GERMAN COMPANY LAW AND THE CAPITAL MARKET*

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- A Critique of the personal and material scope of recent amendments to the German codes in the area of Accounting Principles, Corporate Governance and Transparency -

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I. INTRODUCTION

1. Aim of the Latest Amendments: Eliminating Misunderstandings and Reorientation of the Listed Joint Stock Company

Due to globalization and the process of *desintermediation*, the German capital market is currently undergoing far-reaching, structural changes. Formerly, the German economy was characterized by the dominance of credit finance and the relationship between banks and business. Big business was linked together through holding structures and cross-participations, in which banks played a major role as shareholders in industrial conglomerates. Quite rightfully, the German economy was nicknamed "Deutschland AG" (or "Germany Inc."). The stock market was limited to the top 100 German companies, whereas companies belonging to the famous German "Mittelstand" were usually private limited companies (GmbH) which used bank credit as their mode of finance. Towards the end of the twentieth century, more and more companies—mostly from the "new economy," but also increasingly from the "Mittelstand"—decided to "go public." This trend was strengthened by the establishment of new segments of the "Deutsche Börse" (Frankfurt Stock Exchange), e.g. the "Neuer Markt" (New Market, more or less the equivalent to the American NASDAQ) and "SMAX" (focused on mid-sized companies).

German Company and Accounting Law was not—and still is not—sufficiently prepared for this new rise of the capital market. The AktG[1] was designed for big businesses that belonged to the "Deutschland AG." The HGB, which practices accounting rules, concentrated on smaller companies. Rules for transparency and, hence, investor protection played hardly any role and were consequently underdeveloped. Under pressure from European

1. Note the following abbreviations: (1) *Statutes*: HGB (Handelsgesetzbuch—Commercial Code); AktG (Aktiengesetz—Joint Stock Company Act); BörsG (Börsengesetz—Stock Exchange Law); BGB (Bürgerliches Gesetzbuch—German Civil Code); WpHG (Wertpapierhandelsgesetz—German Securities Trading Act); KWG (Kreditwesengesetz—Banking Supervision Act); KAGG (Kapitalanlegesellschaftsgesetz—Act on Investment Companies); AuslInvestmG (Auslandsinvestmentgesetz—Act on Foreign Investment Companies); (2) *Courts*: BGH (Bundesgerichtshof – Federal Supreme Court), OLG (Oberlandesgericht—Regional Supreme Court), LG (Landgericht—Local Court); (3) *Other legal sources*: BGBl. (Bundesgesetzblatt—Federal Law Gazette); BT-Drs. (= Bundestags-Drucksachen—Documents of the German federal legislature); (4) *Other source*: FAZ (Frankfurter Allegmeine Zeitung—German Newspaper).

legislation,[2] German lawmakers reacted, passing four acts ostentatiously called the "Financial Market Promotion Acts." The German legislature has passed a number of amendments to the AktG and the HGB in reaction to deficiencies in the fields of Accounting, Corporate Governance and Transparency that had become apparent in past practice. This paper intends to demonstrate that the AktG and HGB still do not provide adequate protection. The personal and material scope of the latest amendments are drawn too narrowly, incompletely, and at times, in a contradictory fashion.

After several joint stock companies had delivered unpleasant shocks to the public and their shareholders,[3] the legislature amended the Handelsgesetzbuch (HGB) and the Aktiengesetz (AktG) by enacting the "Law on Monitoring and Transparency in the Business Field" ("Gesetz zur Kontrolle und Transparenz im Unternehmensbereich"—KonTraG)[4] and the "Law to Ease the Raising of Capital" ("Kapitalaufnahmeerleichterungs-gesetz"—KapAEG).[5] Both laws were also reactions to a second development: ten years earlier the joint stock company had seemingly fallen into a deep sleep,[6] and the private limited company (GmbH) had become the optimum form. The tables, however, have turned almost completely and today, the joint stock company is again in vogue,[7] a trend strengthened by the introduction of the *small* joint stock company.[8] Now small companies are crowding onto the stock exchange in significant numbers, and the highly sought-after risk capital for start-up companies is now relatively easy to acquire on the stock exchange with its different market segments.[9]

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2. For the Company Law in the European Union, see Hopt, 1 INT'L & COMP. L.J. 41 *et seq.* (1999); COMPARATIVE CORPORATE GOVERNANCE—ESSAYS AND MATERIALS (Hopt & Wymersch eds., 1997); CAPITAL MARKETS AND CORPORATE GOVERNANCE IN JAPAN, GERMANY AND THE UNITED STATES (1998); Lutter, ZGR 1 *et seq.* (2000). For an overview of European Capital Market Law, see HOPT, SYSTEMBILDUNG UND SYSTEMLÜCKEN IN KERNGEBIETEN DES EUROPÄISCHEN PRIVATRECHTS 307 (Grundmann ed., 1999).

3. Möllers, ZGR 334 *et seq.* (1997). *See also* BT-Drs. 13/9712, 11; cases of *Metallgesellschaft* and *Balsam/Procedo*.

4. v.6.3.1998 (BGBl I S.786). *See* http://www.bundesgesetzblatt.de (for legislation of the capital market). *See also* http://www.bakred.de.

5. v.20.4.1998 (BGBl I S.707).

6. *See* KÜBLER, GESELLSCHAFTSRECHT 166 (establishing that the number of listed joint stock companies has steadily declined); BÖRSENREFORM, 289 *et seq.* (Hopt et al. eds., 1997) (discussing a negative balance).

7. Huff, FAZ, Jan. 6, 1997, at 11; Siebart, *Der Deutsche Aktienmarkt*, SONDERHEFT DER AG, 15 *et seq.* (1996).

8. v.8.2.99 (BGBl I S.1961); Lutter, AG 429 *et seq.* (1994).

9. In 1998 there were a record 77 stock market entries, Picot & Land, DB 570 *et seq.* (1999); Maute, DStR 687 *et seq.* (1999). *See also* Hansen, AG R67 (1999) (citing statistics); Assmann,

The legal objective of these two enactments is significant. They are explicitly intended to improve the internal and external surveillance of companies, to increase disclosure, and thereby enhance transparency among participants in the capital market.[10] The legislature has expressly assigned a surveillance function to the capital markets and has recognized the necessity for an opening for and new orientation of listed companies on the capital markets.[11]

Finally, the enactments emphasize the reciprocal relationship between the amendment of company law, the "Third Financial Market Promotion Law" and the "EC Investment Services Directive" ("Wertpapierdienstleistungs"—RiL).[12] Numerous provisions of the HGB and AktG now differentiate between *listed* joint stock corporations and *unlisted* corporations.[13]

2. *The Interlocking of Corporate and Capital Market Law*

The alignment of corporate law with regard to a capital market law is self-evident and the interlocking of both these legal fields is almost indisputably recognized.[14] The criminal liability attached to insider dealing violations (which can also apply to the board of directors), repurchasing of shares, and share programs, clearly demonstrates the close interaction between equity and capital market laws. However, less clear is the strength and extent to which capital market law as obligatory law impinges on the optional nature of company law.[15] Thus the question arises whether corporate law for big corporations is really, as sometimes claimed, becoming capital market law.[16]

GROßKOMMENTAR ZUM AktG 140 *et seq.* (4th ed. 1992).

10. BT-Drs. 13/9712 at 1, 26; Böcking & Orth, DB 1241 (1998).

11. BT-Drs. 13/9712 at 11 *et seq.*

12. *Id.*

13. Claussen, DB 177 (1998); Pellens & Bonse et al., DB 785, 791 (1998); Böcking & Orth, *supra* note 10, at 1873.

14. Möllers, ZGR 334, 336 *et seq.* (1997); BT-Drs. 13/9712, at 11 *et seq.* (1997) (rationalizing that the KonTraG clearly supports this thesis). *See also* SCHMIDT, GESELLSCHAFTSRECHT at 10 (2d ed. 1991) (stating that the view that the capital market is only marginal to company law can no longer be supported). *But see* SCHMIDT, GESELLSCHAFTSRECHT at 14 (3d ed. 1996). "In the area of public companies, in particular joint stock companies, company law can no longer be operated without consideration of capital market law."

15. Kubler, KritV 79, 84 *et seq.* (1994). *See also* AG 141, 145 *et seq.* (1994); SZW 223 (1995).

16. Hopt, 140 ZHR 201 *et seq.* (1976). *Compare* 140 ZHR 389 *et seq.* (1977) (with a question mark in the title) *with* ASSMANN, HANDBUCH DES KAPITALANLAGERECHTS art. 1, § 8 (Assmann & Schütze eds., 2d ed. 1996) (without a question mark in the title). *See also* Assmann, *supra* note 9, at 356 *et seq.*; Grosßfeld, AG 435 (1997); MÜLBERT, AKTIENGESELLSCHAFT UNTERNEHMENSGRUPPE UND KAPITALMARKT

3. The Regulatory Objective of Capital Market Law: Confidence-Building by Information Provision

It is important to analyze the effectiveness of German corporate law in the capital market. The basis of European capital market law is the protection of the investor through the supply of information.[17] Alongside investor protection, capital market law aims to secure a smooth functioning capital market[18] so as to maintain confidence in the capital markets.[19] Only through information and surveillance can the investor make rational investment decisions.[20] On the other hand, a company will only acquire sufficient amounts of capital through the stock exchange if *lasting and regular information* is made regularly available to potential investors.[21]

In the following, the latest changes to the law are briefly sketched focusing on Accounting (Part II), Corporate Governance (Part III) and Transparency (Part IV). This paper critically evaluates the pertinent norms of corporate law in terms of the regulatory objectives of capital market law and, although the amendments have been successful in part, it points to ambiguities that remain in the law.

89, 101 *et seq.*, 259 *et seq.*, 518 (2d ed. 1996); WIEDEMANN, GESELLSCHAFTSRECHT Art. 9.III at 495 *et seq.* (1980). *See also infra* note 159.

17. KOMMISSION DER EUROPÄISCHEN WIRTSCHAFTSGEMEINSCHAFT, DER AUFBAU EINES EUROPÄISCHEN KAPITALMARKTS 267 *et seq.* (1966); BÖRSENREFORM, *supra* note 6, at 289, 315.

18. Council Directive 93/22, Preamble 2, 32, 41, 42, 1993 O.J. (L 141) 27 (stressing this double objective). *See also* BT-Drs. 12/7918 at 95, 97 (stating that the German legislature sees investor protection as a means of improving functionality); BT-Drs. 12/7919 at 1 (stating that the attractiveness of the German market is beneficial); BLIESENER, AUFSICHTSRECHTLICHE VERHALTENSPFLICHTEN BEIM WERTPAPIERHANDEL art. 3.III (1998) (discussing the various functions of investor protection); Möllers, *supra* note 14, at 334 *et seq.*

19. HOPT, DER KAPITALANLEGERSCHUTZ IM RECHT DER BANKEN 10 *et seq.* (1975); SCHWARK, ANLEGERSCHUTZ DURCH WIRTSCHAFTSRECHT 1 *et seq.* (1979). *See also* ESSAYS IN MEMORY OF STIMPEL 1087, 1093 (1985).

20. Wiedemann, BB 1591, 1593 (1975); Schwark, ZGR 294 (1976); KÜMPEL, KAPITALMARKTRECHT 33 at § 50 (1995); Assmann, ZBB 49, 57 *et seq.* (1989). *See also* Assmann, *supra* note 9, at 364 *et seq.*; Assmann & Schütze, *supra* note 16, at arts. 1, 54 *et seq.*; HOPT, INFORMATION FÜR MÄRKTE UND MÄRKTE FÜR INFORMATION (1983) (laying theoretical foundations); Akerlof, 84 Q.J. ECON. 488 *et seq.* (1970).

21. *See* BUSINESS SECTOR ADVISORY GROUP ON CORPORATE GOVERNANCE, CORPORATE GOVERNANCE: IMPROVING COMPETITIVENESS AND ACCESS TO CAPITAL IN GLOBAL MARKETS (1998) (discussing the protection of information and investor rights). *See also* COMPARATIVE CORPORATE GOVERNANCE (Hopt & Wymeersch eds., 1998).

II. ACCOUNTING

1. Previous Legal Position

In accounting, it is commonly understood that the scrutiny obligation or its equivalent *true and fair view principle* pursuant to Art. 264 paragraph 2 s. 1 HGB,[22] obliges a company to render annual statements in such a way that the actual assets, finance and revenue positions of the company are accurately reflected. This principle introduced by the "First Directive on the Annual Accounts of 1978,"[23] however, is counteracted by the fact that the Directive itself permits seventy-six different evaluation principles.[24] Optional balance sheet procedures laid down in numerous individual regulations are now allowed formally, and are, in essence, materially legal according to the principles of proper accounting (GoB).[25] Nevertheless, they do not necessarily reflect the actual position of the limited liability company. In this context, companies may or may not reveal the existence of hidden reserves, thereby deceiving investors with regard to the actual development and state of the company.[26] This cannot be called modern European accounting law.[27]

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22. Art. 264 §§ 1 & 2 BGB. *See* Baumbach & Hopt, Art. 264 § 9 HGB, (29th ed. 1995) (using the terminology of "inspection prohibition"); Koller, Roth et al., art. 264 § 6 HGB (1996). On the history of English 149 Companies Act 1948 zurückgehenden Prinzips, see Alsheimer, RIW 645-646 (1992).

23. *See* Council Directive 78/660/EEC, 1978 O.J. (L 22) 11 (giving a directory on the annual accounts of certain types of companies) [hereinafter 4th Dir. on Company Law]; Council Directive 83/349/EEC, 1983 O.J. (L 193) 1 (7th Dir. on Company Law (giving a directory on consolidated accounts)) (*both implemented by* "Bilanzrichtliniengesetz," v.19.12.1985 (BGBl I. S.2355) (*found in* arts. 242, 264 *et seq.* HGB)). *See also* Assmann & Buck, EWS 110, 120 *et seq.* (1990). For an update of European legislation see http://www.europa.eu.int.

24. Jonas, DB 1361, 1365 (1978); Grund, DB 1293 (1996). *See also* 4th Dir. on Company Law, *supra* note 23, at art. 31.

25. Baumbach & Hopt, *supra* note 22, at art. 243, § 5.

26. Hopt, 141 ZHR 389, 403 (1977) (criticizing the generally accepted opinon); Baumbach & Hopt, *supra* note 22, at art. 253 § 28; KRUSE, GRUNDSÄTZE ORDNUNGSGEMÄßER BUCHFÜHRUNG 204 *et seq.* (3d ed. 1979); Schulze-Osterloh, 150 ZHR 403, 417 *et seq.* (1986); Hüffer, AktG art. 131 § 29 (3d ed. 1997); MOXTER, BILANZLEHRE 75 *et seq.* (1986); BALLWIESER & KUHNER, RECHNUNGSLEGUNGSVORSCHRIFTEN UND WIRTSCHAFTLICHE STABILITÄT 110 *et seq.* (1994); BUDDE, ESSAYS IN MEMORY OF MOXTER 34, 48 (1994); BUSSE VON COLBE, US-AMERIKANISCHE RECHNUNGSLEGUNG 221, 237 (Ballwieser ed., 1995); Kubler, 159 ZHR 550, 560 (1995); Claßen & Enzweiler et al., CAPITAL 36 *et seq.* (1996) (noting the investigation of Küting).

27. EG-RiL, 4 and 7 (recording the action of the International Accounting Standards Committee). *See also* Claussen, AG 278, 279 (1993); HAVERMANN, ESSAYS IN MEMORY OF MOXTER 656, 668 *et seq.* (1994); BUSSE VON COLBE, MANAGEMENTKONTROLLE DURCH RECHNUNGSLEGUNGSPFLICHTEN 17, 28 *et seq.* (1994) (Honorary Doctorate Lecture, Univ. of Augsburg) (discussing the limitation of accounting law).

The KonTraG has quite correctly reacted and provides for several improvements, of which only four need be examined here.

2. New Legal Regulations

a) Risk Report as Part of Management Report Pursuant to Art. 289 Paragraph 1 HGB

The management report requires medium-sized, large joint stock companies and consolidated companies[28] to issue a risk report.[29] The personal field of application does not differentiate directly between listed and unlisted companies, but rather it refers to medium-sized and large joint stock companies.[30] Similarly the distinction between listed and other joint stock companies, which the KonTraG regularly draws, exists here too. According to the legal fiction of Art. 267 paragraph 3 s. 2 HGB, a limited liability company is always *deemed* large, if it is authorized to trade in securities on the official or regulated markets.

On the material level, the management report aims at past information and prognoses,[31] taking on a consolidating and supplementary function along with the annual statement of accounts.[32] In the past, under Art. 289 paragraph 2 HGB, a company was supposed to address its prospective development. However, this was too often neglected.[33] Under the new wording companies are required "to advise of risks in future developments." Unfortunately, the concept of risk, however, is neither defined nor explained in either the law or the preparatory materials.[34] A dispute promptly arose whether the concept of risk was to be understood as meaning only foreseeable "dangers" or "potential chance of dangers"[35] or, alternatively, whether "risks" were to be conceived narrowly and in terms of foreseeable dangers only.[36] The latter view is supported not only by a systematic comparison with Art. 252 paragraph 1 Nr.

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28. Art. 315 para. 1 cl. 2 HGB.
29. Art. 289 para. 1 cl. 2 HGB.
30. Art. 264 para. 1 sentence 3 HGB.
31. Baetge & Schulze, DB 937, 938 (1998).
32. He has to take the information needs of the addressee into account as the basis of proper management reporting. *See* BAETGE & FISCHER ET AL., DER MANAGEMENT REPORT 9 (1989); Baetge & Schulze, *supra* note 31; MOXTER, ESSAYS IN MEMORY OF LEFFSON 95 (1979).
33. DÖRNER, ESSAYS IN MEMORY OF LUDEWIG 226 *et seq.* (1996); BALLWIESER, ESSAYS IN MEMORY OF BAETGE 151, 155 n.6 (1997); Baetge & Schulze, DB 937, 941 (1998).
34. Baetge & Schulze, *supra* note 31, at 939.
35. Moxter, BB 722 (1997).
36. Baetge & Schulze, *supra* note 31, at 940.

4 HGB, which speaks of "foreseeable risks and losses," but also by everyday usage in which chance is the precise antonym, the counter-part to risk, synonymous with a positive opportunity or future negative occurrence.[37] *De lege lata*, the construction of the risk concept in the sense of "chance" will be of limited value.

b) Disclosure Obligations Pursuant to Art. 285 HGB

Transparency needs are also served by the obligation to annex statements to the balance sheet. According to Art. 285 No. 10 s. 1 HGB, companies are obliged to disclose the membership of board of management and supervisory board members who are also on the supervisory boards of other corporations. According to Art. 285 No. 11 HGB, a company must disclose board member participation in other companies if an individual's share of votes exceeds 5%.

c) Funds Statement and Segment Report Pursuant to Art. 297 Paragraph 1 HGB

There is a new obligation for a listed parent company to provide a funds statement and segment report in the group annex.

d) International Balance Sheets

The law easing capital raising has created Art. 292a HGB, which relieves the listed parent company of the obligation to compile and publish consolidated group accounts corresponding to Art. 290 HGB; provided it prepares and publishes a corresponding group management report according to "internationally recognized accounting principles." Here too, it is apparent that corporate law only follows the everyday practice of the capital market. Since 1997 companies in the "Neuer Markt" (New Market) have been obliged to draw up balance sheets according to IAS (International Accounting Standards) or U.S.-GAAP (Generally Accepted Accounting Principles).[38]

This Anglo-American accounting, favored at present by the majority of listed companies, is nevertheless the subject of considerable debate.[39] The lack of accounting standardization presents the danger of a two-tiered

37. Duden, AG 250, 252 (1997) (supporting Küting & Hütten).

38. KÜMPEL, *supra* note 20, at 7.22 (Neur Market Rulebook (Mar. 10, 1997)). *See also* BT-Drs. 12/9909 no. 456 at 11 (expressing the viewpoint of the legislature).

39. *See generally* Claussen, AG 278, 280 (1993).

accounting law. While some 500 internationally operative groups prepare their accounts according to foreign rules, other smaller companies continue to follow German accounting regulations. If these international group companies were able to undertake accounting according to rules (that are only available in the English language), which do not constitute legal norms nor are based on them, and over whose content the German legislature exerts no influence,[40] then this would have "nothing more to do with accounting *law*," as Lutter put it.[41] It is also disadvantageous that U.S.-GAAP is not exactly an ideal model. It alone may impinge on transparency by permitting hidden reserves and allow considerable leeway in the structuring of accounts.[42] The current balance of power discriminates against foreign companies because the U.S. Securities and Exchange Commission (SEC) only admits foreign shares if they comply to U.S.-GAAP,[43] although the companies can exert no influence whatsoever on legal rules. Thus the legislature was correct not to decide upon a final solution, but rather to create the preconditions for a German accounting commission,[44] which has to contribute to the development of accounting regulations on the international level.

3. Suggestions and Critique

These reforms may be criticized with respect to the personal and material scope of their application.

a) Extension of the Personal Scope of Application

aa) Extension of Obligations to Listed Groups of Companies ("Konzerne") and Listed Single Companies

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40. *See* HOMMELHOFF, ESSAYS IN MEMORY OF ODERSKY 779 *et seq.* (1996) (noting that it seems problematic from the democratic viewpoint). *See also* AKTUELLE ENTWICKLUNGEN IN RECHNUNGSLEGUNG UND WIRTSCHAFTSPRÜFUNG 109, 111 (Baetge ed., 1997); SCHULZE & OSTERLOH, GESELLSCHAFTSRECHT 301, 304 (Hommelhoff & Röhricht eds., 1997, 1998); Budde & Steuber, DStR 504 *et seq.* (1998).

41. Lutter, NJW 1345 (1996). *See also* Weber-Grellet, DB 2089, 2091 (1996) (stating, "It may end up in shambles"); HOPT, EUROPEAN BUSINESS LAW, LEGAL AND ECONOMIC ANALYSES ON INTEGRATION AND HARMONIZATION 333, 337 *et seq.* (Buzbaum et al. eds., 1991) (warning of the blind adoption of the U.S. accounting system); Loehr, WM 148 (1994); Grund, DB 1293, 1294 (1996); Wüstemann, WPg 421 *et seq.* (1996); Möllers, *supra* note 14, at 334, 352; Zimmer, NJW 3521, 3532 (1998).

42. Schildbach, BB 359, 363, 411 *et seq.* (1999).

43. SCHULZE & OSTERLOH, *supra* note 40, at 301, 302 n.40 (mentioning a power question).

44. Art. 342 HGB.

It should be noted that in the personal field of application, obligations only partially affect the group but also affect the single company. This points to a conceptual confusion which the legislature must resolve.[45] Thus it is difficult to understand why the disclosure obligations of Art. 285 HGB only apply to listed single companies but not to groups.[46] If the funds statement enables the misleading secret dispersion of hidden reserves in the annual financial statement or the misleading exercise of evaluation election rights (Bewer-tungswahlrechten) and the profitability/risk structure[47] to be better uncovered, it is difficult to see why this obligation is not extended to listed single companies.[48] The criticism of two-tiered accounting would be weakened if listed single companies were also permitted to undertake accounting according to international accounting regulations. In this way the intended division between listed and unlisted joint stock companies would also be implemented consistently.

bb) Obligations for Regulated Unofficial Trading?

The foregoing strict disclosure obligations apply only to listed companies. Differentiation between listed and unlisted joint stock companies is legitimate. In Art. 3 AktG, the listed company is legally defined as a company whose shares are admitted to a market.[49] But shares of a company are only admitted to an authorized,[50] or regulated[51] market, and to the Neue Markt,[52] but not to unofficial trading.[53] According to the legislative intent, the company whose shares are only traded unofficially should not be classified as a listed company,[54] because these are also excepted from the WpHG (German Securities Trading Act)[55] and the KWG (German Banking Supervision Act)[56]

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45. Kübler, ZGR 550, 554 (2000) (agreeing).
46. Böcking & Orth, *supra* note 10, at 1873, 1874.
47. Pellens & Bonse, *supra* note 13, at 785, 788.
48. *Id. See also* Zimmer, *supra* note 41, at 3521, 3531. *But see* FN-IDW 50 (1998) (dissenting).
49. Council Directive 94/19/EC, 1997 O.J. (L 135) 5 (EC Dir. on Deposit Guarantee Schemes); Council Directive 97/99/EC, 1997 O.J. (L 84) 221 (EC Dir. on Investor Compensation). *See also* BGBl. I S. 1842 (1998).
50. Art. 36 *et seq.* BörsG.
51. Art. 71 *et seq.* BörsG.
52. Pottho & Stuhlfauth, WM-Sonderbeliage No. 3 1, 7 (1997) (regarding the WpHG). *But see* Claussen, *supra* note 13, at 177, 178 (excluding the Neuen Markt from application).
53. Art. 78 BörsG.
54. BT-Drs. 13/9712 at 12. *See also* BT-Drs. 13/7142; Böcking & Orth, DB 1873 (1998).
55. Art. 2 para. 5 WpHG.
56. Art. 1 para. 3(e) KWG.

respectively. In support of such a differentiation it may be said that small or foreign[57] companies would be deterred by further-reaching information obligations and therefore would avoid listing on the stock exchange. After all, there are guidelines for unofficial trading according to which information should be provided on shareholders meetings, issues of dividends, changes to capital and other circumstances. In addition, company shares are often the object of unofficial trading against a company's will.

However, the systematic connection to the WpHG is itself questionable. The definition of the organized market is narrow,[58] because *unofficial trading* as well as insider surveillance[59] are also subject to the rules of conduct for investment services according to Art. 31-37a WpHG. The legislature intended to address the circumstances where (1) an investor often fails to distinguish between individual market segments and (2) where insider and unofficial trading could also impinge upon the effective functioning of the official and regulated market as a market structured according to public law.[60] This premise cannot be easily dismissed, as the stock broker is allowed to trade in shares from all three market segments within the framework of the stock exchange.[61] One could also resolve the objection that foreign securities would avoid the German stock exchange if only German companies were subject to the same obligations as the admitted securities. Ultimately, the trading guidelines are of relatively weak effect because they are controlled only by the German Security Exchange (Deutsche Börse AG).[62]

The decline number of listed joint stock companies in 1999 and 2000, when the market value of individual companies fell by a half or even two thirds,[63] prompts the suspicion that the amendments to the HGB and AktG can only have been a first step. Since the issue of Telekom shares numerous small investors are discovering the share as an investment vehicle, partly because of the current lack of alternatives.[64] If this emerging share culture is to grow[65]

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57. KÜMPEL, *supra* note 20, § 60, at 73 *et seq.* (rejecting an *ad hoc* obligation in unofficial trading).

58. Art. 2 para. 5 WpHG. *See also* art. 2 § 97 WpHG (commentary by Assmann & Schneider (2d ed. 1999)).

59. Art. 12 *et seq.* WpHG. *Cf.* Council Directive 89/592/EEC, 1989 O.J. (L 334) art. 7 (Dir. on Insider Trading). For the full text of the Directive, see http://www.europa.eu.int.

60. BT-Drs. 12/6679, at 45 (discussing the reasoning of the government bill (Regierungsentwurf) for the Third Financial Market Promotion Act ("Dritten Finanzmarktförderungsgesetz")).

61. KÜMPEL, *supra* note 20, § 60, at 73 *et seq.*

62. See articles by Kümpel & Ott, *supra* note 20, at 455 n.20 (citing Art. 6 of the Frankfurt Unofficial Market Rulebook (Apr. 28, 1998)).

63. Examples of such companies include: Mobilcom, Berliner Freiverkehr, net.ipo, Praha Portifolio Bet. and Gazprom.

64. Kölsch, WM 1169 (1996) (noting that in 1994 only 5% of German citizens owned shares);

and become an investment vehicle for the public at large, it must be guaranteed that confidence in the market is not shaken.

If the small investor is to provide risk capital for such companies, he depends even more on company data. This means that, *de lege ferenda*, numerous obligations, derived from the need for transparency (such as the funds statement and segment report[66]) should be extended to shares in unofficial trading.[67] Because this requirement is not particularly cost intensive, it should also be expected of small companies. In other words, these disclosures are the price corporations must pay for the capital resources of investors.

In the future, it would be conceivable to differentiate between *regulated and unregulated unofficial trading*, as it existed up to 1986,[68] and as *Hopt/Baum* again recently proposed.[69] That way, maximum flexibility could be achieved, without simultaneously (as with the creation of the Neuen Markt) having to alternate between the somewhat legally suspect hybrid of regulated market and unofficial trading.[70]

b) Extension of the Material Scope of Application

aa) Forecast on the Future Company Development and Company Report

Capital market law requires an increase of information to facilitate rational investment decisions by investors. From the perspective of the capital market, the information policy of company law is too heavily influenced by the "worst case" scenario to risk of company insolvency.

What is traded on the stock exchange is the future. Not only the facts, but prognoses and rumors often influence market prices. The investor is primarily interested in profit forecasts,[71] as the ratio of market price and company profits are quite important for future price movements. Thus, it would be sensible to

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Passow, WM 1931 (1997) (noting that in 1996 it was 6.5% and in 1997 7.4%); 15 WIRTSCHAFTSWOCHE at 210 (1998). *See also* Steur, WM 281 *et seq.* (1995) (noting the growing significance of securities as an investment); EULER, SPARKASSEE 545 *et seq.* (1995).

65. Büschgen, FAZ, Feb. 8, 1997, at 17.

66. Böcking & Orth, *supra* note 10, at 1873, 1875, 1879 (calling for an obligation on all unlisted limited companies for capital flow accounting and segmental reporting).

67. *See* Kübler, *supra* note 6, at 550, 563.

68. Schwark, Börsengesetz, Art. 78, § 1 (2d ed. 1994).

69. Hopt, *supra* note 6, at 434.

70. *Id.* at 410.

71. *Wer seine Anleger am fairsten behandelt*, 22 DAS WERTPAPIER, 1998, at 54, 55.

check whether listed companies also have *compulsively addressed the future positive development of the company*. This obligation could achieve two results:

First, a management report (with added forecast) could adequately supplement the ad hoc disclosure of the WpHG. While this ad hoc disclosure refers to factual matters,[72] the management report addresses the requirement for information on *chances as unsecured facts*. In this way, the phenomenon could be counteracted by the fact that ad hoc announcements currently contain no facts and are misused as advertising vehicles.[73] Additionally, the supposed reading of tea leaves by investment advisers[74] would be avoided, as the investor gets information first hand and the company, instead of investment advisers, becomes responsible for the information.[75]

The directory regulation of Art. 289 paragraph 2 HGB is not observed.[76] Art. 289 paragraph 1 HGB is to be extended, *de lege ferenda*, to encompass the concept of chances. Perhaps indeed, we are merely at the threshold of a development that will lead to more transparency. Consideration should be given to reviving the old legal obligation to prepare a business report under Art. 160 AktG 1965,[77] whereby the information discussed above could be clearly and understandably summarized. Under such legal provisions the company would, for example, be obligated to address the development of the share price and the result per share.[78]

In any case, an infringement of these legal obligations would be sanctionable. Monitoring could be effected through the auditor, the stock exchange, or the federal regulatory authority for securities trading

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72. *See* Council Directive 89/592/EEC, 1989 O.J. (L 334) 3, 30 (discussing the concept of "Information" in the European directive on insider dealings (implemented as fact in Art. 15 WpHG)). *See also* Grundmann, JZ 274, 284 *et seq.* (1996); Möllers, JZ 787 (1996); Möllers, *supra* note 3, at 334, 347.

73. Casper, FAZ. May 2, 1999 at 22 (discussing the misuse of advertising).

74. Kümpel, AG 66, 69 (1997) (noting that subjective evaluations can influence stock prices).

75. The stock prices quoted for net.ipo, a company traded on the unlisted market, ranged between 370 and 20 Euro in the first half of 1999. The actual price ranged between 140 and 40 Euro at this time. This extreme volatility unnerves the investor. Company data can be reassuring. For standards of analysis on the Neuen Markt only, see FAZ, May 28, 1999, at 25.

76. *See supra* note 33. The general opinion assumes a reporting obligation and rejects an optional right. *See* Art. 289 § 26 HGB (commentary by Ellrott, Beck'scher Bilanz-Kommentar). For a clarification of the management report see BAETGE & FISCHER ET AL., DER MANAGEMENT REPORT (1989). *See also* Ballwieser, *supra* note 33, at 151 *et seq.*

77. Besides the management report, it contains commentary, which has to be observed as the basis of proper accounting. *See* Ballwieser, *supra* note 33, at 151, 157. *See also* Baetge & Armeloh et al., DB 176, 177 (1997); Baetge & Schulze, DStR 176, 177 (1997).

78. For positive and negative examples among the 30 DAX companies see BALLWIESER, *supra* note 33, at 151, 172 *et seq.*, 177.

("Bundesaufsichtsamt für den Wertpapierhandel"—BAWe). The most direct material control, however, would be through the auditor, who already has to scrutinize the management report to look for possible negative implications.[79]

bb) European and International Developments in the Funds Statement and Accounting

The legislature has not specified the funds statement in any more detail. This is difficult to understand because the funds statement and segment report have long been standard under international and U.S. disclosure rules.[80] Furthermore, reliance on the internationally recognized standards would have been quite possible,[81] considering that the legislature has done this already with regard to the international accounting principles.

Accounting has become the subject of intensive discussion in other member states of the EC.[82] The current legal requirement that the consolidated report should correspond to internationally recognized accounting recognitions on the one hand, and the 7th Directive on company law on the other,[83] is frequently impossible to fulfill as has been demonstrated.[84] Thus, it is hoped that a reform of the 4th and 7th accounting directives will address the international harmonization of accounting regulations.[85]

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79. Art. 317, para. 2 HGB. It was also mentioned in the discussion that neither the German stock exchange nor regulatory authorities have the personnel to check company reports thoroughly. Conversely, Herr Georg Wittich, President of the BAWe, notes that the Australian authorities maintain a staff of 1,300. *See also* HIRTE, GESTALUNGSFREIHEIT IM GESELLSCHAFTSRECHT 61, 93 *et seq.* (Lutter & Wiedemann eds., 1998); HOPT, GESTALUNGSFREIHEIT IM GESELLSCHAFTSRECHT 123, 131 *et seq.* (Lutter & Wiedemann eds., 1998). *See also* SCHIESSEL, IST DAS DEUTSCHE GESELLSCHAFTSRECHT KAPITALMARKTTAUGLICH ? Ag 442 *et seq.* (1999) (during the second "Kapitalmarktrechtssymposium" of the Deutsche Börse AG, calling for monitoring by the regulatory authorities). For more information on the German Stock Exchange, see http://www.exchange.de.

80. Küting & Pilhofer, DStR 559 *et seq.*, 603 *et seq.* (1999); Jakoby & Schmechel, WPg 225 *et seq.* (1999); Böcking & Orth, *supra* note 10, at 1873, 1874; Pellens & Bonse et al., *supra* note 13, at 785, 788; Zimmer, *supra* note 41, at 3521, 3531.

81. A reference to IAS 7 would have been possible. *See* Pellens & Bonse et al., *supra* note 13, at 785, 788; Böcking & Orth, WPg 351, 362 (1998).

82. *See* van Hulle, WPg 138 *et seq.* (1998) (discussing Belgium, Denmark, Italy and France).

83. Art. 292(a) para. 2 no. 2(a)-(b) HGB.

84. SCHULZE-OSTERLOH, DIE REFORM DER KOZERNRECHUNGSLEGUNG NACH IAS UND US-GAAP 301, 307 (Hommelhoff & Röhricht eds.); Pellens & Bonse et al., *supra* note 13, at 785, 787.

85. *See* Claussen, *supra* note 27, at 278, 279 (discussing the attempt by the International Accounting Standards Committee (IASC) to supplement the 4th and 7th Dir. on Company Law); HAVERMANN, *supra* note 27, at 656, 668 *et seq.*; VON COLBE, *supra* note 27, at 17, 28 (discussing the limitation of accounting law). *See also* van Hulle, *supra* note 82, at 139 *et seq.* (noting that the EU Commission prefers IAS); Ernst,

III. CORPORATE GOVERNANCE

In the area of corporate governance, distinct changes must occur regarding internal surveillance systems, requirements of supervisory boards, and the role of auditors.

1. Legal Reforms

a) Internal Surveillance [Self-monitoring] System Pursuant to Art. 91 Paragraph 2 AktG

Under Art. 91 paragraph 2 AktG the board of management is obliged "to establish appropriate measures, in particular a surveillance system, so that the occurrences endangering the continuation of the company may be recognized in good time."

b) Changes to the Supervisory Board

So much has been written on the tasks of the supervisory board that, as Hoffmann-Becking recently wrote, one can only repeat what has already been written.[86] Nevertheless, at least partially fresh criticisms can be made.

Under the KonTraG, the board of managers is now obliged, pursuant to Art. 90 paragraph 1 Nr. 1 AktG, to report on questions of finance, investment and personnel planning. Another new feature is the increased frequency of compulsory supervisory board meetings for listed companies.[87] While the legislation does not make committees compulsory, it does expressly call for them to be established.[88] Thus, the supervisory board is put in a position where it can facilitate effective work.

WPg 1025, 1032 *et seq.* (1998).

86. HOMMELHOFF, UNTERNEHMENSÜBERWACHUNG AUF DEM PRÜFSTAND—CORPORATE GOVERNANCE 1 *et seq.* (Picot ed., 1995); Niederleithinger, ZIP 597 *et seq.* (1995); Seibert, ZBB 349 (1994); Lutter, AG 176 (1994). *See also* 159 ZHR 287 *et seq.* (1995); Bernhardt, 159 ZHR 310 *et seq.* (1995); Möllers, ZIP 1725 *et seq.* (1995); Hoffmann-Becking, ZGR 497, 498 (1998) (noting that only repetition is possible).

87. Art. 110 para. 3 AktG (requiring supervisory board meetings at least twice a year).

88. Möllers, *supra* note 86, at 1725, 1731 (noting *de lege ferenda* as an obligation); Deckert, ZIP 985, 992 (1996); Hoerdemann, ZRP 44 *et seq.* (1997). *See also* BT-Drs. 13/9712 at 22 *et seq.* ("behutsam verhaltenssteuernd auf eine vermehrte Bildung von Ausschüssen und höhere Sitzungsfrequenz . . . hinwirken").

c) The New Role of Auditors

Some of the most marked changes under the KonTraG have been to the position of the auditor. Legal changes now recognize an auditor's position, his material responsibilities, and communication with the supervisory board.

aa) Under the new law the auditor is no longer appointed by the management board or the annual general meeting but by the supervisory board alone.[89] The supervisory board selects its own auditor.[90] To counteract bias concerns, the fee share attributable to the single auditing commission may only amount to 30% of the total remuneration for the professional activity.[91] A rotation of auditors is compulsory for officially listed companies in which the auditor has issued the audit certificate in seven instances in the last ten years.[92]

bb) On the material side, the complete redrafting of Art. 321 HGB is most noticeable. Reform is also aimed at informing non-expert supervisory board members with necessary clarity[93] (i.e. giving them significant information and ideas on possible sources of error or weak points in the company organization).[94] As reformed, the auditor's examination now also refers to the risk report of the management report[95] as well as with listed joint stock companies "with official listing" to the internal surveillance system required to be established.[96] This controlling examination,[97] or business audit,[98] must be included in a special part of the auditor's report (business report).[99] Finally, the audit certificate must address possible risks in the report.[100]

cc) Improved communication with the supervisory board is significant. The auditor's report is no longer to be passed to the board of management, but

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89. Art. 111 para. 2, at 3 AktG.
90. Zimmer, *supra* note 41, at 3521, 3532.
91. Art. 319 para. 2 no. 8 HGB.
92. Art. 319 para. 3 no. 5 HGB.
93. BT-Drs. 13/9712 at 28. *See also* Art. 322 para. 2 HGB.
94. BT-Drs. 13/9712 at 28.
95. Art. 317 para. 2 § 2 HGB.
96. Art. 317 para. 4 HGB; Art. 91 para. 2 AktG.
97. Hommelhoff, BB 2625 (1998).
98. WEBER, ESSAYS IN MEMORY OF BAETGE 781, 793 (1997); Dörner, WPg 306 (1998) (discussing the development from "financial audit" to "business audit").
99. Art. 321 para. 4 HGB.
100. Art. 322 para. 3 HGB.

instead directly to the supervisory board.[101] The report is to be presented to each member of the supervisory board,[102] the auditor fulfilling a participatory and instrumental role in the decision making process of the supervisory board.[103]

2. *Suggestions and Critique*

The legislature has implemented numerous proposals to improve the existing norms within the structures of corporate governance. The new regulations in Arts. 90 and 91 AktG only have a clarifying function[104] with regard to the imposed surveillance system.

a) Focusing of the Material Scope: Surveillance System

The responsibilities[105] of the supervisory board and auditor for controlling[106] this surveillance system are secured by written stipulation. The compulsory establishment of a risk management system should not be underestimated, bearing in mind that not the supervisory board, but rather the board of management, constitutes the primary control center of the company.[107] From the point of view of business operation, it is hoped that this surveillance system can be consolidated into a risk management system.[108]

b) Intensification of the Activities of the Supervisory Board

Several legal amendments are not of a compulsory nature and therefore allow the supervisory board a high degree of flexibility.[109] With these non-

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101. Art. 321 para. 5 § 2 HGB.

102. Art. 170 para. 3 § 2 AktG.

103. Art. 171 at 1, 2 AktG.

104. Bt-Drs. 13/9712 at 15 (referring to Art. 91 para. 2); Hommelhoff & Mattheus, AG 249, 251 (1998); Claussen, *supra* note 13, at 177, 181; Kuhl & Nicket, DB 133 (1999); Zimmer, *supra* note 41, at 3521, 3524 (referring to Art. 90).

105. Claussen, *supra* note 13, at 177, 181.

106. Hommelhoff & Mattheus, *supra* note 104, at 249, 251.

107. MARTENS, ESSAYS IN MEMORY OF FLECK 191, 201 (1988); Hoffmann-Becking, ZGR 497, 513 (1998).

108. *Draft IDW Prüfungsstandard*, WPg 485 *et seq.* (1998); Lück, DB 8, 9 (1998). *See also* DB 1925 *et seq.* (1998); Jacob, WPg 1043 *et seq.* (1998).

109. Dreher, GESELLSCHAFTSRECHT 1, 8 (Hommelhoff & Rohricht eds., 1997, 1998) (citing examples).

binding "stimulation norms,"[110] as Hommelhoff has vividly termed them, the danger nevertheless arises that they will continue to be dismissed and ignored. Laws should not merely create the appearance of legislative activity, however, and must be of more than token significance. Thus, the voluntary character or lack of sanctions, the practical value of the amendments including the new risk management system, must be seen as rather low.[111]

As Thon pointed out in the 19th century, legal norms are fundamentally of an imperative, obligatory nature, intended to compel a certain behavior.[112] Four principal factors can cause stimulatory norms to be more than merely token law, and to be actually observed and applied by their addressees.

First, under Art. 77 paragraph 2 AktG, the supervisory board is entitled to issue *standing orders* to the board of management. In this way, the supervisory board can, through the standing orders, require regular reports of the auditing department to the board of management. Second, the greater responsibility given to the supervisory board (with regard to the board of management) is also particularly significant. The supervisory board is not only accountable during the annual general meeting,[113] but also has to report on the type and manner of its control over management, with listed companies also reporting on committees.[114] Third, in the past, the material responsibilities of the board of management and supervisory board were undermined by the fact that the procedures foundered on high minimum quorum.[115] Art. 147 paragraph 3 AktG has now lowered this hurdle and eased the position for claims.[116] Finally, at least as significant as this change is the ARAG/Garmenbeck decision of the BGH. The BGH recognizes a degree of liability-free discretion for the management board. However, if these

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110. Hommelhoff & Mattheus, *supra* note 104, at 149, 250. *See also supra* note 88.

111. Hoffman-Becking, *supra* note 107.

112. On Thon's Imperative theory see: THON, RECHTSNORM UND SUBJEKTIVES RECHT (1878); 1 VON IHERING, DER ZWECK IM RECHT (1878); 4 FIKENTSCHER, METHODEN DES RECHTS 150 (1977); ENGISCH, EINFÜHRUNG IN DIE RECHTSWISSENSCHAFT 22 *et seq.*, 200 *et seq.* (8th ed. 1983); LARENZ, METHODENLEHRE DER RECHTSWISSENSCHAFT 253 (6th ed. 1991); MÖLLERS, ESSAYS IN MEMORY OF FIKENTSCHEN 144 *et seq.* (1998).

113. Baumbach & Hueck, Art. 171 § 10 AktG (13th ed. 1968); Theisen, BB 705 (1988); Geßler, Art. 171 § 14 AktG (1993); Baums, ZIP 11, 13 (1995). *But see* Möllers, ZIP 1725, 1734 (1995). *See also* CLAUSSEN & KORTH, KÖLNER KOMMENTAR Z. Art. 171 § 14 (2d ed. 1986); Kropf, Art. 171 § 40 *et seq.* AktG (1973); ADLER & DÜRING ET AL., RECHNUNGSLEGUNG UND PRÜFUNG DER UNTERNEHMEN Art. 171 § 43 *et seq.* (5th ed. 1987).

114. Art. 171 para. 2 AktG.

115. Bt-Drs. 13/9712 at 21.

116. *See* Zimmer, NJW 3521, 3527 (1998) (offering a critical view); Ulmer, 163 ZHR 290 *et seq.* (1999) (noting that the 5% clause only operates for a gross violation); Krieger, 163 ZHR 343 *et seq.* (1999) (offering a more positive view); Sünner, 163 ZHR 364, 369 *et seq.* (1999).

discretionary limits are exceeded, it obliges the supervisory board to check compensatory claims against the board of management after a careful risk analysis, and as a matter of principle to pursue these claims.[117] Even if, in contrast to the BGH, one wishes to accord discretion to the supervisory board in the pursuit of these claims,[118] the judgment will strongly motivate supervisory board members towards exacting more effective control in the future, otherwise they risk personal liability.[119]

c) New Standing of the Auditor

aa) The increased independence of the auditor from the board of management is certainly welcomed. The board of management is no longer able to choose its own auditor freely;[120] rather the supervisory board will be able to discuss and prioritize points of emphasis with the auditor before the audit commences.[121] The auditor's new role must be emphasized. If the board of management makes a forecast decision based on the management report, the auditor should not, and may not, substitute it with one of his own.[122] The auditor however, is to comment on the viewpoint of the board of management, *objectify* it[123] and render an independent opinion.[124] The auditor must evaluate it and pose questions.[125] This applies above all to controlling the surveillance system. If the law requires an assessment of whether the surveillance system is fulfilling its purpose,[126] the auditor's report must state "whether measures [that] are necessary to improve the internal surveillance system"[127] are instituted, ensuring the existence of functional monitoring of the company's management.[128]

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117. BGHZ 135, 244. *See also* ZIP 883 (1997); JZ 1071-ARAG/Garmenbeck (1997); Horn, ZIP 1129 *et seq.* (1997); OLG Düsseldorf, ZIP (1996), 1183; EWiR 629 (1995); OLG Düsseldorf, ZIP (1994), 628; EwiR 628 (1994).

118. Dreher, JZ 1074 (1997).

119. Art. 93, 116 AktG. *See also* Sünner, 163 ZHR 364, 373 (1999).

120. Hommelhoff, BB 2567, 2569 (1999).

121. *Id.*

122. Bt-Drs. 13/9712 at 27.

123. Hommelhoff, *supra* note 120, at 2567, 2571 (asserting that the following statement would be impermissible: "There is nothing to notify in the supervisory board report.").

124. Art. 321 para. 1 § 2 HGB.

125. BT-Drs. 13/9712 at 27.

126. Art. 317 para. 4 HGB.

127. Art. 321 para. 4 HGB.

128. Brebeck & Herrmann, WPg 390 (1997); Böcking & Orth, WPg 359, 362 (1998); Giese, WPg 458 (1998); Hommelhoff, *supra* note 120, at 2625.

It must be asked, however, why this controlling check only applies to companies whose securities are officially traded.[129] If improved independent auditing serves to reduce the "expectation gap" which was created by the audit certificate of the auditor,[130] this improvement is lost on joint stock companies whose securities are not officially traded. This check should at least be extended to all segments of the regulated market and also to the Neuer Markt and Smax.[131]

bb) As points 1 through 4 of the preamble to the Company Directive express, corporate law must primarily protect the company members, its shareholders at the annual general meeting,[132] so that vital control and information does not end at the supervisory board level. *De lege ferenda*, expanding the amount of information that shareholders have, an entitled strengthening of the information rights of the shareholders with regard to the auditor, is a measure worthy of consideration.[133]

IV. TRANSPARENCY

1. European Law and Art. 335 Paragraph 1 No. 6 HGB

Article 335 HGB provides for a fine of up to 10,000 DM for an abuse in the disclosure of an annual financial statement. Under § 2, however, the registry court can only intervene if certain specifically delineated groups of persons apply. The practice of disclosure was neutralized because only a fraction of the 600,000 private limited companies (GmbH) actually published their annual financial statements.[134] With the narrow application of the requirement, Germany has consciously fallen short, according to Lutter, of the disclosure obligation. Here too, the capital market relevance for joint stock companies is not insignificant, they are not compelled by stock exchange

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129. Hommelhoff, *supra* note 120, at 2625; Böcking & Orth, *supra* note 10, at 1873, 1879 (offering a critical view).

130. BT-Drs. 13/9712 at 29. An expectation gap is defined as a discrepancy between the public expectation of the extent, sense and aim of the legal audit on the one hand, and the professional practice of the auditor according to legal requirements on the other. *See* WEBER, ESSAYS IN MEMORY OF BAETGE 781, 797 *et seq.* (1997); Böcking & Orth, *supra* note 128, at 351, 352.

131. Participation in SMAX requires a contract with the Deutsche Börsen AG. *See* SMAX Admission Rules § 1. For further information see http://www.exchange.de.

132. 4th Dir. on Company Law, *supra* note 23.

133. Hommellhoff, BB 2625, 2631 (1998).

134. LUTTER, EUROPÄISCHES UNTERNEHMENSRECHT 142 (4th ed. 1996) (mentioning 10%); Vogel, *Die Rechnungslegungsvorschriften des HGB für Kapitalgesellschaften und die*, EG-RICHTLINIE 102 (1993); Lutterman, EuZW 264 (1998).

regulations to disclose. This stands in contrast with all joint stock companies whose shares are traded on the open market. In the ECJ Daihatsu decision,[135] the Court observed that Art. 335 paragraph 1 No. 6 together with paragraph 2 HGB does not correctly implement Art. 6 of 1. Gesellschafts-RiL (Publizitäts-RiL),[136] which obliges member states to institute appropriate measures in the event that the disclosure of profit and loss accounts prescribed by Art. 2 paragraph 1 f) is omitted.[137]

The ECJ decision is criticized in that the Court widens the concept of third party in Art. 44 paragraph 3 lit. g) (ex-Art. 54) EGV too far, because a third party can only be a person in a legal relationship to the company.[138] When *Luttermann* points out that neither the German HGB nor Austrian or United Kingdom law provide for a general application authorization,[139] he overlooks that the ECJ employs the comparative construction method which always allows it to derive the optimum result in its regular jurisdiction.[140] The Dutch Burgerlijk Wetboek, however, allows a broad construction in the sense of "anyone."[141]

2. *Liability for Erroneous Prospectus or Company Report Pursuant to Arts. 45 and 77 BörsG*

The Third Financial Promotion Act (Finanzmarktförderungsgesetz) has also fundamentally reformed the old and much criticized prospectus liability,[142] so that liability may be more readily incurred in future.[143] The injured party no longer need establish malicious behaviour on the part of the defendant. The injured party need only prove merely gross negligence or

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135. Case 97/96, Daihatsu, E.C.R I-6843 (1997) (discussing the disclosure of annual accounts). *See also* OLG Düsseldorf, EuZW, 672 (1996) (introducing the preliminary audit); EWS 110 (1996).

136. Council Directive 68/151/EEC, 1968 O.J. (L 65) 8 (1st Dir. on Company Law).

137. Case 97/96, Daihatsu, E.C.R I-6843 (1997).

138. As agreed upon by the federal government. *See* Luttermann, EuZW 264, 266 (1998).

139. Lutterman, *supra* note 138.

140. OPPERMANN, EUROPARECHT § 483 (2d ed. 1999); ECR 1471 (1973). *See generally* MÖLLERS, DIE ROLLE DES RECHTS IM PAHMEN DER EUROPÄISCHEN INTEGRATION (1999).

141. Art. 2:394 para. 1 § 2 Burgerlijk Wetboek. The ECJ rejected a horizontal effect, but unfortunately took no view on the question of correct implementation of the directive. *See generally* Möllers, EuR 20, 43 (1998). *See also* GRUNDMANN, EUROPÄISCHES SCHULDVERTRAGSRECHT § 41 (1999) (with further references).

142. HOPT, DIE VERANTWORTLICHKEIT DER BANKEN BEI EMISSIONEN § 170 (1991); BT-Drs. 11/8223 at 26. *See also* ZIP 400 (1997); Möllers, ZGR 334, 338 (1997); Pötsch, WM 949,950 (1998).

143. Kort, AG 9 *et seq.* (1999).

intention. The circle of responsible parties has also been extended.[144] Among the most significant reforms is the fact that the injured party under the new version of Art. 46 paragraph 2 BörsG no longer has to be the holder of securities in order to pursue a claim. This makes it possible for security holders to sell their securities in time to avoid a total loss. Under the old, highly unsatisfactory legal position, a claim for prospectus liability was excluded.[145] The present legal position corresponds not only to equity but also general principles of compensatory law, such as the mitigation obligation of Art. 254 paragraph 2 BGB.[146]

3. Ad Hoc Disclosure and the Joint Stock Company

It is beyond the scope of this paper to investigate in detail questions raised by the joint stock company's avoidance of insider dealing offenses and observance of ad hoc disclosure.[147] It is highly controversial whether the ad hoc disclosure represses company law,[148] or rather on the basis of multi-layered decision process, the competence of the individual organs remains largely unaffected.[149] Ultimately, it is bound to prevail that, at least in individual questions of the capital market law, company law should prevail.[150]

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144. OLG Frankfurt, ZIP, 107 (1997) (giving an early view).

145. ASSMANN & SCHÜTZE, HANDBUCH DES KAPITALANLAGERECHTS Art. 7 § 207 (2d ed. 1997); GRUNDMANN, BANKRECHTSHANDBUCH Art. 112 § 52 (1997); LG Frankfurt, ZIP, 25 (1996) (commenting on the previous legal position); Hoeren & Sachsenmilch, EwiR Art. 45 BörsG 1081 (1995); OLG Frankfurt, ZIP (1997); NJW-RR 107 (1997); Koller, EwiR Art. 45 BörsG 157 (1997); Schwark & Sachsenmilch, WuB I G 8-2.97.

146. *See also* Art. 20 para. 1 KAGG; Art. 12 AuslInvestmG.

147. HIRTE, BANKRECHSTAG 47 *et seq.* (1995); SCHNEIDER & SINGHOF, ESSAYS IN MEMORY OF KRAFT 585 *et seq.* (1998); Cahn, 162 ZHR 1 *et seq.* (1998); Burghard, 162 ZHR 51 *et seq.* (1998); Ekkenga, ZGR 165 *et seq.* (1999); Casper, WM 363 *et seq.* (1999).

148. HIRTE, BANKRECHSTAG, 47, 53 *et seq.* (1995). *See* Ekkenga, *supra* note 147, at 165 (discussing a capital market law view).

149. *See* Burghard, 162 ZHR 51 *et seq.* (1998).

150. *See* Ekkenga, *supra* note 147, at 165, 182 *et seq.* (discussing the lack of resolution on a capital increase).

V. SUMMARY AND OUTLOOK FOR THE *LEGE FERENDA*

1. Improving the Effectiveness and Shareholder Friendliness of Disclosure-Publicity

The capital market effectiveness of corporate law in no way requires that all systematic differences between the two legal areas should be evened out.[151] Rather, a better interlocking solution would seem sensible.

a) Extension of the Personal Scope

Certainly, there is confusion within the field regarding the scope of personal application. From the capital market viewpoint, it is unsatisfactory that the newly created duties of the AktG and the HGB do not apply to unofficial trading or only partly to official trading, and thereby exclude the "regulated market," and to an extent, the Neuen Markt and SMAX. The small investor is not aware of these fine distinctions. It will not be long before the first bankruptcy of a joint stock company, whose securities are not admitted to trading, permanently damage confidence in the German capital market.

b) Disclosure Through the Requirements of the HGB and Stock Exchange Law

When one views company law through the eyes of the investor, the control and information available have been extended. But this applies mainly to the supervisory board, whereas the general meeting remains deprived of power.[152] In practice, besides the company report, there are short and intermediate reports, shareholder letters, analysis meetings, press conferences, investor discussions and the like[153]—that occur on a merely *voluntary* basis, while the capital market laws and company laws impose no obligations to provide such information.

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151. *See* Schiessel, *Ist das Deutsche Gesellschaftsrecht kapitalmarkttauglich?*, REPORT OF THE 2ND KAPITALMARKTRECHTSSYMPOSIUM OF THE DEUTSCHEN BÖRSE AG 442 *et seq.*

152. HOMMELHOFF & HELMS, VORSCHLÄGE FÜR EINE EUROPÄISCHE PRIVATGESELLSCHAFT 143, 152 *et seq.* (Boucourechliev & Hommelhoff eds., 1999) (giving an instructive comparison with the law of the private limited company (GmbH)).

153. Dörner, WPg 302, 311 (discussion involving the auditor in this area).

Here, the compulsory disclosure duties should be increased by means of an interplay between corporate law norms and stock exchange law norms. The legal requirement of the HGB that obligates a company to prepare an annual balance sheet is still not sufficient to truly meet the information needs of the investor. In corporate law, the purely negative format of the management report is to be criticized because areas of business development and fiscal forecasts of the company are not dealt with.[154]

The requirement for twice annual intermediate reports under Art. 44b BörsG is still clearly inadequate to meet disclosure interests. On the ground of transparency for example, it is questionable why the duty to provide intermediate reports[155] or even information in an investor's prospectus[156] is not necessary for the regulated market or unofficial trading. Instead, the Neue Markt,[157] the SMAX,[158] or the Bavarian "Prädikatsmarkt" indicate an advisable direction to follow: the publication of a quarterly report.[159] The present purely private law segmental differentiation, however, leads to a variety of disclosure requirements, which the private investor is no longer able to distinguish between. The BörsG should follow this and raise the reporting requirements for the official and regulated markets.[160]

2. *The Tension Between Company Law and Capital Market Law*

Demands for an obligatory share law have always been met with the argument that they would be alien to the individual, legally overburden regulation of the joint stock company and hinder the flexibility of the individual company.[161] However, this conclusion is not logically consistent because the joint stock company is subject to numerous mandatory rules by virtue of its *statutes* and is therefore clearly distinguished from the GmbH.[162]

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154. *See supra* Part II.3.b.

155. Art. 76, 44(b) BörsG.

156. Instead of a stock exchange listing prospectus pursuant to Art. 36 § 2 no. 3 BörsG, the AG is only required to render a company report on the regulated market under Art. 73 § 1 no. 2 BörsG.

157. See articles by Kümpel & Ott, *supra* note 20, at Art. 72 S.2 & 3 § 456 (citing Point 7.1 of the Neuer Markt Rulebook (Oct. 3, 1997)). *See also* Hopt & Rudolph et al., *supra* note 6, at 289, 356 *et seq.* (commenting on the Neuer Markt).

158. SMAX Admission Rule pt. 3.1.

159. *See also* Frey, DStR 294 *et seq.* (1999); Maute, DStR 687 *et seq.* (1999).

160. And possibly extend it to unofficial trading. *See supra* Part II.3.b.

161. *See supra* note 109.

162. This is because the statute requirements of Art. 23 § 5 AktG significantly limit statutes autonomy. *See* HOMMELHOFF, DAS SYSTEM DER KAPITALGESELLSCHAFTEN IM UMBRUCH—EIN INTERNATIONALER VERGLEICH 26 *et seq.* (Roth ed., 1990); Bartz, Großkommentar z. Art. 23 § 18 AktG

In addition, it is not a contradiction, but rather a parallel development, if capital market law as a largely mandatory public law exerts influence on German corporate law. This limitation of contractual freedom is also not unreasonable when viewed as the price for being able to refinance in the market.

Capital market law builds confidence. In the wake of globalization nothing is so retiring as money. German securities law with its dualistic system,[163] largely unknown in the rest of the world, should follow the trends of transparency and control more aggressively the disclosures required of corporations. Capital market law constitutes an interplay of stock exchange law, regulatory law, such as the WpHG and KWG, and civil organization law, like the law of joint stock companies—regulatory systems that are closely interlocked with each other. The reforms of the last two years have achieved a preliminary degree of harmonization. However, a need for further fine-tuning remains if the German stock exchanges are to remain competitive in the future.

(4th ed. 1992); Schneider & Singhof, *supra* note 147, at § 85; Huffer, *supra* note 26, at Art. 23 § 34 *et seq.* *See also* GESTALTUNGSFREIHEIT IM GESELLSCHAFTSRECHT 36 *et seq.* (Lutter & Wiedemann eds., 1998); Hueck, GmbHG Intro. 17 (Baumbach & Hueck eds., 1996); Hommelhoff & Helms, *supra* note 152, at 143 *et seq.*; HIRTE, *supra* note 79, at 61 *et seq.*

163. For a comparative law survey, see Windbichler, ZGR 50 *et seq.* (1985); Goerdeler, ZGR 218 *et seq.* (1987); Hopt, *supra* note 21, at 3 *et seq.*