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The Laws Governing Corporations
Formed under the Delaware and the German Corporate Statutes

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I. Introduction

This paper provides an initial, schematic description for students beginning a course comparing the "company laws"1 governing corporations formed under the Delaware General Corporation Law (also referred here to as "DGCL")2 and under the German Aktiengesetz (also referred to here as the "Stock Corporation Act" or "AktG").3 Before students can usefully compare the corporate laws of two or more countries, they need to have some idea of what is included within such bodies of law and, in particular, whether provisions or principles of law from other topical areas or jurisdictions serve to

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1 This paper will use the terms "company" law and "corporate" law indistinguishably. "Corporate law" is a US term and "company" law is used in the United Kingdom, as well as in the English language versions of EU legislation. From a German perspective, the term "corporate" law might be more accurate for this paper, as it focuses on stock corporations that may well be large enough to be listed on a stock exchange, an area of study that German scholars might call "law of capital collecting companies" (Kapitalgesellschaftsrecht), as opposed to "company law" (Gesellschaftsrecht), which would likely include various forms of partnerships and limited liability companies (Gesellschaften mit beschränkter Haftung), as well as stock corporations (Aktiengesellschaften). The German understanding of the term "company law" might be rendered as "corporations and other business organizations."

2 Delaware Code Annotated, title 8.

constitute what is understood as "corporate" or "company" law in the jurisdiction studied. That is, they need to understand why other topical laws (such as securities or bankruptcy laws) might be included within the object "company law", and how rules from different jurisdictions (such as state, federal, supranational or even private organizations) join together to constitute the relevant area of this company law. This should include an analysis of how the rules issued by the various jurisdictions interact with each other. Because such an introduction is factual and descriptive in character, and attempts to depict the topical and jurisdictional composition of the sets of laws, it should also be able to shed some light on the mechanics of how changes can take place within the systems. The configuration and evolution of systems are today often studied under the theoretical headings of "regulatory competition"4 and analyses of "system convergence".5 A detailed description of the systems and their components might be useful for these topics in a way that resembles the utility of micro-market structure analyses to the study of how information affects prices in a securities market.6 It may allow some of the transfers of cause and effect within each system's components to be seen, rather than assumed.

Part II of this paper will discuss the topical areas of law that are normally understood to fall within the company law governing public companies in the United States and Germany. If different


5 See Lucian Arye Bebchuk & Mark Roe, Path Dependence in Corporate Ownership and Governance, in: CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 69 (JEFFREY N. GORDON & MARK ROE, Eds. 2004). The essay was originally published in 52 STAN L. REV. 127 (1999); John C. Coffee, Jr., The Future as History; the Prospects for Global Convergence in Corporate Governance and its Implications, 93 NW. U. L. REV. 641 (1999), and Ronald J. Gilson, Globalizing Corporate Governance, Convergence of Form or Function, 49 AM. J. COMP. L. 329 (2001).

6 For example, instead of saying information X was released at time T and price moved from P1 to P2 by time T2 (assuming the transmission of causality), a "micro-market structure" analysis looks at how the mechanics of trading and the decisions of the persons involved react to information and pass on its effect. See Paul G. Mahoney, Market Microstructure and Market Efficiency, 28 J. CORP. L. 541 (2003); and LARRY HARRIS, TRADING AND EXCHANGES: MARKET MICROSTRUCTURE FOR PRACTITIONERS (2003).
mixes of topical laws govern the same area in different jurisdictions, a comparison that does not take this difference into account could be distorted. For example, if we compared the German company law rule requiring disclosure of an interest in a stock corporation that exceeds 25% of its capital, expressed in § 20(1) of the Aktiengesetz, exclusively with the DGCL and the case law related to that statute, which states no such requirement, we would have to conclude that German company law creates greater transparency. However, if we add to the mix a US federal law, the Securities Exchange Act of 1934 (the "Exchange Act"),\(^7\) and the rule issued under it requiring disclosure of any holding exceeding 5% of the capital of a "registered" company,\(^8\) we tend to reach the opposite conclusion, and German law appears less extensive. Yet when the requirements of § 21 of the German Securities Trading Act (Wertpapierhandelsgesetz, or "WpHG") are also added to the comparison,\(^9\) we see that the obligations of Delaware and German public companies are quite similar in this respect. Because the rules governing companies may be differently distributed in different topical laws within different countries, knowledge of the applicable topical laws, including their nature and the range of their application, is necessary.

Part III of this paper will describe the relationships between the various jurisdictions that enact the laws and issue the rules composing the "company law" governing corporations formed pursuant to the DGCL and the Aktiengesetz. Knowledge of the influence of other jurisdictions, particularly when they have supremacy over or pre-empt the jurisdiction that promulgates the corporate law statute, is a necessary component in any understanding of the workings of the statute and the companies created according to its provisions. Here, the relationships between the federal and state governments in the United States and between the EU and member state governments in the European Union are described. The initial and continued listing requirements of securities exchanges are relevant for both the United States and Germany.

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\(^8\) Rule 13d-1 under the Exchange Act requires that any person who acquires directly or indirectly more than 5% of either the "voting power" or the "investment power" of any class of equity security registered under § 12 Exchange Act must file details on such acquisition (on a form called a "Schedule 13D") with the SEC within 10 days after the acquisition. 17 C.F.R. § 240.13d-1(a). Securities must be registered under § 12 of the Exchange Act if either (i) they are listed on a national securities exchange (§ 12(a) Exchange Act) or (ii) the issuer of the securities has more than 500 shareholders and total assets exceeding $10 million (§ 12(g) Exchange Act in connection with Exchange Act Rule 12g-1, 17 C.F.R. § 240.12g-1). In addition to securities registered under § 12 Exchange Act, Rule 13d-1 also applies to "any equity security of any insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of the Act, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940." 17 C.F.R. § 240.13d-1(i).

\(^9\) § 21(1) of the Securities Trading Act (Wertpapierhandelsgesetz) published on September 9, 1998 (Federal Law Reporter I p. 2708), as last amended by Article 1 of the Investor Protection Improvement Act of October 28, 2004 (Federal Law Reporter I p. 2630), requires that any person who through acquisition, disposal, or in another manner reaches, exceeds or falls below one of the thresholds of 5 per cent, 10 per cent, 25 per cent, 50 per cent or 75 per cent of the voting rights of a listed company must within seven calendar days provide written notice of this to Federal Agency for the Supervision of Financial Services.
The jurisdictional relationships show interesting differences in the United States and the European Union. For example, German companies are required to provide the public with access to their annual financial statements by filing them with the commercial register.\textsuperscript{10} The presence of this requirement in German company law is a result of the way that EU law interacts with the laws of the EU member states. EU company law\textsuperscript{11} has been enacted primarily through directives,\textsuperscript{12} which must be implemented through national law.\textsuperscript{13} The requirement that companies disclose annual accounts was included in Article 2 of the First Company Law Directive, which was issued in 1968.\textsuperscript{14} Germany

\textsuperscript{10} This required disclosure was previously specified in §§ 177 and 178 AktG, but has since been moved for housekeeping purposes into §§ 325-329 of the Commercial Code (\textit{Handelsgesetzbuch}) together with other disclosure duties of stock corporations. See UWE HÜFFER, AKTIENGESETZ 847 (6th ed. 2004) and GÜNTER HENN, \textsc{Handbuch des Aktienrechts} 589 (7th ed. 2002).

\textsuperscript{11} There is a certain lack of clarity on whether to refer to directives as "EU" or "EC" law. As Prof. Eilís Ferran explains with reference to the directives adopted in the area of securities regulation, "[t]he strict technical position is that securities laws are made within the legal framework of the European Community (EC, formerly European Economic Community or EEC), which is a Community within the common structure of the European Union. The EU, as such, has a limited role." EILÍS FERRAN, \textit{BUILDING AN EU SECURITIES MARKET} 7 (2004). The same applies to the company law directives. However, as Prof. Ferran explains, it is common in practice to refer to these directives as "EU" law since the European Community is an integral part ("Pillar I") of the European Union, and she follows this practice unless technical accuracy demands otherwise. For the same reasons, this paper also refers to company law directives and regulations as "EU law" except where discussing the nature of the Community's legislative powers vis-à-vis the EU member states.

\textsuperscript{12} A "directive" is an instrument proposed by the European Commission and issued by the European Council with the consultation or approval or notification of the European Parliament, and that is "binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods." Art. 249, Treaty Establishing the European Community, Dec. 24, 2002, O.J. 33 (C 325) (2002), (EC Treaty). See PAUL CRAIG & GRAINNE DE BURCA, \textit{EU LAW: TEXT, CASES AND MATERIALS} 112-115 (3rd ed. 2003). EU company law has been harmonized almost exclusively through directives enacted under Article 44(2)(g) of the EC Treaty, which provides that, "[i]n order to attain freedom of establishment . . . the Council . . . shall act by means of directives . . . coordinating to the necessary extent the safeguards . . . required by Member States of companies . . . with a view to making such safeguards equivalent throughout the Community." See VANESSA EDWARDS, \textit{EC COMPANY LAW} 3-14 (1999) and STEFAN GRUNDMANN, \textit{EUROPÄISCHES GESELLSCHAFTSRECHT} 48, 69-72 (2004). Articles 43-48 of the EC Treaty guarantee freedom of establishment, and thus "require the removal of restrictions on the right of individuals and companies to maintain a permanent or settled place of business in a Member State." CRAIG & DE BURCA, supra note 12, at 765.

\textsuperscript{13} The two notable exceptions to this use of directives in EU company law arose in the creation of organizational forms directly under EU law. The first was the supranational partnership, the European Economic Interest Grouping, which was created in 1985 with a regulation (Council Regulation 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG) 1985 O.J. (L 199) 1) and the second was a supranational company form, the Societas Europae, which was created effective 2004 with both a regulation (Council Regulation 2157/2001, of 8 October 2001 on the Statute for a European company (SE) 2001 O.J. (L 294) 1) and a directive (Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees 2001 O.J. (L 294) 22). A "regulation" is "binding in its entirety and directly applicable in all Member States." Art. 249 EC Treaty.

\textsuperscript{14} First Council Directive (68/151/EEC) of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, 1968 O.J. (L 65) 8; see also a consolidated version as amended thorough January 1, 1995, available at www.eurlex.eu.
implemented the First Company Law Directive in 1969.\textsuperscript{15} Thus, the same EU law requirement will be found in a substantially similar form in the various company laws of the EU member states, because national legislatures must comply with an obligation to implement the supranational directive.\textsuperscript{16} US federal law does not, and indeed cannot, issue direct instructions to a state legislature to enact a particular type of law.\textsuperscript{17} This means that US federal laws, such as the Exchange Act, operate on a plane separate from that occupied by the state company law statutes. These two parallel systems manoeuvre around each other, and at times leave gaps or collide. An instruction to implement as used in the European Union is, however, found in other forms in the United States, such as the recent federal law instructions – via the US Securities and Exchange Commission (SEC) – to the national securities exchanges to issue listing rules requiring audit committees composed of independent directors.\textsuperscript{18} The relationship also exists on a private, voluntary basis in the manner that centrally formulated changes to the Model Business Corporation Act (referred to here as the "Model Act") are then voluntarily implemented in the laws of the various states that have based their corporate statutes on the Model Act.\textsuperscript{19} It is necessary to understand the relationships between the jurisdictions that adopt or propose company law provisions in or for a given jurisdiction to understand the particular structure, content and historical development of such law.

Part IV will offer some observations based on the description of company law structure laid out in Parts II and III. It will evaluate what the composition of company law and the dynamics of the jurisdictions that create it in the United States and the European Union can tell us about regulatory competition and the international convergence of company laws.


\textsuperscript{16} See, e.g., s 242 Companies Act 1985 for the duty under UK law to deposit annual accounts with the registrar of companies for England and Wales.

\textsuperscript{17} As the US Supreme Court explained in 1997: "The Federal Government may neither issue directives requiring the States to address particular problems, nor command the States' officers, or those of their political subdivisions, to administer or enforce a federal regulatory program." Printz v. United States, 521 U.S. 898, 932; 117 S.Ct. 2365, 2384 (1997).


\textsuperscript{19} The Model Act is drafted by the Section of Business Law of the American Bar Association. The process of updating and adopting the Model Act will be discussed in more detail in Part III.A.2. The Model Act has been adopted in substance in 35 of the 50 US states. See Richard A. Booth, A Chronology of the Evolution of the MBCA, 56 BUS. LAW. 63, 66 (2000).
II. The Topical Areas of Law Included in Company Law

A. In the Abstract

Company or corporate law in all jurisdictions is generally understood to enable the creation of an entity with "five core structural characteristics": "(1) legal personality, (2) limited liability, (3) transferable shares, (4) centralized management under a board structure, and (5) shared ownership by contributors of capital."\(^{20}\) If a law other than a "company" law were to regulate one of these "core characteristics" of the corporate entity, it would likely require treatment in a study of company law. This is unproblematic when another law is expressly linked to the company law. A classic case is labor codetermination in Germany. The sections of the Aktiengesetz that refer to number, qualifications and appointment of members of the supervisory board expressly refer to the provisions of the various laws providing for codetermination in Germany.\(^{21}\) The inclusion of codetermination laws in any study of German company law is thus beyond question. Difficulties arise, however, when certain laws may be necessary to understand the regulation of a corporation in a given country, but are not expressly linked to the company law. If such laws are excluded from treatment, an attempt to understand the system of regulation will be incomplete. Thus, for example, to the extent that laws other than company law regulate the public offering of shares in corporations, such laws are necessary to understand the "core" activity of share transfers and would have to be included within any competent treatment of company law. Likewise, if the initial and continued listing standards of a stock exchange regulate the nature of and rights embodied in shares, the disclosure of information or the

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\(^{21}\) See §§ 95–104 AktG. Codetermination in German companies is regulated by three major laws, one of which – the Law on Co-Determination of Employees in the Supervisory Boards and Management Boards of Enterprises Engaged in the Mining Iron and Steel Industries of 21 May 1951 (Montan-Mitbestimmungsgesetz) – is no longer relevant. The most important law today is the Co-Determination Act of 1976 (Mitbestimmungsgesetz, or "MitbestG"), which applies to all limited liability companies (Gesellschaft mit beschränkter Haftung or "GmbH") and AGs with more than 2,000 employees (see § 1 MitbestG), and requires that one-half of the supervisory board comprise representatives of the employees and their unions (see § 7 MitbestG). See Bernt Gach, Gesetz über die Mitbestimmung der Arbeiter, in MÜNCHENER KOMMENTAR AKTIENGESETZ Vol 3, 1301 (Bruno Kropff & Johannes Semler, ed., 2004). Another important piece of legislation, the Works Constitution Act of 1952 (Betriebsverfassungsgesetz), requires that a company have a supervisory board and that one-third of the board members be appointed by employees if the corporation employs more than 500 persons.
composition and operation of the board, such rules would also need to be included – unless listed companies are to be excluded from treatment.

Each of the five "core" characteristics listed above may, moreover, be closely tied to other areas of law. One purpose of legal personality and limited liability is to demarcate the assets to which creditors may take recourse in collecting debts of the corporation, and this position is integrally tied to the rights creditors hold in insolvency proceedings over the company's assets. The inclusion of bankruptcy law in the study of company law is, however, still debated. Professors Henry Hansmann and Reinier Kraakman would – with the exception of the doctrine of wrongful dealing in insolvency – exclude bankruptcy law from a treatment of company law because "the problems of bankruptcy presented by corporations are often shared by other types of legal entities." This test looks to the legislative purpose and reach of the law in question: "bodies of law designed to serve objectives that are largely unrelated to the core characteristics of the corporate form . . . do not fall within the scope of corporate law." A law designed to serve broad objectives and apply to a number of entities other than corporations should, accordingly, not be included within a study of corporate law. However, it is questionable whether the best test is to focus on the intent and design of the topical law considered for inclusion, or rather to examine the importance of such law for an understanding of how a corporation's core characteristics are regulated in the jurisdiction. German labor laws aim to assure fair working conditions for employees and include corporate representation as one means, US securities laws aim to protect investors and do so by imposing disclosure requirements on the offer and sale of securities regardless of who sells them or whether the securities are issued by a corporation. The principles of agency law that are central to any discussion of corporate governance were not devised to regulate centralized management under a board.

It would appear that the test actually used when evaluating inclusion is whether a given law or set of rules in essential to understand the governance of the corporation in the country studied. For example, in a recent paper addressing regulatory competition in Europe, Prof. John Armour explores whether member states could successfully use their bankruptcy laws to control the flow of regulatory competition opened by recent decisions of the European Court of Justice. He argues convincingly that "[c]orporate insolvency law supplies rules which govern companies experiencing financial distress, and so it is appropriate to consider it as being within the scope of a functional account of 'company law'. In particular, there may be complementarities between insolvency law and other aspects of a

23 KRAAKMAN et al., supra note 20, at 17.
24 KRAAKMAN et al., supra note 20, at 17.
country's corporate governance regime.\textsuperscript{25} The term "complementarities" describes relationships within a given legal system, where one element of the system works together with another, producing a consistent legal framework – the elements \textit{complement} one another as the term would be used in aesthetics.\textsuperscript{26} Thus, if "complementarities" exist between aspects of a corporate law statute and provisions of a law in another topical field, such provisions would play a role in the overall function of corporate law that could not be ignored when deciding whether to incorporate in that jurisdiction. That is, an entrepreneur could not reasonably exclude such provisions from consideration when evaluating the way in which the five core characteristics of a corporation function in such jurisdiction. This "effects" test would demand that provisions of separate law be considered together with the jurisdiction's company law – regardless of whether the legislative purpose of such law focuses on corporations – if they "complement" or provide a necessary supplement to the corporate law statute. Professors Henry Hansmann and Reinier Kraakman seem to acknowledge as much when they include tort law within their discussion of corporate limited liability.\textsuperscript{27}

The following graphic shows how certain topical laws work to complement and qualify the manner in which the five, core characteristics of a stock corporation work in practice.

If the test used when evaluating a topical law for inclusion in a study of company law is the necessity of such topical law for a complete understanding of company law in a given jurisdiction, the topical laws drawn into company law studies could vary from jurisdiction to jurisdiction and depending on the breadth of the analysis. Certain topical laws might be brought into the picture as

\textsuperscript{25} Armour, \textit{supra} note 4, at 38.

\textsuperscript{26} See Reinhard H. Schmidt & Gerald Spindler, \textit{Path dependence and complementarity in corporate governance}, in Gordon & Roe, \textit{supra} note 3, at 114.

\textsuperscript{27} KRAAKMAN \textit{et al.}, \textit{supra} note 20, at 17.
functional counterparts to provisions of the company law of another country in the comparison: to use the example employed above, we draw securities regulation into our comparison of German and Delaware law to show that a corporation formed under the DGCL is subject to "company law" that also includes requirements to disclose equity holdings in corporations because of the applicable provisions of the Exchange Act. Indeed, if the Exchange Act did not exist, the legislature or courts of Delaware might have acted to require such disclosure under the DGCL, which makes its absence from the DGCL more an historical-cultural accident than necessity. When adjustments through the inclusion of topical laws are not made, the laws of a given jurisdiction might be incorrectly condemned as faulty or incomplete.

B. In Germany

The provisions of the Aktiengesetz provide a comprehensive regulation of stock corporations and most may not be waived or altered by the shareholders in a charter of a specific company. Tracking the core characteristics referred to above, the Aktiengesetz provides for the creation of an entity with legal personality, limited liability and transferable shares (see §§ 1-53a AktG), with a centralized management under a two-tier board structure (see §§ 76-116 AktG) that is subject in certain respects to the shareholders (see §§ 118-147). As said, the Aktiengesetz is mainly mandatory, and thus the company's charter may deviate from the letter of the law only where the law expressly so provides.28 The Aktiengesetz also incorporates by reference provisions of the Commercial Code (Handelsgesetzbuch) on the preparation of the annual financial statements, including the specification of reserves and distributable profits (§ 150 AktG), provides a right to demand a special audit (§§ 142-146), and requires the financial statements to be made available to the shareholders for their approval (§ 175 AktG). Going well beyond the range of coverage that would be expected by an American lawyer, the Aktiengesetz contains provisions on the disclosure of equity holdings (§ 20 AktG), for the solicitation of proxies by banks holding shares in custody (§ 128 AktG), incorporates the Co-determination Act to place labor representatives on the supervisory board (§ 101 AktG), specifies the rights, duties and required financial statements of companies operating in corporate groups (§§ 291-328 AktG), and requires listed companies to adopt a governance code on a "comply or explain" basis (§ 161 AktG). As will be discussed in Part III, many of these special provisions originate in EU

28 Under the Aktiengesetz, a stock corporation has a two-tier board. The two levels are the supervisory board (Aufsichtsrat), provided for in §§ 95-116 AktG, and the management board (Vorstand), provided for in §§ 76-94 AktG). The shareholders elect all or some (if co-determination applies) of the supervisory directors (§ 101(1) AktG), and the supervisory board in turn appoints the managing directors (§ 84(1) AktG), who have direct responsibility for managing the company (§ 76(1) AktG). For discussions of this structure, see Theodore Baums, "Company Law Reform in Germany," Johann Wolfgang Goethe-Universität, Institute for Banking Law, Working Paper No. 100 (2002), available at http://www.jura.uni-frankfurt.de/baums/, and Klaus Hopt, The German Two-Tier Board (Aufsichtsrat): A German View on Corporate Governance, in COMPARATIVE CORPORATE GOVERNANCE 3 (Klaus Hopt & Eddy Wymeersch, eds., 1997).

29 § 23(5) AktG, discussed in detail in Part III.B.3.
directives that were incorporated into the Aktiengesetz over the years. Regardless of its jurisdictional origin, however, the resulting law is broad, comprehensive and mandatory. German courts have also filled gaps in statutory law by imposing a significant body of doctrine on such areas as equitable subordination of loans made by shareholders to the company and fiduciary duties of management.  

One exception to the inclusive tendency of the Aktiengesetz is the "outsourcing" of the rules on mergers between stock corporations to a special law, the "Transformation (or Reorganization) Act" (Umwandlungsgesetz).

Although the Aktiengesetz itself includes provisions that an American lawyer would attribute to areas outside of corporate law proper – such as on the disclosure of holdings, the preparation of financial statements and the behavior of custodian banks in the proxy solicitation process – most studies of German company law would also include a number of rules from the topical area "capital markets law" or "securities regulation" in any comprehensive treatment of company law proper, especially when discussing listed companies. Thus, the complete picture of what we understand as "company law" in Germany is rather broad.

C. In Delaware

Although each of the 50 US states have their own corporate law statute, by far the largest portion of major US corporations, including more than half of the publicly listed companies, are incorporated under the law of the State of Delaware. As will be discussed at more length in Part III, this is possible because U.S. law generally holds that the existence and "internal affairs" of a corporation are governed by the place of its incorporation, and US states generally accept corporations incorporated in other states to do business in their state as "foreign" corporations subject to minimal requirements, such as designating an agent for service of process. In the late 1890's a

30 See e.g., the High Federal Court's judicial creation of a German business judgment rule in ARAG v. Garmenbeck, BGHZ 135, 244 (1997).
32 See, e.g., Johannes Semler, Einleitung, in MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ 1, 6-7 (2nd ed. 2000) and KARSTEN SCHMIDT, GESELLSCHAFTSRECHT 32 (4th ed 2002), including the Securities Trading Act (Wertpapierhandelsgesetz) in the "sources of company law."
33 According to the Department of State, Division of Corporations, of the State of Delaware, as consulted in November 2004, "more than half a million business entities have their legal home in Delaware including more than 50% of all U.S. publicly-traded companies and 58% of the Fortune 500." This information is available at http://www.state.de.us/corp/default.shtml/, last visited on October 7, 2005.
34 See EUGENE F. COLES et al., CONFLICTS OF LAWS § 23.2 (3rd ed. 2000). See Part III for a definition of what falls within the term "internal affairs."
35 See FRANKLIN A. GEVURTZ, CORPORATION LAW 36 (2000). Although states do not require local incorporation as a requisite for doing business, the US Supreme Court has held that such a request would not impermissibly burden the interstate commerce whose regulation lies solely within the jurisdiction of the federal government. See Railway Express Agency, Inc. v. Virginia, 282 U.S. 440 (1931).
number of states began to fashion their corporate laws to attract promoters planning to incorporate new companies and companies that might choose to reincorporate in a different state. The State of Delaware joined this race after the future US president, Woodrow Wilson, who was then governor of the State of New Jersey, amended the New Jersey laws to accord with his socially progressive ideals, and has become the clear leader in this market.

The DGCL provides for each of the five, core characteristics of a business corporation. It provides for the creation of an entity with legal personality (§§ 101-136 DGCL), limited liability (§ 102(b)(6) DGCL), management by a centralized board (§§ 141-146 DGCL) and transferable shares (§§ 201-202 DGCL). The aspect of shared ownership by investors is implicit in the company's existence as an entity that must issue stock (§ 102(a)(4) DGCL), which must be paid for (§§ 152-16 DGCL), and which represents a property interest in the corporation that may be classified as a "chose in action." Although shareholders rarely use this power, § 141 DGCL gives shareholders the right to vest management in a body other than the board of directors, thus expressly vesting residual control with the owners of the corporation. Indeed, perhaps the greatest difference between the DGCL and the Aktiengesetz (as statutes) is that the Delaware law functions to a great extent as a set of default terms that shareholders may modify or even eliminate in the company's certificate of incorporation. The result is a mixture of mandatory and optional rules. One element of Delaware law, which is not within the four corners of the DGCL, is, of course, the most obvious difference between the law of a Common Law jurisdiction like Delaware, and a Civil Law jurisdiction, like Germany: the Common Law jurisdiction depends more heavily on case law, which in Delaware law often means judicial decisions shaping fiduciary duties.

36 See Bratton & McCahery, supra note 4, at 15-20.
37 See Part III.A.1 of this paper.
39 Del. Code Ann. tit. 8, § 141(a): "The . . . corporation . . . shall be managed by or under the direction of a board . . . except as may be provided otherwise in this chapter or in its certificate of incorporation" (emphasis added). A similar provision is found in the Model Act. See RMBCA § 7.32(a): "An agreement among the shareholders . . . is effective . . . even though . . . it . . . eliminates the board of directors or restricts the discretion or powers of the board of directors."
41 For the two-year 1999 and 2000, Robert B. Thompson and Randall Thomas found that approximately 78 % of Delaware Chancery Court cases addressed fiduciary duty issues. See Robert B. Thompson, Delaware, the Feds, and the Stock Exchange: Challenges to the First State as First in Corporate Law, 29 Del. J. Corp. L. 779, 785 (2004). It should also be noted that the use of cases as weighty authority is one area in which Common Law and Civil Law are certainly on a convergence path in many European countries. In conversations and experience during the period between 1992 and 2005, the author has received confirmation again and again that case precedent is the soundest authority used in Italy and Germany to discern the meaning of a given statutory provision.
Returning to the contents of the statute itself, we see that the DGCL contains few of the "extras" found in the Aktiengesetz, such as disclosure, accounting and audit rules, or rules on the operation of corporate groups. One exception to the generally true statement that the DGCL is a much thinner and less mandatory statute is that the DGCL provides rules for mergers (§§ 251-266 DGCL) and at least one provision on takeovers (§ 203 DGCL). Given the thin and relatively optional character of the DGCL, it is not surprising that scholarly works on US corporate law inevitably include a healthy dose of securities regulation. As will be discussed in more detail in Part III of this paper, including "securities regulation" means looking to the requirements of some or all of the federal laws grouped under Title 15 of the US Code, which includes the Exchange Act, the Securities Act of 1933 (the "Securities Act"), and the Trust Indenture Act of 1939 (the "Trust Indenture Act"). It is also common to include basic principles of revocable or fraudulent transfers from bankruptcy law in studies of US corporate law. These serve to supplement the very permissive capital maintenance rules found in the DGCL and all other US company law statutes.

The enabling nature of US statutes, which provide many non-mandatory "default" rules, has resulted in a relatively minimal statutory structure that has been filled in, as said, by court decisions imposing fiduciary duties and – usually following major events in which shareholders lose significant amounts of money – by the federal government stepping in to fill a public demand for action. The structure of US company laws, and the DGCL in particular, thus invites a number of supplementing forces, which accounts for the manner in which it has developed. In individual companies, it would have been possible that the articles of incorporation comprehensively provided for every imaginable right, duty and circumstance, leaving little that need to be addressed by other laws. However, once an abuse did take place, a decision of the Delaware Supreme Court became the mandatory law for all companies incorporated in Delaware. If the problem occurred on a scale wide enough to attract national attention, the US Congress would then supplement flexible corporate norms with mandatory provisions of securities laws or SEC rules designed to prevent abuse in circumstances of a given type. This supplementation of the DGCL by the case law of the Delaware courts and the US securities laws

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42 See e.g., BALLANTINE, supra note 20, at 858-886; CLARK, supra note 20, at 293-340 and 719-749; and GEVURTZ, supra note 35, at 537-629 (2000). Gevurtz notes that "federal securities laws have become a significant component of corporation law." Id. at 39.


45 See MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS 859-860 (Concise 9th ed. 2005), and CLARK, supra note 20, at 40-52. Dean Clark also includes bankruptcy provisions on equitable subordination of creditor claims in his treatment of corporate law. See Id., at 52-71.

46 See Part III.A.1 for a discussion of this tendency.
leads us to an analysis of the jurisdictional interaction that forms "company law" for Delaware corporations.

III. Jurisdictions That Interact to Form Company Law

A. The United States

The jurisdictions that create the rules governing public companies in the United States are the states (e.g., the State of Delaware enacted the DGCL), the federal government (which enacted, e.g., the Exchange Act and the Securities Act) and the securities exchange on which a given company’s shares are listed (e.g., the New York Stock Exchange and the Nasdaq Stock Market both issue their listing standards). The character of the provisions enacted or issued by each of these jurisdictions should be understood in at least three ways:

1. the areas that each jurisdiction’s law or rules traditionally cover,
2. the relationship between each jurisdiction, and
3. whether the laws or rules are mandatory or optional in character.

Figure 2 presents a summary graphic of these, three characteristics as applied to the three jurisdictions issuing rules for publicly listed companies in the United States. These characteristics will be discussed in detail in the following paragraphs 1 through 3.

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47 The word “jurisdiction” is used very loosely here in referring to securities exchanges. The agreement between an issuer and the securities exchange on which its shares are listed is a contract, and the exchange has "regulatory" power only over a very narrow group of persons, particularly its members and participants and its listed companies.

48 It should be noted that state law also includes securities laws (usually called "blue sky" laws), many of which were enacted before the Securities Act. Such laws have become progressively less important as federal law has either expressly or tacitly pre-empted their application. Two relatively recent laws, the National Securities Markets Improvements Act of 1996 (the "NSMIA", Pub.L.No. 104-290, 112 Stat. 3416) and the Securities Litigation Uniform Standards Act of 1998 (the "SLUSA", Pub.L.No. 105-353, 112 Stat. 3227) removed a significant amount of activity from the state jurisdictions. See LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 28-30 and 1187-1192 (5th ed. 2004).

49 The initial and continued listing standards of the NYSE are set forth in the NYSE LISTED COMPANY MANUAL, supra note 18. The initial and continued listing standards of the Nasdaq Stock Market are set forth in the NASDAQ MARKETPLACE RULES (Rules 4000-7100), which are available in a continuously updated form at www.nasdaq.com.
1. The areas each jurisdiction's laws or rules traditionally cover

Part II explained how corporate law is generally considered to provide for the creation of an organization with five, core qualities, and that it should at times be understood to include other topical laws that supplement the base statute. This primary realm of state corporate law has been roughly defined as the corporation's "internal affairs," although certain characteristics, such as limited liability, raise questions that strongly affect a company's dealing with third parties in the "external" world. Thus, state corporate law provides for the creation of an entity with legal personality and the management and representation of such entity in dealings with third parties. Because liability is limited, state law imposes certain restrictions on distribution of corporate assets to the shareholders, although such restrictions have become less relevant in the United States over the years as protective measures shifted to disclosure of the company's assets and financial condition and contractual arrangements. Because management is centralized, opportunities for management abuse are present, and thus state courts have developed a fine-tuned system of fiduciary duties to prevent corporate insiders from stealing the company's assets or shirking. Because the company is owned by and ultimately responsible to owner-investors, statutes provide for shareholder participation in important decisions and periodic election of directors. State corporation laws provided for these basic characteristics since the early 19th century, although such laws became significantly more flexible and began to take on the "enabling" character they currently display only at the turn of the century.

50 The concept of "internal affairs" comes from the area of conflicts of law. RESTATEMENT (SECOND) CONFLICTS OF LAW §302, Comment a (1971) defines "internal affairs" as referring to "the relations inter se of the corporation, its shareholders, directors, officers or agents, . . . involve[ing] primarily a corporation's relationship to its shareholders [and] includ[ing] steps taken in the course of the original incorporation, the election or appointment of directors and officers, the adoption of by-laws, the issuance of corporate shares, preemptive rights, the holding of directors' and shareholders' meetings, methods of voting including any requirement for cumulative voting, shareholders' rights to examine corporate records, charter and by-law amendments, mergers, consolidations and reorganizations and the reclassification of shares. Matters which may also affect the interests of the corporation's creditors include the issuance of bonds, the declaration and payment of dividends, loans by the corporation to directors, officers and shareholders, and the purchase and redemption by the corporation of outstanding shares of its own stock."

51 For a thorough discussion of US capital maintenance rules, see GEVURTZ, supra note 35, at 157-167.

52 In the case of Delaware, it is thought that the courts' introduction of stricter fiduciary duties was a reaction to the critical stance taken by former SEC Chairman William Cary in 1974, when he accused the state of leading a "race to the bottom" (see Cary, supra note 4). In a landmark decision of 1977, Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977), the Delaware Supreme Court imposed strict fiduciary duties on the management of a parent company in a cash out merger with a subsidiary. See Bratton & McCahery, supra note 4, at 59-61.


54 This was a result of a well-documented process of regulatory competition led by New Jersey and successfully picked up by Delaware. See Bratton & McCahery, supra note 4, at 15-20. See also Henry
The federal government has traditionally refrained from entering the realm of corporate "internal affairs". Congress has entered the field of company law only after economic and political shocks convinced a significant portion of the national population that the state law had failed to prevent insiders from deceiving outside investors. During the period of the great "trusts", such as Standard Oil, and their abuses that marked the end of the 19th century, the federal government seriously considered replacing the state corporate statutes with federal law, but the project eventually lost momentum in light of more active antitrust prosecution. After the stock market crash of 1929 and the severe economic depression that followed, the federal government entered the securities field in force with the Securities Act, the Exchange Act (which created the SEC), the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. However, these laws and the extensive body of rules issued pursuant to them mostly require registration of companies, disclosure of financial and other information about the company and management, and make only minimal incursions into the internal affairs of the companies regulated. When poor management and inefficient securities settlement procedures led to the collapse of over 100 major securities brokers in the late 1960's, the federal government responded with the Securities Investor Protection Act of 1970 and the 1975

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See Bratton & McCahery, supra note 4, at 36-44.


Probably the best account of this period is found in the first two chapters of Joel Seligman, *The Transformation of Wall Street* (3rd ed. 2003).


In the Exchange Act, incursions into the management of the corporation were limited to such requirements as disclosure of the shareholdings of managers and 10% stockholders, and the disgorgement of profits that such insiders made through short term dealings (within a period of six months) in the company's shares. See § 16 Exchange Act. An exception to the disclosure rule, the Investment Company Act, has always included a requirement that a specified percentage of independent or unaffiliated directors be seated on the board. See 15 U.S.C. § 80a-10 (2000).

For a thorough history on the "paper crunch" of the late 1960's, see Chris Welles, *The Last Days of the Club* (1975).

Securities Acts Amendments, which introduced a form of deposit insurance for investors and gave the SEC complete power to change, add or abrogate securities exchange rules. In 2002, following the revelation of serious accounting misrepresentations by major corporations such as Enron and WorldCom, and the collapse of the stock markets, the federal government enacted the Sarbanes-Oxley Act of 2002 (SOA). The SOA sought to reinforce the exiting system of disclosure by decreasing conflicts of interest, increasing accountability, and improving disclosures. Conflicts of interest were reduced by strictly controlling the services that auditors (who have a gatekeeper function in disclosure) could provide to the companies they audit, by inserting an audit committee composed of independent directors into the boards of listed companies, and by flatly outlawing company loans to directors. These were certainly incursions into the internal affairs of the regulated companies, but were incursions related to the overall disclosure system. Disclosures were improved by requiring inclusion of matters and notification of techniques that had been used to distort disclosed financial information, such as off-balance sheet transactions and pro-forma results. Accountability was increased by requiring chief operating officers (CEOs) and chief financial officers (CFOs) to personally sign required disclosures and attest to the accuracy and completeness of their contents subject to civil and criminal liability. Thus, the subject matter of federal law has been primarily disclosure, imposed in reaction to political pressure arising in the wake of major scandals and market shocks.

The Sarbanes-Oxley Act also provided for the creation of a Public Company Accounting Oversight Board, existing under the supervision of the SEC, to establish and adopt accounting standards, which makes such standards substantially federal in nature. It should also be noted that bankruptcy law, which we discussed in Part II as existing on the borders of company law in the United

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65 P.L. 94-29, 89 stat. 97.
66 See LOSS & SELIGMAN, supra note 48, at 777-779.
68 See the excellent explanation of this function in John C. Coffee, Jr., Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms, 84 B.U. L. REV. 301 (2004).
69 §§ 201-202 SOA.
70 § 301 SOA.
71 § 402 SOA.
72 See Bratton & McCahery, supra note 4, at 56.
73 § 401 SOA.
74 §§ 302 and 904 SOA.
75 § 101 SOA.
States, is federal law. After taking into account all of these federal elements, the degree of federal incursion in state company law is still slight when compared to the degree that EU law has shaped the company laws of the member states, discussed in Part III.B. Aside from bankruptcy laws and accounting standards, the US state/federal divide in corporate law may still be understood as one between substantive rights from the states and disclosure required by the federal government.

The initial and continued listing requirements of securities exchanges long preceded the enactment of federal rules, and cover a broad range of matters, ranging from the “internal” composition of a company’s board to the “external” provision of information to the public, to minimum requirements for total assets and the required public dispersion of the company’s shares. These requirements are contractual conditions to a company’s listing on a given exchange, and a serious violation of these conditions can lead to a company being expelled from the market through involuntary de-listing. Listing standards impose economic requirements (such as minimum aggregate market value and earnings), share structure requirements (such as minimum public float), and corporate governance requirements (such as a board containing certain committees and a percentage of directors that meet specified independence requirements). Because of differences in national legal systems, US securities exchanges have traditionally waived most “internal” corporate governance requirements for foreign companies, although this changed somewhat after the market collapse of 2002. Aside from this partial waiver for companies formed under non-US law, initial and continuing listing requirements thus tend to be pervasive and mandatory.


78 See NYSE Listed Company Manual, supra note 18, at Sections 1-4. For one of the best (non-proprietary) descriptions available of the listing process and requirements for a foreign company, see Michael Gruson, Andrew B. Jánszky, Jonathan M. Weld, Issuance and Listing of Securities by Foreign Banks and the U.S. Securities Laws, in REGULATION OF FOREIGN BANKS (Michael Gruson & Ralph Reisner, eds. 4th ed. 2005).

79 Id. at Section 8.

80 See Id. at Sections 101.01B and 101.01C.

81 See Id. at Section 101.01A.

82 See Id. at Sections 303A.01-07.

83 See Id. at Section 303A.11. For most rules affecting the governance structure of a company, foreign private issuers need only disclose, in a non-itemized manner, the significant ways in which their corporate governance practices differ from those required by the NYSE listing standards. However, certain of the requirements, such as the audit committee specified in § 301 of the Sarbanes-Oxley Act is applicable also to foreign companies.
2. The relationship of the jurisdictions to each other

Federal to state. In the area of company law, the relationship between the federal government and the states may be summarily characterized as one in which the former has power to supplant the latter, but has traditionally not done so.84 Pursuant to Article VI, clause 2, of the U.S. Constitution, known as the "supremacy clause", the laws of the federal government preempt the laws of a state.85 Preemption is not uniformly present in all cases. One might think of the federal preemption power as running on a sliding scale beginning with those cases where exclusive powers of the federal government are specified in the Constitution, and gradually decreasing through cases in which the Supreme Court has found there is a presumption in favor of preemption, to where the legal position is neutral, to cases where there is a presumption against preemption, and finishing with those cases in which the states have a constitutional immunity from preemption.86 Because the Constitution vests the federal Congress with the power to regulate commerce among the states, known as the "commerce clause",87 interstate commercial activity is a field where the argument for preemption is at its strongest.88 Congress based its enactment of the various securities laws listed above on the commerce clause,89 and there is little doubt that Congress could replace the various state corporate laws with a federal statute.90

As explained in section 1, because the US Congress may not – unlike the European Union – command the states to implement specified policies, federal law and state law occupy separate realms. Although the federal government could supplant state corporate law, this has not been seriously considered since the beginning of the 20th century,91 and in the mean time a "tradition" has developed according to which corporations are understood as "creatures of the state,"92 and corporate law is

84 Bratton & McCahery, supra note 4, at 11.
86 This sliding scale analysis is borrowed from Prof. Mark V. Tushnet, who uses it in a discussion of the foreign policy area, with the caveat that the five-point scale is "sufficient" for "the present purposes," which of course indicates that finer distinctions might be appropriate in different circumstances. See Mark V. Tushnet, Globalization and Federalism in a Post-Printz World, 36 TULSA L.J. 11, 19 (2000).
87 U.S. Const. Art. VI, Section 8, clause 3.
90 See e.g., Bratton & McCahery, supra note 4, at 11; Joel Seligman, A Modest Revolution in Corporate Governance, 80 NOTRE DAME L. REV. 1159, 1169 (2005); and Marcel Kahan & Edward Rock, "Our Corporate Federalism and the Shape of Corporate Law," University of Pennsylvania Law School, Institute for Law and Economics, Research Paper No. 04-12 (June 2004).
91 See Bratton & McCahery, supra note 4, and Mitchell, supra note 57.
92 Green, 430 U.S. at 497.
understood as an area in which there is a "longstanding prevalence of state regulation." Thus, "except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation." States are thus understood to have "broad latitude" in regulating the "internal affairs" of corporations. The controversies in this area thus arise because of uncertainty as to whether a state law has entered a field preempted by federal law, or whether a federal law remedy should be applied to an action (such as a "short-form" merger) that is considered "internal" and does not exhibit the characteristics (such as misrepresentation or fraud) that the federal law was enacted to combat, or whether the SEC has overstepped its authority und the Exchange Act in regulating an "internal" matter (such as the voting rights embodied in shares) that is usually provided for in state corporate laws. No legal controversy arises when the federal government expressly enters internal corporate affairs, as it did with §§ 301 and 402 of the Sarbanes-Oxley Act, although commentators may certainly wonder whether the intrusion was wise.

European-style harmonization has taken place to a certain extent on a voluntary basis by some states substantially adopting the Model Business Corporation Act drafted by the American Bar Association’s Section of Business Law. This ABA Committee continuously updates and improves the Model Act, and publishes drafts for discussion in the ABA publication, The Business Lawyer. State legislatures are free to adopt the provisions with or without change. In 2000, it was reported that 35 states had substantially adopted the Model Act. As a result, corporate law in the United States may be seen as divided into three, relatively harmonized camps: the majority of the states follow the Model Act, Delaware and a few states, such as Oklahoma, that follow the DGCL, and some large states like California and New York, which can afford to draft their own statutes from scratch and choose to

93 CTS, 481 U.S. at 86.
95 Id., citing the decision of the Appeals Court’s decision in the same case, Dynamics Corp. of America v. CTS Corp., 794 F.2d 250, 264 (7th Cir. 1986).
96 See Edgar, 457 U.S. 624 (invalidating a state statute that imposed a waiting period of the consummation of takeover offers that was deemed to frustrate the balance achieved in the § 14 of the Exchange Act). On the question of "field preemption" as applied to corporate and securities law, see Roberta S. Karmel, "Reconciling Federal and State Interests in Securities Regulation in the United States and Europe," 3-10 (2002]), available at http://ssrn.com/abstract=343621.
97 Green, 430 U.S. 462 (The court found that, absent an allegation of misrepresentation or fraud – which are the key elements of Rule 10b-5 under the Exchange Act – the federal rule could not be used to invalidate a merger effected properly under state law.)
98 See The Business Roundtable v. Securities and Exchange Commission, 905 F.2d 406 (1990). (The court found that the SEC’s attempt to guarantee that all listed stock carried proportion al voting rights exceeded the agency’s authority under § 14 of the Exchange Act.)
99 See Thompson, supra note 41, at 797-798.
100 See Booth, supra note 19.
follow neither Delaware nor the Model Act. A process that is comparable to the preparation and adoption of the Model Act occurs for rules on fraudulent conveyances.

State to state. The relationships among the US states in the area of company law offer interesting opportunities for comparison with similar relationships in the European Union. Because US state law in this area exists in the shadow of federal power to regulate interstate commerce, the states in their dealings with each other may not enter an area preempted by federal law or unduly impede interstate activity. Courts have sought a balance between a state's reserved and traditional powers to police business within its borders and its obligations under the Constitution. This tension arises in the problem of "foreign" and "pseudo-foreign" corporations. The term "foreign corporation" is used to denote a company established and existing under the laws of a jurisdiction, whether that of a foreign country or another state of the United States, other than the state in which it is doing business. Although the term "pseudo-foreign" corporation is not found in statutes, it is used to designate a corporation that although incorporated elsewhere, has most of its shareholders and business activity in the host state. Most states require merely that a foreign corporation register with the state and provide an in-state agent who can be served with process papers if a judicial action is filed against the foreign corporation. Some states, however, apply significant parts of their own corporate statutes to pseudo-foreign corporations. For example, California applies rules regarding the election of directors (including by cumulative voting), their duties, and the participation of shareholders in the company to any corporation that is not listed on a national stock exchange if over half of its shareholders of record have California addresses and the company's payroll is mainly paid in the state. New York requires the same type (i.e., unlisted, heavy operations in the state) of foreign corporations to provide information to shareholders and applies New York law to actions against and liability of company directors.

101 See JONATHAN R. MACEY, MACEY ON CORPORATION LAW (2002), for a discussion of the states that have followed a specific provision of the DGCL or the Model Act.

102 The Uniform Fraudulent Transfer Act, which was drafted by the National Conference of Commissioners on Uniform State Law (NCCUSL) in 1984, revised a Uniform Fraudulent Conveyance Act that had existed since 1918. The 1984 version has been adopted by 42 states and proposed by two others. See the NCCUSL website, at http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-ufta.asp, last consulted on October 23, 2005.


104 See e.g., § 371(a) DGCL and § 1.40(10) RMBCA.

105 See e.g., § 371(b) DGCL and § 15.03(a) RMBCA.

106 § 2115 California Corporations Code.

The power that states have to impose such requirements on corporations formed under the law of another state has not been clearly defined, but is considered to be extensive. A state may completely ban foreign corporations from operating within state territory, but may not deprive such corporations of their constitutional rights or interfere with interstate commerce (thus foreign corporations retain the right to move through state territory). There is no authoritative federal court decision on whether a state may regulate the internal affairs of a corporation in the manner done by the laws of California and New York, although there has been considerable speculation on the matter. Aside from a finding that such statutes interfere with interstate commerce or are preempted by an expanding federal regulation of corporations, there is little constitutional basis for challenging the statutes. First, a principal constitutional tool for guaranteeing the citizens of one state certain freedoms and rights in another state, the "privileges and immunities clause" of the US Constitution, has been held not to apply to corporations. Second, no federal decision has authoritatively applied another potentially applicable constitutional provision, the "full faith and credit clause," to guarantee that the structure of internal affairs governance of a corporation created in one state be respected in such form in another state. It is important for this question that pseudo-foreign corporation laws of the type used in California have already existed without significant challenge for about 50 years, making it unlikely that they would be struck down on any ground other than federal preemption – if federal rules

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112 On this question, see Langevoort, supra note 111, at 110-118.

113 U.S. Const., art. IV, § 2 ("The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States.").


115 U.S. Const., art. IV, § 1 ("Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State.").

116 For a thorough, recent discussion (in German), see KLEIN, supra note 111, at 383-388; and for older treatment by US experts, see Buxbaum, supra note 111, at 43-47, and Reese & Kaufman, supra note 111, generally.
on internal affairs continue to expand as they have in the Sarbanes-Oxley Act. Given that state courts do not have ultimate authority in matters of federal constitutional law, predictable assertions of authority that have been made by the Delaware and California courts should not be given undue weight on this issue.\footnote{See Draper v. Paul N. Gardner Defined Plan Trust, 625 A.2d 859, 665-66 (1993) (In a case involving a Delaware corporation doing business primarily in California, it was necessary to decide whether California or Delaware law controlled the standard for dismissing a derivative suit filed by a shareholder, and the Delaware Supreme Court found that the matter was governed by Delaware law, asserting that application of the internal affairs doctrine is mandated by constitutional principles, except in "the rarest situations.") The courts of California, on the other hand, have approved imposing their cumulative voting provisions on pseudo-foreign corporations (Wilson v. Louisiana-Pacific Resources, Inc., 138 Cal. App. 3d 216, 187 Cal. Rptr. 852 (1982)), and applied conflicting, Californian rules on shareholder information rights to Delaware corporations (Valtz v. Penta Investment Corp., 188 Cal. Rptr. 922 (1983)).}

Therefore, although cases addressing possible conflicts between federal and state law, have stressed that because corporations are "creatures of the states," state law should be given considerable deference in questions of internal affairs,\footnote{See CTS, 481 U.S. at 86, and Green, 430 U.S. at 479.} this does not necessarily mean that such deference must be given in equal degree if there is a conflict between two states. It would seem that US states have a considerably freer hand than their EU member state counterparts under the decisions of the European Court of Justice in regulating the presence of "foreign" corporations doing business on their soil.\footnote{See Part III.B.1.} Nevertheless, given the degree to which company law has – and is still being – harmonized throughout the European Union, the "threat", if any, posed by foreign companies to host member states is considerably smaller than what might be imagined in the United States.

Federal and state to securities exchanges. Listing requirements are merely contractual in nature,\footnote{"[M]ost exchange rules that regulate the behavior of listed companies are no more than contractual undertakings by the listed company to make particular choices from the menu of state corporate law." Paul G. Mahoney, The Exchange as Regulator, 83 Va. L. Rev. 1453, 1498 (1997). For copies of the agreements between an issuer and the exchange used when listing securities, see the websites of the NYSE, supra note 18, and the Nasdaq Stock Market, supra note 49.} and would thus be invalid if they violated either state or federal law.\footnote{See RESTATEMENT (SECOND) OF CONTRACTS § 178 (2005) and John D. Calamari & Joseph M. Perillo, The Law of Contracts 495 (4th ed. 1998). Aside from the invalidity under contract law, § 19(b)(3)(C) Exchange Act provides that a "rule change of a self-regulatory organization which has taken effect . . . may be enforced by such organization to the extent it is not inconsistent with the provisions of this title, the rules and regulations thereunder, and applicable Federal and State law."} However, if a listing rule were to violate a state law while complying with a valid federal rule, such violation would likely imply that the state law was invalid under the US Constitution's supremacy clause. The general picture (see Figure 2) is thus a hierarchy with the federal government on top, the state governments in the middle, and the stock exchanges on the bottom, with the significant caveat that pursuant to § 19 Exchange Act the SEC supervises all significant rule changes of national exchanges and may instruct
the exchanges to adopt specific rules, thereby giving the rules a federal shading. Because the SEC operates under power delegated to it through the Exchange Act, it may not instruct a securities exchange to adopt a rule in an area not covered by such delegated power. The Court of Appeals for the Federal Circuit found in 1990 that an SEC rule that would have required exchanges to maintain a one share/one vote policy was beyond the agency's statutory authority because, in the court's opinion, voting rights were part of internal corporate governance and beyond the disclosure focus of the Exchange Act. As Prof. Joel Seligman has observed, the court's decision not only ignores the SEC's plenary power under the Exchange Act to change or abrogate exchange rules, but also fails to explain how, if exchanges can adopt rules that go well beyond disclosure, and the SEC has unlimited power over this process, the SEC's own affirmative capacity can be limited to disclosure rules. The expansion of the Exchange Act into "internal" matters through the Sarbanes-Oxley Act amendments may lead future courts to reach different conclusions regarding the scope of the SEC's power in such matters.

3. The flexibility of the various sets of rules.

As stated above, state corporation statutes are composed of some mandatory and many optional rules, but are generally considered to be enabling statutes that allow shareholders to shape their companies. Prof. Jeffrey Gordon finds "four sorts of mandatory rules in modern [American] corporation statutes: procedural, power allocating, economic transformative, and fiduciary standards setting." These categories would include such matters as (procedural) establishing a mandatory procedure for calling shareholder meetings, (allocating) giving shareholders the right to elect and remove directors, (transformative) requiring a shareholder vote on transactions that would change the nature of the corporation, and (fiduciary) duties of care and loyalty applied by courts to "to restrain insiders in exercising their discretionary power over the corporation and its shareholders in contingencies not specifically foreseeable and thus over which the parties could not contract." Federal statutes are completely mandatory. Listing requirements are mandatory, although they provide

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122 The procedure by which national securities exchanges may change their rules in provided for in § 19(b) Exchange Act. According to this provision an exchange must file copies of any proposed rule change with the SEC, stating the proposed rule's basis and purpose. The SEC then provides notice of the proposal and gives interested persons an opportunity to comment. Usually with 35 days, the SEC will then order the rule change or institute proceedings to determine whether the proposal should be disapproved. Under certain circumstances rules may enter into effect immediately without the waiting period. No rule proposal can become effective without SEC approval. See LOSS & SELIGMAN, supra note 48, at 776-779.

123 See Business Roundtable, 905 F. 2d at 411-413.

124 See § 19(b)(3)(C) Exchange Act ("the Commission summarily may abrogate the change in the rules of the self-regulatory organization . . . and require that the proposed rule change be refilled.")

125 LOSS & SELIGMAN, supra note 48, at 778-779.


127 Id. at 1593.
flexibility for foreign listed companies that are subject to different legal systems. The overall flexibility of the set of corporate governance rules for both Delaware and foreign companies listed on a US securities exchange has been reduced by the mandatory, federal rules affecting “internal matters” introduced by the Sarbanes-Oxley Act and the SEC implementing rules, which did not create waivers or significant derogations for foreign companies.\(^{128}\)

B. The Republic of Germany

The jurisdictions that create the rules governing public companies in Germany are the Republic of Germany (e.g., the Aktiengesetz),\(^{129}\) the European Union, which has significantly shaped German law through directives, and has also enacted some directly applicable EU regulations (e.g., the Listing Regulation and the Regulation creating a Societas Europae), and the securities exchange on which the company's securities are listed (e.g., the Frankfurt Stock Exchange).

Figure 3 presents a summary graphic of the three characteristics already discussed for US companies as applied to the three jurisdictions issuing rules for publicly listed companies in Germany. As in sub-part A, the following paragraphs 1 through 3 will discuss these characteristics in turn.

*Figure 3: The Jurisdictional Breakdown of Rules Governing German Corporations*

I. The areas each jurisdiction's laws or rules traditionally cover

With the exception of labor participation and the fiduciary duties of directors, which remain national law questions, it is difficult to draw a clean line separating areas traditionally covered by German company law from those covered by EU law. It may be argued, as does Prof. Stefan

\(^{128}\) See notes 68-71 and accompanying text.

\(^{129}\) Like the United States, Germany has a federal structure, and the individual states, or Länder, have significant power in the federal government through the German Parliament's second house, the Bundesrat. See Arthur B. Gunlicks, *German Federalism and Recent Reform Efforts*, 6 GERMAN LAW JOURNAL 1283, 1285 (2005). Although the Länder do not enact company law, they have supervisory authority over stock exchanges located in their territory.
Grundmann, that EU company law displays a tendency leaning more heavily toward disclosure. However, the demarcation is by no means as pronounced as in the United States. Both German and EU company law cover matters connected to each of the five core characteristics of a corporation, plus disclosure and accounting. EU securities law, which has in part been implemented through German law and in part adopted in directly applicable regulations, covers a wide area focusing on disclosure and the prevention of securities fraud. Aside from administrative law provisions on the licensing and management of securities exchanges, German securities laws are substantially composed of implemented EU law. The initial and continuing listing standards of the Frankfurt Stock Exchange contain disclosure and accounting rules resembling those of US stock exchanges, but delve less deeply into internal affairs. Pursuant to § 161 AktG, listed companies must comply with a Corporate Governance Code of best market practices or explain in the notes to their financial statements why they have chosen not so to conform. The Code contains requirements that are very comparable to the corporate governance standards found in the NYSE Listed Company Manual, such as a general policy of one share/one vote, a shareholder-friendly calling and holding of the annual meeting, and the requirement that an audit committee with an independent chairperson be set up in the supervisory board.

Ten of the company law directives adopted by the European Union harmonize the law on many key aspects of and transactions conducted by public corporations. They represent an effort to create a single standard for corporations in the European Union, that ran strong from the late 1960s to the mid-1980's. This harmonization program was advocated most strongly by France, which feared that

130 See Stefan Grundmann, The Structure of European Company Law: From Crisis to Boom, 5 EBOR 601, 6 (2004). For example, third parties are protected in dealings with the company by disclosure of the persons authorized to bind the company, the capital and financial condition of the company is disclosed, and shareholders are protected in mergers by disclosure of a detailed merger plan.

131 For a recent, insightful treatment of EU securities law, see Ferran, supra note 11.


133 One leading expert estimates that about 80% of German securities law follows EU directives. Siegfried Kümpel, Kapitalmarktrecht – Eine Einführung, in Siegfried Kümpel et al., eds. Kapitalmarktrecht Handbuch für die Praxis 1, 6 (2005).


135 See German Corporate Governance Code (Deutscher Corporate Governance Kodex), available at http://www.corporate-governance-code.de/.

136 Id. at § 2.1.2.

137 Id. at § 2.3.

138 Id. at § 5.3.2.

companies subject to inferior regulation would operate on its territory, and harmonization was considered less a step toward achieving a single market than "an entrance fee Member States accepted to pay for market integration." The First Company Law Directive, adopted in 1968, imposed a harmonized system of disclosure for companies to publish facts regarding their incorporation, legal capital and financial results, as well as to specify those persons authorized to represent the company in dealings with third parties. The Second Company Law Directive, adopted in 1976, provided harmonized rules for the incorporation of public companies and the maintenance of their capital, including a procedure for auditing the value of in-kind contributions to capital, restrictions on dividend distributions and share repurchases, a prohibition of "financial assistance", mandatory preemptive rights, and a required shareholder vote for certain changes in the company's capital. Even taken alone, these two Directives already regulate the corporation's core characteristics. They provide rules on the creation and actual representation of the corporation as a legal person, the capital maintenance requirements that are by many considered a quid pro quo for its limited liability, the nature of certain rights attaching to its shares, and the rights of shareholders with respect to changes in the company capital. Only the nature and operation of the company's centralized management under a board is left to national law. The remainder of the first, nine company law directives aim to harmonize accounting, or address specific company actions or topics, such as mergers and divisions, the establishment of branches in other member states, or guarantee that the existence of a single-

140 Christiaan Timmermans, Harmonization in the Future Company Law in Europe, in Klaus J. Hopt & Eddy Wymeersch, eds., CAPITAL MARKETS AND COMPANY LAW 623, 628 (2003); Grundmann, Structure, supra note 130, at 605.


142 Second Council Directive (77/91/EEC) of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent throughout the Community, 1977 O.J. (L26) 1; see also consolidated version as amended thorough January 1, 1995, available at www.eurlex.eu.


145 Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of
A shareholder company will be respected throughout the Union. In recent years, the European Union has managed to finally adopt longstanding proposals for a directive regulating takeovers, and a regulation/directive package enabling the creation of European Companies (a porous framework that is filled in by the company law of its member state of incorporation and seat). All of the directives are already or soon will be implemented into German company law, and the SE Regulation is both directly binding as law in Germany and has been tied into German law with a special piece of legislation that directs how the gaps in the loose, supranational framework are to be filled in. From this brief overview, we can see that EU and German law do not primarily exist on separate, parallel planes like the federal/state relationship in the United States, but have been fused at numerous points (see Figure 3).

The drive to harmonization that led to this mixed company law waned at the time that the Single European Act was being drafted in the mid-1980’s, giving way to a preference for home country rule and "subsidiarity". The harmonization process then stopped. However, a series of decisions by the European Court of Justice (ECJ) since 1999 on the basis of the right of establishment guaranteed companies in Articles 43 and 48 of the EC Treaty has once again cut deeply into the national company laws of the member states, including Germany. In Centros Ltd v. Erhvervs- og Selskabsstyrelsen, the ECJ found that Denmark must allow a UK private limited company freely to establish itself in its territory, even if Danish citizens bought the company for the sole purpose of evading Denmark’s stricter laws on capital adequacy and none of the company’s activity takes place in its home state. In another State, 1989 O.J. (L 395) 36. This Directive is discussed at length in the European Court of Justice’s decision in Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam and Inspire Art Ltd, [2003] ECR I-10155.

149 The European Company Implementation Act (Gesetz zur Einführung der Europäischen Gesellschaft), German Federal Law Reporter (BGBl) vol. I, p. 3675 (Dec. 22, 2004). Although national law will fill in gaps in the Regulation, it is important to remember that many of the gaps have been left in areas already harmonized by earlier EU directives.
150 See the discussion of US federal and US state law in sub-part A, above.
151 See Timmermans, supra note 140, at 626-630. The concept of "subsidiarity" will be discussed in detail in the following section. A major breakthrough in the philosophy of home country rule came in the famous Cassis de Dijon movement of goods case, Case 120/78, Rewe-Zentrale AG v. Bundesmonopolverwaltung für Branntwein [1979] ECR 649. On this point, also see Grundmann, Structure, supra note 130, at 617, arguing that the principle of home rule is essentially disclosure or information-oriented in nature.
Uberseering BV v Nordic Construction Company Baumanagement GmbH, the ECJ found Germany's conflict of laws rules as they had been applied to a Dutch company to impede freedom of establishment. Unlike the United States, which applies the "incorporation theory," meaning that the internal affairs of a corporation are governed by the laws of its state of incorporation, Germany applies the "real seat" (or siège réel) theory, meaning that the internal affairs of a corporation are governed by the laws of the state where it has its center of administration. The application of the real seat theory to a Dutch company whose shares came to be owned by Germans and which was operated in Germany, resulted in the German courts applying German law to the company, finding that it was not properly constituted and registered as a German corporation, and then denying it the legal capacity to sue in a court of law. The ECJ, following its decision in Centros, found that denying a company duly formed in another member state legal capacity to be party to legal proceedings was "tantamount to an outright negation of the freedom of establishment conferred on companies by Articles 43 and 48" of the EC Treaty. The Court rejected Germany's argument that application of its own company law to pseudo-foreign corporations was justified because it enhanced legal certainty, and the protection of creditors and minority shareholders. It is unclear whether the Uberseering decision has changed Germany's conflict of laws rules for corporations, the substantive law that results from their application, or both. The seat theory will likely remain, in any case, for companies incorporated outside of the European Union, unless a friendship treaty applies. In its next, major decision in this area, Kamer van Koophandel en Fabrieken voor Amsterdam and Inspire Art Ltd, the ECJ held that a

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155 SCoLES et. al., supra note 34, at § 23.2.
156 See Wulf-Henning Roth, From Centros to Uberseering: Free Movement of Companies, Private International Law, and Community Law, 52 ICLQ 175, 180-81 (2003); and SCoLES et. al., supra note 34, at § 23.1. According to Prof. Roth, the "center of administration" as understood in Germany is "the location where the internal management decisions are transformed into the day-to-day activities of a company." Id. at 181, citing the decision of the German High Federal Court reported in BGHZ 97, 269, at 272.
160 Roth, supra note 156, at 207-208.
161 For example, the friendship and commerce treaty between the United States and Germany provides in Article VII that "[n]ationals and companies of either Party shall be accorded, within the territories of the other Party, national treatment with respect to engaging in all types of commercial, industrial, financial and other activity for gain, whether in a dependent or an independent capacity, and whether directly or by agent or through the medium of any form of lawful juridical entity. for the recognition of companies and their right to enter and trade in the jurisdiction." Treaty of Friendship, Commerce and Navigation, July 14, 1956, U.S.- Germany, art. VII, 7 U.S.T. 1839.
162 Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam and Inspire Art Ltd, [2003] ECR I-10155.
Dutch outreach statute against pseudo-foreign corporations was inconsistent with the EC Treaty. The statute required the branches of companies incorporated abroad to make disclosures beyond those provided for in the Eleventh Company Law directive, and that imposed unlimited liability as a penalty for a failure to comply with these and other requirements, such as a minimum capital requirement.\(^\text{163}\)

From the perspective of a comparative analysis with US federalism, the *Inspire Art* decision is interesting in that it is based both on freedom of establishment (which is not guaranteed for companies by the US Constitution),\(^\text{164}\) and a theory of preemption of member state action by an EU directive,\(^\text{165}\) which is the strongest theory for invalidating state law under the US Constitution.

By rolling back the member state regulation of foreign corporations, it would seem that the ECJ had opened the gates to significant regulatory competition. Indeed, scholarly speculation is high as to whether the motivational and legal conditions behind US regulatory competition can be found to exist in Europe.\(^\text{166}\) However, as Prof. Klaus Hopt, the German representative on the EU High Level Group of Company Law Experts has observed, in coming years a number of proposals may be adopted to further harmonize EU company law.\(^\text{167}\) Although most of the planned measures would not be as rigid as the first, nine directives,\(^\text{168}\) they would focus on "internal" governance matters,\(^\text{169}\) and if such matters are roughly synchronized, this would reduce the area of play for regulatory competition and stabilize the opening that the ECJ has created. This is especially true when one considers that a Societas Europae is already available for incorporation at the European level, and that the Action Plan proposes creating more supranational forms.\(^\text{170}\) The SE Regulation specifies certain aspects of a Societas Europaea's corporate structure that are to be filled in by national law, and if the "open areas"


\(^{164}\) See sub-part A.2, above.


\(^{166}\) See *Armour*, supra note 4, and *Gelter*, supra note 4.


\(^{168}\) The Action Plan lists as its "guiding political criteria," a full respect for "subsidarity and proportionality," and states that the measures should be "flexible in application, but firm in the principles." *Action Plan*, at 4.

\(^{169}\) Measures that are being or already have been drafted are a directive to increase the collective responsibility of board members, recommendations to increase the presence of independent directors and better regulate director remuneration, and a directive to facilitate shareholder communications and decision-making, as well as a project to coordinate the national corporate governance codes adopted by member states. *See Action Plan*, at 10-17.

\(^{170}\) *See Action Plan*, at 22. However, the Action Plan reports the High Level Group recommended performing a feasibility study before beginning work on a European private limited company (*Id.* at 21), which is significant because most of the questions regarding regulatory competition arise for this business form, as the Second Company Directive's capital maintenance requirements apply only to public companies.
to be filled have already been harmonized or will be addressed under the Acton Plan, there would be almost nothing for a member state to offer when competing with its neighbors for charters – unless the competition were to move to related, topical laws such as bankruptcy.\footnote{See Armour, \textit{supra} note 4, at 38-50.}


- \textit{Level 1}: general principles;
- \textit{Level 2}: detailed, implementing legislation adopted by the European Commission, in consultation with a newly formed Committee of European Securities Regulators (CESR);
- \textit{Level 3}: interpretive regulations developed by CESR; and
- \textit{Level 4}: Commission polices for compliance.

Prospectus Directive has been fleshed out with a very detailed Prospectus Regulation, which operates something like Regulation S-K in the United States, and obviates detailed national legislation on the content of prospectuses. In fact, the newly adopted German Securities Prospectus Act defines the required, minimum content of a prospectus under German law with a brief reference to the EU Prospectus Regulation.

Given this rather heavy blanket of laws and regulations covering German companies, it is understandable that the initial and continued listing requirements of the Frankfurt Stock Exchange are somewhat lighter than their US counterparts. They primarily require disclosures that are somewhat stricter than those specified in applicable law. For example, a company's whose shares are admitted to the premium market segment, referred to as "prime standard", must prepare their financial statements in a manner compatible with International Accounting Standards (note that this is now required by EU law), and publish reports including financial statements on a quarterly, rather than merely semiannual basis, as required by the federal, Exchange Admission Regulation (Börsenzulassungs-Verordnung).

2. The relationship of the jurisdictions to each other

Community to Member States. As the European Community is the lawmaking portion of the European Union, the Community's relationship to the member states is relevant for this paper. The relationship between the Community and Germany is more complex than the relationship between the
United States and Delaware. Within areas where the Community has been delegated competence that is not concurrent, the ECJ has interpreted the EC Treaty to mean that EU law is supreme over the member states,\textsuperscript{184} but the German Constitutional Court (Verfassungsgericht) has expressly reserved national, sovereign power, which it will however not exercise so long as the Community remains within its delegated powers and does not violate basic rights guaranteed in the German Constitution.\textsuperscript{185} Within those areas where the European Community has not been given exclusive competence, the relationship between the Community and the member states is described by the concept of "subsidiarity" under Article 5 of the EC Treaty, which includes the imperative that "the Community shall take action . . . only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community."\textsuperscript{186} The Community is given the express duty to guarantee the freedom of establishment in Articles 43 through 48 of the EC Treaty, but the promulgation of company law is not an express Community function, and thus the company law area should be thought of as one of "concurrent jurisdiction",\textsuperscript{187} to which the principle of subsidiarity could apply. In this area, however, the Community's exercise of power is judged primarily according to whether it abused the power delegated to it in the EC Treaty, and thus application of the principle of subsidiarity would add little to the evaluation.\textsuperscript{188}

The company law directives discussed in section 1 were adopted on the basis of Art. 44(2)(g) EC Treaty, which instructs the European Council to adopt directives to coordinate, "to the necessary extent the safeguards . . . required by Member States of companies . . . with a view to making such safeguards equivalent throughout the Community."\textsuperscript{189} The word "safeguards" recalls Justice Timmerman's point, mentioned in section 1, that the harmonization program was an entrance fee for market integration.\textsuperscript{190} The ECJ decisions discussed in section 1 were made on the basis of Articles 43

\textsuperscript{184} Case 26/62, NV. Algemene Transporten Expediteie Onderneming van Gend en Loos v. Nederlandse Administratie der Belastingen [1963] ECR 1, 12 ("the Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals."). For a good discussion in German, see Zuleeg, supra note 183, at 582-585.

\textsuperscript{185} See most recently Decision of the Constitutional Court of June 7, 2000, 2 BvL 1/97, available at the website of the German Constitutional Court at http://www.bverfg.de/cgi-bin/link.pl?entscheidungen. An older decision (reprinted in English) expressing a similar line of reasoning on sovereignty is Brunner v. The European Union Treaty [1994] 1 CMLR 57.

\textsuperscript{186} Art. 5, EC Treaty.

\textsuperscript{187} Zuleeg, supra note 183, at 623-24.


\textsuperscript{189} See EDWARDS, supra note 12, at 3-14, and GRUNDMANN, supra note 12, at 48, 69-72.

\textsuperscript{190} See supra note 140, and accompanying text.
and 48 of the EC Treaty, which apply the guarantee of freedom of establishment to companies. As already said, a "directive" is binding, as to the result to be achieved, but leaves the national authorities the choice of form and methods of implementation.\textsuperscript{191} Nevertheless, once a directive has been adopted, it works to pre-empt conflicting national legislation. The ECJ explained this in its \textit{Inspire Art} decision, where it concluded that the Eleventh Company Law Directive on the establishment of branches in other member states provides an "exhaustive" list of required and optional disclosures that may be required of such branches, and held that the disclosure requirements imposed by The Netherlands' Law on Formally Foreign Companies were pre-empted by the Directive.\textsuperscript{192}

\textbf{State to State.} The ECJ does not hesitate in the cases such as \textit{Centros, Überseering}, and \textit{Inspire Art} to declare member state laws unlawful if they burden the freedom of establishment of a company formed under the laws of another member state, unless the laws of the host state remain with the criteria set forth in \textit{Gebhard}:

- they must be applied in a non-discriminatory manner,
- they must be justified by imperative requirements in the public interest,
- they must be suitable for securing the attainment of the objective which they pursue, and
- they must not go beyond what is necessary in order to attain it.\textsuperscript{193}

The vertical impact of these decisions is to apply a clear principle of supremacy of EU law over member state national company law, and the horizontal impact is to create standards that a member state may use in assessing the permissibility of its company law and related legislation on companies formed under the law of another member state. One clear rule from the decisions is that although member states may protect themselves from fraudulent actions by foreign companies, the deliberate use of a system of company law that relies on disclosure, especially one found in the 1\textsuperscript{st} and 11\textsuperscript{th} Company Law Directives, rather than legal capital to protect creditors does not constitute such fraudulent action.\textsuperscript{194}

\textbf{State to securities exchange.} German securities exchanges adopt their rules pursuant to all three layers of state hierarchy: the European Community, the Republic of Germany, and the \textit{Land} (province or federal state) in which they are located. For the Frankfurt Stock Exchange, the relevant \textit{Land} is the State of Hesse. Pursuant to § 32 of the German Exchange Act,\textsuperscript{195} the federal government issues an

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\textsuperscript{191} Article 249 EC Treaty.  
\textsuperscript{194} See Timmermans, \textit{supra} note 140, at 633.  
\textsuperscript{195} § 32(1) requires that the regulation contain "provisions necessary to protect the public and for orderly exchange trading, regarding: 1. admission requirements, and in particular: a) requirements for the issuer regarding its legal form, its size and the duration of its existence; b) requirements for the securities to be admitted regarding their legal basis, negotiability, face value, and printed format; c) the minimum amount
exchange admission regulation, which provides guidelines on the procedure to be used and requirements to be met when admitting securities to listing on the exchange. A governing body of the exchange, an "exchange council" (Börsenrat) on which representatives of listed companies and market participants are seated, then issues more detailed Exchange Rules. These rules must be approved by the supervisory authority of the Land, which in the State of Hesse is the Commerce Ministry. As the Exchange Rules are issued pursuant to the German Exchange Act and under the supervision of state authority, they take on the character of a public law charter (öffentlich-rechtliche Satzung), which gave ground for considerable speculation when, in 2001, they were changed to delist substandard companies from the Frankfurt Stock Exchange. Provisions of EU law must be taken into account at each level within Germany. The resulting character of the relationship between the state and the exchanges is thus somewhat like that between the European Community and Germany: there is substantial instruction given from above, and the resulting rules on the lower level are permeated with provisions formulated on the higher level.

3. The flexibility of the various sets of rules.

The Aktiengesetz is, in itself, quite inflexible. Section 23(5) AktG provides that the company charter may deviate from the provisions of the law only where expressly provided for in the law, and such express grants are not generously provided. As Prof. Karsten Schmidt notes, pursuant to German corporate law, "the constitution-like, prescribed structure of the stock corporation may be altered only slightly by the articles of incorporation, given that – contrary to limited liability companies and partnerships – the stock corporation is governed by the principle that the form of constitutional documents is strictly prescribed." Indeed, Prof. Hans-Joachim Mertens quipped in an essay written of the issue; d) the requirement that the application for admission include all shares of the same class or all debt securities of the same issue; 2. the language and the content of the prospectus, in particular the securities to be admitted and the issuer, its capital, business activity, assets and liabilities, financial position, management and supervisory bodies, its recent development and prospects, any lockup agreements between the issuer and its shareholders, including any understandings and measures designed to secure performance on the agreement, as well as the persons or companies that take responsibility for the contents of the prospectus; 3. the date on which the prospectus is to be published; and 4. the admissions procedure." § 32(1) German Exchange Act, author's translation.

196 See Exchange Admission Regulation, supra note 182.
197 §§ 9 and 13 German Exchange Act.
199 Id. at 7/182.
200 See Manfred Wolf, Der Ausschluß vom Neuen Markt und die Aufnahme von Ausschlußgründen in das Regelwerk Neuer Markt, 38 WM 1785 (2001), for an excellent analysis of the contract law problems arising in the unilateral amendment of this type of contact.
201 SCHMIDT, supra note 32, at 771 (italics in original) (Author's translation). For an interesting discussion of mandatory corporate law in Continental Europe, see Sofie Cools, "The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers," Harvard John M. Olin Center
shortly after German reunification that a future economic historian would have great difficulty in discerning whether the Aktiengesetz, with its strictly prescribed structure, originated in the capitalist or in the communist half of Germany.202

Although the provisions of the EU company law directives are generally mandatory, the European Union did introduce some flexibility into Germany and the other member states with the SE Regulation. The Regulation allows shareholders to choose either a single-tier or a two-tier management board structure in settling up a Societas Europae,203 and to specify a percentage of less than 10% of the shareholders to call a shareholders’ meeting.204 Perhaps the greatest source of flexibility coming from EU law, however, has been the ECJ’s insistence that even pseudo-foreign corporations be given free reign within the Union. Taken to its logical extreme, this could allow German entrepreneurs to choose the company law of any EU Member State for their operations in Germany, although Prof. Wulf-Henning Roth has argued that a rule like the one invalidated in Überseering might be valid if it provided for the smooth conversion of a foreign company into a German corporate form by operation of law.205

Like the initial and continuing listing standards of US securities exchanges, the federal Exchange Admittance Regulation and the rules of the Frankfurt Stock Exchange are mandatory. However, within the Exchange, there are a number of segments with differing standards to accommodate issuers of different size and stability.206 The German Corporate Governance Codex allows companies to accept or reject it in whole or in part, but § 161 AktG requires that any failure by a listed company to comply with the Codex must be explained in the company’s annual financial statements. The entire structure of regulation offered German companies thus leaves very little room for adaptation to individual companies and circumstances.

IV. What Company Law’s Structure and Composition Can Tells us About Other Issues

The foregoing analysis attempts to be factual and descriptive. It hopes to present a description of the actual components of company law in Germany and Delaware. It is designed as a roadmap for further comparative study of these two sets of laws. It shows us that:

- The Aktiengesetz covers a wider range of topics than the DGCL and is considerably less flexible.

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203 Art. 38(b), SE Regulation.

204 Art. 55(1) SE Regulation.

205 Roth, supra note 156, at 208.

206 See Foelsch, supra note 198, at 7/211 – 7/217.
• What is studied as "company law" in both Germany and the United States includes other topical laws, notably securities regulation and a certain measure of accounting.

• US company law tends to import bankruptcy principles to fill in for laxer capital maintenance rules.

• Listing requirements in the United States are more extensive than those in Germany, and supplement gaps in legislation.

• Both German and Delaware law operate subject to preemption by a higher jurisdiction.

• The federal government in the United States could replace the DGCL, but appears unlikely to do so, while the European Union could not wholly replace the Aktiengesetz, although it has already significantly shaped it and plans to shape it even more.

• Because US federal law cannot instruct states to adopt rules or policies, federal and state law remain separate.

• German law is marbled with EU law and coexists with EU regulations that create alternative business forms.

• Securities laws for a German company do not come primarily from a higher jurisdiction, but are like the Aktiengesetz – national laws marbled with EU law and coexisting with directly applicable EU regulations.

• EU member states have a duty to allow corporations formed in other member states establish themselves freely, while US states have only a duty not to interfere with the constitutional rights of comparable companies – particularly their rights to engage in interstate commerce.

From these findings, we may conclude that the Aktiengesetz is comprehensive, inflexible and closely tied to EU law, while the Republic of Germany must take great care not to interfere with the operation of companies formed under either EU law or the law of another member state. The DGCL is comparatively less comprehensive, quite flexible, and independent from federal law, while the State of Delaware can subject foreign corporations to significant regulation and other states, like California, may do the same to Delaware companies. Both systems of law operate in juxtaposition to systems of securities regulation, but only Delaware would see such securities laws as a special threat to its area of competence, given that the European Union – unlike the United States – enacts company law directly. Both for historical reasons, and because US regulation is substantially less pervasive, the listing standards of US securities exchanges enter gaps and control company management to a much greater extent than do their European counterparts.

Perhaps the main policy debate today concerning the interaction of legal systems falls under the rubric of regulatory competition.²⁰⁷ This is particularly true in Europe following the Centros, Überseering, and Inspire Art decisions. Regulatory competition is the competition that jurisdictions engage in to attract companies to incorporate under their law. One of the main issues in the regulatory

²⁰⁷ Indeed, this issue was one of the most hotly debated questions in connection with the vote on the draft European Constitution in 2005.
The competition debate is motive – motive of both the state and of the corporate promoters or management. The motivation of the state or country might be to attract revenues from taxes charged incorporated companies, as is the case in Delaware,\textsuperscript{208} or some other benefit, such as an increase in fees earned by professionals licensed in the jurisdiction – lawyers and consultants – who provide services to corporations established under local law.\textsuperscript{209} The motive of the corporate promoters or management might be to seek out flexible laws that allow them to operate with little capital and reduce management accountability to shareholders and third parties (“race to the bottom”).\textsuperscript{210} Or the motive of such promoters or management might be to seek out an efficient, intelligent system of law so that their company can excel (“race to the top”).\textsuperscript{211} Although the type of study performed in this paper tells us next to nothing about motivation, it does allow us to see whether competition is possible and whether the (good or bad) effects of competition can be transmitted among the components of a legal system.

A description of the elements of company law in Delaware and in Germany helps us understand the dynamics of the systems that might be seen to compete. Professors William W. Bratton and Joseph A. McCahery have provided an insightful and instructive analysis of US regulatory competition form the perspective of game theory, examining the development of two competitive equilibriums since the late 19\textsuperscript{th} century.\textsuperscript{212} One equilibrium exists in the competition among states for corporate charters and the second exists among the makers of nationally applied securities laws.\textsuperscript{213} The analysis of the contents of these equilibriums shows that although the federal system does adjust the results achieved by the state system,\textsuperscript{214} state and federal products do not really compete, and thus laws like the Sarbanes-Oxley Act do not eliminate the competition between states.\textsuperscript{215} The entrance of the federal lawmaker into the area occupied by the state equilibrium does, however, affect the latter because it reduces the space within which competition among state laws occurs. In a two-tiered (federalist or international) legal system, the greater the pervasiveness and impact of the law enacted by the higher tier, the less room there is for competition among the units of the lower tier.\textsuperscript{216}

\textsuperscript{208} See Bratton & McCahery, supra note 4, at 58.
\textsuperscript{209} See Armour, supra note 4, at 26.
\textsuperscript{210} See Cary, supra note 2, at 66.
\textsuperscript{211} See Romano, Genuis, supra note 2, at 14-44.
\textsuperscript{212} Bratton & McCahery, supra note 4.
\textsuperscript{213} Bratton & McCahery, supra note 4, at 34-37.
\textsuperscript{214} Bratton & McCahery, supra note 4, at 10.
\textsuperscript{215} Bratton & McCahery, supra note 4, at 50.
\textsuperscript{216} See Prof. Roberta Romano’s withering assault on the Sarbanes-Oxley Act, The Sarbanes-Oxley Act and the Making of Quack Corporate Governance, 114 Yale L. J. 1521 (2004), which she launches exactly because the expansion of federal regulation found in that law reduces the quantity of regulatory competition that she finds salutary for the US legal system.
Our analysis has shown that EU directives penetrate and determine the content of member state company laws in a way that does not occur in the relationship between US federal law and state company law. Except for rules on private limited companies, EU and national law are extensive and are substantially intertwined. Moreover, the European Union has directly entered the member states’ competitive equilibrium by creating its own corporate entity, albeit this entity is in part dependent on fill-ins from member state law. Unlike the US system, in which states with flexible law have considerable space to compete under a system of federal law, EU member states are tied to their ceiling of EU law, and one of the competing entities is supranational. This, in addition to the other factors not addressed here such as differences in court systems, cultures and languages, would seem to indicate a low potential for regulatory competition in Europe. However, on the horizontal level, ECJ decisions like *Inspire Art* appear to give EU member states much less freedom to take unilateral action to "protect" themselves against foreign corporations than US states have under the US Constitution. Horizontal freedom may compensate for vertically imposed uniformity. The EU’s company law action plan published in 2003 may lead to a further increase in uniformity, but it is too early to tell.

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217 *See* Armour, *supra* note 4, at 18-19.

218 Of course, the requirements of the Eleventh Company Law Directive must be included in the calculus when computing the ease of entering another member state to set up a branch and do business. However, these requirements do not go to the internal affairs of a company, and parallel the light requirements imposed on foreign corporations by such states as Delaware.
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