be given such an opportunity might be those that *elect* to be available for

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1509 (1993).

231. The corporation's pleading document is to say whether or not there is a nominating committee and, if so, whether or not the committee will consider nominees for director recommended by shareholders. 17 C.F.R. § 240.14a-7(e). At the time this document is disseminated, the reading shareholder may not yet be a citizen capitalist, but by the time of the next annual meeting he will be.

that purpose. The elected availability should be limited to situations where a free-ranging discussion is warranted. One example is when input regarding a shareholder proposal which is, or is likely to be, opposed by management is sought. Another example is when input concerning opposition to a management proposal that is either on the table or is in the offing is sought.[232]

Management currently has the right, under U.S. regulation, to exclude any proposal of a ambitious citizen capitalist that bears on the "conduct of ordinary business operations" from the corporation's disclosure statements.[233] This principle should be modified to make clear that any proposal peculiarly within the expertise of the citizen capitalist, as "venture capitalist" equivalent, will not be excluded. Thus, any proposal that seeks to provide *advisory* guidance as to the definition of the corporation's enterprise objectives, should be permitted. Advisory guidance regarding criteria for the earning of a particular element of compensation should be permitted.

The current threshold of share ownership to demonstrate "eminence" in the shareholder community is the lesser of $2000 in market value or one percent of voting power. This is too low. A better monetary threshold would be the lesser of *$5000* of value and one percent of voting power. Additionally, as seen above, it is proposed that the definition of "citizen-capitalists" be amended to require at least a two-year investment period.

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232. The program for a meet-and-confer among citizen-capitalists could be as follows. Currently, a citizen capitalist has only limited information to enable him to meet and confer with other citizen-capitalists. Thus, he has available to him, for proper corporate purposes, the listing of shareholders that were of record for the *last* annual meeting. Under state law, a list of record shareholders would have been required by law, to be open to all shareholders at least ten days in advance of the previous annual meeting. DEL. CODE ANN. tit. 8, § 219 (1994). He therefore has a tentative and very approximate listing of shareholders that may qualify as citizen-capitalists for the upcoming annual meeting. However, the listing is incomplete. This is because, while it included the record ownership of various broker-dealers and banks that hold shares in nominee name, it did not include a listing of the *beneficial* owners of those shares. Management had that information. Management should be required to disclose the information to a citizen capitalist for meet and confer purposes if the latter wishes that to be the case.

In any event, in the absence of a strong citizen capitalist representation on the board, management, in its "discussion and analysis," should be required to specify whether or not it will make available to any citizen capitalist wishing to meet and confer with other citizen-capitalists on proper subjects, a listing of record and non-objecting beneficial owners of shares. A precedent exists in Rule 14a-7(b) under the Securities and Exchange Act. This rule makes such a process mandatory if the requester is faced with a "going private" transaction proposed by management. *See* 17 C.F.R. § 240.14a-8(c)(5).

233. 17 C.F.R.§ 240.14a-8(c)(5).

There is a requirement that the corporation's pleading phase documents include a "management discussion and analysis." This should explain any unusual proportion as between independent directors and "dependent" directors to the citizen-capitalists. Further, although the size of the pool from which independent directors can be drawn is theoretically unlimited, in practice it is difficult to identify candidates that have qualifications for serving as a catalyst to free-ranging discussions. This is particularly in the case of larger corporations. The same stock exchanges that require a board to have independent directors, could be required to list citizens with special qualifications. This list would serve not only to take advantage of the broad universe of candidates available but also to provide an expectation that the director will assume a catalytic function in promoting free-ranging discussions at board meetings.[234]

X. AN UNDERPINNING—ASSURING A THRESHOLD ATTENTION TO ENTERPRISE OBJECTIVES IN THE U.S.

As the annual meeting approaches, the citizen capitalist can have confidence that management's freedom to make patently misguided decisions bearing on enterprise objectives have been limited, notwithstanding provocations.[235] This, too, will help make the citizen capitalist's vote at the ensuing annual meeting meaningful. Such decisions bearing on enterprise objectives will have been deterred by adherence to the Yankee concept of publicized performance of ministerial duties.

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234. Precedent exists in the sense that citizen sustainer self-regulatory organizations, like the New York Stock Exchange and the National Association of Securities Dealers, maintain pools of arbitrators to resolve disputes involving the operations of members of those self-regulatory organizations. *See* NATIONAL ASSOCIATION OF SECURITIES DEALERS, MANUAL § 3 (reprint 1988), N.Y.S.E. Guide (CCH) § 4.

The presence of professionally qualified independent directors to stimulate discussion may be particularly important in the context of the addressing of enterprise objectives. Such professionally qualified independent directors could be those "deliberately chosen from the ranks of businessmen, bankers and lawyers, because of their expertise in evaluating the merits of corporate enterprise proposals." Panter v. Marshall Field and Co., 646 F.2d 271, 294 (7th Cir. 1981).

235. For an article espousing the view that the activities of third-party outsiders, covered in this Part, constitute a needed source of oversight of management, *see* Ryngaert, *supra* note 46.

A. Perspective of the Citizen-capitalists

As seen above, it is contended that enterprise objectives for U.S. purposes, encompass the business plan and capital structure that accommodate the composition of the controlling group of citizen-capitalists. This is indicated by the average investment objective of the current citizen-capitalists. If the enterprise objectives are still susceptible to further fulfillment, the obvious remedy for any discovered shortfalls in long-term corporate operating performance, or in short-term, share price, performance lies either in (1) a change in management, (2) a change in business plans, or (3) a change in the capital structure. This would be without a change in the composition of the controlling group. A change involving all three remedies, constituting a "restructuring" of the corporation without a termination of enterprise objectives, would still accommodate the average investment objectives of the citizen-capitalists whose "control" of the corporation would continue.

If enterprise objectives are susceptible to further fulfillment, can the citizen-capitalists depend on management to apply the obvious "restructuring" remedy for shortfalls? And what are the remedies to be applied if the enterprise objectives are found *not* so susceptible? This latter condition could also be evidenced by an excess of undeployed cash with respect to long-term operating performance. It could also be evidenced with respect to short-term, share-price, performance by an on-going undervaluation of the corporation's shares in the market. The obvious remedy for non-susceptibility to further fulfillment of enterprise objectives lies in termination of the enterprise objectives. This would be accomplished by "cashing out" the citizen-capitalists and, under principles of egalitarianism, cashing out the other shareholders at the same price. The term "cashing out," as used in this article includes the receipt of a cash equivalent, such as marketable debt instruments. Can the citizen-capitalists depend on management to apply this obvious remedy of ending the "control" of the current group of citizen-capitalists in the case of non-susceptibility of the corporation to further fulfillment of enterprise objectives?

In a cashing out, the citizen-capitalists are entitled to receive a *premium* above the *fair* market value of their shares. This premium compensates them for the added value to corporate performances, long-term operating and short-term share price, that their "stewardship" has brought about. The premium is also a form of sharing in a special cash recovery derived by the corporation, thanks to their stewardship, that is, is a form of "bonus." Again, the question for the citizen-capitalists, as the annual meeting approaches, is whether management has accurately gauged its opportunities

advantageously to restructure the corporation or to terminate the enterprise objectives. Of particular relevance is the case of *a coercive proposal by a counter-entrepreneur* confronting management with the need to decide whether to (a) preserve the corporate structure and enterprise objectives unchanged, (b) restructure the corporation, or (c) terminate the enterprise objectives and cash out the citizen-capitalists.

B. Possible Opportunities for the Citizen-capitalists

A coercive proposal for cashing out the citizen-capitalists could come from the executive officers themselves as counter-entrepreneurs. They could propose to the board of directors that the corporation "go private" as a means of terminating enterprise objectives. Alternatively, the executive officers, as counter-entrepreneurs, may coercively propose a restructuring of the corporation. One such proposal is replacing some of the citizen-capitalists' equity with debt while enabling the citizen-capitalists to retain voting control. This enables some of the surrendered equity to be transferred to the executive officers and give them an enhanced equity stake to justify a comparatively low compensation for their services. The purpose is to enhance corporate performances to benefit the citizen-capitalists.

If the executive officers, with board approval, have not placed a proposal for terminating the enterprise objectives or restructuring the corporation on the agenda for the upcoming annual meeting, the citizen-capitalists want assurance that management has acted correctly and in their best interest. This assurance is desired if management in fact has deterred *outsiders* that have suggested to management that it terminate or restructure since the last annual meeting. A justification used by management to deter an outsider is that the outsider is seeking to *coercively* wrest control from the citizen-capitalists in a termination. The proposal would be "coercive" in the sense that a citizen capitalist has no true individual choice. However, a special threat that the citizen-capitalists face is that the board of directors might *improperly* take it upon itself to deter a coercive but beneficial counter-entrepreneur proposal to terminate or restructure.

C. Possible Justifications for Management Opposition to Tender Offers

A management effort in the U.S. to deter may be in order, which complicates life for the citizen-capitalists. Temporary undue volatility in the market place of the corporation's shares may create a low price of the shares in relation to the "book" value of corporate assets. A counter-entrepreneur might seek an opportunity to derive a short-term profit from this volatility by threatening to acquire control of the corporation through

coercive means. Thus, the counter-entrepreneur will likely have acquired shares cheaply in order to obtain a threshold ownership from which to make a proposal. The counter-entrepreneur's coercive proposal typically is as follows. He would offer to cash out the citizen-capitalists with money that he, or an entity he controls, has borrowed. He would propose that, once the cash-out is accomplished, he will cause the corporation to be "busted up" at a short-term profit to himself. This bust-up would be accomplished by sale of some or all of the corporation's assets and by application of some, but not all, of the proceeds to pay off his debt.

The proposed termination of enterprise objectives and cashing out of the citizen-capitalists is typically coercive in one of the following manners. One alternative is that the counter-entrepreneur could make an offer calling for the tender of all shares of the corporation in return for *two* sets of prices. The coercive proviso is that later tenderers would receive a less advantageous set price than earlier ones. Second, the counter-entrepreneur could make an offer for tender of enough of the shares of the corporation at a set price to give him a majority. The coercive aspect is that a "back-end" merger of the corporation with the counter-entrepreneur would follow, where shareholders who have not tendered may not receive a price as high as the price contained in the tender offer.

Only management is in a position to thwart a coercive proposal to terminate enterprise objectives. This is particularly the case if the remedy employed by the corporation is more effective than the destruction of corporate assets occasioned by the corporation's payment of "greenmail" to the counter-entrepreneur so that the corporation might buy back the counter-entrepreneur's shares at *his* sought-for premium. Further, "management", as an entrepreneurial concept, would be ideally suited to make a judgment whether to support or oppose a termination or restructuring. Thus, the executive officers are deemed to be expert in assessing entrepreneurial issues. The board of directors is deemed to be comprised of "citizens" who are expert in discerning the strengths and weaknesses of entrepreneurs.[236]

D. Management's Conflict of Interest

The difficulty in placing reliance on management to make the correct decision in the face of a counter-entrepreneur proposal, is that the proposal, even if coercive, may in fact present an *opportunity* for the citizen-

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236. *See In Re* J.P. Stevens and Co., Inc., Shareholder Litig., 542 A.2d 770, 780 (Del. Ch. 1988); *see also* Smith v. Van Gorkum, 488 A.2d 858, 893-98 (Del. 1985)(McNeilly, J., dissenting).

capitalists. The opportunity should clearly be availed of if the enterprise objectives are *no longer* capable of further fulfillment in terms of long-term operating performance or on-going short-term, share price, performance. In this case, the citizen-capitalists have an opportunity to be cashed out at fair market value plus an appropriate control premium.

However, management faces an important conflict of interest when confronted with such a possible opportunity for the citizen-capitalists. Courts in the U.S. have taken pains to address the conflict that if the proposal is implemented, it is likely that the counter-entrepreneur will unseat management, both the board of directors and the executive officers.[237] The scheme of U.S. corporate governance regulation is not opposed to this unseating. *Executive officers* are to be subject to being "de-selected" by the board at its will and the *board* is subject to being de-"drafted" by the shareholders at their will. Threatening to defeat this scheme, human tendency favors continuation of one's employment in making the above rather subjective judgments with respect to enterprise objectives.

Various U.S. court decisions and state laws, mostly over the course of the 1980's, have established the components of a "business judgment rule" to protect the interests of the citizen-capitalists,[238] as well as the selectman and draft processes, in the face of a coercive offer to terminate enterprise objectives or restructure the corporation.[239] This rule protects the citizen-capitalists by using the Yankee concept of public performance of minutely-divided ministerial duties. Under the court decisions and laws, the business judgment rule protects management from answerability to the citizen-capitalists if the required minutely-divided duties are performed. An affirmative showing of bad faith is required to overcome the presumption of validity in the decision that is reached.[240] If the duties are not performed, an affirmative showing of "entire fairness"[241] to the citizen-capitalists is required to overcome a presumption of gross negligence.[242] A listing of the principal ministerial duties based on precedent and statutes is found in

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237. *See* Unocal Corp. v. Mesa Petroleum Corp., 493 A.2d 946, 954 (Del. Ch. 1985).

238. City Capital Assoc. Ltd. Partnership v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988).

239. *See In Re J.P. Stevens Co., Inc. Shareholders Litig.*, 542 A.2d 770, and *Smith*, 488 A.2d 858, 893-98 (McNeilly, J. dissenting).

240. *See In Re J.P. Stevens Co., Inc. Shareholders Litig.*, 551 A.2d 770; Moran v. Household, 500 A.2d 1346 (Del. 1985); *City Capital Assoc. Ltd. Partnership*, 551 A.2d 787; Robert M. Bass Group v. Evans, 552 A.2d 1227 (Del. Ch. 1988).

241. *City Capital Assoc. Ltd. Partnership*, 551 A.2d. 787; *Robert M. Bass Group*, 552 A.2d 1227.

242. *Smith*, 488 A.2d 858; *City Capital Assoc. Ltd. Partnership*, 551 A.2d. 787.

Appendix C.

E. Suggested U.S. Change as to Enterprise Objectives

1. Enterprise Objectives

In the pleading documents preceeding an annual meeting, there should be management discussion and analysis as to any perceived *threat* by a counter-entrepreneur that has arisen during the past year. This threat can either a proposed coercive termination of enterprise objectives or a proposed coercive restructuring of the corporation. The discussion should include management's response to the perceived threat, including any expenditure of corporate assets involved. Disclosure should include payment of "greenmail" to the counter-entrepreneur or payment of contingent compensation to experts used in considering how to thwart the threat. There should be analysis on how management has sought to protect the interests of the citizen-capitalists.

2. Conclusion as to the U.S.

Yankee concepts of due process as enunciated in de Tocqueville's *Democracy in America* provide a useful "lens" to discern the validity of the U.S. monitoring of management's performance through an annual meeting of shareholders where the citizen capitalist has a primary role. A criticism of the U.S. annual meeting process is that it is superfluous. In contrast to the citizen of a political entity, a citizen capitalist has a means of egress by selling his shares. However, it can be countered that the annual meeting opinion provides a second opinion, a form of intra-government competition to the judgment of the stock market.

Further, the stock market judgment has its well-known limitations. The U.S. annual meeting, dominated under the law by the citizen motivated by thrift, lends a stabilizing element. "Financial aristocrats," oversized investors and counter-entrepreneurs, have a dominant role in the U.S. stock market. They tend to have a short-term orientation. These aristocrats, on the one hand, contribute to the marketability of shares and thus protect against undue share price volatility. On the other hand, their short-term orientation can contribute to volatility.

Assuming that renewed attention is given in the U.S. to the Yankee concepts discussed above, this article suggests certain changes. These changes, summarized in Appendix D, are to assure that there is an optimal balance in the U.S. between the citizen capitalist, on the one hand, and the oversized investor and counter-entrepreneur, on the other. The suggested

changes fall into three general categories: assurances that the citizen capitalist has meaningful information bearing on the corporation, assurances that he has a meaningful governance role, and assurances that there are outside underpinnings to this corporate governance role.

XI. GERMAN MODEL'S EMPLOYMENT OF DE TOCQUEVILLE CONCEPTS OF DUE PROCESS

There is an overriding difference in the German model from the U.S. approach. The German model includes a scheme of protection of fundamental rights of the German citizen. These rights are enunciated in Germany's "Basic Law," which is an equivalent of the U.S. Constitution.[243]

A. Background

The basic law, unlike the U.S. Constitution, provides for "reactive" fundamental rights of individuals and entities against direct action of government and also "pro-active" fundamental rights of individuals and entities[244] against indirect, or even the inaction, of government.[245] Arguably, this concept of reactive and proactive rights is broader than rights of individuals and entities under the U.S. Constitution, including the "due

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243. *See* Juergen Christoph Goedan, *The Influence of the West German Constitution on the Legal System of the Country,* 17 INT'L J. LEGAL INFO., 111 (1989). *See also* Dieter Lorenz, *The Constitutional Supervision of the Administrative Agencies in the Federal Republic of Germany*, 53 S. CAL. L. REV. 543 (1979). An important drawback of the basic law as compared to the U.S. Constitution may be an inadvertently easy amendability. *See* Christoph J. Partsch, *Constitutions and Revolutions: The Impact of Unification and the Constitution of the Five New German States on the Amendment of the Constitution of the Federal Republic of Germany*, 21 DENV J. INT'L L. POL'Y 1, 7 (1992).

244. Reflective of the fundamental right of the German nation as an entity to "self-determination," fundamental rights of non-German citizens are somewhat less than those of German citizens. *See* Partsch, *supra* note 243, at 6–7, 23–26; *see also Who is a German?,* THE ECONOMIST, Apr. 5–11, 1997, at 45.

245. Pro-active rights can be enforced in civil lawsuits even though the government is not a party. *See* Goedan, *supra* note 243, at 121–22 (refers to pro-active rights as relating to "an objective order of value"). *See also* Lorenz, *supra* note 243, at 558–59, 562–65. In common with the U.S. approach, the German model permits states to enact pro-active fundamental rights that go beyond federal ones. *See* Partsch, *supra* note 243, at 11–13. As we shall see, these pro-active fundamental rights are "private." A German citizen does not have the fundamental right to enforce the personal rights of others as well as his own, as is arguably the case in the U.S. with the class action. *See* Edward J. Eberle, *The West German Administrative Procedure Act: A Study in Administrative Decision Making,* DICK. J. INT'L L., 67, 85–88 (1984).

process" and "equal protection" clauses.[246] A main effort of the German model is the reconciling of conflicting basic law rights by "national" entities,[247] whether government or private enterprise. The process of reconciliation has been referred to as "structured interaction."[248] The reconciler of first choice is the legislative branch of the government. The legislature is expected to be quite detailed in the wording of statutes that reconcile basic law rights.[249] The judicial branch is not expected to give broad reasoned elaboration of the intent of the legislature as it is in the U.S.[250] If this were otherwise, the sole promulgator of government rules that control society would be agencies in the German executive branch.[251] The German model provides for no "independent" regulatory agencies with rule-making power like the SEC in the U.S.[252] In the course of

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246. *See* Goedan, *supra* note 243, at 113–14, 118–19. As a point of contrast with the U.S., pro-active fundamental rights under the German model include a right to life on the part of an unborn child. *See id.* at 115–16. Pro-active fundamental rights, however, do not include social values or political aims, even though named in the basic law, that are dependent on economic growth and "the availability of appropriate finances." *See id.* at 119; *see also* Partsch, *supra* note 243, at 11, 20–23.

247. The German model relies on the concept of "the nation," or "the state," as distinct from either "government" or "society." *See* Hans A. Linde, *The Constitutional Supervision of the Administrative Agencies in the Federal Republic of Germany*, 53 S. CAL. L. REV. 601, 605 (1980).

248. *See* Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan and the U.S.*, 102 YALE L. J. 1927, 1941–46 (1993)

249. *See* Lorenz, *supra* note 243, at 555–57. *See also* Linde, *supra* note 247, at 602–03. Focus is not to be had to the U.S. practice of reviewing legislative history to determine the meaning of a statute. Rather, the "general politics" behind the wording of a statute is to be "inferred." *See* Lorenz, *supra* note 243, at 555–56.

250. *See* Lorenz, *supra* note 243. On the other hand, the judiciary is expected to assure that the legislative branch does not violate the basic law. The assurer is the federal Constitutional Court. *See* Goedan, *supra* note 243, at 121–22 and Lorenz, *supra* note 243, at 572.

251. *See* Lorenz, *supra* note 243, at 543–45. The majority party exercises control of agencies in the executive branch through "ministries" that the executive agencies are ultimately answerable to. *See* Linde, *supra* note 247, at 603.

252. It is worthwhile to set forth in detail the author's understanding of the sense in which the German law does not provide for "independent" regulatory agencies in the U.S. sense. The U.S. independent regulatory agency scheme accords a legislative, judicial and executive role to an agency, each element approximately equal in importance. The German model emphasizes the executive to a greater degree than the U.S. approach and de-emphasizes the legislative and judicial.

As to the *legislative*, the U.S. approach gives independent regulatory agencies broad legislative discretion in recognition of the lack of expertise of Congress on a particular subject. *See* Eberle, *supra* note 245, at 71 n.17 and accompanying text. As to the *judicial*,

implementing legislation that affects fundamental rights, the executive branch, in accordance with a "leadership principle," is expected to adhere scrupulously to the wording of the legislature used in its balancing of fundamental rights."[253]

If it is believed that an executive branch agency has incorrectly implemented legislative intent regarding the reconciling of fundamental rights, the resort is to the German administrative courts.[254] These courts need give little, if any, deference to executive branch agencies' interpretation of legislative intent in balancing fundamental rights.[255] To assure a correct balancing of fundamental rights even if government is not actively involved, the German model relies on "institutions" to provide guidance to various entities in German commercial life.[256] The institutions are referred to as "institutions of public law" if the guidance is given to executive branch agencies. These institutions are created by legislation, but do not fall under any German ministry and therefore, are not part of the scheme of executive agencies. They are, in fact, socially-trusted in service of the nation to provide a counterbalance to executive branch government agencies.[257]

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the U.S. approach, as seen earlier in this article, is to employ judicial-form procedures both for "rule-making" or legislative writs and for "adjudications" or executive writs. The German model prohibits employment of judicial-form procedures as a matter of a routine that does not examine whether or not private fundamental rights are at issue, unless such a procedure is specifically authorized by statute as a signal that "general societal interests," that is a fundamental right of the nation, are involved. *See id.* at 74–75.

As to the *executive,* the U.S. approach is for the legislature to approve senior management of an independent regulatory agency. In contrast, the German model is to give the legislature no role in the selection of personnel below the level of Chancellor in the executive branch of the government. This is because selection is regarded as the province of the majority party. Thus, control of personnel is achieved not through consent of the legislature as a whole but through criticism of the minority party in the legislature. *See* Linde, *supra* note 247, at 602–03.

253. *See* Lorenz, *supra* note 243, at 545, 548–49, 553–56, 562. *See also* Linde, *supra* note 247, at 604–05 and Eberle, *supra* note 245, at 72–73. The federal legislature has a right of veto over implementation of regulations that it determines not to conform to legislative enactments. *See* Lorenz, *supra* note 243, at 563–64.

254. A fundamental right is to have access to the courts, including the administrative courts. *See* Eberle, *supra* note 245, at 77.

255. *See* Lorenz, *supra* note 243, at 573–76. For the procedures involved in judicial review of decisions of executive branch agencies, *see* Eberle, *supra* note 245, at 102–06. Significantly, executive branch administrative agencies have no fundamental rights under the basic law. *See id.* at 90.

256. *See* Lorenz, *supra* note 243, at 545.

257. *See id.* at 550–52, 564–65, 567–70; *see also* Linde, *supra* note 247, at 602–03.

When the guidance is given to private or quasi-private entities, such as publicly-traded stock corporations, the institutions are referred to as "institutions of private law." These institutions are created by legislation.[258] To become such an institution, an entity must fall within an area of public need and agree to observe an internal code of conduct pursuant to an "honor code" principle.[259] If the entity fails and cannot

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Examples of institutions of public law are the German Federal Bank, Goedan, *supra* note 243, at 602–03, the opposition party, *id.* at 565–66, the "Petitions Committee" of the federal legislature, *id.* at 567, the "Military Commissioner" of that legislature, *id.* at 567–68, and the Auditor's Office. *Id.* at 569–70. For institutions of public law relevant to stock corporations and to the stock markets, *see* Ursula C. Pfeil, *Finanz-Deutschland: Germany Enacts Insider Trading Legislation*, 11 AM. U. J. OF INT'L L. & POL'Y, 137, 172 (1996). For a critique of institutions of public law as possible thwarters of decision-making, *see* Partsch, *supra* note 243, 26–27.

258. An example of an institution of private law is the universal bank. *See* DROSTE, ET AL., BUSINESS LAW GUIDE TO GERMANY, 206–07, 213–14 (3d ed. 1991) , and Roe, *supra* note 248, at 1971, 1984–85. For an extreme application of the concept of "institutions of private law," *see A German Eye on Scientology*, THE ECONOMIST, Feb. 1–7, 1997, at 50 (referring to "constitutional protection agencies").

259. The honor code principle is reflected in the employment by even criminal statutes of subjective adjectives characterizing a proscribed standard of conduct. One example is "orderly." *See* Martin Peltzer, *The Criminal Responsibility and the Personal Liability of the Director in the Bankruptcy of His Company - Germany*, 9 INT'L BUS. LAW. 3. Another example is " true." *See* text accompanying note 555. Others are "conscientious" and "impartial." *See infra* text accompanying note 560.

The honor code principle as applied to various situations by an institution of private law may or may not be determined by internal codes of conduct drawn up by the institution. Internal codes of conduct are regarded as particularly important in the case of executive agencies of the German government. *See* Eberle, *supra* note 245, at 73 n.25 and accompanying text. At least for such agencies, the honor code principle, as implemented by internal codes of conduct, is the subject of a separate branch of law described as the "organizational law of executive agencies." *Id.*

The underlying philosophy of the "honor code" principle was once revealed by an author of a *voluntary* code against insider trading. This was extant until 1994, at which point the voluntary code was supplanted by an insider trading law making insider trading a crime. The author of the voluntary code was justifying the lack of sanctions under that code. He said that the code would be "recognized voluntarily and approved by the *professional community*" (emphasis added). He said that regulation by a "distant state authority cannot be as effective as a rule by which the behavior of the affected individual is observed by professional colleagues." He said that, moreover, "it is practicably not possible to supervise carefully individuals for all violations (of regulations)." *See* Blum, *supra* note 5, at 517.

Contrasted with the German honor code principle, is what a German commentator describes as the U.S. approach. The commentator described this approach, in the context of *product* liability of directors of a corporation, as "*catering for* the latest standards of technology and security margins" (emphasis added). Dieter Schwanke, *A Broker's Point of View of Directors and Officers Insurance*, 9 INT'L BUS. LAW. 13 (1981). Also descriptive

demonstrate that it fulfilled the quality of performance that it volunteered to supply, it is subject to liability.[260] As an inducement to become an institution of private law, a volunteering entity is given tax incentives and permitted to hold itself out as an institution of private law to attract proprietary business.[261] Institutions of private law are socially trusted to provide a counterbalance to purely private business entities.[262]

One of the fundamental rights under the basic law is the right of individuals and entities to choose their professions. This is to the extent feasible to receive a continuing cash flow from their current employments or businesses.[263] For this reason, rights of contract, and rights to

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of the honor code principle is a quoted statement of the head of an institute of public law that had studied medium-sized companies which are in a sense, institutions of private law insofar as stock corporations, under the German model. As to why, under that model, management is not comfortable taking risks, he stated that "it's a question of honor. If you go bankrupt, you are out forever." *Small Beginnings,* THE ECONOMIST, Nov. 23–29, 1996, at 14.

This statement, and the existence of an honor code principle, is borne out by the rather ruthless way in which bankrupt entities, including stock corporations, can be said to be treated under the German model as compared with the U.S. *See* Axel Flessner, *German Report,* 5 CONN. J. OF INT'L LAW 121, 123, 137–38 (1989).

260. *See* Peltzer, *supra* note 259, at 33, 35.

261. An example of an institution of private law that is given inducements in return for its obedience to the "nation" as such an institution, is the universal bank. *See* Friedrich K. Kubler, *Institutional Owners and Corporate Managers: as a German Dilemma,* 57 BROOK. L. REV. 97, 108 (1991); for discussion of the role of such a bank, *see* Roe, *supra* note 248, at 1971.

Another example, is the "accredited investment company" as a structure for the management of investment funds. The advantages of being an accredited investment company are that, unlike other collective investment vehicles, it will be permitted to use the word "investment" in its name and will be given significant tax advantages including pass-through tax treatment in respect of interest and dividends. The German model does not prohibit other collective investment vehicles, but they cannot use the word "investment" to describe their activities and are not given these tax advantages. In return for these proprietary incentives, the accredited investment company must undertake to do such things such as maintain assets for the benefit of unitholders in a trust account with a bank, limit its investments to securities and real estate, diversify its portfolio, and comply with various disclosure requirements. Failure as to this last is a basis for civil liability if the failure cannot be justified on the basis of reasonable exercise of care. *See* Hans-Michael Kraus, *Securities Regulation in Germany? Investors' Remedies for Misleading Statements by Issuers,* 18 INT'L BUS. LAW. 109, 113–16 (1984).

262. *See* Roe, *supra* note 248, at 1971, 1984–85.

263. *See* Goedan, *supra* note 243, at 119, 120–22; *see also* Lorenz, *supra* note 243, at 562. Buttressing the right to receive a cash flow from a business is the right to form an association or coalition for that purpose. *See id.*

confidentiality are paramount. The latter encompass an individual's compensation and a business entity's trade secrets and other business plans.[264]

Another of the relevant basic rights is that of individuals and entities to own property which includes the rights relative to receipt of dividends.[265] Arguably, the right of shareholders of a corporation to "own" their shares includes rights to information that are as strong as those that exist in the U.S.[266] However, the German model applies the rights of privity of contract and business confidentiality as conflicting basic rights. The result is that disclosure is largely limited only to that which is required by privity of contract and various "fundamental rights" of government. One such right is the right to an internationally-respected stock market.[267] Other relevant fundamental rights include (1) the right of the individual and entity to "equal and fair treatment" from executive branch administrative agencies,[268] (2) the right of the press to investigate and publish,[269] (3) the right to associate with others,[270] and (4) the right of labor and management to bargain collectively on an "autonomous" basis.[271]

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264. *See* LAW OF STOCK CORPORATIONS, COMMERCIAL LAWS OF THE WORLD—GERMANY §§ 93, 116, 117, 131 (Foreign Tax Law Publishers ed., revised October 1995). A possible source of diminution to the right of privacy in the case of compensation and business plans is the countervailing right of the German citizen to inspect documents and records in so far as necessary to protect his own fundamental rights. *See* Eberle, *supra* note 245, at 79.

265. *See* Christian J. Meier-Schatz, *Disclosure Rules in the U.S., Germany and Switzerland*, 34 AM. J. COMP. LAW 271, 289 n.111 and accompanying text (1986). *See also* Walter Kolvenbach, *Co-determination in Germany History and Practical Experience*, 9 INT'L BUS. LAW. 163, 166 (1981).

266. In addition to the fundamental right to own property, the shareholders have the fundamental right to "inspect" books and records of the corporation insofar as appropriate to protect that right. *See* Eberle, *supra* note 245, at 79.

267. *See* Pfeil, *supra* note 257, at 262. Other fundamental rights of the "German nation" are (1) "self-determination," *see* Partsch, *supra* note 243, at 6-7, 9; (2) observation of "social norms," *see* Eberle, *supra* note 245, at 94; and (3) one individual not causing damage to another "in a manner contrary to public morals" or through lack of "good faith," *see* Goedan, *supra* note 243, at 113-14.

268. *See* Eberle, *supra* note 245, at 73 n.24.

269. A particularly important fundamental right under the basic law is freedom of speech. The emphasis is on "public discussion of questions of social importance." *See* Goedan, *supra* note 243, at 114. To protect this right to publish, the press has a fundamental right to "inspect" records and documents. *See* Eberle, *supra* note 245, at 79; *see also* Goedan, *supra* note 243, at 119, 118-22;, and Lorenz, *supra* note 243, at 558-59, 561-62.

270. *See* Goedan, *supra* note 243, at 119, 118-22, and Lorenz, *supra* note 243, at 558-59, 561-62.

271. *See* Kolvenbach, *supra* note 265, at 166.

B. The Goals

1. Encouraging the Exercise of Thrift and the Use of Education

As argued above, a de Tocqueville concept is the promotion of sober virtues in a citizenry, such as the affirmative exercise of *thrift*, to assure that savings are available.[272] One illustration is the requirement that there be detailed disclosure of corporate performance to the citizen capitalist in connection with corporate governance by a widely-traded corporation. This is so he can be induced to investigate and use his intelligence in the course of implementing his own self-invented investment objectives.[273] We have seen that another de Tocqueville concept is that every citizen is presumed to have had a basic formal *education* and a thorough practical grounding. He is presumed to be a man-of-the-world. He is considered capable of fulfilling magisterial responsibilities, that is responsibilities along the lines of a "justice of the peace."[274] An application of this concept to corporate governance in the U.S. is regulatory insistence on thorough disclosure, even on the most technical of subjects. Similiar to a justice of the peace, a U.S. citizen capitalist has the right to demand "additional information" from a corporation, that is, the corporation's rather technical document filed with the SEC for regulatory purposes.[275] In contrast, the German model places little emphasis on creative *thrift* on the part of any citizen capitalist investor in a widely-traded corporation.[276] Reflecting a balancing of property ownership rights against rights to engage in a profession, a thrust of the German model is to foster acceptance of governmental and institutional

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272. *See supra* note 23 and accompanying text.

273. *See supra* note 25 and accompanying text.

274. *See supra* note 25 and accompanying text.

275. *See supra* note 95 and accompanying text.

276. *See* Kubler, *supra* note 261, at 100. This lack of emphasis is evidenced by (1) the small number of German companies whose stock is widely distributed, *id.* at 101 and Blum, *supra* note 5, at 509; (2) the decision to tax transfers of stock ownership, *see* Roe, *supra* note 248, at 1971; (3) a government-countenanced high level of brokerage commissions, *see* Pfeil, *supra* note 257, at 184–93 and Blum, *supra* note 5, at 509; (4) a government-countenanced need to pay more to brokers, usually universal banks, to obtain stock certificates, *see* Baums, *supra* note 5, at 506; (5) government-countenancing of brokers charging fees for securities custodial services, *see id.* at 507 and *see* Pfeil, *supra* note 257, at 184–93; (6) the decision to require tax-withholding on dividend payments, *see* Blum, *supra* note 5, at 509; (7) national stock exchange policies that favor oversized investors, *see* Pfeil, *supra* note 257, at 184–93; and (8) government countenancing of high stock prices via the device of requiring high par values, *see id.* at 184–88.

measures to assure that savings are available to citizens.[277] Also reflecting a similar counterbalancing, the German model's approach to thrift is that there must be *privity of contract* for a shareholder to be entitled information above and beyond the level of what an average prudent shareholder would find material. This is particularly true if a corporation's right to confidentiality is involved.[278]

Another point of contrast is that, notwithstanding a vaunted *educational* system, the German model does not regard the citizen shareholder as a knowledgeable entrepreneur.[279] Stock market issues, including corporate governance, are from the standpoint of purely the "public weal," not a

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277. As to *governmental* measures, the German model does not encourage U.S.-type private employment-based pension plans in which the risk borne by the employee relates to the performance of investments. Rather, it encourages pension commitments given by employers to employees in which case the risk borne by the employee relates to the performance of his company. *See* Kubler, *supra* note 261, 100–01.

As to *institutional* measures to assure that savings are available to citizens, an individual citizen, as a general rule, needs to contact a universal bank, an institution of private law, as a broker in order to purchase shares of a stock corporation. *See* Bodo Haggeney, *Private Agreements for Takeovers of Public Companies: West Germany*, 12 INT'L BUS. LAW. 211 (1984). Shares are for the most part issued by stock corporations in bearer form. *See* DROSTE ET AL., *supra* note 258, at 223. Therefore, for safety and avoidance-of-transfer-tax purposes, it makes sense for an individual citizen to leave the shares in the custody of the broker, that is, the universal bank. *See* Roe, *supra* note 248, at 1971. Additionally, as to corporate governance in the course of this custodianship, governmentally encouraged is the assumption of an active role on the part of the universal bank and a passive one on the part of the shareowner. Thus the shareowner must give his universal bank special instructions if the recommendation of the universal bank, as to voting of shares, is not to be followed. *See* Baums, *supra* note 5, at 506; *see also infra* Part XI.

278. *See* Blum, *supra* note 5, at 514. Thus, unlike the case in the U.S., there is as a lack of provision for updating of information for purposes of trading in the "secondary market," that is, the market in which transactions are not in essence between an issuer and an investor as is the case in the "primary" market, but rather, between investors. *See* Baums, *supra* note 5, at 515.

One commentator espouses a theory that disclosure under the German model has a primary purpose of controlling the behavior of the corporation in the interest of the nation, creditors and targets of fraudulent activity in particular, and only a secondary purpose of informing the individual citizen investor. Therefore, once the price of a share of stock has been set rationally and creditors placated, there is no need to make further information readily available to the individual shareholder. *See* Meier-Schatz, *supra* note 265, at 282–83, 287, 290–91. This is particularly the case if the corporation has an interest in not having the information disclosed to the markets. *Id.*; *see* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 93, 116, 117.

279. For expressions of this attitude, *see* Meier-Schatz, *supra* note 265, at 293–94 and Jonathan R. Macey and Geoffrey P. Miller, *Corporate Governance and Commercial Banking: A Comparative Examination of Germany, Japan and the United States*, 48 STAN. L. REV. 73, 89 (1995).

proper subject for "laymen," that is, the ordinary citizen. Rather they are only a subject for "professionals."[280] An example of such professionals is the universal banks as institutions of private law.[281] In short, the German model assumes that the most educated layman is *incapable* of comprehending full disclosure of corporate performance issues.[282] Therefore in the interest of protecting the public weal, he is not provided with full information about corporate performance. The theory is that corporate performance issues, unless of obvious significance, cannot be adequately expressed in a way that is understandable to even the educated layman.[283] The citizen, that is, layman, shareowner holding shares through universal banks is, in fact, encouraged to adopt an attitude of "rational apathy."[284]

2. Encouraging the Citizen as Master

This article has argued that a de Tocqueville concept promoted in U.S. corporate governance, is that of the substantially unconstrained drive of the citizen in pursuing ends "that concern him alone"[285] Further this article argued that application of this concept is seen in the recognition of a citizen-as-master trinity in the case of a widely-traded issuer that is a corporation. This U.S. trinity consists of (1) the executive officers as the equivalent of entrepreneurs for a start-up corporation, (2) the "citizen capitalist" shareholders as the equivalent of venture capitalists for a start-up corporation and (3) the board of directors elected by the citizen capitalist as the equivalent of the initial board of directors selected by venture capitalists. The executive officers and board of directors comprise "management" of U.S. corporations for various purposes, including day-to-day operation of the corporation and the logistics of holding annual meetings of shareholders. We have seen how the U.S. citizen capitalist has a variety of opportunities for input into the citizen-as-master trinity. These include (1) the ability to submit shareholder proposals that are cleared for inclusion in management pleading documents for the annual meeting

280. *See* Blum, *supra* note 5, at 513.

281. *See* Roe, *supra* note 248, at 1971.

282. This viewpoint is, indeed, arguably borne out by the German experience with public participation in the stock market in the mid-1960s. *See* Blum, *supra* note 5 and accompanying text.

283. *See* Meier-Schatz, *supra* note 265, at 293–94 and Macey, *supra* note 279, at 89.

284. *See* Roe, *supra* note 248, at 1942.

285. *See supra* note 26 and accompanying text.

through management and (2) the ability to institute election contests at his own expense. We have seen how the scope of the relatively unfettered discretion of this trinity, including the citizen-capitalists, encompasses, among other subjects, the choice of the "home state" law that will govern the operation of the corporation.[286] In contrast, the approach of the *German model*, for a corporation as a widely traded issuer, can be characterized as a one of "nation as a master" rather than citizen as a master.[287] This approach, consisting of a balancing of fundamental rights referred to as "co-determination," involves an interplay of "citizens-as a-master" and institutions of private law that are present within the corporate structure.

Thus, using the U.S. trinity as a model, the "entrepreneurs" under the German model are the executive officers. In a special balancing of fundamental rights, special and specific legislative requirements will have placed constraints on the entrepreneurs as a founders of a stock corporation in a start-up phase. This will assure that the corporation will not be declared bankrupt in the foreseeable future.[288] These anti-bankruptcy constraints continue once the corporation becomes widely-traded as a stock corporation. At this point, the constraints take the form of guidance, mostly from various institutions of private law.[289]

As for the "citizen-capitalists" (using U.S. words), this second part of the trinity under the German model will have also been a "venture"capitalist of sorts. As such for a "start-up" corporation, he will have been subject to anti-bankruptcy constraints. A "discipline" will have been that he is effectively tied to the corporation by inability to sell his shares.[290] Once

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286. *See supra* note 33 and accompanying text.

287. With respect to the concept of "nation," *see supra* note 247 and accompanying text.

288. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 36 (provision for application to court in the corporation's home state for registration of corporation in the "Commercial Register"), § 32 (report to court with which corporation registered as to the circumstances of the founding), § 33 (provision for appointment of "founding auditors" by court), § 46 (description of responsibilities of "founders"), § 48 (requisite standard of care in the founding), § 50 (provision for corporate removal of claims against founders). *See also* Kubler, *supra* note 261, at 98.

289. *See infra* Part XI.H.

290. Special personal disclosure obligations are placed on the German model entrepreneur/venture capitalist ("founder") if an attempt is made to "trade" shares of the corporation during the first two years after its registration with a court. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 47. This is the case even though shares of the corporation may have commenced trading within these first two years, by means of a public offering.

Even though the public offering is without disclosure at least in the U.S. sense, such commencement of trading is permitted under the German model so long as the trading is

this "venture capitalist" (now a citizen capitalist of sorts) becomes a shareholder of a stock corporation, he must pay a price for the raising of the constraints on his ability to sell his shares. This "price" is that his role in corporate governance is constrained in a number of ways if he does not choose to become subservient to the will of a particular institution of private law, the universal bank.[291]

The board of director for a "start-up" corporation will, under the German model, have been subject to legislative requirements of answerability to assure against eventual bankruptcy of the corporation.[292] Once the entity becomes a publicly-traded stock corporation, additional constraints in the form of requisite guidances from institutions of private law, are placed on the German equivalent of the U.S. board of directors called the "supervisory board."[293] As for the "citizen master" trinity's scope of discretion, the trinity, reflecting the anti-bankruptcy thrust of the German model, has no choice of law discretion as a to "home state" law or other law, such as a law pertaining to trading of shares.[294]

3. Encouraging Exercise of Political Ambition

We have seen that a de Tocqueville concept is that of the exercise of modest "political" ambition, at a township meeting, by any educated citizen who has achieved a modest level of eminence in the community. This article argues that this concept is reflected in the U.S. encouragement to a shareholder of very modest standing but less modest ambition who desires that a proposal on his part, even if opposed by management, be included in management's pleading document for the annual meeting. This encouragement applies to proposals that have a heavy social policy content

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other than that of a corporation whose shares are listed for trading on a national stock exchange, that is, so long as the shares are traded pursuant to trading privileges for unlisted shares on such an exchange or are traded in the over-the-counter market. It is only when the corporation seeks to be listed on a national stock exchange in advance of public trading that registration, and a prospectus, in the U.S. sense, are required by law. *See* Blum, *supra* note 5, at 511-12.

291. *See infra* Part XI.C.1.

292. *See supra* note 288 and accompanying text.

293. *See infra* Part XII.H.

294. *See infra* Part XII.B.

so long as various legal requirements are satisfied.[295] The concept is also reflected in the favored status of a citizen capitalist in the institution of an election contest through his own pleading document.[296]

The German model does not favor exercise of unfettered political ambition by the *citizen* shareholder. Consistent with the model's preference for institutions, the citizen shareholder can make shareholder proposals or institute election contests only if he is in the tax-disadvantageous position of being in privity of contract with the corporation.[297] On the other hand, the universal bank, as an institution of private law, is expected to be sensitive to the "social" demands of the concept of socially-obligated property before it exercises "political ambition."[298]

4. Constraining the "Financial Aristocrat"

A de Tocqueville concept is avoidance of a landed aristocracy because such an aristocracy is inherently unproductive. This article urges that an analogous concept of "financial aristocracy" is present in the U.S. regulation of corporate governance. A financial aristocrat is generally any shareholder whose holdings in a corporation are too great for exercise of voting rights to fit within the ambit of household management. Financial aristocrats, in short, are either "oversized shareholders" or "counter-entrepreneurs." We have seen that one of the problems with oversized investors is that, for reasons of saving costs, they tend to abdicate with respect to their right to vote . To overcome this tendency, U.S. law requires that oversized shareholders that are regulated entities, in fact not abdicate.[299] In contrast, rather than seek to control the influence of the "financial aristocrat," the German model enhances the power of such an aristocrat if he undertakes to assume a role of institution of private law. If any oversized investor indicates its willingness to submit himself to guidance from government and institutions of public law and thus become an institution of private law, the German model provides its rewards.[300]

We also have seen that the U.S. system requires disclosure to citizen-capitalists of acquisitions of stock of any size, by oversized investors that qualify as "institutional investors." This requirement counterbalances a

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295. *See supra* note 225 and accompanying text.

296. *See supra* notes 163–164 and accompanying text.

297. *See infra* Part XII.E.

298. *See infra* Part XII.A.

299. *See supra* note 55 and accompanying text.

300. *See infra* Part XII.C.

typical oversized investor preference towards observing the "Wall Street Rule" of "delegating" to management. Additionally, this is in order to alert citizen-capitalists of the probable presence of the "regulated entity" attitude in the overall electorate.[301] In contrast, under the German model, the universal banks, consistent with the principle of confidentiality, need not disclose the full extent of its control of stock voting rights.[302]

Further, this article demonstrates that U.S. law makes a special effort to overcome any tendency of an oversized shareholder managed by a regulated entity to react to business pressure from management of the corporation in which the oversized investor holds shares. One measure is by public disclosure of an attempt by management to place business pressure on the regulated entity. This disclosure must be made by the management of the corporation. Another effort is a wall of separation, involving observance of divided ministerial duties within a commercial bank, of which the regulated entity is part, to deter business pressure of this nature.[303]

We shall see that, in contrast, the German model addresses the problem of reaction to business pressure only if a fundamental right is affected. For this purpose, the model recognizes that the fundamental right of pursuing an occupation exists in the case of an investment fund that the universal fund manages for the benefit of shareholders. To protect such a right, the German model does not resort to publicity or divided ministerial duties. Rather it resorts to an "honor code" requirement.[304]

Moreover, to counterbalance any tendency to be overly "pro-active" of an oversized shareholder with his non-entrepreneurial mind set, there are U.S. rules requiring special disclosures. These disclosures alert citizen-capitalists that there exists a threat to the prevalence of an entrepreneurial mind set.[305] In contrast, the German model gives the universal bank

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301. *See supra* notes 57–58 and accompanying text.

302. Until 1994, notification to a corporation and publication in the Federal Gazette, was required once a shareholder acquired voting power in excess of twenty-five percent of total voting power. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 20. By virtue of legislation in 1994, that percent was reduced to five percent, a threshold similar to that in the U.S. *See* Pfeil, *supra* note 257, at 154. However, not counted in determining whether or not this threshold is exceeded, are shares held by a universal bank in a custodial capacity. This is the case even if the bank has been given full voting discretion by the beneficial owner of the shares. *See* Macey, *supra* note 279, at 890–91 and Baums, *supra* note 5, at 507–08.

303. *See supra* note 62 and accompanying text.

304. *See infra* Part XII.C.

305. *See supra* notes 69–73 and accompanying text.

shareholder a somewhat entrepreneurial mind set. This is consistent with the principle of giving financial encouragement to institutions of private law.[306]

Finally, to overcome any tendency of a financial aristocrat who is a counter-entrepreneur to use voting power over a substantial block of share for short-term purposes, the U.S. employs publicity for acquisition of a block of as little as five percent of voting power. This is to alert the citizen-capitalists.[307] The U.S. also requires the performance of divided ministerial duties in the making of public tender offers to purchase stock. This is to assure fairness in the methodology, whereby the counter-entrepreneur has acquired his shares.[308] In addition, the U.S. home state of the corporation may, among other measures, impose a special fiduciary duty on the acquirer, to other shareholders in his exercise of his new voting power.[309]

In contrast, consistent with the principle of confidentiality, the German model until recently has not required *public* disclosure of an acquisition of a relatively small block.[310] In making of public tender offers, guidance from an institution of public law would counsel counter-entrepreneurs. The German model protects the fundamental ownership rights of shareholders against fraud on the part of the would-be counter-entrepreneur in attempting to become in "privity of contract" with the shareholders approached.[311] Additionally, the German model imposes no fiduciary duty to other shareholders that is enforceable in court merely by virtue of owning of shares in a proprietary capacity over a certain amount. Rather, consistent with the "honor code" principle, the owner of the block must have voluntarily taken on fiduciary accountability for a fiduciary duty to occur.[312]

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306. *See* Part XII.C.

307. *See supra* notes 75–77 and accompanying text.

308. *See* Securities Exchange Act of 1934 § 14, 15 U.S.C. § 78n(d) (1994); Securities Exchange Act of 1934 Rule 14d, 17 C.F.R. § 240.14d (1998).

309. *See supra* notes 78–82 and accompanying text.

310. Until 1994, the threshold size of a block requiring public disclosure was twenty-five percent. *See supra* note 302 and accompanying text.

311. *See* Haggeney, *supra* note 277, at 213–14; *see infra* Part XII.I.

312. For instance, by placing as a representative on the supervisory board. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, §§ 117, 93.

C. Devices

1. The Draft

We have seen that the de Tocqueville concept of the "draft" is that the public electorate can draft into public service any citizen. This is out of a largest possible universe regardless of formal education or other attainments of the draftee beyond being a man-of-the-world. Technically he need not consent to being drafted. He must serve until the electorate relieves him of his duties but he is to serve no longer. However, as a restraint on the electorate, the draftee cannot be forced to work for free.[313]

This article has argued that the selection of a director of a U.S. corporation is, in effect, a draft by the shareholders of a management-proposed nominee. Thus the executive officers are in as a sense, graded on their ability to suggest nominees out of a widest possible universe for consideration by the board of directors. There is no governmental requirement of education or other attainment impeding the proposal process. There is no requirement of nationality or disclosure of nationality. Any special understanding relating to a nominee's willingness to serve a director must be disclosed to the electorate. Since the director is technically not a volunteer, the assessment of the draftee's performance while a director is not too rigorous.[314]

We shall see that the German model represents as a contrast. Here, the "draft", with its emphasis on disclosure to the electorate and its de-emphasis on pre-screening, is *not* a concept to be adhered to in the election of capital members of the supervisory board.[315] Rather there is little, if any, disclosure to the shareholders in the course of the drafting process.[316] There is pre-screening to satisfy both statutory criteria and to assure that the nominees are acceptable to institutions of private law.[317] The selection is

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313. *See* DE TOCQUEVILLE, *supra* note 4, at 66. *See supra* text accompanying note 108.

314. *See* DE TOCQUEVILLE, *supra* note 4, at 66. *See supra* text accompanying note 110.

315. *See infra* Part XII.E.1.

316. *See infra* Part XII.E.1.

317. Supervisory board members are typically executive officers or directors of universal bank shareholders. *See* Kubler, *supra* note 261, at 103; Robert E. Benfield, Note, *Curing American Managerial Myopia: Can the German System of Corporate Governance Help?*, 17 LOY. L.A. INT'L & COMP. L. J. 615, notes 88, 89 and accompanying text; Baums, *supra* note 5, at 510.

Also serving in a typical instance is the "independent" professional supervisory board member that has an "informal relationship" with a particular universal bank and is elected "again and again" with the votes of that bank. *See* Baums, *supra* note 5, at 509–10.

not out of as a wide a universe as possible. This is because of the additional reason that relevant institutions of private law are in a position to dictate who at least the majority of nominees will be by virtue of their insider positions on the supervisory board and as a creditor.[318] The objective of the selection is not to find the "undiscovered" citizen capitalist, but to find individuals who will volunteer to follow the leadership and honor code principles[319] justifying their membership on an institution of private law.[320]

2. The Selectman

A de Tocqueville concept is that a certain kind of elected officials called "selectmen" are given unfettered discretion by an electorate to hire and fire government officials, as well as determine their compensation. The officials selected in de Tocqueville's day included grand jurors who made major township decisions. This article has argued that the board of directors of a U.S. corporation constitutes a body of selectmen solely for the purpose of hiring, firing and compensating the corporation's executive officers. All functions performed by the board are subordinate to this selectman role. For instance, the board of directors would not itself define the long-term enterprise objectives of the corporation. Instead, the executive officers' perception of these objectives would be disclosed to the board. If the board

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On the other hand,, the supervisory board, comprised as well of representatives of labor has, as a whole, members "coming from different walks of life." See Peltzer, *supra* note 259, at 34.

318. *See* Baums, *supra* note 5, at 514.

319. In one sense, leadership is provided by statutory elaboration of the principle of co-determination as between not-so-conflicting fundamental rights only of fixed claimants — employee wage-earners and universal bank creditors. *See* Macey, *supra* note 279, at 196.

320. In a sense, the honor code is derived from a "network of mutual monitoring" among stock corporations and universal banks, to assure that "there are no obvious violations of the fiduciary duties of care and loyalty." *See* Kubler, *supra* note 261, at 109-10. An honor code aspect is that selection of the managerial board is "the most important task of the supervisory board," with termination to be only "for cause" since the latter involves a "matter of honor" and can give the corporation a bad reputation if it occurs. *See* Baums, *supra* note 5, at 514-15 and LAW OF STOCK CORPORATIONS, *supra* note 264, at § 84.

To assure "honorable" conduct, members of the supervisory board of a stock corporation even though they are also executives or supervisory board members of a shareholder universal bank are to act independently and are not *bound* to follow instructions from that shareholder bank. *See* Baums, *supra* note 5, at 514-15. To assure freshness, a member of the supervisory board is prohibited from serving on more than ten supervisory boards at one time. *See* Baums, *supra* note 5, at 510 and LAW OF STOCK CORPORATIONS, *supra* note 264, at § 100.

does not approve, a course of action is for the board to fire the executive officers and replace them with new executive officers. Because of this ability to act precipitously, this article regards the U.S. board of directors as a part of "management."[321]

In contrast under the German model, the supervisory board does not have a selectman role in the precipitous U.S. sense.[322] On the other hand, reflecting reliance on institutions of private law, Germany gives the supervisory board, as such an institution, formal authority to make policy decisions.[323] This is an authority which, this article contends, the U.S. board of directors does not have if it has appointed executive officers to operate the company.

3. The Wage

As we have seen, the wage is a de Tocqueville-discerned element of a government official's compensation. This element is to be determined and paid only on a piece-work basis after services have been performed, that is, after a particular period of employment has ended.[324] This article has argued that U.S. corporate executive officers are paid such a "wage" rather than a salary, at least as a part of their compensation. U.S. corporate governance rules reflect this concept. They require detailed disclosure to citizen-capitalists that serves to justify compensation as if the compensation were a "wage." This disclosure includes analysis of any corporate performance "add-on" attributable to the efforts of the chief executive officer. This article urges that as an element of wage, profits to an executive officer derived from materialization of contingencies in the past year should be disclosed as well. This would require disclosure of a justification of the profit accorded to the executive officer. This justification would be in terms

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321. *See supra* Part IV.A.

322. Termination can only be for cause. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 84 and Kubler, *supra* note 261, at 504. Regarding termination of employment on "restructuring of the corporation," as the phrase is used in this article. *See* Flessner, *supra* note 259, at 134–37, 140. Regarding termination of employment on "termination of enterprise objectives," also a phrase used in this article, *see id.* at 141–47.

323. Authority to initiate policy decisions is limited to crisis situations such as a impending insolvency. However, the supervisory board does have on-going authority to screen and, if called for, veto management plans. *See* Macey, *supra* note 279, at 87–88. According to a commentator, it is the "veto" that creates the most potential for supervisory board member liability. *See* Peltzer, *supra* note 259, at 33.

324. *See* DE TOCQUEVILLE, *supra* note 4, at 66. *See supra* text accompanying note 101.

of not-yet-compensated-for value added to the corporation, achieved through the performance of his duties.[325]

Under the German model, the compensation to be paid an executive officer, that is, a member of the managerial board, is, to a large extent, promised in advance by contract. Therefore, it can be better characterized as a salary. "Honor" is relied on to assure that the executive, confident in his fundamental right to pursue a profession, performs in accordance with the contract.[326]

4. The Bonus

The de Tocqueville concept that government officials be permitted to share in special cash recoveries that they have brought about for the benefit of the government, is used to define the U.S. concept of the "bonus" as a special form of compensation to executive officers. The bonus has its roots in this de Tocqueville concept. Payment of a bonus to an executive officer is proper in the U.S. so long as it is disclosed to the citizen-capitalists, that is, to the capital markets given the U.S. approach to "transparency." The bonus is on the basis of interim enterprise objectives being met and interim cash flow objectives being exceeded. The bonus can be either a cash bonus or a bonus that materializes from events following the award of a stock option, or the equivalent, to the executive officer.[327]

In contrast, we shall see that the German model does not favor cash bonuses to members of the managerial board. For purpose of the German model, a bonus is a payment that serves no important governmental interest beyond a slight degree of entreprenurialism. It raises questions of interference with the fundamental rights of others, such as rights to own property[328] The situation may be different for profits derived in the future

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325. *See supra* text accompanying note 134.

326. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 87; Kubler, *supra* note 261, at 109–10; and, *see generally*, Flessner, *supra* note 259.

327. DE TOCQUEVILLE, *supra* note 4, at 66. *See supra* text accompanying note 114.

328. *See* Kubler, *supra* note 261, at 109–10. The reason for a lack of bonuses can be stated as follows. All payments of compensation to members of the managerial board must have approval of the supervisory board. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 87(1). The supervisory board represents, in a sense, two classes of capital, equity capital or shareholders and "pension" capital or employees, including members of the managerial board. *See* Kubler, *supra* note 261, at 107–08. For the managerial board to recommend to the supervisory board that one of its members receive a bonus detracts from both forms of capital. Even if the shareholder component is sympathetic to the idea of rewarding the entrepreneurial spirit, the labor component is likely not to be. After all, there is the German tradition of encouraging workers to suppress short-term demands in exchange

from the granting of stock options to executive officers.[329] Traditionally, stock ownership has been regarded as a an important perquisite of German executives in pursuing their professions. That is, it is a means of compensating them for their expertise in a manner that does not interfere with the fundamental rights of others.[330]

5. "No Work for Free"

We have seen that a de Tocqueville concept is that no government official is to work for free, that is, work as a volunteer in the employ of the government.[331] This article argues that U.S. law applies this concept to corporate executive officers. The law requires, first, disclosure to citizen-capitalists regarding the level of compensation paid to high-ranking executive officers. One purpose, it is submitted, is to assure that the level is not inordinately low, as well as not inordinately high. U.S. law requires, second, disclosure as to confluences and conflicts of interest affecting high-ranking executive officers. One purpose is to enable the citizen capitalist to assess, given the level of compensation, the degree to which the amount of any underpayment may reflect motives other than satisfaction of the corporation's enterprise objectives.[332] The German model is that possible underpayment is a matter of private contract and honor. Given institutional constraints, voluntarily working for less than an adequate salary, after co-

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for a share of longer term benefits of growth. *See Europe Isn't Working*, THE ECONOMIST, Apr. 5-11, 1997, at 16. Should not members of the managerial board, who themselves are workers, be included in this tradition? Isn't the managerial board being selfish in recommending that one of its members receive a bonus?

Conceivably, if sympathetic to a managerial board desire for award of bonuses in appropriate cases, the shareholders could risk "polarization" by using the second vote of the chairman of the supervisory board necessarily a shareholder representative to break a tie or suggest to the managerial board that they present the issue of award of bonuses directly to the shareholders meeting perhaps for a super-majority vote in favor of awards of bonuses. *See* Baums, *supra* note 5, at 514 and LAW OF STOCK CORPORATIONS, *supra* note 264, at § 119.2. *See also* Peltzer, *supra* note 259, at 34 (tendency on the part of shareholders to reduce the catalogue of transactions requiring supervisory board approval).

329. However, according to one commentator, bonuses in the form of stock options have not been as prevalent as in the U.S. *See* Kubler, *supra* note 261, at 109-10.

330. *See* Blum, *supra* note 5, at 515 n.32 and accompanying text.

331. DE TOCQUEVILLE, *supra* note 4, at 66. *See supra* text accompanying note 115.

332. *See supra* notes 118-119 and accompanying text.

determination has been worked through, is not regarded as a matter appropriate for disclosure to those who are not in privity of contract with the corporation.[333]

6. Compensation Egalitarianism

We have seen that a de Tocqueville concept is that the compensation gap between high-ranking executive officers and high-ranking government officials should be comparatively narrow. The U.S. establishes egalitarianism in terms of compensation between low-ranking executive officers and lower-ranking white-collar employees, through disclosure of the compensation level of the higher-ranking executive officers. This is even if the recipients of the information, the citizen-capitalists and thus the capital markets, are not in privity of contract with the corporation.[334] This article suggests that a main reason for the current extremely high level of salaries, in particular of U.S. chief executive officers, is the executive officer's justifiable exercise of thrift as a de Tocqueville virtue. This means bargaining for special compensation of a job-security nature in addition to wages and bonuses because he is subject to the risk of being fired, or receiving reduced compensation, at the will of the board of directors.[335]

Further, if one views compensation as including "returns" from the holding of shares, U.S. "plebe shareholders" enjoy various "compensations" on an equal basis with citizen-capitalists. One compensation is the enjoyment of the privilege of giving an opinion on corporate performance even though the plebe shareholder has not established investment intent.[336] Another compensation is the enjoyment of the privilege of receiving a control premium paid on a buy-out as the result of a coercive take-over, even though the plebe shareholder has not engaged in corporate stewardship efforts to the same degree as the citizen capitalist.[337]

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333. It is not always the case that the managerial board and the shareholders are on one side of "structured interactions" and labor on the other. Sometimes it is necessary for universal banks shareholders to marshal forces to challenge an alliance among members of the managerial board, other white-collar employees and blue-collar employees. The level of compensation in general, including but not limited to the level of salaries of members of the managerial board, would be one obvious scenario. *See* Roe, *supra* note 248, at 1945. *See also infra* Part XII.D.

334. *See supra* notes 121–122 and accompanying text.

335. *See supra* Part V.B.2.

336. *See supra* note 21 and accompanying text.

337. *See supra* Part X.A.

In contrast, we shall see that under the German model, issues of compensation egalitarianism and job-security compensation are handled institutionally. This is through "co-determination" rather then through disclosure to the public.[338] Encouraging socially-trusted institutions does not readily permit sharing of benefits and responsibilities between socially-trusted universal bank record holders and non-socially-trusted beneficial owners of shares held of record by these banks.[339]

D. Facilitators

1. A Fact-Oriented Press

De Tocqueville discerned reliance on a fact-oriented, rather than issue-oriented, press in the U.S. This press focused on every day issues to facilitate the pursuit of their own material interests by men-of-the-world citizens.[340] U.S. corporate governance law relies on the diligence of the press to make the public aware not only of releases prepared by a corporation to advance corporate interests, but also filings with the government. These are the filings that are subject to principles of "full disclosure" and therefore, are neutral as to advancement of corporate interests.[341]

In contrast, we shall see that under the German model, the press is a vehicle of free speech relative to public policy issues. Only incidentally to that role is it encouraged as a vehicle to provide information to the public.[342] Less emphasis therefore, is placed on making information available to the press. This is particularly true of information that would be of a private nature as a German society norm.[343]

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338. *See* Kubler, *supra* note 261, at 109–10 and *see infra* Part XII.D.

339. *See infra* Part XII.I.

340. *See supra* text accompanying note 15.

341. *See* Meier-Schatz, *supra* note 265 and Lorenz, *supra* note 243.

342. According to one commentator, the primary purpose of any rules requiring corporate disclosure under the German model is to influence corporate behavior in the general public interest rather than help the natural person investor exercise initiative in his own private interest. *See* Meier-Schatz, *supra* note 265, at 266, 278–79, 281–82, 287, 293–94.

Before passage of a tightened insider trading law in 1994, corporate executives would often include the press in confidential "fireside chats" to discuss significant corporate developments before their announcement to the public. Pfeil, *supra* note 257, at 139.

343. *See infra* Part XII.A.

2. The Citizen Sustainer

We have seen that de Tocqueville discerned that every citizen is expected to guide, support and sustain any government official that is intervening in his own proper sphere as a U.S. concept.[344] The U.S. expects that essentially entrepreneurial entities like the New York Stock Exchange will guide, support and sustain the SEC in their quite aggressive but "proper" intervention in the sphere of trading in stocks and corporate governance.[345] This article contends that in addition, the U.S. expects that citizen-capitalists as essentially entrepreneurs, will guide, support and sustain the appropriate efforts of the U.S. government to fulfill the U.S. Congress policy declaration contained in the Securities Exchange Act of 1934 in favor of "fair and honest markets in stock transactions."[346] An important example of this sustainment, according to this article, is holding a public annual meeting opinion on corporate performance.[347]

In contrast, we shall see that, under the German model, the concept of a citizen, with instincts that are entrepreneurial, sustaining an assertive government regulatory effort, is not to be found. This is particularly the case for a field, like corporate governance, that requires a balancing of fundamental rights in a wide variety of contexts. This balancing is an undertaking that can be accomplished only by an institution of private law—not by an individual expected to act primarily as his own instincts dictate.[348]

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344. *See* DE TOCQUEVILLE, *supra* note 4, at 95. *See supra* note 17 and accompanying text.

345. *See supra* note 36 and accompanying text.

346. According to one comparative law commentator on the German model, an example of the U.S. citizen sustainer, as the term is used in this article, is the "lobbyist" as a member of the personal constituency of the individual U.S. legislator. This citizen sustainer, even though representing his own entrepreneurial interests, still can be said to "guide, support and sustain" the governmental efforts of the legislator. *See* Linde, *supra* note 247, at 601, 603.

347. *See supra* Part I.A.

348. According to a commentator, the German model has rejected citizen sustainership by the U.S. lobbyist, in favor of a combination of executive branch agencies and the political party as an institution of public law. *See* Linde, *supra* note 247, at 603. *See also infra* Part XII.A.

E. Means of Responding to Crises

1. The Publicized Dissident Faction and the Grand Jury

There is a de Tocqueville concept of reliance on the publicized *dissident faction* which is to alert others as to crises and to provide alternatives to a current "legislature," that is, the board of directors.[349] Thus, a predominant way of addressing a corporate crisis in the U.S. is for outsiders to marshal forces so they are in a position to challenge management in a forthcoming election contest. Under this de Tocqueville rubric, secret societies that seek to overthrow a current legislature by surprise are to be avoided. U.S. corporate governance rules protect current management from surprise presentations in favor of an alternative slate of directors in two ways. First, if the alternative slate has not been presented to the nominating committee of the board of directors, management is protected against having to include the alternative slate in management's pleading document. Rather, the proponent of the alternative slate must provide a pleading document at his *own* expense as a "penalty" for late selection of an alternate slate. Second, management cannot be surprised on annual meeting day by a secretly-accumulated majority voting block in favor of an alternative slate. Information about the organizing efforts of the faction, once it amounts to an "alternative legislature" opposed to management, must be provided to management. At the same time, management must cooperate with the faction organizer in disseminating the position of the alternative legislature to all the shareholders who indicate a desire to vote.[350]

We have seen that a related de Tocqueville concept for responding to crises is that of the *grand jury*. This body constitutes a recourse to information in the hands of the general public and a resource of the sense of the general public on a particular issue which might amount to a crisis. The existence of a grand jury dispenses with the need for an investigative staff assigned to a public prosecutor.[351] This article contends that U.S. corporate law uses the grand jury concept as recourse to the public to determine whether the SEC should issue an executive writ, a bill of impeachment, in response to evidence of interference with the pricing of shares by insider trading on insider information. Thus, the SEC does not place reliance on an investigative staff to assist its division of enforcement

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349. *See* DE TOCQUEVILLE, *supra* note 4, at 75–77. *See also supra* text accompanying note 29.

350. *See supra* Part VII.

351. *See supra* note 195 and accompanying text.

as a public prosecutor in arguing before an SEC hearing officer, a grand jury equivalent. Rather the SEC is willing to pay a bounty to any citizen who provides information that assists in a successful prosecution.[352]

In short, we have seen that the alternative legislature, in the case of an election contest, and the grand jury, in the case of an executive writ are peculiarly U.S. ways of responding to crises. Each of these rely on participation by citizens. An example is the "crisis" of a significant negative corporate development which is announced to the public at some point. If insider trading occurred prior to the announcement, employment of the grand jury addresses any crisis relating to "confidence of the market for the corporation's shares." If a change in management appears warranted because of the information in the announcement, employment of the dissident faction concept addresses this "crisis relating to corporate performance."[353]

We shall see that under the German model, institutions of private and public law as well as executive branch agencies of government are favored for the role of addressing an announcement to the public of a negative development, in particular, a crisis, rather than dissident factions.[354] Further, the German model does not provide for a "populist" *grand jury* to address a crisis of confidence relating to the market for the corporation's shares. Rather, the German model is that government agencies *initiate* investigations involving possible criminal prosecution or other sanction. This is only on the petition of German citizens and business enterprises either seeking to protect their own fundamental rights or admitting that they may have impaired the fundamental rights of others.[355] Alternatively, an investigation is initiated through guidances on the need for investigation from the government agencies' own internal staffs or institutions of public or private law, as expressly required by legislation.[356] The government agencies conduct the investigations by using their own staffs who may

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352. *See supra* note 196 and accompanying text.

353. *See supra* Part VII.

354. *See* Part XII.F.

355. *See* Lorenz, *supra* note 243, at 576–77; *see also* Eberle, *supra* note 245, at 75–77, 82. Under the regime designed to curb insider trading before enactment of the current insider trading law enacted in 1994, an insider who believed he may have violated insider trading guidelines could himself initiate proceedings. *See* Blum, *supra* note 5, at 523.

356. Only individuals whose fundamental rights may be affected and members of investigatory staffs of the executive agency, may *attend* executive agency or other investigatory activities. *See* Eberle, *supra* note 245, at 82. As to the use of institutions of public law, as opposed to executive branch agencies, for investigatory purposes, *See infra* Part XII.G.2.

solicit input from those whose fundamental rights may be involved. Proceedings are therefore not public unless the public, by virtue of the specific circumstances, has a "fundamental right" to attend. In the German model for an administrative agency there is no equivalent of a public prosecutor akin to the SEC's division of enforcement in the U.S. There is also no equivalent for payment of a bounty to a citizen purportedly providing information "in the public interest" to the agency, that leads to a successful prosecution.[357]

2. Limited Intra-Government Competition as Facilitator

We have seen that a de Tocqueville concept is that, to a limited degree, government agencies compete with each other for "territory" in a collegial manner. This prevents any one agency from having a despotic dominance. Such competition, for one thing, promotes experimentation as a means of enhancing quality of regulation.[358] As background, the U.S. constitutional scheme is based on the concept of powers enumerated in the Constitution.[359] For instance, the federal government can enact laws with a primary purpose of governing interstate commerce even if a state's jurisdiction over police power issues within its boundaries may also be affected.[360] A state government can enact laws with a primary purpose of governing police policy matters within its boundaries, even if (1) interstate commerce may be affected so long as the affecting is only secondary,[361] and (2) the same subject may be covered by a federal law so long as the state addresses the subject only secondarily.[362] In general, the federal government cannot co-opt state personnel against the will of the state in the implementation of federal law.[363] The federal government does not make its personnel available to a state to implement state law, unless a federal interest is served

357. *See infra* Part XII.G.2.

358. *See supra* Part III.A.

359. Relevant constitutional provisions include: the "commerce clause" U.S. CONST. art. I, § 8, cl. 3; the "full faith and credit" provision U.S. CONST. art. IV, § 1; the reservation-of-powers-to-the-states provision U.S. CONST. amend. X; and the "due process" clauses U.S. CONST. amend. V, amend. XIV.

360. *See, e.g.,* United States v. Carolene Products Co., 304 U.S. 144 (1938).

361. *See* Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440 (1960).

362. *See* H.P. Welch Co. v. New Hampshire, 306 U.S. 79 (1939).

363. *Compare* National League of Cities v. Usery, 426 U.S. 833, 849-50 (1976) *and* Carroll v. Finch, 326 F. Supp. 891 (D. Alaska, 1971) *with* U.S. v. Ohio Department of Highway Safety, 635 F.2d 1195 (6th Cir. 1980), *cert. den.* 451 U.S. 949 (1980).

involving the implementation of federal law.[364] A state law that has the primary purpose of governing police policy matters within the state may also have a primary effect on police policy matters within another state as long as the cumulative effect on the regulatee is not unreasonable.[365] All of the above permits independent action by all players, without the need to coordinate among themselves.

Specifically in relation to U.S. corporate governance, one agency, consistent with principles of comity, may add to the impact of rules established by a tangential agency. An example mentioned in this article is the SEC rules that strengthen annual meeting requirements of a corporation's home state, that is, "hearing rules," by virtue of exclusive SEC jurisdiction over interstate commerce and thus "pleading rules". Alternatively, an agency, by virtue of its own particular contacts with a situation, may be able to lessen the impact of rules applicable to the situation imposed by a tangential agency. One example of this is the corporate governance rules of a state with which a corporation has substantial contacts adding to the otherwise too low corporate governance requirements imposed by the corporation's home state. Another example is the corporate governance rules of the U.S., through the SEC, that add to the impact of otherwise too low corporate governance requirements imposed by a foreign domicile of a corporation whose shares are traded in the U.S.[366]

In contrast, we shall see that, under the German model, fundamental rights of the federal government and the states preclude the above fluidity of tangential government. As a background, the federal government and the states are separate entities. Theoretically each has the fundamental right under the basic law to enact laws within its jurisdiction even if it cuts across the jurisdiction of the other entity. The jurisdiction of the federal government theoretically extends to the entire nation, even to the most local of matters. However these laws are subject to the state government entities' fundamental rights.[367] It is the federal legislature that resolves these fundamental rights in a structured interaction on the particular subject. This is done on an ad hoc basis and takes place in the Federal Council, the rough

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364. This would be pursuant to a principle of "cooperative federalism" in which the integrity of the federal government as an entity separate and distinct from the state government, is maintained. *See generally*, *Carroll*, 326 F. Supp. 891.

365. *See* American Rockwool, Inc. v. Owens-Corning Fiberglass Corp., 640 F. Supp. 1411, 1426-28 (E.D.N.C. 1986).

366. *See supra* Part III.A.

367. *See* Lorenz, *supra* note 243, at 552-53, 562-63. For a review of the genesis of the federal system under the German model, *see* Partsch, *supra* note 243, at 3-6.

equivalent of the U.S. Senate.[368] This resolution of fundamental rights can result in the states' implementation of federal laws.[369] The interaction of the Federal Council assures that there is state input on the implementations and state interests are kept in mind. On the other hand, once the Federal Council has permitted structured interaction, the state is subservient to a common goal under the leadership principle and there is no competition as the U.S. sense. Moreover, even in areas where the Federal Council has not acted, there is reluctance on the part of states to act too independently of each other or of the federal government on a subject of common interest. If they do, the result is likely to be a structured interaction of some sort, probably in the Federal Council, to resolve the differences. Hence, in areas of a common concern, the states may well act independently only as a parochial statement.[370] The federal government and the state governments have strictly separate jurisdictions. Any coordination is achieved through the leadership of the federal government after a process that requires a careful and detailed balancing of the fundamental rights of the states as against those of the federal government.[371]

F. Protocol

1. Participatory Democracy Sessions

A participatory democracy session, that is, a free-ranging discussion at a town meeting in which subjects to be discussed have been announced in

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368. Germany's federal legislature consists of two bodies, (1) the Federal Diet, members of which are elected by the people and (2) the Federal Council, members of which are appointed by the governments of the various states. *See* Lorenz, *supra* note 243, at 547. The basic law requires that statutes of the Federal Diet and regulations of any federal executive agency, be approved by the Federal Council, if the fundamental rights of one or more states are at issue. *See id.* at 562–63.

The regulation of Germany's stock exchanges constitutes a careful balancing of federal and state roles, with a key arbiter assuring this balancing being the Federal Council. *See* Pfeil, *supra* note 257.

369. Implementation of federal law by a state could be done through the state's administrative agencies and/or through the state's courts. *See* Lorenz, *supra* note 243, at 552–53; *see also* DROSTE ET AL., *supra* note 258, at 463.

An example of state implementation of federal law is the execution by the states of a plan devised by the federal interior minister to ship back Bosnians living in Germany. *See Who is a German?*, *supra* note 243, at 547.

370. *See* Pfeil, *supra* note 257, at 177–84 and Bernadette Surya, *Germany - Modernising and Rationalising the Securities Market*, 7 THE COMPANY LAW. 38 (1986).

371. *See* Lorenz, *supra* note 243, at 547.

advance is a de Tocqueville concept.[372] The U.S. regulatory scheme encourages such free-ranging discussion between *management* and *citizen capitalist* shareholders exemplified by the question and answer sessions that occur after detailed exchange of papers at the physical holding of the annual meeting. Even shareholders who hold their shares beneficially and not of record, are permitted by law to attend these meetings and ask questions.[373] An occasion for free-ranging discussion between management and citizen-capitalists is also provided by the SEC rules encouraging the narrowing of issues between these two parties in the event of a shareholder request that his proposal, opposed by management, be included in management's proxy statement for an annual meeting.[374]

We have seen that as a further example, U.S. corporate law encourages participatory democracy among executive officers in advance of noticed board of director meetings by permitting more than one executive officer to be a member of the board. This encourages free-ranging discussion among executive officers as equals as to board agenda items in advance of board meetings.[375] Another example is that the U.S. enhances the value of participatory democracy between the executive officers, on the one hand, and the board of directors, on the other. This is through a requirement that the executive officers not merely make reports to the board but also must also initiate proposals and provide detailed information in support of them in advance of any board meetings.[376]

As still another example, an attempt is made in the U.S. to cause board of directors meetings to amount to productive participatory democracy between the directors. This is by a requirement that the board membership include at least two "independent" directors who will be catalytic to free-ranging discussion.[377] Finally, it is argued in this article that U.S. law presents the opportunity for pre-annual meeting free-ranging discussion between any "politically-ambitious" citizen capitalist and other citizen-capitalists that indicate their availability to give input on the issues of interest to their politically ambitious compatriot. We shall see that, in contrast, the German model provides for a meet and confer which differs from a participatory democracy. The German approach is one of

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372. *See* DE TOCQUEVILLE, *supra* note 4, at 44, 64–65. *See supra* text accompanying note 146.

373. *See supra* Part VI. B.

374. *See supra* notes 224–228 and accompanying text.

375. *See supra* Part IX.A.

376. *See supra* Part IX.A.

377. *See supra* Part IX.A.

"structured interaction," within an institution of private law. This approach puts opposing parties in the same room to resolve differences relating to fundamental rights, so that common social objectives can be achieved.[378]

2. Divided Ministerial Duties

We have seen that a de Tocqueville concept is public performance of divided ministerial duties by different individuals whose offices are specifically disclosed to the public. A failure, by any of these individuals to perform his function is civilly actionable.[379] The theory is that each function is viewed by an electorate which can judge whether the functions are in fact being performed and within the prescribed limits. Otherwise individual elected officials may have too much power and there would be despotism as to both the parts and the sum of the parts. This U.S. approach is regarded as a an exaltation of process over short-term efficiency. The German model in contrast can be regarded as an exaltation of efficiency over process.

With respect to performance of ministerial duties as a requirement, this article has discussed how various U.S. "corporate officials" perform separate ministerial duties. This is done to assure that the process of physically holding an annual meeting has integrity.[380] Also, various corporate officials and members of the SEC staff, perform separate ministerial duties to assure that accurate and prompt financial information is furnished to the capital markets.[381] In contrast, consistent with honor code principles, the German model is that administrative functions be performed non-publicly but efficiently by appointed officials whose offices are not necessarily disclosed to the public.[382] The officials are employed either by

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378. *See* Lorenz, *supra* note 243, at 557–59. *See also infra* Part XII.H. According to a U.S. commentator, a justice of the Oregon Supreme Court, "structured interaction" might have useful applications in certain situations in the U.S. For example, the German model might be used to enable partisan and other interest groups to structurally interact on the board of directors of broadcast stations deciding on programming that is consistent with freedom of speech. The model might also be used for university boards that seek to administer affirmative action consistent with equal protection. *See* Linde, *supra* note 247, at 607–08.

379. *See supra* note 12 and accompanying text.

380. *See supra* Part VI. C.

381. *See supra* notes 181–83 and accompanying text.

382. A follower of the honor code principle has "dependency on the confidence" of a superior rather than direct answerability to the public. *See* Lorenz, *supra* note 243, at 557–59.

According to one commentator, there is a German focus on the "law of

German executive branch agencies or by institutions of public or private law. As seen above, the performance of functions is disciplined by the requirement that the legislative balancing of fundamental rights be strictly adhered to.[383]

As to performance of ministerial duties as a safe harbor, each director and executive officer of a U.S. corporation who decides to make a "forward-looking statement" about the corporation's enterprise objectives and long-term operating performances, can avoid liability for a decision so long as he has exercised judgment in good faith and has performed individual ministerial duties, depending on the situation presented, in the course of exercising that judgment.[384] This is true for each individual who wishes to address the subject of a coercive tender offer made to the corporation's shareholders.[385] In contrast, the German model relies on honor code principles with accountability. However there is also the ability to get dispensation to protect the fundamental right to pursue a profession.[386]

3. Judicial-form Procedures

De Tocqueville's concept that even legislative and executive proceedings be given judicial form[387] is in the interest, at least in part, of understatedness to assure public acceptance. This article has argued that the concept is reflected in the U.S. separation of the annual meeting into typically judicial-form "pleading" and "hearing" phases for regulatory purposes.[388] It is also demonstrated in the procedures of the SEC as it performs its rule-making, legislative, and enforcement or executive activities by issuing writs of mandamus or prohibition.[389] Again, the U.S. approach is one of exalting process over near-term efficiency.

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administration", that is, the law pertaining the internal code of conduct of executive agency administrators. In contrast, according to this commentator, there is a U.S. focus on the "law of administrative procedure," that is the law pertaining to professional representation of private clients before administrative agencies. *See* Linde, *supra* note 247, at 604.

383. *See* Lorenz, *supra* note 243, at 570–72, 574–76. This fundamental rights gloss on the leadership principle creates the issue: how does one prevent judicial control from stultifying decision-making by executive agencies? *See id.* at 545–46, 576.

384. *See* text accompanying note 177.

385. *See supra* Part X.

386. *See infra* Part XII.H.

387. *See supra* note 30 and accompanying text.

388. *See supra* Part II.A.

389. *See supra* Part VIII.

In contrast, the German model for action by agencies of the executive branch is that judicial-form procedures need not be followed except as a expedient for proper balancing of fundamental rights through structured interaction.[390] This does not require a pleading phase. The focus of the German model is the necessity for procedures to develop full information for protection of national rights or fundamental rights of private parties. The model uses informality "whenever possible."[391] Even if hearings are held, judicial form is not strictly adhered to if non-adherence assures protection of fundamental rights. For instance, an executive agency typically makes informal adjustments to "final" decisions if fundamental rights are not violated by doing this.[392] It typically assists uninformed participants at a hearing to assure that their fundamental rights are protected, as long as a fundamental rights of others are not impinged upon in the process.[393] Further, if there is any general public interest in the proceeding, the German model asks the public to trust the agency's judgment as to what the public interest may be in as a particular case. This is consistent with confidentiality. In contrast to the U.S. approach, the German model can be called an exaltation of near-term efficiency over process.

G. Tools of Government

1. The Writ Issued by a Court of General Sessions

We have seen that a de Tocqueville concept is that elected officials in the U.S. can still be subject to broad direction by a higher governing body in the form of writs, even though mainly responsible to their electorate.[394] An example of this higher body is a court of general sessions as it was in de Tocqueville's day. In the field of U.S. corporate governance, the SEC by issuing a legislative writ of mandamus commands the elected board of directors of a corporation, on pain of civil penalty, to make sure that certain procedures are adopted. These procedures must assure that accurate and up-to-date information is provided to the securities markets in order to

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390. *See* Lorenz, *supra* note 243, at 552, 562–63. *See also* Eberle, *supra* note 245, at 74–75 (referring to a fundamental right to participate in an administrative hearing so long as one's other fundamental rights are involved.).

391. *See* Lorenz, *supra* note 243, at 552, 562–63. *See also* Eberle, *supra* note 245, at 76–77.

392. *See* Eberle, *supra* note 245, at 76–78.

393. *See id.* at 76.

394. *See* DE TOCQUEVILLE, *supra* note 4, at 78–79 and text accompanying note 178.

protect against undue volatility resulting from insider trading or rumors of such an activity.[395] Also, by issuing a legislative writ of both mandamus and prohibition, the SEC commands the elected board of directors of a corporation not to engage in insider trading and, in addition, to take steps to assure that insider trading is not engaged in by executive officers and other insiders of the corporation.[396]

The German model provides a contrast. In light of the pre-eminence of the judiciary in the protection of fundamental rights, the German model does not lend itself to the issuance of legislative or executive writs, that is, directives issued at the discretion of agencies in the executive branch in sensitive areas. This lack of issuance prevails even if the agency is guided by institutions of public or private law. This is because of the threat of de novo review of the writs by German administrative courts if there is a fundamental rights issue.[397] To be free of this threat, directives affecting fundamental rights are typically the province only of the specific wording of statutes issued by democratically-elected *legislatures*. The German model envisions no agency, along the lines of the SEC in the U.S., that has reasonably broad discretion to issue writs that affect fundamental rights.

As a result of this hesitancy to issue writs, the German model, that is agencies in the executive branch, provide only "guidance" on legislative writs or "rules"[398] if there could be any question of inconsistency of a rule

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395. *See supra* note 179 and accompanying text.

396. *See supra* note 194 and accompanying text.

397. *See* Lorenz, *supra* note 243, at 574–76. For a critique of this de novo review as threatening to turn Germany into a "judge's republic," *see id.* at 581–82. For possible limits on an administrative court's ability to overturn a "writ" issued by an executive administrative agency, *see* Eberle, *supra* note 245, at 104–06.

398. These guidances are described as a form of divulgence of the contents of internal codes of conduct of the administrative agency personnel to those whose behavior the agency seeks to influence. These instances of guidance are not regarded as "ordinances" which are reviewable in court. Lorenz, *supra* note 243, at 574–76.

An example of the providing of guidance, rather than the issuing of writs, in the field of corporate governance is provided by the scheme of insider trading "regulation" under the German model as it existed before passage of Germany's insider trading statute in 1994. Up to that point, reliance was placed on "Rules of Procedure" adopted in 1968 by a "Commission of Stock Exchange Experts." These Rules constituted a "voluntary code to educate corporate executives as to the harms and immorality of insider trading." The voluntary code was intended as a basis (1) for insiders to refrain from insider trading, (2) for insiders, in addition, to bind themselves contractually with their corporate employers to refrain from insider trading, and (3) for national stock exchanges to establish boards of inquiries to investigate allegations by complainants of insider trading on the part of those bound "morally," or contractually, not to engage in that practice. *See* Blum, *supra* note 5, at 515–21.

with fundamental rights. For instance, if a corporation's supervisory board fails to heed this guidance, such a failure may still be (1) civilly actionable on the theory that the supervisory board, unheedful of guidance, did in fact interfere with fundamental rights of others or (2) criminally prosecutable on the theory that the board, unheedful of guidance, interfered with the right of the nation to pursue a legislatively-enacted government policy.[399] Similarly, the German model is that executive branch agencies provide only guidance regarding executive writs or enforceable decisions in *specific* cases. This is particularly if a fundamental right, such as that of "equal treatment" from government agencies, may be involved.[400]

2. Administrative Impeachment

"Administrative impeachment" is a de Tocqueville concept. This is a form of executive writ, issued by one administrative agency after a public proceeding. The basis is a bill of impeachment previously issued by a separate administrative agency. Impeachment is an administrative remedy enforceable by a court if disobeyed but it is not issued by a court. It is a remedy that is effective because it is highly embarrassing to be the subject of the writ.[401] This article contends that the SEC makes use of this concept, at least partially. The SEC issues a bill of impeachment but, rather than resort to a second administrative agency to do the final impeaching, the SEC resorts to the courts. This article urges that, particularly in the case of an elected board of directors, a second administrative agency should do the final impeaching.[402]

In contrast, the German model does not make use of the concept of administrative impeachment. Rather, consistent with protection of fundamental rights, immediate resort is to a prosecutor and to the criminal courts as the definitive balancer of fundamental rights in order to cause removal from office.[403] Consistent with principles of the honor code, a sanction that the courts provide is permanent ineligibility to hold any

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For other instances of the providing of governmental "guidance" to business enterprises, *see Germany — Bismarck's Steed,* THE ECONOMIST, Mar. 29-Apr. 4, 1997, at 57 and *Auf Wiedershewn, Shareholders,* THE ECONOMIST, Mar. 29-Apr. 4, 1997, at 68.

399. *See* Lorenz, *supra* note 243, at 570.

400. *See id.* at 574-76.

401. *See supra* note 198 and accompanying text.

402. *See supra* notes 211-212 and accompanying text.

403. Enforcement of a law prohibiting trading in shares of a corporation on the basis of inside information, is totally criminal. *See* Pfeil, *supra* note 257, at 164-75.

corporate office.[404] If this is not the case, the German model provides for a mild, face-saving form of "removal" from office. This removal process can be instituted by an administrative agency or by an institution of public or private law. It is usually used informally. The removal institution consists of a "vote of no confidence."[405] It is typically given in secret.[406]

3. The Private Litigant in the Public Interest

Finally, we have seen that a de Tocqueville concept is that of the "private litigant in the public interest." The private citizen litigant is given some form of advantage for promoting government policy.[407] This concept is most apt if the thwarters of government policy are considered public officials or "quasi-government" officials.[408] One controversial aspect of such a concept is the statutory bounty for providing information to a government agency charged with policing the activities of officials.[409] Another example is various benefits given to the private litigant in a civil action that he instituted against a government official or quasi-government official. Such benefits include: (1) an ability to pay one's lawyer a fee contingent on success rather than an up-front cash fee; (2) not having to pay the target's attorney fees if one loses; (3) being able to bring the action as a "class action" representing others similarly situated as well as oneself; (4) being able to cause the action to be arbitrated rather than tried in a court; (5) being able to have a jury of one's peers decide the case rather than a judge; and (6) being able to recover punitive damages from the government,

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404. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 76(3) and Peltzer, *supra* note 259, at 33.

405. If as a coalition desires to remove from office the federal Chancellor who is the approximate equivalent of the U.S. President, the minority party in the federal legislature assumes the role of institution of public law. It initiates a "constructive vote of no confidence" before the legislature. *See* Lorenz, *supra* note 243, at 547–48.

406. Prior to passage of the new insider trading law in 1994, if a board of inquiry of a national stock exchange found after an investigation, that an insider had violated the insider trading guidelines established by the Commission of Stock Exchange Experts, it would do the following. First, it would charge the cost of the proceedings to the violator. Second, it would report its findings to the corporation and to the federal Minister of Economics. The decision would not be published (a) unless the violator consented or (b) the violation was "considered extreme." *See* Blum, *supra* note 5, at 513, 520–21; *see also infra* Part XII.G.2.

407. DE TOCQUEVILLE, *supra* note 4, at 80.

408. *See id.*; *see also supra* Part VIII.C.

409. *See supra* Part VIII.C.

or quasi-government, official if he is found liable and his conduct has been particularly egregious.[410]

Once again, the German model provides a contrast. The German model limits itself to protecting the fundamental rights only of the particular litigants by ordinary civil action instituted by these private litigants. The protection is for rights derived from stock ownership and privity of contract.[411] The German model does not foster any private litigant in the public interest.[412] It does not countenance the payment of statutory bounties to informant citizens.[413]

XII. HOW THE GERMAN MODEL WORKS IN PRACTICE

A. Overview of the German System of Corporate Governance

1. Primary Purpose of Regulation

The scheme of regulation of corporate governance of publicly-traded stock corporations is to assure the position of the nation as an industrial power. This is consistent with principles of co-determination.[414] The German model is, first, based on the preservation of certain traditional German approaches such as the leadership and honor code principles. Second, it is supplemented by a post-World War II special emphasis that accounts for the fundamental rights of citizens who are natural persons.[415] The German model does not emphasize assuring the ability of industry to raise capital in the German securities markets.[416] Rather, it focuses on the fundamental rights of creditors and the raising of capital by German industry in the form of borrowing from universal banks.[417] The focus,

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410. *See supra* notes 204–207 and accompanying text.

411. According to a commentator, a civil proceeding before the judiciary concerns itself only with protection of the fundamental rights of private individuals or entities, although the rights of the community are also, incidentally vindicated. Class actions have been argued for as a special way of achieving these dual objectives but have been legislatively disapproved so far. *See* Lorenz, *supra* note 243, at 577.

412. *See infra* Part XII.G.2.

413. *See infra* Part XII.G.2.

414. *See* Goedan, *supra* note 243, at 119.

415. *See* Lorenz, *supra* note 243, at 545 and Partsch, *supra* note 243, at 6–7.

416. *See* Meier-Schatz, *supra* note 265, at 276. *See* also Blum, *supra* note 5, at 507–10.

417. *See* Benfield, *supra* note 317, at 62. A perception is that German corporations are able to borrow from universal banks more cheaply than if they were to raise capital in the equity markets. This is because of the special on-going ability of the banks, as creditors, to

therefore, has been not so much protection of the fundamental rights of shareholders as protection of those of *creditors*, who are perceived to have the stronger fundamental rights.[418]

In recent years distinct downsides to the German model have been noted. One downside relates to tax and other policy that encourages the holding and voting of shares only by German universal banks.[419] In

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"control the moral hazard" of improvident decisions of management. *See* Macey, *supra* note 279, at 207.

The German model has so far rejected the formation of German money market funds as a substitute for universal banks as a source of credit to German corporations. It has also restricted the ability of German investment funds to invest in foreign money market funds as an indirect way of extending credit to German corporations. *See* Carl Graf Hardenberg, *Amendment of German Investment Fund Laws*, 18 INT'L BUS. LAW. 224 (1990).

418. According to a commentator, the purpose of the prototype German law requiring public disclosures by corporations was to protect not so much shareholders, as creditors. *See* Meier-Schatz, *supra* note 265, at 276, 279, 283.

In contrast to the U.S., creditors are given special standing to sue directors and executive officers of a corporation for mismanagement whereas shareholders are not. The German model does not provide for shareholder derivative or class actions against directors and officers. *See* Eberle, *supra* note 245, at 92–93. On the other hand, the German model does provide for creditor actions (sounding in tort against executive officers and directors. *See* Peltzer, *supra* note 259, at 35–36.

In the above tort actions brought by creditors, the burden of proof to show non-negligence, particularly if the corporation is insolvent, is on the executive officer or director. *Id.*; *but see* Schwanke, *supra* note 259, at 13. If there is insolvency and the executive officer or director has performed a specified type of negligent act, the offence is criminally prosecutable. *See* Peltzer, *supra* note 259, at 34.

There are special reasons for the above strong protection given the fundamental rights of ordinary unsecured creditors. First, the fundamental rights of *secured* creditors, even if the security interests are not recorded, are stronger vis-a-vis unsecured creditors than is the case in the U.S. Secured credit has been very prevalent under the German model. There is apparently no system of recordation of security interests in moveable property as in the U.S. *See* Flessner, *supra* note 259, at 125. This makes bankruptcy proceedings impracticable because of the lack of available assets to satisfy the claims of ordinary creditors. The impracticability of bankruptcy proceedings equals lack of a bankruptcy administrator, which equals a weakening of the all-important fundamental rights of employees to pursue a profession or trade. *See id.* at 124–26. To avoid this domino effect, the ordinary creditors need special protection against improvident action by the executive officers and directors of a stock corporation.

Further, the employees, as creditors of the corporation with respect to their promised pensions, compete with the other ordinary creditors if there is insolvency. The claims of ordinary creditors, in the event of insolvency, are inferior to the "social plan claims" of employees that have been dismissed because of insolvency. *See id.* at 131–35 and Kubler, *supra* note 261, at 101.

419. With respect to the *holding* of shares, *see supra* note 283 and accompanying text. With respect to the *voting* of shares, *see* Benfield, *supra* note 317, at 628. *See also* Baums,

following this policy, Germany has discouraged the holding and voting of shares by other individuals and entities in a variety of ways. Among the latter investors have been individual German citizens[420] and foreign investment funds.[421] This may well have discouraged needed investment in the German stock market.[422] Further, approximately half of the population of Germany is advocating a more populist approach to corporate governance. There is particular criticism of the perceived domination of corporations by the universal banks.[423] The balance of this article analyzes how the German model works in practice.

2. The Annual Meeting as Centerpiece

The German *annual meeting* is not a centerpiece in the U.S. sense. Rather, the uncontested annual meeting has two main functions. One is to protect the primacy of *capital* as a big picture matter. The other is to protect, in a rather pro forma manner, fundamental property ownership rights of shareholders to vote on issues at annual meetings.

First we examine *assuring the primacy of capital.* A peculiarity of the

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supra note 5, at 505, 507-08, 514 (universal banks dominate the voting process).

420. *See supra* note 277.

421. Foreign investment funds are discouraged from the holding and voting of shares in German stock corporations in two respects. First, if they are organized outside of the European Economic Community [hereinafter EEC] and purport to represent the interests of *German* investors, they are treated as other than institutions of private law. They are saddled with tax and other disincentives for having sold shares to German investors. *See* Hardenberg, *supra* note 417, at 225-26; *see also* DROSTE ET AL., *supra* note 258, at 224-25.

These two commentaries refer to two facets of the discrimination against foreign, that is non-EEC, investment funds: (1) an EEC directive regarding distribution of foreign mutual funds within the territory of an EEC member and (2) a specifically German retaliation against the U.S. SEC for the latter's reluctance to open up the U.S to the distribution of shares of German mutual funds in the U.S. *See* Kraus, *supra* note 261, at 116 describing the situation in the early 1980s before these two facets came into play.

Second, the German model favors corporate activism on the part of a shareowner only if it in "privity of contract" with the corporation, that is, itself holds shares in bearer form that are "on deposit" with the corporation or the equivalent. U.S. law, for one, impedes the ability of U.S. investment companies to hold shares, if in bearer form, in countries that are foreign to the U.S. *See infra* Part XII.C.3.

422. *See* Benfield, *supra* note 317, at 628-29 (lack of liquidity in secondary market); *see also* Kubler, *supra* note 261, at 102-03 (reform proposals). On the other hand, there is a trend to more foreign investment in member states, such as Germany, of the European Economic Community. *See generally*, Edward Carr, *A Survey of Business in Europe: A Fortress Against Change*, THE ECONOMIST, Nov. 23-29, 1996, at 62.

423. *See* Macey, *supra* note 279, at 76. *See also* Benfield, *supra* note 317, at 629.

German model is that the shareholder's right to own property is deemed to include a right to examine the financial statements. This is done at an annual meeting to see if there is a surplus out of which dividends can be paid.[424] If so, there is the right to declare dividends at the annual meeting. It is at the annual meeting that capital has the "big stick" of being able to declare dividends to undergird its "soft speaking" at meetings of the supervisory board.[425] As discussed below,[426] the membership of the supervisory board is divided 50-50 between capital and labor. Dividends necessarily restrict the pool of cash out of which wages can be paid and affect the fundamental right of labor to earn a living.[427]

Second, the *protection of shareholder voting rights, within the ambit of the Universal Banks* is examined. The shareholder of "record" with the corporation is usually a universal bank.[428] The beneficial shareholders are those shareholders whose interests are not of record with the corporation except through the universal bank's record ownership. These shareholders, at least theoretically, have their rights of beneficial ownership protected by the universal banks as record-holders.[429] These beneficial holders include first, the universal bank itself as extender of credit to,[430] and as investment banker for, the corporation in its proprietary capacity.[431] Second, the beneficial holders are investment funds that the universal bank is sponsor and custodian for, and investment manager of, which reflects a quasi-proprietary capacity of the universal bank.[432]

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424. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 119.1(2).

425. *See id.*

426. *See infra* Part XII.H.1.

427. Labor's countervailing "big stick" is more indirect. This stick relates to the stiffness of the union stance in negotiation of regionwide collective bargaining agreements between unions and employer associations. *See* Flessner, *supra* note 259, at 137.

428. Shares, typically in bearer form, are purchased and sold through universal banks as brokers. The shares are typically left on deposit with these banks. *See* Haggeney, *supra* note 277, at 211; *see also* Baums, *supra* note 5, at 517. For statistics showing universal bank primacy with respect to record ownership, *see* Baums, *supra* note 5, at 507.

429. *See* Benfield, *supra* note 317, at 629; *see also* Kubler, *supra* note 261, at 103.

430. *See* Macey, *supra* note 279, at 89; *see also* Benfield, *supra* note 317, at 627-28 *and* Kubler, *supra* note 261, at 103.

431. *See* Baums, *supra* note 5, at 518 *and* Kubler, *supra* note 261, at 103.

432. *See* Benfield, *supra* note 317, at 631 n.91 and accompanying text. The "quasi-proprietary" relationship between a universal bank and its investment fund can be described as follows. The bank is primarily acting in a purely proprietary capacity insofar as it earns fees as sponsor of the fund and provider of administrative services to the fund other than acting as custodian of assets. It is primarily acting in a fiduciary capacity, vis-a-vis unitholders in the fund, insofar as it is acting as custodian of assets of the fund other than

Reflecting a strictly non-proprietary capacity of the universal bank are various beneficial shareholders who have their shares in the custody of the universal bank as the broker-dealer with which they place securities trades.[433] Hereinafter these last beneficial shareholders are referred to as "ward shareholders." The voting rights of these shareowners are rather paternalistically protected through efforts of the universal bank. As we shall see, there is little statutory encouragement given to assertive exercise of voting rights by these beneficial shareowners.[434]

Third, there are *shareholder voting rights outside of the ambit of the Universal Banks*. This "independent" shareholder is disfavored from tax and other standpoints under the German model.[435] Thus, without having been "pre-qualified" as an institution of private law, he has the "effrontery" to have the right to participate directly in corporate governance without guidance from a universal bank. It is the management of the corporation who has the function of protecting the voting rights of the independent shareholders. Management also protects the voting rights of the representatives of independent shareholders, that is, the "shareholder associations."[436]

The German annual meeting disregards the U.S. values that we have reviewed which make the annual meeting a centerpiece of corporate governance.[437] Under the German model, the annual meeting is a

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in a voting capacity. In voting shares held in custody, the bank can therefore be said to be acting in a capacity that is a combination of these two capacities, that is, in a "quasi-proprietary" capacity.

433. *See* Roe, *supra* note 248, at 1982.

434. *See* infra Part XII.D.F.H.

435. If the independent shareholder holds his shares in bearer form, there is a tax and a brokerage commission, for each purchase and each sale of stock if, in the process, there is a change in custody of the stock. *See* Roe, *supra* note 248, at 1942. There are certificate fees. *See* Baums, *supra* note 5, at 506; *see* also Pfeil, *supra* note 257, at 184–85. If the independent shareholder holds his shares in registered form, there are the disadvantages of high registration fees. *See* Roe, *supra* note 248, at 1982. There is also the ability of other shareholders to amend the corporate charter to restrict his ability to transfer his shares. *See* Haggeney, *supra* note 277, at 211–12 and LAW OF STOCK CORPORATIONS, *supra* note 264, at § 24. In short, the independent shareholder can be regarded as the equivalent of the investment company, that is not an "accredited investment company" and therefore not a favored institution of private law. *See supra* note 261.

436. *See* Law OF STOCK CORPORATIONS, *supra* note 264, at §§ 121–137.

437. First, any German equivalent of the U.S. performance of ministerial duties as an independent justification for the annual meeting does not apply. Thus, the intra-entity following of the leadership principle and the observing of an honors code, all in such a way as to protect fundamental rights, does not constitute a significant enough public statement for there to be special value in such a statement. The same is the case for the employment

centerpiece only in the case of an unusual situation, that is, a crisis. A main example is when the rights of unsecured creditors are threatened. In that case, the annual meeting itself becomes an institution of private law in which structured interaction occurs. In short, absent a crisis, the German annual meeting takes second place to the work of the supervisory board. In fact, the "political ambition" of the universal bank as shareholder participant in annual meetings is rather fettered absent a crisis. Unless the pre-eminence of entrepreneurship is threatened the bank is discouraged from succumbing to feelings of political ambition in favor of private enterprise or capital. At almost all costs, the policy of the German model is to avoid "polarization" between capital and labor.[438]

3. Critique

The annual meeting could profitably be made more of a centerpiece. One purpose is to attract investment from German citizen investors and

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of judicial-form procedures to protect fundamental rights.

Similarly, the uncontested annual meeting, under the German model, is only secondarily a vehicle for an opinion on how well the corporation is performing in light of enterprise objectives. Absent a crisis, the supervisory board, and the managerial board, have the primary role for this subject. *See infra* Part XII.I. Absent a crisis, the annual meeting is not an occasion for a possible election contest to replace management. *See infra* Part XII.F.

Further, the satisfaction of giving a report card on corporate performance as a counterbalance to a tendency to sell shares if one is dissatisfied with management performance, has, at least up until recently, been unimportant. Until recently, there has been a national lack of concern about the liquidity and price continuity of shares traded in German stock markets. *See supra* notes 416–421 and accompanying text. An important factor in this lack of concern has been a perceived absence of fundamental rights issues where purchasers and sellers of shares are not in strict privity of contract with each other or with an issuer in the stock market. *See supra* note 279 and accompanying text. In any event, the German model has not encouraged *any* investment decision on the part of an individual "citizen" or entity. *See supra* notes 277, 280 and accompanying text.

Also, found unimportant have been (1) the U.S.-supposed annual meeting opportunity for the citizen to exercise instincts of thrift according to his own judgment, and (2) the U.S.-supposed opportunity for a citizen to exercise "man-of-the-world" sophistication on corporate governance matters. Again, a decision by a layman is not seen to be necessarily in the nation's interest under the German model. *See supra* Part XI.B.1.

Finally, a chance to give the press full rein is not, under the German model, a justification for an uncontested annual meeting. Instead, the annual meeting is treated as largely a private affair with just enough information and advance notice to protect fundamental rights of the press to conduct reasonably unfettered investigation and to publish the results. *See supra* Part XI.D.1.

438. *See* Krupp & Thyssen, *Exaggerated Rumours of a Death*, THE ECONOMIST, Mar. 22, 1997, at 79–80; *see also Bismarck's Steed*, THE ECONOMIST, Mar. 29, 1997, at 57–58.

foreign investment funds. A second purpose is to counter the populist reaction against the perceived domination by universal banks. From the perspective of these two purposes, the declaration of dividends opportunity as a counter-balancing "big stick" facet of co-determination is of little relevance.

Greater attention could be paid to the fundamental right of the "disenfranchised" investors to *equal treatment from government*.[439] The "bogey," for comparison purposes is the treatment currently accorded the universal bank record shareholders insofar as they represent their own proprietary, or quasi-proprietary, interests.

B. Overlap of Statutory Schemes

There is little German overlap of statutory schemes as among the states or between the federal government and the states. Virtually, all the details of the operation of the stock corporation are enacted in the form of federal "home state" law.[440] This imposes specific legislative constraints on stock corporations that are more rigorous than those imposed by U.S. home state laws. The purpose is to protect against bankruptcy.[441] The states theoretically have rights to provide additional legislation from two perspectives. The first is that of being a "home state" of the corporation. Under the German model, this home state is the state in which the corporation is registered under federal law. However, the federal government has pre-empted the area of home state law. A state court monitors corporate governance compliance with federal law.[442] The states are involved only peripherally from a substantive "home state" perspective.[443]

The second perspective is that of the state as the location of a national stock exchange on which shares of the corporation are traded. The states in which a national stock exchange is located, regulate the operation of the stock exchanges in the areas of trade clearance, trade settlement and securities custody mechanisms through regional exchange supervisory authorities. This is, of course, insofar as it is outside the following five

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439. LAW OF STOCK CORPORATIONS, *supra* note 264, at § 119.1(2).

440. *See generally* Blum, *supra* note 5, and accompanying text; *See also* Kraus, *supra* note 261, at 109–10.

441. *See supra* notes 292–94.

442. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 14, 38, 104, 132. *See also* DROSTE ET AL., *supra* note 258, at 463.

443. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 12.

areas of federal pre-emption.[444] There are currently eight national stock exchanges in Germany.[445] The five areas of federal pre-emption are: (1) criteria for listing of shares for trading on them,[446] (2) criteria for coercive tender offers for shares traded on them,[447] (3) criteria for membership on the exchanges,[448] (4) general conduct of business by exchange members,[449] and (5) criteria for dissemination of issuer information relative to trading on the exchanges.[450]

The states have chosen not to regulate the subject of corporate governance. Perhaps they could well have been chosen to regulate. This would be from the standpoint of the conceptual closeness of "voting of shares" to "clearance, settlement and custody." Thus, the states, as well as the federal government, have chosen to ignore the consideration that corporations traded on the national stock exchanges may include foreign stock corporations whose home state laws on corporate governance may be less rigorous than those for German corporations.[451]

A second reason for total state non-regulation of corporate governance may be that any regulation would, in any event, impinge upon fundamental rights of property and contract that are traditionally paramount vis-a-vis operation of the exchanges.[452] The exchanges, and therefore "their" states, have been in intense competition with each other.[453] Therefore, they understandably have awaited federal regulation of the issue of corporate governance after a structured interaction among the states within the Federal Council.[454]

Eight different laws on the subject of corporate governance for exchange mechanism purposes may be impracticable. It is suggested that

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444. *See* Pfeil, *supra* note 257, at 177–84 and Surya, *supra* note 370, at 38.

445. *See* Pfeil, *supra* note 257, at 173.

446. *See* Blum, *supra* note 5, at 510–12.

447. *See* Haggeney, *supra* note 277, at 213.

448. *See* DROSTE ET AL., *supra* note 258, at 221.

449. *See* Kraus, *supra* note 261, at 110–13.

450. *See* Pfeil, *supra* note 257, at 168–70 and Kraus, *supra* note 261, at 110–13.

451. Germany does not regulate the foreign corporation whose shares trade in Germany, under its "home state law" (the Stock Corporation Act). *See* Kraus, *supra* note 261, at 113. For a summary relating to the exceptional rigor of that Act as Germany's home state law, *see* Kubler, *supra* note 261, at 98.

452. *See* Meier-Schatz, *supra* note 265, at 282 (referring to a German model tradition of not regulating market mechanisms).

453. *See* Pfeil, *supra* note 257, at 177–84 and Surya, *supra* note 370, at 38.

454. *Id.*

the federal government is in a position to enact improvements in the German model of corporate governance. This is mainly because of the federal government's exclusive authority over universal banks who are the only broker-dealers permitted to be members of national stock exchanges. No change is suggested on an opportunity-for-experimentation theory. The German model has an adequate substitute for the lack opportunity that it provides for experimentation vis-a-vis the concept of limited intra-government competition. German federal government agencies in particular, are able to hire and promote civil servants of the highest caliber.[455] This assures a quality of regulation that is arguably as high as the quality promoted by the U.S. approach of opportunity for experimentation.

C. The Annual Meeting Participants under the German Model

1. The Participants

At least from a U.S. perspective, the universal banks are very strong participants in the annual meeting process. They cannot be totally trusted. The other participants trail behind in a number of respects. There is no favored citizen capitalist. The only favored "capitalists" are institutions of private law, and these are the universal banks and their investment funds. We have seen that there are three main classes of annual meeting participants under the German model. One class consists of the universal bank in its proprietary and quasi-proprietary capacities including its investment fund capacity. In these capacities and for fundamental rights purposes, the universal bank is in privity of contract with the corporation. This is because of an arrangement whereby the shares on deposit with the universal bank are regarded as on deposit with the corporation.[456] The second class of participant is the shareholder, other than the universal banks, who hold their shares in registered form on the books of the corporation or, if shares are in bearer form, the shareholder has them on deposit, for annual meeting purposes, either directly with the corporation

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455. *See* Linde, *supra* note 247, at 603.

456. The mechanism whereby privity of contract is achieved can be said to work as follows: (1) the universal bank is "known" as a shareholder by the corporation; *see* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 121; (2) as an institution of private law, which is therefore socially trusted, it requests annual meeting information; *see id.* at § 125; (3) it has deposited a "certificate of deposit" for the bearer shares that it owns (and therefore typically has on deposit with itself) with a notary public or "securities deposit bank"; *see id.* at § 135.4; and (4) insofar as acting in a quasi-proprietary capacity such as an investment fund capacity, it has provided the corporation with an "authorization certificate" showing its authority to vote the investment fund shares; *see id.*

or through a notary public or "security deposit bank." These "independent shareholders" are also regarded as in privity of contract with the corporation.[457] The third class of participant consists of shareholders that own bearer-form shares beneficially. However, these shares are on the books of the corporation in the name of a universal bank record holder. These, the "ward shareholders," are not in privity of contract with the corporation.[458]

A theoretical "citizen capitalist" under the German model can be defined as an independent shareholder, or ward shareholder, that is (1) neither an "oversized investor" nor "counter-entrepreneur," (2) has held shares, amounting to a threshold for at least a threshold period, and (3) has not fallen into passivity so as to constitute any sort of "plebe shareholder." First, if the ward shareholder or independent shareholder fulfilled these requirements of a capitalist, he would still not be favored. As shown below,[459] a status as "ward shareholder" prevents him from receiving full information directly from management of the corporation in advance of the annual meeting. Nor would he necessarily be in a position to demand full information directly from his main contact, his record holder universal bank. He might well not be able to demand that his universal bank submit a shareholder proposal on his behalf[460] or be able to attend the annual meeting in person.[461]

In contrast, even though the "independent shareholder" is disfavored because he is subject to extra tax and other disadvantages, he has certain advantages over the ward shareholder as a "citizen capitalist."[462] First, he

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457. *See id.* at §§ 123, 125. These statutory provisions imply that registration, with the corporation, of registered shares creates privity of contract, but, as seen earlier in this article, there is the disadvantage that the charter of the corporation may link any transfer of registered shares to approval of the supervisory board and/or the shareholders meeting. *See* Haggeney, *supra* note 277, at 212.

As to an independent shareholder that holds bearer shares, he may well rely on a "shareholders' association" to represent his interests at annual meetings. The shareholders association is in privity of contract with the corporation along the same lines as the above mechanism for privity of contract on the part of a universal bank. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 125, 135. But being represented by a shareholders' association does not cause the independent shareholder to lose the tax and brokerage commission disadvantages of being an independent shareholder and therefore, unaccredited. *See supra* note 435 and accompanying text.

458. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 123.

459. *See* discussion *infra* Part XII.D.

460. *See* discussion *infra* Part XII.D.

461. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 123.

462. *See infra* Part XII.D.

is entitled to receive information directly from management, even though this information is of a rather bare-bones sort compared to the U.S., in advance of the annual meeting. He gets this information as a matter of course if his shares are on deposit "with the corporation."[463] He gets it on demand once he has deposited his shares with a notary public or security deposit bank in time to participate in the annual meeting.[464] Second, he is entitled to submit his own shareholder proposals to management for inclusion in a management document provided to shareholders "of record" in advance of the meeting.[465] Third, he would be entitled to attend the annual meeting in person.[466] We shall see that this would give him the right to demand at the meeting a wide scope of information.[467] Fourth, he is entitled to view a record of shareowners present at the meeting as well as a record of ward shareholders on the day of the meeting. The ward shareholders must be willing to be disclosed as beneficial owners and are represented at the meeting by universal banks and other proxy-holders.[468]

There is also a plebe shareholder, but he is different than in the U.S. Whereas the U.S. plebe is one by circumstance, that is, he has held his shares in less than a threshold amount or for less than a threshold period,[469] the German plebe is one by choice. The German model "plebe shareholder"[470] is a ward shareholder who bows to pressure to "serve the nation" by being inactive. In other words, he volunteers, influenced perhaps by a "rational" apathy,[471] to give a 15-month proxy to his universal bank without indicating how the universal bank is to vote.[472] This absence of direction gives the bank an obligation of sorts, to vote in favor of its own proposals as conveyed to this ward shareholder.[473]

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463. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 125.2(1).

464. *See id.* at §§ 125.2(2), 23.

465. *See id.* at §§ 125-127.

466. *See id.* at § 131.

467. *Id.*

468. *See id.* at § 129.

469. *See supra* Part XII.B.

470. Applying the method of analysis this article uses for the U.S. approach, another "plebe" under the German model would be an independent shareholder whose holding period is too short for him to have viewed the register of shareholders, including disclosed beneficial shareowners, open at the last annual meeting. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, §§ 129, 135.

471. *See* Roe, *supra* note 248, at 1941–42.

472. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 135, 128.3.

473. *See id.*

There is, in a sense, a favored citizen shareholder. Citizen shareholders who are natural persons are favored over foreign oversized investors. They are particularly favored over U.S. investment companies. If a citizen shareholder chooses and is willing to weather tax and other disadvantages, he can always become an "independent shareholder." However, the U.S. investment company registered with the SEC probably cannot become one. If its shares are held in bearer form the U.S. law may preclude the investment company from depositing the shares in order to vote, either with the corporation or with a notary public or security deposit bank, unless that institution is a U.S. bank.[474]

Of potential financial aristocrats, an obvious subject of scrutiny is the universal bank because of its overriding strength as an annual meeting participant.[475] Subject to co-determination limitations, the universal bank is given full rein to express not only its "fiduciary" but also its "proprietary" and "quasi-proprietary" personalities.[476] The universal banks may act as abdicating shareholders. For co-determination reasons discussed below, the *federal government* and *institutions of public law* are in continuous contact with the universal banks as "oversized investors" to assure that they do not "abdicate" from their role as voters at annual meetings.[477] Universal Banks may also act as *delegating shareholders*. As suggested above, and for co-determination reasons discussed below, universal banks, as oversized investors, are *encouraged* to observe a "Wall Street rule" so long as there is no crisis.[478] The universal bank is indeed a potential *reactive oversized investor*. If cash that is on hand or available is plentiful, the managerial board of a stock corporation is in a position to exert pressure on a universal bank in is record shareholder capacity, to vote its shares as the managerial board wishes. This reactiveness may, of course, go against the best interests

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474. Investment Companies Act of 1940 Rule 17f-5, 17 C.F.R. § 270.17f-5(1998). A debatable issue is whether the German model's lack of deference, on corporate governance issues, to U.S. investment companies, as opposed to accredited German investment funds, would violate the basic right of equal treatment from the German government. *See* Hardenberg, *supra* note 417, at 425.

475. *See* Roe, *supra* note 248, at 1939.The universal bank, of course, also derives strength in the corporate governance process just by being a creditor. *See* Baums, *supra* note 5.

476. *See* Macey, *supra* note 279, at 76, 89 and Benfield, *supra* note 317 at 627–28 ("personality" as creditor of corporation); Baums, *supra* note 5, at 518 (personality as investment banker for corporation), and Kubler, *supra* note 261, at 103 (personality as "house bank" for corporation). *But see* Roe *supra*, note 248, at 1939 ("fading," at least for large corporations, of house bank function).

477. *See* Roe, *supra* note 248, at 1971.

478. *See id. See* Macey, *supra* note 279, at 514–15.

of the ward shareholder. This is particularly if one is of a "plebe" variety that depends on the universal bank for objectivity.[479] The investment fund managed by the universal bank is protected, to a degree, from this reactiveness. German law requires that the investment fund, to protect its interests, have its "own" representative present at the physical holding of the annual meeting.[480]

Finally, the universal banks may act as *pro-active shareholders*. The German model does curtail the universal bank as pro-active oversized investor. The model enables the other shareholders to deny the bank voting power to the extent that its own proprietary ownership of shares typically exceeds five to fifteen percent of total voting power.[481] On the other hand, depending on economic conditions, the universal bank might well assume an oversized investor's conservative mind-set which unduly constrains the entrepreneurial spirit of management. For example, on capital structure issues, the universal bank shareholder might assume the mind-set of a super-cautious extender of credit if the universal bank believes itself to be too highly leveraged.[482] In the meantime, already influenced by the pressure of this conservative element in its corporate deliberations, management is attempting to negotiate with the universal bank regarding the extension of credit. Creative tension in the negotiating process may therefore be lacking because of the universal bank's strong position as an annual meeting participant.

2. Curtailment of Any Counter-entrepreneur

Again, depending on economic conditions, the universal bank might assume a short-term speculative orientation as a sort of "counter-entrepreneur." Similar to the creditor orientation discussed earlier, this might be in opposition to the more long-term entrepreneurial orientation of the managerial board. Thus, the bank record shareholder with the substantial voting power at its disposal might be a lead investment banker for the corporation.[483] As such, the universal bank, no matter how controlled and sophisticated it may be in fulfilling its role, is nevertheless a speculator. The bank, both a major voter of shares and an investment

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479. *See* Baums, *supra* note 5, at 519.

480. *See id.* at 505 n.16.

481. *See* Macey, *supra* note 279, at 88–89 and Baums, *supra* note 5, at 507–08.

482. *See* Macey, *supra* note 279, at 76, 94.

483. *See* Baums, *supra* note 5, at 518 and Kubler, *supra* note 261, at 103. *But see* Roe, *supra* note 248, at 1939.

banker, is in a position to enhance its equity investment in the corporation. It is also in a position to enhance its voting power. Thus, it might require the corporation to give it "rights of first refusal" or "pre-emptive rights" in connection with any offering of shares to the public.[484]

The German model curtails the role of the universal bank as counter-entrepreneur by enabling the other shareholders to limit the universal banks voting power once its proprietary interest voting power exceeds a threshold.[485] However, a significant level of ownership, such as five percent, does not subject the counter-entrepreneur to a standard of care in exercising its voting power. Rather, there must have been an "honor code principle" undertaking on the part of the universal bank. Such an undertaking could be in the form of willingness to send a representative to serve on the supervisory board.

3. Critique

Certain specific statutory rights of ward shareholders, in relation to their dealings with universal bank record shareholders, could be spelled out by statute enacted by the federal legislature.[486] This could be in the interest of equal treatment of those willing to take on the duties and limitations of "institutions of private law" by the government. [487] These rights could pertain to a variety of subjects including (1) information in advance of the annual meeting,[488] (2) getting together with other ward shareholders in advance of the meeting regarding such subjects as shareholder proposals and alternative slates of supervisory board members,[489] and (3) presence at the physical holding of the meeting.[490]

D. Disclosure Leading to an Annual Meeting

The universal banks have significant advantages from a disclosure standpoint. The independent shareholder does not have them. There are

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484. *See* Baums, *supra* note 5, at 516–17 and Kubler, *supra* note 261, at 98.

485. *See* Macey, *supra* note 279, at 890–91 and Baums, *supra* note 5, at 507–08.

486. For a commentator who is also of the opinion that universal bank holdings in commercial corporations should somehow be "limited," *see* Kubler, *supra* note 261, at 108.

487. "Shareholders" are given a statutory right to be treated in the same manner as other "shareholders." *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 53(a).

488. *See infra* Part XII.D.

489. *See infra* Part XII.F.H.

490. *See infra* Part XII.E.

scant statutory assurances that the advantages will be shared with the ward shareholders. The capitalist catered to under the German model is the universal bank. It is the universal banks that are typically lenders to stock corporations and are therefore in privity of contract with them. The German model has permitted the use of insider information derived from a non-securitized lending relationship by a universal bank.[491] This includes use by the investment funds as long as the inside information is not material for purposes of Germany's insider trading law.[492] In addition, there are informational advantages to the universal banks by virtue of their representation on the supervisory board. However, these are strictly circumscribed as compared to the advantages from the lending relationship.[493]

The universal bank is clearly preferred over the ward shareholder in other respects as well. However, they are not preferred over the independent shareholder. The three main constituencies of shareholder, the universal bank, the ward shareholders and the independent shareholder,

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491. *See* Benfield, *supra*, note 317, at 633–34 and Baums, *supra* note 5, at 517. Even after the passage of an insider trading law in 1994, use by universal banks of potentially market-moving information that has not yet been disclosed to the public, is permitted if use is restricted to voting at the annual meeting. And, since the universal bank, in its credit-extending capacity, is not a "stockholder," it is not a highly accountable "primary insider" for purposes of the German model's insider trading law but, rather, a somewhat less accountable "secondary insider." As a "secondary insider," the universal bank *may not trade* on inside potentially market-moving information for itself or for others. However, as such a less accountable insider, it is not precluded from *providing others*, such as its sufficiently separate investment funds, with potentially market-moving information. Thus, the universal bank representative on the corporation's supervisory board may not be at risk of liability under the insider trading law for any violation by the bank's investment funds so long as they adhere to "honor code" principles of separateness. The German model takes steps to assure that the investment fund, as managed by a universal bank, is separate and distinct from the bank in its other record stockholder capacities, particularly on the floor of the annual meeting. *See* Pfeil, *supra* note 257, at 162–64.

492. The investment fund, once it receives the inside credit information, becomes a secondary insider such that its use of the information cannot include trading on the basis of the information but can include voting on that basis. *See* Pfeil, *supra* note 257, at 162–64.

493. As to the circumscribing of the informational advantages of membership on the supervisory board, if a universal bank representative on the board informs his principal (in its shareholder capacity) of confidential information that he has received as a member of that board, there is a statutory requirement that the information also be made available to any shareholder requesting it on the floor of the annual meeting. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 131.

As to the greater informational advantages of a credit relationship, *see* Baums, *supra* note 5, at 512–13, 517. *See also* Macey, *supra* note 279, at 87–88 (deposit-taking, as well as other lender functions, as a source of inside information).

receive the following information relative to corporate performance *in advance* of the physical holding of the annual meeting:

> 1. *Procedural information.* All three constituencies will receive the call of the meeting, any special circumstances of the meeting if this information is demanded, and the agenda items as prepared by the managerial board.[494]
>
> 2. *Recommendations of management.* All three constituencies will receive the recommendations of the managerial board and those of the supervisory board. Reasons for the management recommendations need not be given except in the case of a shareholder proposal opposed by management.[495]
>
> 3. *Information regarding shareholder proposals.* All three constituencies will receive these proposals. As seen above, these can be made only by independent shareholders or the universal bank.[496]
>
> 4. *Information mainly relating to long-term operating performance.* The universal bank record holders and the independent shareholders are in a position to receive or demand various additional items of financial information directly from management, in advance of the meeting. One is the corporation's annual financial statements as prepared by the managerial board. Another is the supervisory board's "report" on its "audit" of the financial statements. A further item is the managerial board's recommendation as to "appropriation" of "unappropriated earnings." Finally there is the "business report" prepared by the managerial board relating to the corporation's capital structure, provided that there may be the omission of information necessary for the well-being of the "nation or one of its states."[497]

No statutory provision specifies how the *ward shareholder* is to receive this conglomeration of reports. Rather, he typically receives the information only to the extent that his universal bank record-holder, influenced by the

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494. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 124, 125, 127, 128.

495. *See id.* at §§ 124.3, 126, 128.

496. *See id.* at §§ 123, 126.

497. *See id.* at § 175.

ward shareholder's fundamental right of stock ownership, *chooses* to pass it on to him perhaps in accordance with an internal code of conduct.[498] In short, under the German model, only the universal bank record holder is given by management in advance of the annual meeting by virtue of lending relationships. This information is routinely given by management in the U.S. to the citizen capitalist: business and services, enterprise objectives, short-term share price performance, comparing performances with objectives, comparing results with the competition, and personnel policies and compensation.[499]

There are other sources of information as well. This is not to say that the independent shareholders and ward shareholders are totally in the dark. First, there are a variety of sources of information accessible to a hard-digging press although they are not readily available to the public.[500] However, a corporate spokesman is discouraged from talking by the threat of criminal prosecution if he reveals "confidential" information as broadly defined by statute.[501] Second, full information is available if the corporation is in the midst of or has just completed a public offering of shares that have been newly listed on a stock exchange. In this case, even a ward shareholder can readily get information.[502] However, the information on file with the exchange for this offering need not, under the German model, be updated for purposes of trading in the "secondary market."[503] Third, material developments in the corporation's fortunes will likely be timely in front of the public. Under Germany's new insider

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498. The law, as translated into English, merely provides that the reports relating to long-term operating performance "shall be exhibited for inspection by shareholders (sic) in the company offices" and a copy of the reports "shall be given, without delay, to any shareholder (sic) who so requests." *See id.* However, the law does not specify how a ward shareholder is to prove to the corporation that he is indeed a "shareholder" if he approaches the corporation directly. It can only be assumed, therefore, that at least as a practical matter, the ward shareholder can "approach" the corporation only through his universal bank, to get the reports relating to long-term operating performance. *See id.*

499. *See supra* Part V.A.

500. Main sources of information to the hard-digging press would be (1) the "Commercial Register," (2) the "Federal Gazette," (3) "company newspapers," and (4) notices at establishments of the corporation. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 20(6), 106, 124, 125. *See also* DROSTE ET AL., *supra* note 258, at 192.

As to the necessity for a digging press,"practically no investor ever reads (the Federal Gazette)," according to one commentator. *See* Hardenberg, *supra* note 417, at 226.

501. *See* Kraus, *supra* note 261, at 110-13 and Blum, *supra* note 5, at 511-12.

502. *See* Kraus, *supra* note 261, at 110-13. *See also* Blum, *supra* note 5, at 511-12; DROSTE ET AL., *supra* note 259, at 608.

503. *See* Kraus, *supra* note 261, at 110-13. *See also* Blum, *supra* note 5, at 511-12.

trading law which was enacted in 1994, corporations are statutorily required to "immediately" announce new corporate developments publicly. This information must be "capable of considerably influencing the value of a security" once announced. However, this would probably not go beyond information that is considered material to an "average" prudent investor in buying or selling the shares. Therefore, the information might well not make up for the detailed information that the universal bank has, particularly as extender of credit.[504]

Usually, there is no disclosure of compensation to the independent shareholders or ward shareholders in advance of the annual meeting under the German model. Compensation involves the right to choose one's occupation and therefore is confidential unless there is a crisis requiring resolution of fundamental rights. Then, the subject of compensation is therefore an agenda item for the annual meeting.[505] This is not to say that compensation is unimportant under the German model. It is simply not a subject disclosed for the record shareholders before the annual meeting. As for "*job-security compensation*," in theory this form of compensation is not necessary. A German executive officer, that is, an "executive" member of the managerial board, cannot be fired at will but rather only for a statutorily specified cause.[506] From the point that the executive was appointed by a two-thirds vote of the supervisory board,[507] the executive's contract is for a five-year term.[508]

Additionally, compensation of a *wage* nature does not exist for executives under the German model. The terms of the contract are regarded as assuring that an executive will provide the corporation with the value that

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504. *See* Pfeil, *supra* note 257, at 168–69. A commentator has argued that such a disclosure, addressed to the "average" investor, is of value only for the purpose of determining *price* in organized capital markets, and not for sophisticated analysis by an individual investor. *See* Meier-Schatz, *supra* note 265, at 290–91.

505. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 124.4. Even if the subject of compensation is not an agenda item for the annual meeting and is confidential, management, in the interest of equal treatment, must reveal compensation information on the floor of the meeting, at the request of a shareholder, if the managerial board or supervisorial board has given information on compensation to another "shareholder" in advance of the meeting. *See id.* at § 131.4.

506. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 84. *See also* Baums, *supra* note 5, at 504.

507. There are permutations to the two-thirds vote to assure the slight pre-dominance of the capital half of the supervisory board referred to earlier in this article. *See* Kolvenbach, *supra* note 265, at 165.

508. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 84 and Baums, *supra* note 5, at 504.

the latter has bargained for. Only if there is a statutorily prescribed degree of diminution in the financial fortunes of the corporation is a reduction of compensation permissible.[509] As for the U.S. approach that materialization of conflicts of interest constitutes a "wage," the German model provides for court supervision of the issue instead of disclosure to the shareholders.[510]

Further, compensation in the form of a cash "*bonus*" is rare under the German model. "Extra" compensation is regarded as inappropriate for doing one's duty. Any recommendation that executives be paid cash bonuses by the managerial board to the supervisory board is subject to an accusation of selfishness.[511] Constituencies innately hostile to a cash bonus would be both labor, employee wages, and capital, dividends.[512] However, if the bonus is "an equity participation bonus," as defined earlier in this article, the labor and capital hostility may not exist. The traditional view is that stock ownership is a "perquisite of management."[513] Under normal circumstances, principles of confidentiality would preclude disclosure of the equity participation bonus to shareholders in advance of an annual meeting.[514] The "volunteer" who *works for free* or for a salary that is too low by community standards is viewed as sufficiently counterbalanced by application of the honor code principle in the German model. Palpable conflicts of interest would be subject to judicial scrutiny.[515]

Lastly, *compensation egalitarianism* is already handled by the supervisory board. In fact, it is a main function of this overseeing body to fix an appropriate relationship among (1) compensation to capital in the form of dividends, (2) compensation to managerial board members and other white collar workers in the form of salaries, and (3) compensation to blue collar workers in the form of wages.[516] A crisis requiring disclosure regarding compensation issues exists once there has been a public announcement of unfavorable material developments in the corporation's fortunes. This may prompt management to put compensation issues on the agenda to essentially obtain a release from responsibility from the annual meeting.[517] Even if there is a crisis relating to compensation issues and the

509. *See id.*

510. *See id.* at §§ 88, 117.

511. *See supra* note 328 and accompanying text.

512. *See supra* note 328 and accompanying text.

513. *See supra* note 330 and accompanying text.

514. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 93, 116, 117, 131.

515. *See id.* at §§ 88, 117.

516. *See* Kubler, *supra* note 261, at 109–10.

517. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 117.2.

matter is on the agenda, even the independent shareholders are accorded little opportunity to get meaningful information in advance of the annual meeting unless management provides it. Perhaps they may do so in accordance with an internal code of conduct sensitive to fundamental rights.

A tool needs to be devised whereby ward shareholders can receive the same information in advance of annual meetings as German investment funds. The device could apply to either German citizen shareholders or foreign investment fund shareholders.[518] One possibility arises from the honor code methodology that applies to German investment funds under the German model. The methodology is that individual officers of the universal banks are deemed to represent the interests of the investment fund. Under internal codes of conduct, they are to receive information rigidly conveyed to them by the universal bank as fiduciaries answerable only to the investment fund.

Similarly, individual officers of the universal bank could receive information from the universal bank as fiduciaries answerable only to the ward shareholder. The advantage of this approach is that confidential information would not have to actually be conveyed to individuals outside the employment of the universal bank. A disadvantage is that the ward shareholders may well represent a variety of interests and perspectives. Therefore, too many separate employees of the universal bank would have to follow "honor code" principles if such ward shareholders are to be represented. Alternatively, the ward shareholders could become contractually bound to the universal banks to observe principles of confidentiality themselves and undertake certain other obligations. This would be an "institution of private law" obligation imposed upon them if they are to receive the same information in advance of an annual meeting as is given to the German investment funds.[519]

E. Assurance of Integrity of Any "Grade" Given Management

Giving a grade on the performance of management is not a main purpose of the annual meeting under the German model. Unlike the case in the U.S., the annual shareholders meeting is not characterized by judicial-

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518. The desirability of involving foreign investment fund shareholders in corporate governance, in particular, encouraging personal attendance at annual meetings has been the subject of a German study group investigation. *See* Kubler, *supra* note 261, at 106.

519. This would give the ward shareholder insider information that he may be precluded from trading on, as a "primary insider," until the information is divulged (on a statutorily-mandated immediate basis) to the trading markets *See* Pfeil, *supra* note 257, at 156–58; *see* also Roe, *supra* note 248, at 1987 n.189.

form procedures. Moreover, there is no "drafting" of directors as in the U.S. There is no drawn out process for digestion of information as a basis for a participatory democracy session at the annual meeting. There is also no specific *statutory* assurance of dependable voting protocol as in the U.S.

1. Citizen-as-master Dynamism

There is no citizen-as-master "dynamism," under the German model. The core U.S.-type purpose of a draft of directors out of a legally unlimited universe is not to be found. Rather, the effort is to elect members of a supervisory board that are acceptable as members of that institution of private law.[520] As for initiation of the process of selecting nominees for the *capital* half of the supervisory board, the managerial board is *not* to recommend nominees out of an unlimited universe. It recommends nominees that will satisfy statutory requirements of Germany's co-determination law.[521] This mandate militates against the recommendation of any "independent" director who would not assuredly represent the interests of the "capital" half of the supervisory board. The model encourages the managerial board to rely on suggestions from current "capital" members of the supervisory board, that is, from the current shareholders, primarily the universal banks.[522]

Absent an election contest, there is no statutory requirement to disclose any conflicts or confluences of interest of the nominees, to ward or independent shareholders. All that is required in an uncontested setting for the process of voting on the nominees for the capital half as recommended by management, are management's recommendations and the "names, addresses and occupations" of the nominees.[523] Once the nominees assume office, their performance of duties in the event of a crisis situation is judged in the courts more rigorously than it would be the case for "drafted" directors in the U.S. courts.[524]

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520. *See supra* notes 315-320 and accompanying text.

521. *See* Baums, *supra* note 5, at 505; Kolvenbach, *supra* note 265, at 164; and Peltzer, *supra* note 259, at 34. The universal bank shareholder component of the supervisory board (an institution of private law, expert on the subject of co-determination) is regarded as particularly knowledgeable about the "management market" and therefore in a position to appoint "the right people to the supervisory board" *See* Baums, *supra* note 5, at 513.

522. According to one commentator, it is very common for "nominees of banks" to sit on supervisory boards, and these nominees "are often directors and officers of the banks at the same time." *See* Blum, *supra* note 5, at 519 n.65.

523. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 124.3.

524. *See* Peltzer, *supra* note 259, at 34-35. *See also* Schwanke, *supra* note 259, at 13.

2. Participatory Democracy Vigor

There is vigor as it exists in the U.S., only if there is a crisis. Even then, there is an absence of the vigor that exists in a participatory democracy of free-ranging discussion with participants, including citizens, armed with advance information and with the expectation that creative ideas will emanate from the citizens. Rather, under the German model, the vigor is exercised mainly at the annual meeting itself in a structured interaction where matters discussed are kept reasonably confidential.[525] The structured interaction is largely among the managerial board, socially-obligated capital, and independent shareholders. There is little, if any, substantive involvement of the supervisory board. This interaction, however, is monitored by labor since any member of the supervisory board, including a labor member, may be present.

It is at this physical holding that detailed information is for the first time given to the shareholders present. The information must be relevant to an agenda item, unless previously disclosed in advance of the meeting to one of the shareholders present.[526] If requested information is withheld by management, the German judiciary is given a statutory mandate to immediately adjudicate the issues.[527] In other words, the German model emphasizes structured interaction at the physical holding of the meeting. The U.S. approach, in contrast, emphasizes not so much what occurs at the annual meeting but rather the whole "judicial-form" process, including the pleading phase in advance of the meeting.

The "vigor" of the structured interaction at the physical meeting is tempered under the German model. With one significant exception,[528] management is not required to give requested information if: (1) "on the basis good business judgment, divulgence is apt to cause considerable damage to the corporation;" (2) the request would require disclosure of "trade and operational secrets and other confidential information," learned through membership on the managerial or supervisory board; or (3) unless the annual meeting is itself performing an "audit," the request would require divulgence of financial statement-related information.[529] Moreover, the "vigor" is not enhanced, as it is in the U.S., by any presence of the press at the annual meeting. For one thing, there is no central governmental

525. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 131.

526. *Id.*

527. *See id.* at § 132.

528. *See id.* at §§ 131.4, 131.5, 132.

529. *See id.* at §131.

repository of information for corporate objectives and performance like the SEC. Rather, the relevant governmental repositories under the German model are scattered, requiring particularly diligent investigation by the press if it wishes to be knowledgeable.[530] Moreover, the press may not be permitted to attend the annual meeting since it is generally a crime for a member of management to divulge to the *public* information that may harm the corporation under the German model.[531]

3. Ministerial Duties Dependability

There is a dependability of ministerial duties of some sort which is predicated on internal codes of conduct such as the honor code principle but dependability is not sought as in the U.S. It is questionable whether this dependability is enough if the proprietary interests of the universal bank, largely responsible for discharge of internal codes of conduct, create a conflict of interest.[532]

There is protection from the more unconstrained of fellow shareholders. The approach of the German code is that a discipline of ministerial duties is not necessary to counter any large and untested electorate. Thus, it is not considered necessary to give management relatively unfettered discretion to select the time and place of the annual meeting. The electorate is tested under the German model rather than "untested," as is arguably the case in the U.S. Besides the unlikely-to-be disruptive universal banks record holders and investment funds, the independent shareholders and the shareholders' associations that represent them, must go through the trouble of depositing their shares with the corporation or with a notary public or security deposit bank.[533] Rather, the German model is more interested in assuring attendance of the responsible institutions of private law, as well as protecting fundamental rights. Therefore, there is a predictable location for the annual meeting. In general, the meeting must occur in either the "home state" of the corporation or in the state of one of the national stock exchanges on which its shares are traded.[534]

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530. *See supra* note 500.

531. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 93, 117 and Peltzer, *supra* note 259, at 34-35.

532. For elaboration on the existence of conflict, *see* Roe, *supra* note 248, at 383. *See also*, Macey, *supra* note 279, at 80.

533. *See supra* Part XII.D.

534. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 129.4.

There is no statutory listing of procedures to assure that proxies are exercised strictly in accordance with the directions of the proxy-giver. The only statutory requirement is that a proxy holder have provided his beneficiary with a "form" to indicate his instructions.[535] There is no specific statutory requirement that a beneficiary state whether or how instructions to his proxy holder may be *revoked*.[536] Further, German statute permits a proxy holder to deviate from an express or implied directive of a beneficial owner, provided he tells the latter about the deviation and the reasons for it, after voting.[537] A proxy holder is, by statute, permitted to deviate from its own proposals disclosed to a beneficiary and deemed accepted by him if, on further reflection, the proxy-holder has reason to believe that the shareholder would not approve of the proposal.[538]

The German model has no provision for election inspectors who are independent of management to oversee discharge of internal codes of conduct. Rather, by statutory requirement, the corporate charter is to specify how the right to vote is to be "exercised."[539]

Protection of "co-determination" is more important under the German model than protection against corporate uncertainty. The term of a "capital" member of the supervisory board ends when the next annual meeting is held. Unlike the U.S., there is no additional requirement that a successor to a member shall have been elected and qualified on that day.[540] The problem faced by the German model is that there has to be equality between the process for the capital vote and the one for the labor vote.[541] For this reason, on petition of the managerial board, a court is statutorily given discretion to appoint a "capital" member to fill any vacancy because of a failure to elect one at the annual meeting. The purpose of involving the court is so that the fifty-fifty split that co-determination requires between capital and labor, is not disturbed.[542] In addition, floor nominations for

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535. *See id.* at § 121.

536. *See id.* at §§ 123, 125.

537. *See id.* at § 135.4.

538. *See id.* at § 135.8.

539. There is no express statutory requirement that the corporation specify how a proxy may be revoked as an aspect of the exercise of the right to vote. *See id.* at § 134.4.

540. *See id.* at § 102.

541. *Cf.* Kubler, *supra* note 261, at 106.

542. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 104.

directors are permitted to counterbalance any such failure. However, they are subject to a statutory rule that a director elected in this manner is subject to recall on a vote by three-fourths of the shareholders.[543]

4. Critique

From the perspective of the ward shareholder, there could be strengthening of the role of dynamism in the selection of capital members of the supervisory board. This could be achieved by statutory provisions requiring that a universal bank's record shareholders have a special nominating committee of honor-code-bound officers of the bank. It is this nominating committee to whom ward shareholders could convey suggestions for nominees. In addition, the universal banks could be statutorily required to give their ward shareholders information bearing on possible conflicts and confluences of interest of their representatives on the supervisory board with the particular corporation.

Like German investment funds, the ward shareholders could, by statute, have the right to have a separate officer of the universal bank personally present at the annual meeting to represent their interests only.[544] Alternatively, by statutory provision, the ward shareholder could have the right to have his own representatives present at the meeting as a special "invitee" of his universal bank. He would be subject to all the contractual and "institution of private law" obligations of his universal bank.

An argument can be made that universal bank internal codes of conduct are sufficient to protect rights to voting procedures that have integrity. However, more assured protection could be provided by a statutory listing that is in greater detail. For example, areas where greater statutory detail could occur are those of (1) revocation of proxies and (2) deviation from instructions of the proxy-giver, by the proxy-holder.

F. Assured Integrity for any Election Contest

Except in the case of universal banks, the German model discourages the formation of dissident factions in advance of an annual meeting. The universal banks, on the other hand, are encouraged to "test the waters" in advance of the meeting, so they may form a faction that can take vigorous part on the floor of the meeting. However, there are no statutory provisions specifically directed to the right of ward shareholders to test the waters for

543. *See id.* at § 103.

544. *See* Kubler, *supra* note 261, at 106.

election contests, whether or not through the universal banks. Independent shareholders have only a very limited ability to test the waters and are therefore discouraged from attempting to form a dissident faction.

The German model recognizes a right to propose a slate of capital nominees for supervisory board membership as involving a fundamental right to associate as well as a fundamental right of stock ownership. In contrast to the U.S. approach, the model does not provide for the existence of a channel of communication between a *nominating committee* of the supervisory board and "citizen shareholders."[545] On the other hand, unlike the U.S., the German stock corporation *is* required to include *all* slates of capital members in a corporation information statement relating to the meeting. This is true whether the slates are proposed by management, separately by universal banks, or are proposed separately by independent shareholders.[546]

1. Initial Testing of the Waters by a Contestant

Initial testing is encouraged if the contestant is a universal bank record-holder through the representatives of universal banks sitting together on the supervisory board. The universal banks are also in a position to test the waters with those of its ward shareholders who are assertive enough to become involved by invitation from their universal bank. However, in contrast to the U.S., there is little, if any, ability on the part of the ward shareholders to get in touch with *each other*.

The position of the ward and independent shareholders to test the waters with each other is potentially improved by virtue of Germany's new insider trading law.[547] Now even they will be aware of potential crises. They will be alerted to the possible advisability of instituting election contests. The obvious effort on the part of an independent shareholder is to attempt to quickly form shareholder associations to hold the shares and place them on deposit with the corporation, a notary public or a "security deposit bank." The association would then inform corporate management of its alternative slate so that it would be included in the management

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545. There can be no nominating committee consisting of only part of the supervisory board, that is, a nominating committee that does not include labor members of the board. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 107.3.

546. *See id.* at §§ 125, 126. This is in contrast to the U.S. where the management proxy statement need not include alternative director slates proposed by outsiders. In the U.S. any such slate must appear in a separate proxy statement prepared at the expense of the alternative slate proponents.

547. For a description of this law, enacted in 1994, *see* Pfeil, *supra* note 257.

information statement. By then, the association will have hopefully learned the identities of independent shareholders present at the previous annual meeting. They will also have learned the identities of ward shareholders who were assertive for purposes of that annual meeting by directing "their" universal bank record holder to disclose their identities in the registration book for that previous meeting.[548]

2. Existence of Any Favoring of "Citizen Organizers"

Only in a very narrow sense and only in a publicly-announced crisis are *citizen* organizers of factions favored. The German model can accomplish the equivalent of the U.S. "vigor of the publicized dissident faction" only in that the German model makes the annual meeting an institution of private law in the event of a crisis.[549] Still, this vigor, exerted behind essentially closed doors, is designed more to protect fundamental rights than to favor citizen organizers as protectors of the public interest. There is likely no press present to appreciate the efforts of independent shareholders on the meeting floor.

3. Curtailment of Organizers

As seen above, curtailment of counter entrepreneur organizers who are independent shareholders is not achieved by publicity in advance of the annual meeting. Thus, alternate slates of supervisory board members may be proposed for the first time from the floor of the meeting as long as the election of such directors is announced in advance as an agenda item.[550] However, any such slate of board members actually elected is subject to later recall on the vote of three-quarters of the shareholders. The universal record holders, if disenchanted with the slate as elected, may well be able to muster such a voting block.

Once factions are organized, only bare-boned information is required about the faction in advance of the annual meeting. Thus, there is no statutory requirement that a universal bank give U.S.-type detailed information to its ward shareholders relating to an alternative slate of capital members of the supervisory board.[551] No information, for example, is

548. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 129, 135.

549. *See id.* at § 119.

550. *See id.* at § 124.4

551. *See id.* at § 128.2.

statutorily required bearing on all conceivable confluences or conflicts of interest on the part of the members of the slate, with the corporation, as required in the U.S.[552]

4. *Critique*

Admittedly, internal codes of conduct instituted by some universal bank shareholders of record could, in fact, have the effect of promoting the testing of the waters by ward shareholders who would be faction organizers. However, whatever internal codes of conduct exist, they are private. Prospective investors in German stock markets, such as German citizen investors and foreign investment funds, could well need up-front assurances of protection of their rights to institute election contests. Such assurances could be provided by an explicit statutory framework. The first level of the framework could be a statutorily-prescribed structured interaction among ward shareholders and "their" universal bank record holders. The interaction entity for this purpose (hereinafter "the first level shareholder board") could be organized along the lines of the supervisory board. Its membership could consist of both representatives of the universal bank as record owner in a fiduciary capacity, and ward shareholder representatives. The chairman, with a tie-breaking vote, could be a universal bank representative. This is because of the institution-of-private-law importance of the universal bank under the German model.

In a meeting of the shareholder board involving the universal bank that is record shareholder in a particular corporation, there would be a "second level structured interaction" among all the universal bank record holders at a meeting of a "second-level shareholder board." This meeting follows the "first-level structured interaction." The goal is to ultimately arrive at a final position on the part of that corporation's "capital." This final position could, as one alternative, be conveyed to management by a universal bank spokesman as a suggestion for *management's* slate of supervisory board. As another alternative, the final position could be an opposition slate proposed by the universal bank for final instructions from its respective ward shareholders.

Under this proposed statutory rubric, the *universal banks in their investment fund and strictly proprietary capacities*, as well as the "*independent shareholders*," will not have been contacted in advance of the annual meeting for purposes of structural interaction in meetings of the shareholder board. This is not to say that a mechanism could not be devised

552. *See* Baums, *supra* note 5, at 521. *See also supra* Part XII.D.

that includes these constituencies. This will, however, require cooperation of corporate management. The need for this cooperation might move the project partially away from the universal banks in their clearance, settlement and custody capacities. The project could well involve corporate "home state" law under the German model and limit the prospects of applicability to *foreign* corporations whose shares trade on German national stock exchanges.

To sum up, the German model's main protection against undesirable surprise at the physical holding of the annual meeting is still not publicity. Rather, it is the involvement of the universal banks in a "primary responsibility capacity" as institutions of private law in any election contest. To assure that assertive ward shareholders are socially-responsible, they could be required to take on an institutional coloring. Statutory provisions could require a common goal of "social capitalism" at meetings of the above two levels of shareholder board. This common goal would be analogous to "co-determination" for meetings of the supervisory board. The deliberations of the shareholder board would include the tie-breaking vote of universal bank chairmen. A disagreeing assertive ward shareholder could have immediate access to the judiciary branch to resolve issues of balancing the fundamental rights which is not to ignore his right to stock ownership.

G. Underpinning of an Assured Minimum Level of Short-term Share Price Performance

The German model provides less statutory and regulatory assurance of dissemination of accurate financial information to the market place than does the U.S. In addition, the German model's "pragmatic" definition of material inside information for purposes of deterring insider trading, requires guidance from institutions of public and private law before a development becomes material. As a result of this, the German model has distaste for the abstractly worded writ issued by a regulatory agency and corporate officials with an "anti-social" mind-set are still able to take advantage of the traditional stock ownership prerogative of trading on important inside information which has not yet been deemed material by institutions.

Since the insider trading law of 1994 was enacted, the German citizen capitalist can have a modicum of confidence that patently self-interested interference by insiders with the market price of shares has been avoided. This is the case even though, as we have seen above, the German model requires only one-time disclosure of a detailed nature as found in the U.S. This occurs when the shares are first registered with an exchange for

trading on it.[553] Thereafter, such disclosure is updated by disclosure of material developments as required, for instance, by the insider trading law.[554]

1. Dissemination of Accurate Information

We start with this first aspect of an assured level of short-term share price performance. The nature of ministerial duties must be considered. The German stock corporation, in connection with its accounting for its operations, has not been subject to a *writ* setting forth objective standards for the maintaining of objectively-defined internal accounting controls. There is no statutory provision broadly defining such controls to assure the accuracy of financial information whether it is used internally or conveyed to the public.[555] On the other hand, strong responsibility is placed on the managerial board to assure that specific preventive actions are taken if internal financial information gives statutorily-defined warning signals.[556] The supervisory board cannot rely on financial information conveyed by the managerial board regarding the lack of any such signals. Rather it *must* perform or be involved in an "audit" of the corporation's financial disclosure documents.[557] The supervisory board may, for this purpose, *inspect* the corporation's books and records. This is a precaution that is typically unnecessary because the supervisory board or the annual meeting appoints an "accounting auditor" to perform that function.[558] In a sense, the auditor is an institution of private law guiding other institutions of private law, primarily the supervisory board and the annual meeting.[559]

The sanctions are severe if mistakes are made and they lead to the corporation's declaration of bankruptcy. Thus, the members of the managerial and supervisory boards, on pain of criminal prosecution or civil action for damages based on privity of contract, must be able to prove that

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553. *See* Kraus, *supra* note 261, at 110–13.

554. *See* Pfeil, *supra* note 257, at 168–69.

555. The only statutory provision is that financial statements "answer the conditions of a true and conscientious accounting." *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 131.2.

556. *See* Peltzer, *supra* note 259, at 34–35 (criminal liability for failure to inform shareholders if half of capital is lost or failure to initiate insolvency proceedings in case of "overindebtedness").

557. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 11, 171.

558. *See id.* at §§ 119, 142. *See also* Arlene G. Wenig and Godehard H. Puckler, *Public Accounting in West Germany: an Overview*, J. OF ACCT. 82 (1982).

559. *See* Wenig, *supra* note 558.

they "applied the care of an orderly and prudent man of business." If an auditor is appointed he must be able to prove he has "performed his audit conscientiously and impartially."[560]

Next, those *performing ministerial duties* must be considered. In response to these non-objective accountability standards, the managerial and supervisory boards are not statutorily given a publicized list of officers to assign public ministerial responsibilities as in the U.S. Statutory provision is made only for a "president" of the supervisory board, a president of the managerial board, an auditor as selected by the supervisory board or annual meeting, and a special auditor as selected by the annual meeting.[561] These officials are not *public* in the U.S. sense. Rather, they can be regarded as representatives of the boards as institutions of private law who are constrained by principles of confidentiality.[562] Otherwise, provision is made for company administrators expected to follow an honor code in fulfillment of the leadership principle. Thus, the managerial board, with guidance from the supervisory board, "sets up its own rules."[563] The supervisory board, to a limited degree, may but they need not establish committees of its own members.[564]

In short, there is no legislative mandate for any U.S.-type officials whose prescribed duties have public implications, including: (1) a corporate secretary; (2) a compliance official; (3) a principal accounting officer; (4) a current "independent public" accountant; (5) a *former* independent public accountant who is publicly accountable as in the U.S.; (6) any director who, if he has resigned, has the right to bring financial-statement-related disagreements he has had with the other directors to the attention of the citizen-capitalists and thus, the public markets; or (7) officials of a government agency, such as the SEC, who are publicly accountable for expeditious monitoring of financial information.[565]

Let us consider the likely process of corporate preparation of the financial disclosure documents required by law to be made available to universal bank and independent shareholders. In considering this process, let us assume that the previous annual meeting has selected an accounting auditor for purposes of auditing the annual financial statements. The procedure of an individual corporation is likely to be as follows. First, the

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560. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 93, 116, 144.

561. *See id.* at §§ 107, 84, 119.

562. *See id.* at §§ 93, 116, 117, 144.

563. *See id.* at §§ 77, 111, 107.

564. *See id.* at § 107.3.

565. *See supra* Part VIII.A.

auditor inspects and audits the books and records of the corporation as kept by an undisclosed administrative employee assigned to the task by the managerial board pursuant to an internal code of conduct. The auditor performs his functions taking into account auditing guidances of an "institute of auditors," an institution of private law. The latter will have not made a determination that the standards are objectively "generally-accepted." Rather it will have made the judgment that the guidance is consistent with a "true and conscientious accounting."[566] The above administrative employee who has kept the records will, like the above auditor, have had in mind these accounting guidelines.

In performing his audit, the auditor tests any internal accounting controls monitored by an administrative employee privately designated by the managerial board to perform internal audits. The latter relies on guidance of the above institute of auditors regarding internal audits. Another undisclosed administrative employee prepares the annual financial statements for the managerial board. He, and that board, perform their duties in accordance with the above accounting guidance promulgated by the institute of auditors. The auditor, as one of his duties, offers his comments on these statements to the supervisory board in plenary session to include labor members. He will not have had a definitive pre-screening with any audit committee composed of part, but not all, of the supervisory board members before doing this. The events that transpired in this plenary session of the supervisory board will be reflected in minutes signed by the chairman of the supervisory board. The minutes are statutorily required to set forth only "essential" contents of the proceeding.

If the supervisory board approves the annual financial statements, the managerial board assigns an undisclosed administrative employee to assure that the required information is made available to the universal bank and independent shareholders in accordance with legal requirements. No government agency assists or monitors the dissemination of information relevant to the annual meeting, as the SEC does in the U.S.

2. Dissemination of Timely Information to the Market Place

We now consider this second aspect of an assured level of short-term share price performance. There is no reliance on legislative or executive writs issued by *an administrative agency* to deter undue volatility in the price of shares, as in the U.S. There is a specific directive promulgated by a democratically-elected legislature which requires a managerial board to

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566. *See* Pfeil, *supra* note 257, at 168-70.

cause the corporation to immediately disclose all potentially market-moving information to the "investing public" via exchange newspapers and electronic information systems.[567] At the same time, it is by specific directive promulgated by the same legislature, that insiders are prohibited from, and criminally prosecuted for, trading on this information before it is publicized.[568]

There is also no reliance on a grand jury to uncover and initiate proceedings against an offending trader on the basis of inside information as there is in the U.S. Thus, there is no "convening" of the general public in the form of a publicized hearing by an administrative agency hearing officer. There is no supplementing of this process by the payment of statutory bounties to members of the public who provide information culminating in a successful prosecution. Instead, as seen below, the German model relies on institutions of private and public law. It is these institutions that assure federal prosecutors become aware of insider trading violations.[569]

Reliance is not placed on administrative impeachment as a remedy to remove offending inside traders from office as in the U.S. Rather, the criminal prosecutors seek removal from office as a criminal sanction provided by the courts. Instead of a bifurcated process with a bill of impeachment issued by one agency and a decision to impeach issued by another agency, the German model, as seen below, only allows prosecution in the criminal courts.[570] The German model's equivalent of the U.S.-type grand jury and impeachment processes works as follows. As the result of its receipt of information regarding securities trades from credit institutions, as institutions of private law, the Federal Supervisory Authority, an institution of federal public law, concludes that further investigation is warranted. It then issues a "warning" to the applicable state Regional Exchange Supervisory Office, an institution of state public law. This state authority then issues a *warning* to the applicable exchange operating authority which operates largely under state authority. The latter funnels the results of its investigation up to the state regional authority. It then funnel its conclusions up to the Federal Supervisory Authority. If it feels criminal prosecution is warranted, the conclusions are funneled to the federal criminal prosecutor.[571] The German model has no concept of a

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567. *See id.* at 164.

568. *See id.*

569. *See id.*

570. *See id.*

571. *See id.*

"private litigant in the public interest" as seen in the U.S. Absent traditional relationships giving rise to private causes of action[572] such as privity of contract, there is no *private* right of action for violation of the insider trading law. The focus is totally on a wide array of subjects for criminal prosecution.[573]

3. Critique

There could be a more specific statutory break-down of functions. This breakdown would be to assure that fundamental rights of the German nation as a financial center will be protected. This, in turn, may ensure that the German citizen shareholder and the foreign investment fund shareholder will have more assurances against a stock market that is unduly volatile because of a lack of reliable basic information. The German model of reliance solely on criminal prosecution to deter corporate officials contributing to volatility by trading on insider information is arguably not as effective as the U.S. multi-pronged reliance on (1) the grand jury, (2) the statutory bounty, (3) administrative impeachment, and (4) the private litigant in the public interest. This reliance solely on criminal prosecution may detract from the confidence of any citizen shareholder or foreign investment fund that there has been a sanction-type underpinning serving to limit undue stock market volatility from insider trading.

The German scheme could be slightly modified to better achieve the anti-volatility objective, while still retaining its sole reliance on criminal prosecution. The change would be to have a definition of material information for purposes of criminal prosecution of insider trading, that is different from the one used for purposes of immediate corporate dissemination of the information into the market place. Currently, the definition is the same for both purposes under the German model. This definition is "information capable of considerably moving the price of the security if it were publicized."[574] A corporation need not, and in some cases is required not to, disseminate such information until after advice from institutions of private and public law.[575] This need to consult gives insiders who are intent on insider trading a window of opportunity to trade on

572. *See id.*

573. *See id.*

574. It is assumed that a commentator's phrases (1) "capable of considerably influencing the value of an insider security if (the information) were publicized;" Pfeil, *supra* note 257, at 160 n.129 and accompanying text, and (2) "potentially market-moving;" *id.* at 168 n.173 and accompanying text; have the same meaning.

575. *See* Pfeil, *supra* note 257, at 170 nn.180 & 181 and accompanying text.

significant developments that have not yet become public[576] while management and the various institutions are making up their minds. This in turn, puts an undue strain on the criminal prosecution mechanism, which in any event, is not as aggressive as the above U.S.-type four-pronged mechanism.[577]

A solution is that there could be an explicit statutory definition of material inside information for criminal prosecution purposes which is more abstract, narrow and comprehensible. It would not need expert guidance. The definition would be information that would cause a reasonable man modestly familiar with the corporation's operations and capable of financial or other analysis to buy or sell shares in the corporation whether he is a conservative investor, a speculator or a chartist. The short-term purpose of this definition, which reflects the definition employed in the U.S.,[578] would eliminate windows of opportunity perceived by insiders derived from information that has not yet been cleared by institutions for announcment to the marketplace. The long-term purpose of the definition protects the "fundamental right" of the German nation to a leading position as a financial market.[579]

H. Underpinning of an Assured Minimum Level of Long-term Operating Performance

As the annual meeting approaches, there will have been no "outsiders" in meet and confer proceedings among components of the German model's nation-as-master trinity to give entrepreneurial and community perspective and assure a minimum level of long-term operating performance. Rather the model will have relied on institutions of private and public law to give a nation-conscious perspective. Assurance of "entrepreneurial dynamism" will have come from the vaunted German work ethic, derived from the two underpinnings of leadership, and honor code, principles. On the other hand, the German model's structured interactions will have been conducted with informality without too much concern for "process." In contrast, in the U.S., participatory democracy sessions will have been conducted, at least in part, with a process-focused attention to performance of "ministerial duties."

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576. *See id.* at 164–75.

577. *See id.*

578. *See* Sec. Exch. Comm. v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (1968), *cert. den.* 394 U.S. 976 (1969).

579. *See* Pfeil, *supra* note 257, at 144–52.

1. Use Made of Participatory Democracy Sessions

Under the German model, executive officers will have been constrained by a legal requirement that they *make* day-to-day operating decisions only within the context of a meeting of a managerial board. This institution of private law includes all of the executive officers plus one labor member.[580] The executive officers are also constrained by a requirement that they implement operating decisions only after consultation with a workers' council. This institution of private law consists of labor representatives plus one representative of the executive officers.[581] In addition, the executive officers, through the managerial board, are statutorily encouraged to consult directly with the annual meeting of shareholders, an institution of private law, before the making of crucial operating decisions in crisis situations.[582] As seen above, this institution is in a position to lay the foundation for absolving the executives of personal liability for actions that they may have in mind to resolve a crisis.[583]

The U.S.-type "big stick" of the threat of a disruptive board of directors meeting if a meet and confer is not held, does not exist. At supervisory board meetings, there is to be only one "speaker" for the managerial board.[584] No other executive officers can even be present at meetings of that board unless they qualify as "experts" or "specialists."[585] The leadership and honor code principles are deemed sufficient to assure collegiality among executive officers and the one labor member in the course of preparatory meetings of the managerial board.

Absent a crisis, the supervisory board will not have received reports that it *specifically requests* from the managerial board so much as it receives reports required by statute.[586] Therefore, in the usual situation, executive officers under the German model are relatively free from close monitoring by the supervisory board.[587] The real power of the supervisory board

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580. *See* Kubler, *supra* note 261, at 98 *and* Peltzer, *supra* note 259, at 33. The German name for the managerial board is "Vorstand." *See* Kolvenbach, *supra* note 265, at 165.

581. *See* Kubler, *supra* note 261, at 98. The German word for workers' council is "Betriebsrat." *Id.*

582. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 119.2.

583. *See id.* at § 117.2.

584. *See id.* at § 105.

585. *See id.* at § 109.1.

586. *See id.* at § 90.

587. *See id.* at § 97. *See also* Macey, *supra* note 279, at 87-88; Benfield, *supra* note 317, at 631-32 *and* Peltzer, *supra* note 259, at 33, 35-36.

comes in defining enterprise objectives.[588] This board is, by statute, specifically given the power to assume limited direct responsibility for the making of operational decisions, particularly in crisis situations. Unlike the U.S. situation, it derives this power primarily, rather than secondarily through an ability to fire the chief executive officer on the spot.[589]

Reflective of the German model's reliance on structured interaction to achieve co-determination,[590] the supervisory board of the typical stock corporation consists fifty percent of individuals elected by the shareholders at their annual meeting and fifty percent of individuals elected by employees of the corporation and relevant labor unions at an annual meeting of labor.[591] Therefore, before the capital half can make any operational decisions, it must consult with the labor half. To insure that the labor element cannot itself make decisions against the will of the capital half, the chairman of the supervisory board is to be a member of the capital half.[592] In the event of a tie vote, he is to have a second vote. [593] Reflective of the German penchant toward informality, *personal* attendance by members is not required for the supervisory board to make decisions as it is in the U.S. Written votes are permitted such as a member giving a proxy to another individual to represent him at meetings of the board.[594]

There is no statutory assurance of *independent directors* to serve as catalysts to debate on the supervisory board. The focus of statutory requirements has been to assure only that no member has any ties whatsoever to the executive officers.[595] Partial assurance that a member of the capital half is not captive to a *universal bank* shareholder and lender is

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588. *See* Baums, *supra* note 5, at 510. According to a commentator, the supervisory board is "the classic representation of shareholder interests in Germany." *See* Peltzer, *supra* note 259, at 34. Compare the U.S. approach as discussed earlier. *See supra* Part V.A.

589. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 111. This is not to say that, given the honor code principle, the selection and de-selection of managerial board members is secondary in importance. *See* Baums, *supra* note 5, at 514 (*selection* of members of the managerial board as the "most important task" of the supervisory board)

590. In contrast to the approach favored for U.S. board meetings, and in order not to place undue strain on the structured interaction, there is a lack of a "searching agenda" at a typical meeting of the supervisory board. *See* Roe, *supra* note 248, at 1980.

591. *See* Kolvenbach, *supra* note 265, at 164-65. The German word for supervisory board is "Aufsichsraft." *Id.*

592. *See* Roe, *supra* note 248, at 1942-43. The chairman (who by statute must have been shareholder-elected) maintains a close, informal relationship with the managerial board. *See* Baums, *supra* note 5, at 510.

593. *See* Roe, *supra* note 249, at 1942-43.

594. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at §§ 108, 109.

595. *See id.* at § 105.

that a member of the capital half of the board cannot "be subject to a consent reservation."[596] In other words, he must himself be an *executive officer* capable of resisting any pressure from his employer against his observance of a degree of independence. Otherwise, there is a statutory bias against "outsider" membership on the supervisory board. Directors independent of the universal banks, in the sense of having no business relationship with them, have rarely been elected at shareholder meetings.[597] The statutory bias is that, as a practical matter, both the managerial board and the supervisory board with its labor membership are expected to agree on each capital nominee.[598] Any member of the supervisory board, including a labor member, has the right to be present as an observer at the physical holding of the annual meeting.[599] He is therefore in a position to make sure that the universal banks, as prime participants on the floor of the meeting, oppose any nomination of a slate of capital members believed to be unsympathetic to co-determination that comes from the floor.

Although the process by which labor members are elected is beyond the scope of this article, it would appear that independent directors as found in the U.S., are unlikely to be found on this side either. The statutory bias is that labor members be accountable to the current employees of the corporation and to the unions as representative of these current employees.[600] There is a lack of representation of the *unemployed* who engage in trades relevant to the corporation.[601]

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596. *See id.* at § 100.1.

597. *See supra* note 317 and accompanying text.

598. To assure agreement, the universal bank shareholders, "prefer(ring) to take their chances" first with the managerial board rather than deal directly with the supervisory board; *see* Roe, *supra* note 248, at 1942, 1970; typically would suggest their respective "capital"nominees to the managerial board. The managerial board then presents as its own a slate of capital nominees to the supervisory board as a whole (including to the labor half). *See id.* at 1942.

599. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 125.3

600. *See* Kolvenbach, *supra* note 265, at 164-65.

601. Whether or not there is a lack of representation apparently depends on whether a union can be said to represent the interests of a trade, members of which may or may not be employed either by the particular corporation or, for that matter, by any other employer. Assuming that a union representative does, in part, technically represent the unemployed as one of his constituencies, the question is whether he indeed can be said to have a broad enough mindset to actively represent the unemployed in deliberations with the shareholder component on the supervisory board (not to mention in deliberations with management on the workers' councils and on the managerial board).

Two factors say "no" to this question. They are, first, that union representatives are outnumbered by representatives of current employees on the supervisory board. A majority

The universal banks are given a preferred position when it comes to meet and confers between management and any capitalists regarding shareholder proposals. The "politically-ambitious" independent shareholder is indeed statutorily given a right to have a proposal of his which bears on enterprise objectives included in a management information statement in advance of the annual meeting. This right is subject to much the same disciplines against overweening ambition as they exist in the U.S.[602]

However, this independent shareholder has little bargaining power in attempting to meet and confer with management as a prelude to his submitting a proposal, in comparison to the U.S. citizen capitalist. The independent shareholder will have had little ability to get in touch with other independent shareholders in advance of the annual meeting except through his membership in a "shareholders' association" which is in privity of contract with the corporation, or through his personal recollection of other independent shareholders that were registered as personally present at the previous annual meeting.[603] Only his personal recollection of the *ward* shareholders disclosed by universal banks as having given proxies to them at the previous annual meeting will enable him to get in touch with the *ward* shareholders.[604]

The identity of other independent shareholders who are not part of his shareholders' association but will assuredly be present at the meeting, will

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of the labor members must be current blue-collar employees; the other two categories of labor representative (added together numbering less than the blue-collar employees) are the union representatives and white-collar workers (the German word for the latter is "Leitender Angestellter"). A second factor against a broad mindset is that only the *current employees* actually have the right to vote in elections of labor representatives (including union representatives) on the supervisory board.

One factor can be said to say "yes" to the question of whether the union representative can have a sufficiently broad enough mindset to make a difference in favor of the unemployed. This is that elections can be either direct or indirect. The statutory bias is in favor of indirect election in the case of the larger stock corporation. Indirect election involves election of a limited number of electors to an electoral college. The college then exercises discretion in selecting the actual labor representatives on the supervisory board. A union electioneering goal has been election of a heavy union component to the electoral college. *See generally*, Kolvenbach, *supra* note 265, at 164-65.

There is certainly a perception that the interests of the unemployed are under-represented within labor components of corporate supervisory boards. *See Europe Isn't Working*, THE ECONOMIST, Apr. 5-11, 1997, at 16 and *Europe Hits a Brick Wall*, THE ECONOMIST, Apr. 5-11, 1997, at 21-23.

602. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 126.2

603. *See id.* at §§ 129.1, 135.4.

604. *See id.*

not become available until the actual day of the annual meeting.[605] This is in contrast with the U.S. where states typically require the opening-to-inspection of a register of all shareholders of record at least ten days prior to the meeting.[606] Even if the independent shareholder could galvanize a coalition on the floor of the meeting, he is denied the right to make a proposal from the floor of the meeting, by statute, if the subject matter was not previously announced as an agenda item when notice of the meeting was given by management.[607]

There is no express statutory provision for inclusion of any proposal the politically-ambitious *ward* shareholder may have in the management information document. It is always possible that a universal bank will establish an internal code of conduct to assure that management takes cognizance of any proposal a ward shareholder may have. However, this possibility rests on an "internal code of conduct" judgment call by the universal bank.[608] Similarly, the holding of any meet and confers between the universal banks and ward shareholders and among ward shareholders themselves, regarding proposals of the more politically ambitious ward shareholders will have to depend on an internal codes of conduct judgment call by the relevant universal bank. Again there are no statutory provisions that delineate the participation rights of these assertive ward shareholders.

2. Critique

The same two levels of *shareholder board* that this article suggests for alternative slates of directors in connection with election contests, could be used to consider shareholder proposals drafted by ward shareholders. The use of such two levels would assure that the assertive ward shareholder will be able to volunteer to participate in the process of fine-tuning enterprise objectives by means of shareholder proposals. This participation would be on the basis that the shareholder will voluntarily take on the coloring of an institution of private law. As in the case of election contests, the universal banks would be assured a slightly pre-eminent position by virtue of their being an especially important institution of private law under the German model.

Further, granted that the U.S. concept of an "independent director" runs directly counter the German model, there is still a need to lessen the

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605. *See id.* at § 129.4.

606. *See supra* note 151 and accompanying text.

607. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 124.4.

608. *See supra* note 259 and accompanying text.

pre-eminence of the universal banks and *employed* labor on the supervisory board. To assure that this lessening occurs, the federal legislature could modify its statutes regulating the national stock exchanges to provide that a minimum number of members of the capital half of the supervisory board must be answerable under the honor code principle solely to statutorily-defined "broad" interests of the capital community. This requirement would be a condition of listing shares on an exchange. The federal legislature could similarly amend its statutes on the subject of co-determination to require that at least a minimum number in the labor half be answerable solely to defined broad interests of the labor community. This would also be under the honor code principle.

I. Underpinning of an Assured Minimum Attention to Enterprise Objectives

As an annual meeting approaches, the assurance of at least a minimum level of attention to enterprise objectives, will have come principally from regular monitoring of the supervisory board under the German model.[609] Principal assurance will not have come, as in the U.S., from *ad hoc* express scrutiny only when there is a threat of a coercive takeover. We have seen how the German model gives the supervisory board a special mandate to assure that enterprise objectives are always capable of further fulfillment. If, at any point, the supervisory board should find that enterprise objectives are not fulfilled, as in the case of insolvency, it is responsible for assuring that the corporation acknowledges this fact and files for a declaration of bankruptcy.[610]

The supervisory board has greater on-going power than the U.S. board of directors to assure further fulfillment of the business plan. Further, capital structure aspects of enterprise objectives are still a likelihood. The U.S. board of directors has the greater on-going power in the identity of executive officers used to continue to pursue the objectives. As a result of the exclusiveness of the role of the supervisory board in the area of enterprise objectives, the independent and ward shareholder can currently *only* have assurance that the continued operation of the corporation is on no more than a solid foundation. These shareholder types will have had little assurance that counter-entrepreneurs will likely have arisen as "environmentally-useful" predators if the pursuit of enterprise objectives

609. *See* Roe, *supra* note 248, at 1971.

610. *See supra* note 588 and accompanying text.

has been sub-optimal because of a need, for example, to restructure the corporation.

No special recognition is given to any right of independent shareholders and ward shareholders to the providing of opportunities to sell their shares at a premium in a takeover attempt that constitutes a "buy-out" if performance is sub-optimal. These shareholders are not regarded as having a fundamental right to any reward for their stewardship efforts. Thus, they never voluntarily undertook to perform any stewardship efforts on an honor code basis. Moreover, the rights of independent and ward shareholders would not seem very important in the case of proposed buy-outs since any prospective control premium opportunity is diminished as a right to be availed of by the right of the shareholders to declare dividends to themselves.

Neither the federal or state government, nor any institution of public law will have enacted guidelines for corporate responses to the coercive tender offers. One reason for this is that the "fundamental rights" of the counter-entrepreneur are not believed sufficiently noteworthy.[611] There is little incentive for any counter-entrepreneur to emerge. His rights to *use of cash* that he owns, to acquire and enjoy a controlling block of shares in the corporation are only marginal.[612] Additionally, only recently has the German nation's right to a world-class stock market been fleshed out to give any special standing to counter-entrepreneur attempts to achieve coercive takeovers on German national exchanges.[613]

Arrayed against these "rights" of the counter-entrepreneur and the German nation have been the following "fundamental rights in opposition": (a) a right of labor not to be fired precipitously on consummation of a

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611. *See* Peltzer, *supra* note 259, at 36. There are no legal principles, as in the U.S., that control the conduct of corporate management in addressing coercive tender offers. *See* Haggeney, *supra* note 277, at 212–13.

612. There are, however, anti-trust constraints on the acquisition of shares by the counter-entrepreneur as well as *voluntary* guidelines for him to follow in the making coercive tender offers. Moreover, the counter-entrepreneur must notify the corporation as soon as his voting power in a proprietary capacity exceeds a five percent threshold. *See* Haggeney, *supra* note 277, at 212. The shareholders have the right to enact a provision in the corporate charter to block voting rights, if exercised in a proprietary capacity, beyond a certain threshold that they have determined. *See* LAW OF STOCK CORPORATIONS, *supra* note 264, at § 136. Typically the shareholders use this right to block voting rights, if exercised in a proprietary capacity, beyond a five to fifteen percent threshold. *See* Macey, *supra* note 279, at 88–89.

613. *See* Pfeil, *supra* note 257, at 145–47. There has been debate in Germany as to whether the perceived difficulty of achieving "hostile takeovers" is warranted. *See* Kubler, *supra* note 261, at 103. And universal banks have been criticized for supporting anti-takeover amendments to corporate charters. *See* Baums, *supra* note 5, at 521.

takeover,[614] (b) a right of other unsecured creditors that any takeover not impair their property rights by adding to debt-load,[615] (c) a past right of current "capital" to payment of dividends as it saw fit thereby reducing available cash to pay off debt to accomplish any takeover incurred by the counter-entrepreneur,[616] (d) a statutorily-prescribed right of current capital to deny the vote to the counter-entrepreneur to the extent his holdings exceed a threshold amount,[617] and (e) the "right" of the German nation to use universal banks as an institution-of-private law which are believed to be the optimal representative of "socially-obligated capital" to provide guidance to the corporation.[618] This last "counter-fundamental" right currently has no statutory proscription against supervisory board members who represent the universal banks from meeting and conferring with each other as representatives of shareholders. This is the case even if the meet and confers have the express purpose of defeating any attempt at a restructuring of the corporation by an outsider. Additionally, meet and confers are primarily had on the basis that any takeover is inimical to the proprietary interests of the universal banks. This is the case even if the restructuring proposed by the counter-entrepreneur would be advantageous to independent and ward shareholders.[619]

Furthermore, there are no statutory provisions setting forth duties of management to protect and balance fundamental rights, as it addresses the issue of a bid to restructure the corporation or terminate enterprise objectives. In short, although a German institution of public law *has* issued guidelines for the *making* of coercive tender offers,[620] any counter-entrepreneur envisioning a tender offer will have been entering into legally

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614. *See* Fiessner, *supra* note 259, at 131-47. *See also Auf Wiedersehen, Shareholders*, THE ECONOMIST, Mar. 29-Apr. 4, 1997, at 68. *See generally*, Roe, *supra* note 248, at 1970.

615. *See* Peltzer, *supra* note 259, at 33-35.

616. LAW OF STOCK CORPORATIONS, *supra* note 264, at § 119.1(2).

617. *See* Macey, *supra* note 279, at 890-91 *and* Baums, *supra* note 5, at 507-08.

618. *See* Roe, *supra* note 248, at 1964-65 (stating that cross-holdings among universal banks, insurance companies and major German industrial corporations are a defense against takeovers); Kubler, *supra* note 261, at 109 (stating that the supervisory board is a mechanism linking universal banks, industrial corporations and major unions); Baums, *supra* note 5, at 505 (stating that the German model relies on "institutional precautions" rather than the "takeover market for corporate control"); and Baums, *supra* note 5, at 519 (stating that through the efforts of universal banks, charter amendments are typically passed to protect the larger stock corporation from takeover).

619. *See* Baums, *supra* note 5, at 519. *See also* Benfield, *supra* note 317, at 629-30.

620. *See* Haggeney, *supra* note 277, at 213-14.

uncharted territory regarding what response to expect from management and shareholders of the target corporation. He is dependent on any internal codes of conduct purporting to resolve conflicting fundamental rights, that the managerial and supervisory boards may have in place. For the above reasons, the successful coercive tender offer has been a rare occurrence under the German model.[621]

The German model does not give importance to the conflict that a U.S. executive officer would have, that is, the protection of his job versus pursuing the best interests of shareholders. As to the latter, one of the "capital" parties, the universal banks, would typically have more to lose than gain from a successful takeover by an outsider counter-entrepreneur. Therefore, they are typically in favor of management on the job protection issues.[622] For another thing, an elaborate statutory scheme under the German model is either in place or suggested for protecting the rights of wage-earners and salary-earners, including those of members of the managerial board in the case of coercive takeovers. This is particularly the case for takeover of a corporation in financial straits.[623] In such crisis situations, the German model "covers all the bases" The model would employ the device of structured interaction rather than the U.S.-type device of observance of minutely-detailed ministerial duties. The structured interaction would occur within a special "standby committee." Members of the committee could be representatives of the counter-entrepreneur, management, labor, current capital, and the creditors of the corporation.[624]

The German model could be improved in the case of coercive tender offers to *restructure* the corporation. Two measures could improve the assurances that the independent and ward shareholders will receive optimal "enterprise objective" performances in this respect. First, the reforms suggested above for election contests and membership on the supervisory board should assure that at least a minimum number of the supervisory board members will be sensitive to the interests of the independent and ward shareholders as the board addresses the offer to restructure. Second, the German legislature could specify the procedures to be followed in addressing the offer, thereby avoiding any need of the independent and

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621. *See* Baums, *supra* note 5, at 505 (statement, in article published in 1992, that "no hostile takeover bid has been successful") and Macey, *supra* note 279, at 98 (statement in article published in 1995, that there have been "four recorded cases of hostile takeovers in Germany since World War II").

622. *See* Baums, *supra* note 5, at 519, 521.

623. *See* Flessner, *supra* note 259, at 138, 146.

624. *See id.*

ward shareholders to rely solely on undisclosed internal codes of conduct that may or may not have been followed by management.

J. Conclusion as the German Model

The German concepts of due process, which are quite different in theory from the de Tocqueville concepts that we have discussed, nevertheless provide a coherent and balanced framework for enacting corporate governance rules. We have seen that the main criticisms of the German model, from the U.S. perspective, are pragmatic ones. These are that (1) the model, in different ways, gives too much power to the universal banks and current employees of a corporation, (2) it unduly discourages the "independent shareholder" and the "ward shareholder" from attempting to protect their investments by participating in corporate governance, and (3) it gives scant opportunity for expression of broad community interests. The above critiques suggest ways in which experts on the German model might address the criticisms by drawing on U.S. tools as described in this article. All the while, none of the U.S. tools need be actually imported into the German model by these German experts. Rather tools of the German model would still be used.[625]

625. According to a German commentator, the universal banks have repeatedly announced that "they are not particularly interested in retaining the present system." Kubler, *supra* note 261, at 104 n.45 and accompanying text and Roe, *supra* note 248, at 1968–69 (the universal banks say that they will not fight curbs on their domination of proxy machinery). However, according to Kubler, "no-one has come forward with a plausible concept for a system of proxy voting that could operate without the assistance of the banking sector." Kubler, *supra* note 261.

APPENDIX A

I. DIFFERING VIEWS ON PURPOSES OF CORPORATE GOVERNANCE REGULATION IN THE U.S.

One viewpoint has been that the primary purpose of an annual meeting is to protect the rights of *shareholders as a whole*. This has been expressed by T. Boone Pickens and the United Shareholders Association, an organization he founded. A second view, expressed by the National Association of Investors Association, has been that the primary purpose is to protect the rights of shareholders who are *natural persons*. In contrast, a third viewpoint is that the primary purpose of the annual meeting is to nurture the rights of *institutional shareholders*. This theory holds that these shareholders are in a position to be the most influential. A fourth view is that the primary purpose is to provide formal procedures to legitimize the stewardship of *management*. Entities tending to espouse this viewpoint which is reflective of the well-known "Berle-Means" model of the U.S. corporation, have been the Business Roundtable and the American Society of Corporate Secretaries. A fifth view is that the primary purpose of the annual meeting is to assure adherence to the principles of *participatory democracy*. Espousers of this viewpoint have been Ralph Nader and Americans Concerned About Corporate Power.[1]

The sixth view is that the primary purpose is to enable *government*, that is, the Securities and Exchange Commission ("SEC") to influence corporate decision-making. Some people contended that this is the case with other industrialized countries, and should be in the U.S., to an even greater extent than it is now.[2] A seventh viewpoint is that the primary purpose of the annual meeting is to help enhance the ability of *U.S. industry* to raise capital in various securities markets. Insofar as regulation does not fulfill this objective, inductive reasoning or the scientific method is to be used in determining changes to the method of regulation. "First principles," that is, the protection of any specific constituency, are to take second-place.[3]

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1. *See The Case for a Corporate Democracy Act*, BUS. & SOC'Y REV. 55 (1980).

2. Such a position has been espoused by H. Ross Perot. *See* reference to a speech by him in *Other Developments—Enhancing Corporate Competitiveness*, Fed. Sec. L. Rep. (CCH) No. 1495 (Apr. 1992). For a commentary on the efforts of government to induce management to pursue social policy objectives, *see* Charles Hansen, *Other Constituency Statutes: A Search for Perspective*, 46 BUS. LAW. 1355 (1991).

3. *See* Joseph A. Grundfest, *Zen and the Art of Securities Regulation*, 5 CONTINENTAL BANK J. OF APPLIED CORP. FIN. 4 (1993).

APPENDIX B

I. MANIFESTATIONS REGARDING PERCEIVED POLITICAL IMMATURITY OF THE GERMAN MIDDLE CLASS

A. From the Enlightenment on:

1. The German middle class, in general but not in every case, has a stifled sense of frustration and upheaval. Within the middle class, a cult of opposition to "progress" and thus, to "financiers," has developed. This cult typically has taken the form of "utopianism."[1]

2. The German citizen had a tendency to be anti-state but pro-nation at the same time.[2]

3. At least up until World War II, there has been a cult of opposition to democracy because it is a byproduct of the Enlightenment. Even since the end of the war, voting in political elections has commonly been regarded merely as a "duty." There has been a dearth of energetic and dedicated citizens in the political sphere.[3]

4. There has been a belief in work as "worship" which is a concept of Martin Luther. This is rather than work as manifestation of being in charge of one's own destiny.[4]

5. German male students have a reputation of mindless and typically violent rambunctiousness within university towns.[5]

6. The secular authorities have sought to provide institutional guidance to the churches, the Lutheran Church in particular. Originally, this was to "protect against subjectivity in biblical interpretation."[6] In the meantime,

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1. GORDON A. CRAIG, THE GERMANS, 22-26, 63-67, 119-42, 163-84, 196-97, 241, 264-67, 275-76, 289-96, 316-19, 328-32 (1982).

2. *Id.* at 30-34, 49-50, 248-60.

3. *Id.* at 29-30, 84-96, 163-64, 240-42, 290-94, 310-11.

4. *Id.* at 112-13.

5. *Id.* at 180-84, 41-44. This tradition might be a root cause of the current "German dread of disorderly legions in the street." *See Germany—Bismarck's Steed,* THE ECONOMIST, Mar.29-Apr. 4, 1997, at 57.

6. CRAIG, *supra* note 1, at 85-90, 98-99.

the other major confession in Germany, the Roman Catholic Church, has developed a tradition of providing institutional guidance to the state.[7] A third denomination, the Calvinists, has introduced a tradition in Germany, through Henry IV, the King of France and Prussia, of "active obedience and service to the state."[8]

7. Particularly in the early stages of industrialization in Germany, there was particularly strong reliance on the banks for the raising of capital.[9]

B. Since the End of World War II:

1. The large political party, in a sense, an institution, rather than the individual candidate or the small ad hoc party, has played the major role in German politics. In particular, there is a current bias against the individual that is a "strong" political executive.[10]

2. Co-determination has in a sense been substituted for militarism as a vehicle to "control" blue collar and lower-level white collar employees of German business enterprises.[11]

3. A major effort of the German nation has been to "control" its "bad" institutions, for instance, the German military. Control of such institutions has been largely achieved through a "collaboration of elites" seeking to effectuate a compromise that preserves and takes advantage of "good" traditions of these discredited institutions.[12]

4. the concept of "social polarization" has arisen as a highly undesirable condition to be avoided at all costs.[13]

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7. *Id.* at 94–99.

8. *Id.* at 86.

9. *Id.* at 107–08.

10. *Id.* at 39–44.

11. *Id.* at 41–44, 180–84, 239–41.

12. *Id.* at 49, 170–74, 244–52, 298.

13. *Id.* at 295–96. This motivation can be said to be a cause of the opposition to plebicites of those currently in power in Germany. The view is that these threaten parliamentariansim. The preference is therefore for exclusive reliance on representative, rather than direct, democracy. *See* Christoph J. Partsch, *Constitutions and Revolutions: The Impact of Unification and the Constitutions of the Five New German States on the Amendment of the Constitution of the Federal Republic of Germany,* 21 DENV. J. OF INT'L L. & POL'Y 1, 18 (1982).

APPENDIX C

I. LISTING OF MINISTERIAL DUTIES (A U.S. TOOL OF DUE PROCESS) IN THE EVENT OF AN OUTSIDE PROPOSAL TO RESTRUCTURE OR TERMINATE CORPORATE ENTERPRISE OBJECTIVES

1. Management has a duty to have in mind enterprise objectives for the corporation, both in terms of long-term operating performance and in terms of short-term share price performance. The objectives must fulfill "average" investment objectives of the citizen-capitalists.[1]

2. Management has a duty to place the corporation in a position to oppose coercive and uneconomic proposals by counter-entrepreneurs only if undue volatility in the price of the corporation's shares presents coercion-oriented counter-entrepreneurs with opportunities to fulfill an intent to realize short-term profits.[2]

3. Management has a duty to make a decision either to act or not act when faced with a proposal by a counter-entrepreneur.[3]

4. Management has a duty to abstain from action that is expressly forbidden by the corporate charter or otherwise by the citizen-capitalists.[4]

5. Management has a duty to be fully informed when faced with a counter-entrepreneur proposal or the prospect of one. The board, as required by the magisterial role of the "citizen," has the duty to insist on due diligence and full disclosure from the executive officers on the issues of relevance to the citizen-capitalists.[5]

6. The board has a duty to only make decisions that are concurred with by

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1. *See* City Capital Assoc. Partnership Ltd. v. Interco, Inc., 551 A.2d 787, 795–96 (Del. Ch. 1988) (uses test of a "reasonable shareholder" given "differing liquidity preferences and different expectations").

2. *See* Smith v. Van Gorkum, 488 A.2d 858 (Del. 1985); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

3. Aronson v. Lewis, 473 A.2d 805 (Del. 1984); *Smith*, 488 A.2d 858.

4. *Moran*, 500 A.2d 1346.

5. *Aronson*, 473 A.2d 805; *Moran*, 500 A.2d 1346; In re J.P. Stevens & Co., Inc. Shareholder Litig., 542 A.2d 770 (Del. Ch. 1988); *Smith*, 488 A.2d 858; *City Capital Assoc. Partnership Ltd.*, 551 A.2d 787 ; Robert M. Bass Group v. Evans, 552 A.2d 1227 (Del. Ch. 1988).

the executive officers. Thus, the board functions only as a body of *selectmen* elected by the citizen-capitalists judging the performance of the executive officers. If the board does not have confidence in a recommendation, it is to inform the executive officers where they have fallen short and require a new recommendation. Otherwise, they must select new executive officers.[6]

7. In the event of a counter-entrepreneur's proposal for a termination of enterprise objectives or a restructuring of the corporation, management has the duty, by action or inaction, to refrain from a coercive restructuring of the corporation in response unless the counter-entrepreneur's proposal is itself coercive.[7]

8. Management's response, if coercive, must have a definite proper goal in mind. This goal must be documented in minutes. One goal could be preserve the enterprise objectives currently in place, a goal effectuated by "just saying no" to the counter-entrepreneur proposal to terminate the enterprise objectives. Another goal could be to restructure the corporation to provide a viable alternative to a disadvantageous termination or restructuring. Another could be to assure the best available restructuring out of multiple possibilities. Finally another goal could be to assure the "best price and execution" of a termination so as to assure that the citizen-capitalists receive an appropriate control premium over fair market value.[8]

9. No coercive response by management is to involve the destruction of corporate assets.[9]

10. A majority of independent directors must approve any decision to thwart a coercive termination or restructuring instituted by a counter-entrepreneur.[10]

11. Management has a duty to assure that any coercive restructuring that it proposes to shareholders resulting from negotiations with counter-

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6. *See Smith,* 488 A.2d 858.

7. *See id.*

8. *See* Revlon v. McAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

9. *See* Moran v. Household, 500 A.2d 1346 (Del. 1985).

10. Unocal Corp. v. Mesa Petroleum Corp., 493 A.2d 946 (Del. Ch. 1985); Aronson v. Lewis, 473 A.2d 805 (Del. 1984); *Moran,* 500 A.2d 1346; *Robert M. Bass Group,* 552 A.2d 1227.

entrepreneurs, includes a provision that dissenting a minority shareholders will receive fair market value for their shares.[11]

12. If a coercive termination is found by the board to be inevitable enterprise objectives are deemed to be *not* susceptible to further fulfillment.[12]

13. In the case of a total or "partial" termination of enterprise objectives calling for a cashing out of the citizen-capitalists, management has the duty to adhere to a prescribed public auction process to assure that there is best price and execution of the cashing-out. If this duty is fulfilled, the law deems that an appropriate control premium over fair market value has been achieved.[13]

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11. *Unocal Corp.*, 493 A.2d 946 (Del. Ch. 1985).

12. *See* Panter v. Marshall Field Co., 646 F.2d 271 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981).

13. For a total cashing out, *see* In re J.P. Stevens & Co., Inc. Shareholder Litig., 542 A.2d 770 (Del. Ch. 1988); Smith v. Van Gorkum, 488 A.2d 858 (Del. 1985); City Capital Assoc. Ltd. v. Interco, Inc., 551 A.2d 787 (Del. Ch. 1988); *Revlon*, 506 A.2d 173 (1986). For a partial cashing out (sale of a division), *see Robert M. Bass Group*, 552 A.2d 1227.

APPENDIX D

I. SUMMARY OF SUGGESTED CHANGES TO U.S. CORPORATE GOVERNANCE REGULATION PROPOSED IN THIS ARTICLE

A. Information

1. Corporate operating performance should be disclosed over a full business cycle of ten years. Operating results should also receive a non-technical analysis. Enterprise objectives should be more expressly alluded to. Finally, share price performance should be discussed more in terms of avoiding short-term share price volatility and less in terms of its being an indication of long-term operating performance.

2. There should be analysis of compensation in terms of *each* of the three relevant components, the wage, the provision for security, and the bonus. Less detail and precision should be required as to the provision of an entrepreneurial stake that does not amount to compensation in the fullest sense. Wages and corporate performance should be set forth over comparable periods. There should be a description of any "wage" brought about by the materialization of a conflict of interest. A comparison of the compensation of the chief executive officer with executive officers as a group should be made.

3. There should be disclosure of compensation paid to legal and financial advisers in an annual meeting contest.

4. There should be disclosure of management efforts to deter counter-entrepreneur proposals to terminate enterprise objectives, that is, cash out the citizen-capitalists and counter-entrepreneur proposals to otherwise restructure the corporation. There should be disclosure of compensation paid to legal and financial advisers for *this* purpose as well.

5. Management should discuss and analyze any unusual proportion between independent and "dependent" directors. Stock exchanges should have a hand in assuring a pool of qualified "independent" directors.

B. Role for the Citizen-capitalist

1. For foreign corporations whose shares are traded in the U.S. but not on a U.S. stock exchange, there should be U.S. style pleading phase regulations to provide intra-government competition to the foreign "home state" hearing phase regulation.

2. If an institution's ownership exceeds one percent of voting securities, any important compromise of management with the institution should be disclosed as well as the institution's policy on voting its shares so that citizen-capitalists can prepare.

3. The definition of "citizen capitalist," for various purposes should be changed to require that he was a shareholder for at least two years. There should be disclosure as to which, if any, of the directors comprise citizen-capitalists and of opportunities that they have to meet and confer in advance of an annual meeting on subjects appropriate to the citizen capitalist. In the absence of such meet-and-confer opportunities, there should be disclosure regarding the other opportunities that should be given for citizen-capitalists to meet and confer.

4. The definition of "corporately ambitious" citizen capitalist should be made more rigorous; his financial stake should be at least $5,000 rather than the current $1,000.

5. Greater leeway should be given to certain "financial aristocrats" to meet and confer in private with other shareholders than is presently available. This is namely to counter-entrepreneurs seeking to organize a dissident faction for an election contest and certain large shareowners.

C. Underpinnings

1. Consideration should be given to making members of the SEC staff, as members of government, personally liable for money damages for failure to perform minutely-divided *ministerial* duties relevant to the providing information to the marketplace for a corporation's shares.

2. The SEC should no longer be able to extract *court* consent decrees for violation of the insider trading laws from insider trading defendants where removal from office is an objective. The SEC should be required to bring administrative bills of impeachment before another "political agency" such as a stock exchange, rather than before a court proceeding for this purpose.

3. The jury list for complex insider trading cases should be pre-cleared by an elected selectman. Arbitrators in these cases should uniformly be able to award punitive damages.