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Arbeitspapier Nr. 76

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I. Introduction

Shareholder voting is back on the agenda of public debate for several reasons. One is the investors' internationalization of capital investments and the raising of funds globally by companies. It can be predicted that considering the growing together of capital markets the trend to international investments will increase not least because the introduction of the Euro will create a uniform European stock market. This leads to the question how the law deals with this development and its problems. The EU Commission has commissioned a comparative study dealing, inter alia, with shareholders' representation at general meetings in the EU member states.[1] The aim is to simplify the operating regulations for public limited companies in the EU. Furthermore, the internationalization of shareholdings leads the investors to ask how their interests are protected abroad. Are the mechanisms of shareholder protection sufficient for foreign investors? In particular the formation of transnational companies like Daimler-Chrysler will change corporate governance systems. It remains to be seen whether and how foreign institutional investors will use measures of - in this case - German corporate law to control the management. From a microeconomic point of view the question is what specific features of a given corporate governance system might contribute to better performance of firms. The following remarks will however, be confined to one specific aspect of corporate governance only, the exercise of shareholders' voting rights at the general meeting.

[1] EUROPEAN COMMISSION (ed.), "The Simplification of the Operating Regulations for Public limited Companies in the European Union. Final Report", 1995.

Before turning to describe the German approach to shareholder voting two general points about German corporate law are to be made.

First, there are two different legal forms of corporations – the "Gesellschaft mit beschränkter Haftung" (GmbH; limited liability company) and the "Aktiengesellschaft" (AG; stock corporation).[2] They are regulated in different statutes. The GmbH is established as something in between the stock corporation and the partnership. Because of its personalized structure the GmbH is the typical legal form of smaller and medium-sized companies. Its shares are not traded publicly. This article will focus on shareholder voting in stock corporations only. The AG is the typical legal form of large enterprises. There is a special statute on stock corporations, the "Aktiengesetz" of 1965.

The distinction between the AG and the GmbH leads to the second general point. Whereas the law on the GmbH is for the most part not binding, most rules on the Aktiengesellschaft are mandatory and may not be modified by by-laws (§ 23 (5) Aktiengesetz)[3]. The German Aktiengesetz is not an "enabling" statute or a set of default rules but offers a highly standardized product. It does not allow the founders of a corporation to establish their own system of corporate governance or their own rules concerning voting. It does also not enable investors to choose the corporation which fits their needs best with respect to corporate governance and voting rights. Because of the lack of competition for the best by-laws the given provisions concerning voting rights have to be carefully analyzed to assess whether they are really effective and whether they really meet the needs of investors. Comparative studies will help to detect defects in our regulation and to improve our domestic law.

II. Why do shareholders vote?

The right and the possibility to vote is one of the most distinctive features of corporate law. Voting enables shareholders to influence the affairs of their company. From a legal perspective the right to vote is the means for the shareholder to participate in forming the company's will by passing a resolution at the shareholders' meeting.[4] Of course the question

[2] There exist about 5,000 stock corporations as compared to more than 815,000 GmbH. However, only about 800 stock corporations are publicly quoted.

[3] This concept has been debated recently; cf. the critic of MERTENS, "Satzungs- und Organisationsautonomie im Aktien- und Konzernrecht", *Zeitschrift für Unternehmens- und Gesellschaftsrecht*, 1994, at p. 426 et seq.; cf. further more SPINDLER, "Deregulierung des Aktienrechts?", *Die Aktiengesellschaft*, 1998, at p. 53 et seq..

[4] Cf. ZÖLLNER, *Die Schranken mitgliedschaftlicher Stimmrechtsmacht bei den privatrechtlichen Personenverbänden*, 1963, at p. 11.

remains why only shareholders vote. Why do they have a right to vote, and what are the incentives for shareholders to exercise their voting rights?

The reason for the fact that only shareholders have voting rights whereas other investors like bondholders or creditors don't is that equity and debt suppliers have a different exposure to the firm's risk. Bondholders expect a calculable return from the beginning for their investment whereas shareholders as equity suppliers only have a residual claim. Both the shareholders as well as the debt suppliers need a safeguard that their investment cannot be altered without their approval. For bondholders these safeguards are the detailed covenants. The shareholders however are the residual-risk bearers and thus cannot expect a fixed return but get "what is left over".[5] Their outcome depends on the market situation and on the development of the firm in general. As complete contracts cannot be written, much would have to be left to managements' discretion if there was no right to take at least basic decisions later by voting and thus fill in the gaps or alter the initial contract where necessary. Thus, voting is an inevitable supplement to the incomplete statutory rules concerning the division between ownership and control.[6] Requiring shareholders' consent for any fundamental change in corporate policy is a safeguard for the residual risk-bearers of a corporation against ex post-expropriation by the management. Voting rights are to shareholders what covenants are to bondholders: by limiting managerial discretion, they serve as a protection against moral hazard.[7] But unlike bondholders, shareholders receive most of the marginal costs and benefits of fundamental corporate decisions. Thus, they have the right incentives to decide on those matters.[8] Also, voting under a majority rule is the only feasible method to implement major improvements of corporate policy. Renegotiations would on the one hand be difficult to organize, because of the dispersion of equity holdings, and on the other hand would require unanimity and thus give veto power to all shareholders, regardless how many shares they own.[9]

Unfortunately, voting as a decision mechanism suffers from collective action problems. Shareholders with small stakes are likely to be "rationally apathetic" when it comes to acquiring information necessary for taking informed conclusions. The cost of informing oneself in order to cast an intelligent vote on a management proposal will exceed the expected benefits. Therefore, voters who hold a small fraction of shares only will remain rationally

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[5] EASTERBROOK/FISCHEL, *The Economic Structure of Corporate Law*, 1991, at p. 11.
[6] EASTERBROOK/FISCHEL, *supra* n. 5, at p. 66.
[7] EASTERBROOK/FISCHEL, "The Corporate Contract", in: BEBCHUK (ed.), *Corporate Law and Economic Analysis*, 1991, at p. 186.
[8] EASTERBROOK/FISCHEL, *supra* n. 5, at p. 69.
[9] Cf. BAUMS, "Shareholder Representation and Proxy Voting in the European Union: A Comparative Study", in: HOPT et al. (ed.), *Comparative Corporate Governance*, 1998, at p. 547.

ignorant. In companies with controlling shareholders that will result in free-riding on their efforts to control management (and, on the other hand, to a lack of control of the behavior of the dominant shareholder). For companies without any large shareholder a failure of control of the management by the shareholders can be predicted provided that there were no corrective regulation in place.

III. Does Voting Matter?

Whether voting matters and to what extent it contributes to corporate performance is necessarily an empirical question. Although there are no conclusive answers several considerations are suggestive. If voting contributes to the performance of a firm there should be evidence that firms whose structure prevents the formation of a controlling bloc of shares do relatively poorly in comparison to other firms. This point leads to the question whether owner controlled firms are more profitable than manager controlled firms. In companies with dispersed ownership and dispersed voting power the incentives for direct monitoring are weak. Free rider problems and absenteeism in general meetings are the consequences. Whereas when ownership as well as voting power is concentrated, the large shareholder will have the incentives and the power to control the management. Therefore one could predict that owner controlled firms will perform better. But unfortunately in this case there will be conflicts between majority and minority shareholders. Concentrated ownership might lead to decisions that are advantageous for the controlling blockholders but not in the interest of the minority. The controlling shareholder might transfer resources which leads to sub-optimal performance of the company. Not astonishingly, the results of empirical studies on the question whether manager controlled firms are less profitable than owner controlled firms are ambiguous.[10]

Given these mixed results one could argue that, from a micro-economic point of view, exit is the more rational strategy. Considering the collective action problems in case of manager controlled firms, and the possibility of easy exit through the stock market, selling shares may be seen as the more desirable course of action for dissatisfied shareholders instead of investing time and money to cast an intelligent vote.

[10] See most recently GUGLER, "Corporate Governance and Economic Performance: A Survey", Department of Economics, University of Vienna, 1998. This study surveys the economic literature as well as the available empirical micro-economic data about the interrelationship of corporate governance and economic performance.

But following the Wall-Street-Rule is not always a solution. If a proposal is accepted by the investors that leads to a decrease of the firm's value there will be price adjustments. These price adjustments are reflected in every share and thus the investors have to bear the costs of adopting an adverse term. They may sell their share but they cannot avoid the loss because the market will anticipate this.[11] Informed traders will know the problems and anticipate that even value-decreasing proposals of the management may be adopted. This would lower their willingness to pay accordingly. Only where a buyer acquires large blocks of shares do collective action problems not occur. He has the opportunity to control the management and can change the course of action of the firm. In this case voting rights help to provide incentives to the management to work hard in the shareholders' interest because a poorly performing firm may become a target for a takeover. [12] But concentration of share capital reduces liquidity in the market so that the informational content of the stock exchange price may be limited and therefore the possibility to assess the value of a firm by the development of the market price of the shares may also be restricted.[13]

To sum up voting seems not to be the perfect monitoring mechanism. It plays its most important role in companies with one or more large shareholders. In firms with widely distributed shares there is a market failure problem. Regulation tries to cope with this by various means: reduction to taking basic decisions only and lowering information and transaction costs for shareholders to cast their votes. The details of this regulation will be described in the following.

IV. Data on Voting in Large German Corporations

In order to evaluate what voting rights mean in practice one must look at the distribution of ownership and at the extent to which shareholders are present at general meetings.

The empirical data shows that, as is the case in most continental European economies, ownership is highly concentrated even in quoted companies. According to a study by *Jenkinson* and *Ljungqvist*[14] nearly three quarters of all listed companies in Germany have a

[11] EASTERBROOK/FISCHEL, *supra* n. 5, at p. 32.
[12] On the efficiency of takeovers as a disciplinary mechanism for the management see, e.g., GUGLER, *supra* n. 10, at p. 32 et seq..
[13] HOLMSTRÖM/TIROLE, "Market Liquidity and Performance Monitoring", *Journal of Political Economy* 101 (1993), at p. 678.
[14] JENKINSON/LJUNGQVIST, "Hostile Stakes and the Role of Banks in German Corporate Governance", Discussion Paper No. 1695, Centre for Economic and Policy Research; with data from September 1991.

majority owner. 23.1 % have blocks of 90 % or more of the stated capital. That means that in these firms the influence of the minority shareholders is clearly limited. They cannot, for example, commence damage suits on behalf of the corporation against the management or supervisory board (cf. § 147 (1) Aktiengesetz). If the controlling shareholder is a stock corporation itself and holds more than 95 %, it can acquire the minorities' shares (§ 320 (1) Aktiengesetz). 18.4 % of all listed companies in Germany are controlled by a shareholder holding 75 % of the stated capital. In these firms the majority shareholder can amend the by-laws as well as enter into control agreements. In 30.5 % of the listed companies there is a block of 50 % or more of the stated capital. Only a quarter of the firms listed in 1991 were not majority-controlled. According to a study by *Baums* and *Fraune* in 1995[15] there were only 24 public corporations where the majority was widely held. These companies also involved shareholders with at least blocking holdings. Hence there are only very few firms of the Berle-Means-type in Germany. That means that the principal-agent problem between management and the shareholders as a whole seems to be somewhat less pronounced. Instead there will be conflicts between small and controlling shareholders. Given an average presence of about 58 % of votes at general meetings, [16] a 25 % block can provide substantial influence if there is no other large shareholder. Voting rights of a minority of less than 25 % in a company with a firmly established majority are almost meaningless.

A look at the 24 largest companies with widely-held majorities shows that large blocks are held by other firms. But the predominant role is played by the banks. In most cases voting rights were exercised by banks as proxies. Although on average banks themselves did not hold more than 5 % of the share capital of the respective firms in the 1992 sample, their voting rights amounted on average to 84 % of the represented votes.[17] This means that about 60 % of all votes cast resulted from proxies given to banks. This data on shareholder representation by banks shows that German banks exercise significant control over large publicly held corporations through proxy voting.

According to the *Baums* and *Fraune* study, the banks had the majority of votes in 20 of the 24 examined corporations (including the shares of related mutual funds). In 18 general meetings they voted with more than three quarters of the stock present. Therefore in 75 % of the

[15] BAUMS/FRAUNE, "Institutionelle Anleger und Publikumsgesellschaft: Eine empirische Untersuchung", *Die Aktiengesellschaft*, 1995, at p. 97 et. seq.. In this study the holdings as well as the practice of voting of institutional investors are explored. For this purpose the records of the general meetings of 24 companies in 1992 were evaluated. Objects were stock corporations out of the 100 largest corporations according to the value added. From these companies the corporations with widely held stock were selected.

[16] BAUMS/FRAUNE, *supra* n. 15, p.102, tab. 4.

[17] Cf. BAUMS/FRAUNE, *supra* n. 15, p. 103 tab. 6. Votes of dependent mutual funds are included.

examined companies, the banks were able to change the by-laws by means of their proxies. Many of these corporations provide in their by-laws that shareholders may not vote with more than 5 % of all shares in the company. However, this rule does not apply to banks voting as proxies. On average 60 % of the votes present are exercised by banks as proxies. This provides a comfortable and stable power base at shareholders' meetings.

Moreover the *Baums* and *Fraune* study shows that voting power is highly concentrated in the three largest private banks (Deutsche Bank AG, Dresdner Bank AG, Commerzbank AG). In 1992 these banks exercised about one third of the votes present. At four general meetings these banks had the majority of the votes, at other meetings they had at least a blocking minority, so that they could prevent an amendment of the by-laws. At nine further general meetings their share in the voting rights accounted for between 10 % and 25 %. In companies with widely held stock they exercised about 40 % of the votes. The voting results show that the banks will normally vote according to the suggestions of the management board.

The exercise of the right to vote at a depository bank's own general meeting is only admissible if an explicit instruction by its shareholder exists (§ 135 (1) Aktiengesetz). Each of the five largest banks[18] cast the most votes in their own general meeting in 1992. The quora ranged from 18 % (Commerzbank AG) to 44 % (Dresdner Bank AG). The voting rights of all five banks together made up for the majority of votes in all of these banks' general meetings.

It is however not clear from this data whether the banks really wield as much power as appearances suggest. Whereas smaller shareholders tend to simply rubber stamp proxies for banks without giving individual instructions, large investors might do so. As banks as proxies need not disclose whose shares they represent and whether they have been given instructions, the extent to which they really govern the respective firms is not clear. The proxy system disguises the true shareholding structure behind it.

Other institutional shareholders than banks do not play an important role so far. On average, mutual funds owned more than 10 % of the respective companies' share capital. But at the general meetings in 1992 their voting rights made up only 10 % of the represented votes. This shows that mutual funds do not exercise all their votes themselves. The exercise of voting rights by insurance companies did not play an important role, either. On average they exercised voting rights amounting to below 1 % of the represented votes. Considering the shareholdings of insurance companies in the examined companies (about 5% of the total share capital), these data show that insurance companies exercise their voting rights only partially in

person. This does not mean that insurance companies do not look after their voting rights. Rather, it is probable that they were represented by banks exercising the right to vote on behalf of the insurance companies. Also, the participation of pension funds at general meetings does not play a role. It should be noted that there are no Anglo-American style pension funds in Germany so far. Only one foreign pension fund participated in the general meeting of BASF AG in 1992, with 0.02 % of the votes present.

In 1992, foreign investors owned on average more than 20 % of the share capital,[19] but only foreign banks and mutual funds exercised their voting rights at general meetings. The voting rights exercised by foreign banks including their domestic subsidiaries and dependent mutual funds amounted to 8 % of the votes present.[20] In the general meetings of companies with a high portion of widely held stock, foreign banks' votes amounted on average to 15 % of the votes present. This may be explained by the fact that foreign investors hold more stock of these companies because of their higher liquidity and because information is more easily available.[21] Among the foreign banks, Swiss banks in particular participated in the general meeting. They participated in nearly every general meeting, while U.S. banks were almost exclusively represented by their German subsidiaries.

There are also some shareholder associations and activists working for greater shareholder influence in big companies. But their influence counted by voting rights is very small.[22] In 1992, shareholders' associations represented 0,3 % of the votes present. The exercise of voting rights by private persons is also almost meaningless. On average only 1,7 % of the votes present were thus exercised.

V. On What Do Shareholders Vote?

An analysis of shareholder voting must consider the range of competencies reserved for shareholders. The competencies of the general meeting are listed in the Aktiengesetz and must not be extended because as the Act is mandatory (§ 23 (5) Aktiengesetz). The balance of

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[18] Deutsche Bank AG, Dresdner Bank AG, Commerzbank AG, Bayerische Vereinsbank AG, Bayerische Hypotheken- und Wechselbank AG.

[19] Cf. FRAUNE, *Der Einfluß institutioneller Anleger in der Hauptversammlung*, 1996, at p. 103.

[20] Cf. FRAUNE, *supra* n. 19.

[21] FRAUNE, *supra* n. 19.

[22] See BAUMS/FRAUNE, *supra* n. 15, p. 102, tab. 4.

powers between the legal organs of a corporation, i. e. the board of directors, the supervisory board and the shareholders' meeting is fixed.

The competencies of the general meeting can be divided into three groups:[23]

First, there are the basic decisions like amendments of the articles of association (§ 179 Aktiengesetz), measures to increase and to decrease the stated capital (§§ 182, 237 Aktiengesetz), consent to group contracts (§§ 291 et seq. Aktiengesetz), change of the corporate form (§ 13 Umwandlungsgesetz) or dissolution of the association (§ 262 Aktiengesetz). Otherwise, the management is obliged under certain circumstances to submit matters of vital importance to the shareholders' meeting for approval.[24]

The second group are the decisions that must be taken regularly. Those are, e.g., the appointment of the members of the supervisory board (§ 101 Aktiengesetz), the appropriation of retained earnings (§ 119 Aktiengesetz), the discharge from responsibility of the members of the board of management and the supervisory board (§ 120 Aktiengesetz) or the appointment of auditors (§ 163 Aktiengesetz).

The third group of competencies concerns decisions in special cases like the appointment of special auditors (§ 142 Aktiengesetz), the removal of members of the supervisory board (§ 103 Aktiengesetz) or taking decisions on managerial matters if the management board requests (§ 119 (2) Aktiengesetz). This last provision does not mean that the shareholders' meeting may interfere with business decisions. Rather, this rule must be seen in conjunction with § 93 (4) Aktiengesetz, which states that the obligation of the management board to compensate the corporation for damages does not arise if the action rests upon a valid resolution of the shareholders' meeting. § 119 (2) Aktiengesetz, allows the management to obtain such a release from the shareholders' meeting.

This list of competencies shows that German law does not consider the shareholders' meeting to be the superior organ in a public company. Rather, its competencies are restricted to taking basic decisions. Interference with business decisions is in principle impossible.

VI. The Regulatory Framework

1. Deposition of Bearer Shares

[23] Cf. ZÖLLNER, in: *Kölner Kommentar zum Aktiengesetz*, 1984, § 119 note 13 et. seq.; RAISER, *Recht der Kapitalgesellschaften*, 1983, at p. 98 et seq..

[24] This obligation is judge-made law; see Federal Supreme Court in BGHZ 83, 122 et seq. – "Holzmüller".

As German stock corporations mostly issue bearer shares rather than registered shares, the by-laws of the company may provide that the right to participate and vote at the meeting can only be exercised if bearer shares have been deposited (§ 123 (2) Aktiengesetz). Most by-laws of companies with widely held stock contain such a provision.[25]

German notaries public[26] and depositary banks can act as legal depositories (§ 123 (3) Aktiengesetz). The by-laws may determine other depositories. In practice they authorize the management board to determine where the shares are to be deposited.[27] That is because usually banks with which the corporation maintain business connections are chosen as depositories. These connections may change and the by-laws would thus require alteration were depositories named. Even if the by-laws name other depositories the deposit of shares at German notaries public and depositary banks will suffice. Shareholders may also deposit their shares with foreign depositary banks if resident banks are allowed to entrust them securities for collective safekeeping.[28] Although not stated, the shares may be deposited with the company itself.[29] This is in accord with the purpose of depositing the shares in order to prepare the general meeting. In most cases the by-laws provide for that explicitly.[30]

The management, authorized by the by-laws, usually names only particular banks as depositories. Thus shareholders who have deposited their shares with other banks must transfer their shares to the banks mentioned in the by-laws. This would be a very complicated procedure and is thus not used in practice[31]. The by-laws normally provide that the deposit of shares at banks other than those indicated in the invitation is sufficient if a depository that is mentioned in the by-laws so agrees.[32] A depository is therefore authorized to issue a certificate of deposit for a depositary bank not named in the by-laws. Thereby it is possible to fulfill the requirement of deposit and at the same time, to leave the shares where they are deposited. But the by-laws must provide explicitly for this procedure. This provision gives

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[25] Cf. KÖNIG, "Teilnahme ausländischer Anleger an der Hauptversammlung – Eine empirische Untersuchung", Schriftenreihe des Instituts für Handels- und Wirtschaftsrecht der Universität Osnabrück, Arbeitspapier 7/93, at p. 5.

[26] Whether also nonresident notaries can be seen as legal depositories, according to § 123 (3) Aktiengesetz, is disputed. But the by-laws may provide that the deposit of bearer shares with nonresident notaries is sufficient. See HÜFFER, *Aktiengesetz*, 3rd ed., 1997, § 123 note 11.

[27] WERNER in *Großkommentar zum Aktiengesetz*, 4th ed., 1993, § 123 note 37.

[28] This question is disputed. Cf. WERNER, *supra* n. 27, § 123 note 41. To clarify this in most cases the by-laws provide foreign banks as depository, especially if the shares are listed at foreign stock exchanges. Cf. KÖNIG, *supra* n. 25, p. 6.

[29] HÜFFER, *supra* n. 26, § 123 note 11; ECKARDT in GEßLER/HEFERMEHL et al. (ed.), *Aktiengesetz*, vol. 2, 1974, § 123 note 42.

[30] Cf. WERNER, *supra* n. 27, § 123 note 37; KÖNIG, *supra* n. 25, p. 6.

[31] WERNER, *supra* n. 27, § 123 note 43.

[32] See KÖNIG, *supra* n. 25, at p. 6.

foreign investors in particular the chance to deposit shares with banks not indicated in the by-laws.

The by-laws may provide a time limit for the deposit of shares, but in any case it will suffice to deposit the shares ten days before the general meeting (§ 123 (3) Aktiengesetz).

If the by-laws of the company require that the shares be deposited, shareholders not depositing their shares may not participate and vote at the general meeting.

2. Blocking of shares

An issue giving raise to concern is the blocking of shares before and during shareholders' meetings. Foreign institutional investors in particular attach importance to the possibility that the shares can be sold and transferred at any time should the operating results be unsatisfactory or should the stock price decline.

The transferability of shares before and during the general meeting cannot be blocked. In particular the fact of being deposited does not mean that the respective shares are technically "blocked" from trading. The shares may still be traded on a stock exchange.[33] The depositing procedure is intended only to allow the shareholder to prove his right to vote and to prevent the share from being represented by two or more "shareholders" simultaneously. Most large German custody banks with which shares are deposited allow trading up to 24 hours before general meeting.

This practice leads to problems concerning voting. Banks will ask the seller of the shares to return the depositary receipt issued by the credit institution and entitling the holder to cast his vote. On the other hand, the buyer himself might not be able to obtain such a receipt in time to vote. Hence in such cases the shares are usually not represented.[34] Albeit the seller may authorize the buyer to vote with his stock (§ 123 (3) Aktiengesetz)[35] this is not possible in case of sale on a stock exchange[36]. It would be better if the seller remained entitled to vote

[33] FRAUNE, *supra* n. 19, at p. 109. In this case the transferor loses his position as shareholder so that he may not participate at the general meeting. Nevertheless he is still (formally) entitled to do so because he holds the deposit receipt. However, voting at a general meeting without being shareholder or even being authorized is a regulatory offence according to § 405 (3) Aktiengesetz. Cf. for more details WERNER, *supra* n. 27, § 123 note 49; ZÖLLNER, *supra* n. 23, § 123 note 24.

[34] See FRAUNE, *supra*. n. 19.

[35] See WERNER, *supra* n. 27, § 123 note 49.

[36] See FRAUNE, *supra* n. 19, at p. 109.

with the shares even where he had sold them during the depositing period.[37] He should be treated as a proxy and should, of course, have to act in the buyer's interest.

3. Information

An important aspect of shareholder voting is whether the legal system provides for informed voting. How easy or difficult German corporate law make obtaining information?

a) Invitation of Shareholders

A first point is the invitation of the shareholders to the general meeting.
A consequence of issuing bearer shares is that the company does not know its shareholders. Therefore the general meeting must be publicly announced. The convocation of a shareholders' meeting must be published in the Federal Bulletin (§ 121 (3), § 25 Aktiengesetz). Otherwise the by-laws of the corporation may provide for additional gazettes, like daily newspapers. Besides, the stock exchange regulations usually provide for a publication in compulsory gazettes if the firms' shares are listed.[38] If all shareholders are known by their name the company may invite them by letter (§ 121 (4) Aktiengesetz). That rule applies especially in the case of registered shares (§ 67 (2) Aktiengesetz). If the company has issued bearer shares as is normally the case, it is unlikely that the management board knows the shareholders except in smaller companies.
Furthermore, the Aktiengesetz provides that the management board must furnish banks and shareholder's associations with information about shareholders' meetings (§ 125 (1) Aktiengesetz). These notices are required to be communicated within twelve days of publication in the Federal Bulletin. The banks must transmit these notices to every shareholder for whom they hold shares on deposit (§ 128 (1) Aktiengesetz). The banks are reimbursed for this service by the company.[39]
Apart from that, every shareholder who deposits a share with the corporation must be notified. Moreover, the company must furnish shareholders so demanding with information after publishing the convocation in the Federal Bulletin. A request for information made before

[37] Cf. the American solution of this problem. See CLARK, *Corporate Law*, 1986, at p. 359.
[38] SEMLER, in: HOFFMANN-BECKING (ed.), *Münchener Handbuch des Gesellschaftsrechts*, vol. 4. Aktiengesellschaft, 1988, § 35 note 26. Cf. § 63 (1) Börsenzulassungs-Verordnung.
[39] Cf. "Verordnung über den Ersatz von Aufwendungen der Kreditinstitute vom 18. Juni 1968", Bundesgesetzblatt I, p. 720.

publishing of the convocation in the Federal bulletin does not oblige the management board to inform the shareholder.[40]

Where the company has issued registered shares (§ 67 Aktiengesetz) the shareholders must be notified by the company if they are registered in the share register and if their voting rights were not exercised by a proxy at the last general meeting (§ 125 (2) Aktiengesetz).

As to foreign shareholders, there are no special provisions for inviting them as the company will not reliably know how many of its shareholders are domestic or foreign shareholders.

Foreign investors are recommended to make use of the possibility of obtaining information transmitted by banks holding their shares on deposit. The management board is also obliged to provide foreign banks with information on general meetings if the requirements of § 125 Aktiengesetz, are fulfilled.[41] However, there is no duty of the foreign bank to transmit this information to the shareholders because § 128 (1) Aktiengesetz will not apply. Nonetheless, the shareholder and the bank could enter into an agreement obliging the bank to transmit the information. But considering that for the management there is a time limit of 12 days after the publication of the announcement for transmitting information to banks (§ 125 (1) Aktiengesetz) as well as the time needed for the delivery of the invitation by mail, there are only two weeks left for foreign shareholders to fulfill the requirements for participation and to give a proxy to a bank. This may prevent the participation of foreign shareholders at general meetings.[42]

The communication between the company, e.g., invitation to the shareholders' meetings and the like, relies completely on the bridge between the company, domestic and foreign depositary institutions and the foreign shareholder holding. In some cases where a domestic company is also listed on a foreign stock exchange which requires public information in the respective country and language, there is an additional information channel. Increasingly, companies also use the internet as a comfortable way to inform and invite investors. It would be advisable that stock exchanges require that listed companies also provide information for shareholders on the internet, preferably in their own language and in English. This information would then be available worldwide. That could be extended to the convocation of shareholders' meetings, transmitting ballots, and the like.

[40] WERNER, *supra* n. 27, § 121 note. 63.

[41] This question is discussed controversially. See for more details ZÖLLNER, *supra* n. 23, §§ 125 – 127 note 33; WERNER, *supra* n. 27, § 125 note 30; FRAUNE, *supra* n. 19., at p. 106.

b) Agenda

Another condition for informed voting is the transmission of a detailed agenda.

The agenda lists the items the general meeting will deal with. These items should be specified in sufficient detail for the shareholder to be able to prepare himself for the meeting. The items on which the meeting is asked to take a resolution must be published.[43] The general principle of this provision is to protect shareholders from surprising developments.[44] Therefore in case of important resolutions like amendments to the articles of incorporation or the consent to a contract that needs to be approved, the text of the amendment and the essential content of the contract must be set out in the announcement of the meeting (§ 124 (2) Aktiengesetz). If the general meeting will elect members to the supervisory board it must be indicated in the announcement which rules apply and whether the general meeting is limited by election proposals.

The agenda must be published in the Federal Bulletin and if the by-laws so provide, in other newspapers (§ 124 (1) Aktiengesetz). Only if the company knows the shareholders by name may the agenda be transmitted by letter. Otherwise, the announcement, the agenda with the proposals of the management board and counter motions of opposing shareholders must be communicated to shareholders through the depositary banks and shareholders' associations (§ 125, § 128 Aktiengesetz).[45] The publishing of the agenda is subject to the same time-limits as the publishing of the invitation. Accordingly, it must be published at least one month before the general meeting. Where a minority of 5 % of the company's shareholders demand to add items to the agenda these items must be published within ten days after the convocation of the general meeting (§ 124 (1) Aktiengesetz). If the items of the agenda have not been published according to the rules the general meeting may not take decisions on these items (§ 124 (4) Aktiengesetz).

These regulations are supplemented by a series of further instructions are aimed at guaranteeing proper information of shareholders. Thus the management board must publish the annual financial statement, the report of the supervisory board and its proposal for the distribution of profits at the corporate headquarter one month before the annual general meeting (§ 175 (2) Aktiengesetz). On the demand of a shareholder, the company must send

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[42] For details see FRAUNE, *supra* n. 19, at p. 107.
[43] See WERNER, *supra* n. 27, § 124 note 14.
[44] See WERNER, *supra* n. 27, § 124 note 5.

him a copy of these documents. Apart from that, the by-laws can provide for a broader duty to inform the shareholders. However, such regulations are uncommon in practice.[46]

c) Shareholders' Questions

The shareholder is entitled to ask questions relating to the affairs of the company, so far as this information is necessary for appropriately assessing an item on the agenda (§ 131 (1) Aktiengesetz). This right to information may not be restricted by by-laws.[47]
The purpose of this right is to provide the shareholder with the information necessary for the exercise of his rights, be it the right to vote or minority rights. Therefore shares without the right to vote, such as preference shares, will nevertheless also give the right to information.[48]
The right to information refers to all affairs and activities of the company. That includes business relations, planning, the affairs of related companies and the like. In any event the information must be necessary for the appropriate assessment of an item on the agenda.[49]
Questions may be asked orally or in writing. The by-laws may not exclude oral questions. The shareholder has neither to give reasons for his question nor is he obliged to announce his question before the meeting. But in case of complex questions he should inform the management board before the meeting so that the management is able to prepare an answer. Otherwise he will risk getting no answer.
The right to information would be ineffective if the management board could object simply on the ground that it is not able to answer without preparation. Therefore the right to information extends to all items to which the management board can give information with the aid of expert staff and documents. The management board is obliged to keep these aids ready. Despite appropriate preparation, it may occur that the management board is unable to answer a question, especially if it is very specialized and could not have been expected. In such case the management does not violate the right to information if it does not answer the question.[50]
The answer of the management board must be in accordance with the principles of conscientious and loyal account (§ 131 (2) Aktiengesetz). It must therefore be complete and correct. Information can be refused if it would lead to disadvantages for the company, if the information refers to the amount of taxes or to valuation methods or as far as the management

[45] For details see above.
[46] WERNER, *supra* n. 27, § 125 note 5.
[47] ECKARDT, *supra* n. 29, § 131 note 16; ZÖLLNER, *supra* n. 23, § 131 note 5.
[48] HÜFFER, *supra* n. 26, § 131 note 1.
[49] See for details and examples HÜFFER, *supra* n. 26, § 131 note 17 et seq..
[50] Federal Court in BGHZ 32, 159, 165 et seq.; HÜFFER, *supra* n. 26, § 131 note 10.

board would incur a penalty. Beside these cases enumerated in § 131 Aktiengesetz, giving information can also be refused in the case of misuse of the right to information.[51]

For the effectiveness of the right to information it is very important that this right can be enforced by the courts (§ 132 Aktiengesetz). The enforcement is a matter of non-contentious jurisdiction. This should guarantee accelerated legal protection.[52] Otherwise unlawfully refused, wrong or incomplete information is a ground for avoidance. A resolution based on such an information may be contested by court action for violation of the law. Where refused information, it is irrelevant that the shareholders' meeting or shareholders state that the refusal did not influence their passing of the resolution (§ 243 (4) Aktiengesetz).

In general, questions must be asked during the shareholders' meeting and they must be answered during this meeting. Only if the information is enforced by the courts may the answer be given outside the meeting (§ 132 (4) Aktiengesetz). Besides, the by-laws can provide for the possibility of asking questions outside the meeting. If any information is given to a shareholder outside the meeting, every other shareholder has the right to obtain this information himself, even if it is not necessary to assess an item on the agenda (§ 131 (4) Aktiengesetz). This regulation guarantees equal treatment of shareholders.

All in all the information of shareholders in and outside meetings seems to be too restricted in German corporate law. This can be seen in two points:

First, the members of the supervisory board are not obliged to answer questions of shareholders even if the answer would be relevant for decisions to be taken by the shareholders. The duty of the supervisory board to report on the results of the audit of the annual financial statements (§ 171 (2) Aktiengesetz) or of the report on the relations with connected enterprises (§ 314 (2) Aktiengesetz), for example, has become a mere formality in practice.[53] The law also lacks an obligation on the supervisory board to inform the general meeting on matters concerning its own responsibilities. Furthermore, the general meeting should be informed about contracts between members of the supervisory board and the company. In general more transparency concerning business relations between board members and the company would be desirable. Apart from that, the auditor should be obliged to answer shareholders' questions. Where auditors are charged with a special audit in case of

[51] This question is disputed. Cf. K. SCHMIDT, *Gesellschaftsrecht*, p. 852 with examples.
[52] For details concerning procedure see HÜFFER, *supra* n. 26, § 132 note 1 et seq..
[53] Cf. THEISEN, *Überwachung der Unternehmensführung*, 1987, p. 158 et seq..

mismanagement (§ 111 (2) Aktiengesetz) the report should be made available to shareholders.[54]

Second, there is no way to obtain information on the company if the issue is not related to a decision to be taken by the shareholders' meeting (§ 131 (1) Aktiengesetz). That is a practical issue especially when the minority shareholders want information on the value of their shares. There is no right to such information so far.

4. Technology

Issuing bearer shares may preserve anonymity, but it also renders communication between the company and its shareholders or among shareholders difficult. Most German companies do not know who their shareholders are if these do not hold large blocks above 5 %, which must be disclosed. That means that if management control by shareholders in publicly held corporations is not to decrease dramatically especially with the internationalization of shareholdings, new answers must be found. One is more widely spread information. The other is to ease the communication between the company and its shareholders by using modern technology.[55]

The use of modern means of communication has so far been hindered by German corporate law.[56] The right to vote can only be exercised during the shareholders' meeting (§ 118 (1) Aktiengesetz). The exercise of the voting right outside the meeting is inadmissible.[57] Therefore shareholders of German companies may not vote by mail. Moreover the law provides that the shareholders physically attend the meeting so that participation by the internet is not admissible. If shareholders wish to vote, they must either attend the meeting in person or give a proxy to a representative acting in their place.

A publication of the announcement of the general meeting on the internet as well as the possibility to give proxies to banks by e-mail would be desirable. Under German law the latter is inadmissible at present. Other information concerning the company recorded in different

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[54] Cf. the appealable decision of the Oberlandesgericht Köln, *Zeitschrift für Wirtschaftsrecht*, 1998, 994 et seq.. In this case the court stated that the *management board* has the duty to disclose the contents of such a special audit if this is necessary to form an appropriate opinion on the discharge of the management from responsibility (§ 131 (1) Aktiengesetz). But this is at least doubtful because the supervisory board ordered the special audit and thus the management board may not be able to submit the results.

[55] For a proposal from the point of legal policy see SEIBERT, "Stimmrecht und Hauptversammlung – eine rechtspolitische Sicht", *Betriebs-Berater (BB)*, 1998, at p. 2536 et seq..

[56] Concerning the use of modern means of communication in a general meeting see RIEGGER/MUTTER, "Zum Einsatz neuer Kommunikationsmedien in Hauptversammlungen von Aktiengesellschaften", *Zeitschrift für Wirtschaftsrecht*, 1998, p. 637 et. seq..

registers could also be made easily accessible via internet. A next step could be the broadcasting of general meetings at different places. The shareholders could participate via satellite transmission. This would mean a considerable facilitation especially for foreign shareholders because they would avoid the costs of travelling to another country. One could even imagine of whole meetings in the internet.[58] However, without an amendment of the law technical facilitation of this sort may not be used.[59]

5. "Rights to Initiate"

Another aspect of shareholder voting is the question whether the shareholders themselves can bring matters to a shareholders vote. Are changes only proposed by the managers and accepted by the shareholders or can shareholders actively influence the affairs of their firm?

a) In general, the management board convenes the shareholders' meeting (§ 121 (2) Aktiengesetz), but shareholders owning 5 % or more of the company's share capital may demand that the management board convene an extraordinary meeting (§ 122 (1) Aktiengesetz). If the management board does not comply with this the court can authorize the convention of a shareholders' meeting. The company must bear the cost of the meeting even if it was called by the shareholders (§ 122 (4) Aktiengesetz).

b) In general, the agenda is set by the management board. Shareholders owning a minimum of 5 % of the shares or shares with a nominal value of DM one million may add items to the agenda (§ 122 (2) Aktiengesetz). This right is subject to the same terms as the right of the minority to convene the general meeting.
The right to add items to the agenda must be clearly distinguished from the right to counter-motions. According to § 124 (3) Aktiengesetz, the management board must make proposals for any decision of the general meeting concerning an item on the agenda. Every shareholder may table counter-motions providing they concern with an item on the agenda (§ 126 Aktiengesetz). A counter-motion is a proposal to take a decision deviating from the

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[57] Cf. HÜFFER, *supra* n. 26, § 118 note 7; ZÖLLNER, *supra* n. 23, § 118 note 8.
[58] Software for such a virtual general meeting has already been developed. See *Frankfurter Allgemeine Zeitung*, October, 20, 1998.
[59] For the different possibilities to use modern means of communication within the law of companies see in detail NOACK, "Moderne Kommunikationsformen vor den Toren des Unternehmensrechts", *Zeitschrift für Unternehmens- und Gesellschaftsrecht*, 1998, p. 592 et seq..

suggestion of the management. This motion must be sent to the company within one week after the convocation of the general meeting. Furthermore the shareholder must give reasons for it[60]. If these provisions are fulfilled the counter-motion must be communicated by the company to its shareholders through the depositary banks and shareholders' associations (§ 125, § 128 (1) Aktiengesetz).[61] There are some exceptions from this obligation to communicate in case of misuse, e.g. if the reasons for the counter-motion are obviously false, if the motion would lead to an illegal or void decision or if the management board would thereby incur a penalty etc. (cf. § 126 (2) Aktiengesetz).[62] If the reasons for the counter-motion comprises more than hundred words, they need not be communicated.
Other than counter-motions, every shareholder may make election proposals where the general meeting is to elect members to the supervisory board or appoint auditors (§ 127 Aktiengesetz). These motions are subject to the same terms as counter-motions, though the shareholder need to give no reasons for his suggestion.

c) Beside counter-motions and election proposals, every shareholder may table a motion. This right is part of the right to participate in the general meeting. He can also give notice of his motion to the company before the meeting. But if this motion does not fulfill the requirements of § 126 Aktiengesetz, as described above, it cannot be a counter-motion in a legal sense and the company needs thus not communicate it to the shareholders. If the general meeting does not vote on an admissible and properly submitted motion the decision may be voidable.

6. Nominal Versus Factual Voting Power

The right to vote as a fundamental right of each shareholder cannot be withdrawn. The voting rights are proportionate to the par value of the shares (§ 134 (1) Aktiengesetz). According to § 12 (1) Aktiengesetz, every share grants a right to vote. It is therefore inadmissible to provide that the exercise of the voting right depends on ownership of a minimum number of shares or a minimum period of ownership.[63] Multiple voting shares are also inadmissible.[64]

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[60] HÜFFER, *supra* n. 26, § 126 note 3.
[61] For details of this procedure see above. In case a shareholder did not give a proxy he may demand the communication of the counter-motions from the company.
[62] For more details see WERNER, *supra* n. 27, § 126 note 35 et seq.; HÜFFER, *supra* n. 26, § 126 note 5 et seq..
[63] ECKARDT, *supra* n. 29, § 123 note 61.
[64] Until the enacting of the "Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG)", Bundesgesetzblatt I, 786 (in force since May 1, 1998), multiple voting shares were admissible if specifically approved by the Secretary of Commerce.

However, there are some devices in German company law and practice to leverage control relative to ownership in listed stock corporations. In practice pyramiding, personal interlocks, cross shareholdings, and contractual control arrangements are widely used. There are also preference shares without voting rights (§ 12 (1) ,§ 139 et seq. Aktiengesetz). These shares give the holder a prior claim over the holders of ordinary shares in respect of the dividend. However, the par value of preference shares without voting rights may not exceed the par value of the other shares (§ 139 (2) Aktiengesetz).

Where a shareholder owns several shares, his right to vote can be limited by the by-laws (§ 134 (1) Aktiengesetz). In practice, caps of 5 % or 10 % of the company's share capital have been chosen[65] and the by-laws of several corporations provide for such a limitation of the right to vote[66]. This limitation must apply to every shareholder (§ 134 (1) Aktiengesetz). A restriction, e.g., on foreign shareholders or on non-members of the founders' family is therefore inadmissible. The limitation may also be introduced by amending the by-laws.[67] Since the „Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG)" has been in force (May 1, 1998) such a limitation of voting rights is only admissible in non-listed corporations (Art. 1 (20), KonTraG).[68] There is however, a grand-father clause for existing voting caps.

7. Proxies

The last comments are to be made on the German proxy system. The shareholder need not appear in person at the shareholder's meeting. Even the by-laws may not require exercise of the voting right by the shareholder himself.[69] Besides giving a proxy, the shareholder can authorize another person to cast the vote in his own name (§ 129 (3) Aktiengesetz). The beneficial owner need not be disclosed in this case. Apart from that, voting by credit institutions and shareholders' associations in street name is possible (§ 129 (2) Aktiengesetz).

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[65] See HÜFFER, *supra* n. 26, § 134 note 5.

[66] Cf. RAISER, *supra* n. 23, § 16 V 4, at p. 110; BAUMS, "Höchststimmrechte", *Die Aktiengesellschaft*, 1990, at p. 221.

[67] See Federal Court in BGHZ 70, 117.

[68] From the point of legal policy the possibility to limit voting rights is always disputed. See for details ADAMS, "Höchststimmrechte, Mehrfachstimmrechte und sonstige wundersame Hindernisse auf dem Markt für Unternehmenskontrolle", *Die Aktiengesellschaft*, 1990, p. 63 et. seq.; BAUMS, "Höchststimmrechte", *Die Aktiengesellschaft*, 1990, p. 221 et. seq.; U. H. SCHNEIDER, "Gesetzliches Verbot für Stimmrechtsbeschränkungen bei der Aktiengesellschaft", *Die Aktiengesellschaft*, 1990, p. 56 et seq.; ZÖLLNER/NOACK, "One share – one vote? Stimmrecht und Kapitalbeteiligung bei der Aktiengesellschaft", *Die Aktiengesellschaft*, 1991, p. 117 et seq..

[69] See ZÖLLNER, *supra* n. 23, § 134 note 72; HÜFFER, *supra* n. 26, § 134 note 21.

a) If the by-laws do not provide for special regulation, the shareholder determines to whom he gives a proxy.[70] Every natural or legal person who can be a representative in legal transactions is admissible as proxy. Therefore a proxy may be given to any person, to a bank or a shareholders' association. As a practical matter, most smaller shareholders are represented by their custodian banks because most banks offer custodian services including voting with the depositors' shares. The proxy must be given in writing. The document conferring the proxy must be presented to and deposited with the company (§ 134 (3) Aktiengesetz).

The by-laws may provide for a limitation of the proxy.[71] They may prescribe that a proxy be given only to another shareholder. However, the freedom of selecting a proxy may not be restricted unreasonably. The corporation itself or its organs cannot be given a proxy[72] because this would contradict § 136, (2) Aktiengesetz, which provides that the obligation of a shareholder to vote according to a direction of the management is void .[73] Moreover the shareholders' power to select a proxy is restricted by his fiduciary duties in respect of the corporation and to other shareholders. The general meeting may therefore reject a proxy who is a competitor of the company or whose acceptance would be unreasonable because of his earlier conduct.[74] The number of proxies is not restricted. The shareholder may give proxies to more than one person if the by-laws do not exclude this. These persons may only exercise the right to vote uniformly.[75] Whether the proxy may delegate his authority to another person depends on the contract with the shareholder. Such delegation is in any event admissible under corporate law.[76]

In general the proxy may be given for an unlimited time, but if the shareholder is represented by a bank, the proxy is valid for a maximum of 15 months (§ 135 (2) Aktiengesetz). Furthermore the proxy has to be revocable because the right to vote may not be separated from the share.[77]

The shareholder can give instructions to the proxy at any time. Where the proxy does not vote in accordance with this instruction the resolution of the general meeting is nonetheless effective. However, the proxy will be liable for damages to the shareholder.

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[70] See HÜFFER, *supra* n. 26, § 134 note 25.
[71] This question is disputed. Cf. HÜFFER, *supra* n. 26, § 134 note 26.
[72] In fact the management board or the supervisory board as an organ of the company may not be given a proxy but a proxy of the board members ad personam is admissible. Special duties of the board members regarding the proxy or special provisions to control how they use their proxies do not exist. See ECKARDT, *supra* n. 29, § 134 note 37; HÜFFER, *supra* n. 26, § 134 note 25.
[73] This question is disputed. Cf. HÜFFER, *supra* n. 26, § 134 note 25; ZÖLLNER, *supra* n. 23, § 134 note 79.
[74] See HÜFFER, *supra* n. 26, § 134 note 25.
[75] Cf. ZÖLLNER, *supra* n. 23, § 134 note 81; HÜFFER, *supra* n. 26, § 134 note 27.
[76] See ZÖLLNER, *supra* n. 23, § 134 note 94.

b) As mentioned, it is inadmissible for the management to collect proxies from the company's shareholders. Rather, German company law puts the professional representation of small investors into the hands of the depositary banks. Small investors will normally as a routine matter sign a pre-formulated proxy for their depositary bank by which the bank votes with its client's shares.

The authorization of banks to exercise voting rights as proxies is codified only rudimentarily in German corporate law.[78] First, the bank needs a written proxy which is valid for a maximum of 15 months and which may be revoked at any time (§ 135 (2) Aktiengesetz). It may not be included in the general standard form contract governing the bank-customer relationship. The proxy may not be delegated to another person (§ 135 (2) Aktiengesetz). Before the general meeting, the bank must inform the shareholder of how it intends to vote. If the shareholder does not give other instructions, the bank is obliged to vote according to its proposals (§ 135 (5) Aktiengesetz). The discretion of the bank is thus restricted. The bank must justify any deviation from its proposal. Where banks have offered to exercise shareholders' voting rights, they must accept mandates so to do from all deposit customers (§ 135 (10) Aktiengesetz). Thus a bank cannot refuse to exercise a voting right by proxy if the shareholder's instruction does not correspond with its interests.

There are few special rules on the casting of votes by proxy. Instructions given by the shareholders must be observed and voting rights should be exercised in line with the interests of the shareholders (§ 128 (2) Aktiengesetz).[79]

The current system of proxy voting in Germany suffers from severe deficiencies. For example it is admissible that the bank exercise its proxies although it is also a creditor in case of a reorganization of the respective firm. Of course the bank is liable for damages resulting from voting as a proxy contrary to its duty to observe the interests of the shareholders but in practice this liability does not play a role. The provision that the proxies should be exercised according to the interests of the shareholders (§ 128 (2) Aktiengesetz) is too broad and allows almost any interpretation.

On the one hand, proxy voting by banks prevents incidental majorities but on the other, banks do not have the right incentives. They are not compensated for an active engagement for their

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[77] See HÜFFER, *supra* n. 26, § 134 note 21.

[78] See KÖNDGEN, "Duties of Banks in Voting Their Clients' Stock", in: BAUMS, BUXBAUM, HOPT (eds.), *Institutional Investors and Corporate Governance*, 1994, at p. 531 et seq..

[79] For the provisions added by the "Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG)", *supra* n. 64, see below.

clients. Furthermore there may be conflicts of interests. These conflicts result from the multiple roles German banks play as advisers, lenders, equity holders, and voting agents. The interests of a bank as a creditor are not to increase the shareholder value but to protect the banks' own credit investment. Therefore they will prefer a risk-adverse investment strategy. Another incentive to act as a proxy is that the bank may want to get a portion of the respective firm's financial business. Restrained exercise of voting rights that does not harm the management may thus be expected. Furthermore, banks may want to hold proxy voting power in order to maintain their dominant role as leaders of a syndicate when new shares or debt instruments are issued.[80] These conflicting incentives may adversely affect the interests of inactive shareholders.[81]

Few provisions deal with these conflicts of interests. In their own general meetings the banks may exercise proxy voting rights only if the shareholder has given instructions (§ 135 (1) Aktiengesetz). § 128 (2) Aktiengesetz, demands a disclosure in the case of interlocking directorates between the bank and the corporation. Supervision by the Federal Supervisory Office for Banking is limited to checking whether the provisions of corporate law have been observed (§ 30 (1) Kreditwesengesetz). Otherwise the banks must record the basis of their voting suggestions. The recent amendment of the Stock Corporation Act[82] has brought with it three provisions dealing with conflicts of interests. First, banks are obliged to take organizational measures to prevent their own interests in other areas from influencing their proposals. Furthermore a depository bank must appoint a member of the management to monitor the fulfillment of this duty and the voting of the proxies according to the rules. These provisions do not really solve the problems resulting from conflicts of interest. The essential goal of these provisions is that the proposals and the voting behavior of the depositary banks will be independent and uninfluenced by instructions from other departments of the bank.[83] Even if this goal is reached it means only a formal independence. In practice the staff members will know what interests the bank has and they will therefore still make suggestions according to these interests. They do not need instructions to know what to do. It cannot be expected that a employee of a bank make proposals which are contrary to the interests of his employer. Moreover, the provision that a bank may not exercise its proxies if it holds more

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[80] See BAUMS/V. RANDOW, "Shareholder Voting and Corporate Governance: The German Experience and a New Approach", in: AOKI, *Corporate Governance in Transitional Economies*, at p. 449.

[81] For more details concerning the conflict of interests see BAUMS/V. RANDOW, "Der Markt für Stimmrechtsvertreter", *Die Aktiengesellschaft*, 1995, at p. 147 et seq.; BAUMS, "Vollmachtstimmrecht der Banken – Ja oder Nein?", *Die Aktiengesel1schaft*, 1996, p. 11 et seq..

[82] "Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG)", *supra* n. 64.

[83] Cf. the reasons given for the KonTraG, published in: *Zeitschrift für Wirtschaftsrecht*, 1997, p. 2063 et seq..

than 5 % of the company's share capital will not have much effect in practice because on the average a bank's interest in the company's share capital will only rarely amount to 5 %.[84]

Market forces will also yield only limited disciplinary power.[85] The benefits resulting from a control of a management are public goods. Because of the free riding effects, offering voting services for money is not a profitable venture and such a market would break down. Therefore the market position of banks which exercise their clients' voting rights without charge will remain unchallenged.

All in all, the basic problem of proxy voting by banks, namely the implicit compensation through the opportunity to look after their own interests, is inadequately regulated in German corporate law.[86] Empirical studies show that firms with a high number of investors attending general meeting perform better than those with a high proportion of shares represented by depository banks. According to a *Franks* and *Mayer*[87] study the investors of firms with concentrated ownership react to bad performance significantly more frequently than firms with widely held shareholdings and a general meeting dominated by depository banks. The *Gorton* and *Schmid*[88] study shows similar results. Therefore the thesis that depository banks have no or at least weak incentives to act in the interest of the shareholders and to maximize the performance of the firm is confirmed by the empirical facts.

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[84] See BAUMS/FRAUNE, *supra* n. 15, at p. 99.

[85] For more details see BAUMS/V. RANDOW, *supra* n. 81.

[86] For the different proposals on a reform see survey in BAUMS, "Vollmachtstimmrecht der Banken – Ja oder Nein?", *Die Aktiengesellschaft*, 1996, p. 17 et seq.; BAUMS/V. RANDOW, "Der Markt für Stimmrechtsvertreter", *Die Aktiengesellschaft*, 1995, p. 3 et seq..

[87] FRANKS/C. MAYER, "The Ownership and Control of German Corporations", LSE/Univ. of Oxford Working Paper, 1994

[88] GORTON/SCHMID, "Universal Banking and the Performance of Firms", Working Paper, 1994; see also the studies of NIBLER, "Bank Control and Corporate Performance in Germany: The Evidence", 1995; PERLITZ/SEGER, "The Role of Universal Banks in German Corporate Governance", *Journal of Business and the Contemporary World*, 1994, at p. 49 et seq.; CHIRINKO/ELSTON, "Finance, Control, and Profitability: An Evaluation of German Bank Influence", Working Paper, 1995; with different results, SEGER, *Banken, Erfolg und Finanzierung*, 1997.