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Reform of the Structure of the American Corporation: The “Two-Tier” Board Model

By

THOMAS J. SCHÖENBAUM* and JOACHIM LIESER**

I. INTRODUCTION

It is undeniable that the corporation as a legal, economic and social institution has been a great success. Its ability to organize large numbers of people and great amounts of capital into an instrument for action is proverbial. It has become mainly responsible for technological innovation in the western world. It plays a social and philanthropic role, replacing the historical function of the churches in this regard. It is a chief patron of art and architecture, thereby carrying out a function once fulfilled by princes and nobility. The modern state turns to it for everything from military defense to anti-poverty programs.

Paradoxically, however, there exists a certain uneasiness about the corporation as an institution. This is felt not only in the United States, but in substantially all western industrialized countries. It stems primarily from the realization that corporations hold great power and influence and the feeling that sufficient controls on the exercise of such power are lacking. The many facets of this phenomenon have been well documented. Management’s freedom from control by the shareholders in certain larger corporations is well known.¹ Corporate power leads to some measure of control over markets and the prices of goods and

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¹ See generally A. BERLE & A. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932); Rostow, To Whom and For What Ends is Corporate Management Responsible, in E. MASON, THE CORPORATION IN MODERN SOCIETY 46, 53 (1960) [hereinafter cited as MASON].
services. It is Professor Galbraith's thesis that many varieties of products are not provided as a result of consumer demand, as classical economics would have it, but are determined in advance by the marketing and advertising power of the corporation. Environmentalists charge that many corporations through lobbying activities thwart the passage of effective laws for the control of pollution and that they do not attempt to comply with environmental legislation and regulations. The great corporations have been described as "political systems" with market, social and political influence going beyond their function as legal and economic entities, and yet they are not sufficiently subject to the checks and balances on overbearing power that characterize a democratic system.

The wide spectrum of solutions advanced to combat these problems have for the most part been concerned with developing countervailing forces that will provide a check on abuse of corporate power but will not unnecessarily inhibit the power of action of management. There has been a trend toward greater governmental regulation of economic matters and increased requirements of disclosure by corporations. Many have looked to the shareholder group, the owners of the enterprise, as the best agency for controlling managerial power. This approach has centered on improving the system of voting by proxy and infusing the shareholders' meeting with greater powers. Still others have contended that the constituency of the corporation includes not only the shareholder-owners but also workers, suppliers, customers and the general public, and that these groups should be

2 See Brewster, The Corporation and Economic Federalism, in Mason, supra note 1, at 72.
5 Latham, The Body Politic of the Corporation, in Mason, supra note 1, at 218, 223.
6 See generally Eisenberg, The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking, 57 Calif. L. Rev. 1 (1969).
7 A governmental program for the regulation of wages and prices has, of course, been instituted in the United States. Moreover, the Securities Exchange Commission has repeatedly taken the initiative to strengthen corporate reporting of financial and business information. See generally Schoenbaum, The Relationship Between Corporate Disclosure and Corporate Responsibility, 40 Ford. L. Rev. 565 (1972).
8 Rostow, To Whom and for What Ends is Corporate Management Responsible, in Mason, supra note 1, at 53; Schwartz, The Public Interest Proxy Contest: Reflections on Campaign GM, 69 Mich. L. Rev. 421 (1971).
represented in some way in corporate management. Another group of writers sees management power as inevitable and welcomes the strong manager who is in a position to balance the conflicting claims of all the "constituencies" of the corporation and, using principles of management ethics, to make decisions in the public interest. All of these solutions have been implemented to some extent. The past decade has witnessed the passage of new governmental regulatory measures and new forms of corporate disclosure, reform and greater use of the mechanism for proxy voting, the installation of "public-interest directors" in some corporations and a greater consciousness on the part of management of its ethical obligations toward society. But despite the partial success of these developments, there is a widely held view that larger reforms are needed.

The debate on corporate responsibility has recently shifted to new ground. Increasingly, scholars are examining and questioning the legal "constitutional" structure of the corporation, the essence and interrelationship of the legal forms required for carrying out the process of corporate decisionmaking. Is the American legal model of entrusting the management of the corporation to a theoretically unitary board of directors elected by the shareholders inherently defective? Should it be discarded in favor of another more workable system?

The principal alternative legal model for corporate decision-making in use in the western industrialized world is the "two-tier" board system, originally developed in Germany. It is based on inserting a supervisory board between the shareholder and management power centers, whose main function is to watch over the activities of the managing board. The German system was explored in 1966 by Professor Vagts who took a largely negative view regarding its possible use in the United States. Chayes, The Modern Corporation and the Rule of Law, in Mason, supra note 1, at 25, 43. See Blough, Functions of Directors under the Existing System, 27 Bus. Law. 37 (Special Issue 1972). See Vagts, Reforming the Modern Corporation: Perspectives from the German, 80 Harv. L. Rev. 23 (1966) [hereinafter cited as Vagts]. Professor Vagts has pointed out that there are many advantages in the two-tier system, however. See Vagts, The European System, 27 Bus. Law. 165 (Special Issue 1972). For a recent negative view by a German scholar see Roth, Supervision of Corporate Management: The "Outside" Director and the German Experience, 51 N.C.L. Rev. 1369 (1973).
Others have taken a more favorable view of the two-tier system. Dean Manning, in 1958, called for a new corporate model which would recognize management supremacy but would include a separate supervisory board to watch over and act as a check and balance on management.\textsuperscript{12} Professor Conard has recently proposed that the outside directors in American public corporations be given control of the shareholder proxy solicitation machinery or, alternatively, that a council of auditors be created to supervise management.\textsuperscript{13} Both of these suggestions would tend to create a two-tier system. Furthermore, the two-tier idea has shown remarkable strength in Europe outside Germany. In 1966, the French Law on Commercial Companies was modernized, and the two-tier board consisting of an executive board (directoire) and a supervisory council (conseil de surveillance) was provided as an optional alternative to the existing single tier French system.\textsuperscript{14} A commission appointed to modernize the Belgian company law has proposed that the two-tier administration be adopted as the exclusive organizational structure for a stock company.\textsuperscript{15} In the Netherlands a 1971 law requires that large companies, most of which already had a council of auditors, have a supervisory council in the image of the German system.\textsuperscript{16} The two-tier board system has received increasing favor on the supra-national level of the European Community (E.C.). The Commission of the E.C. has approved a draft of a European law for stock companies which is intended for the use of multi-national companies operating in more than one country. The two-tier system would be mandatory for companies organized and operating under this law.\textsuperscript{17} In October, 1972, the Commission agreed upon a proposed fifth directive on


\textsuperscript{14} Law No. 66-587 of July 24, 1966, J.O. (July 26, 1966) Arts. 118-50. There are, however, significant differences between the French and German two-tier systems. For an analysis see E. Stein, \textit{Harmonization of European Company Laws} 337 (1971) [hereinafter cited as \textit{Stein}].

\textsuperscript{15} For details see \textit{Stein}, supra note 14, at 126-36.

\textsuperscript{16} \textit{WETBOEK VAN KOpHANDEl} (Netherlands Corporation Code) § 50. For the background of this legislation see \textit{Stein}, supra note 14, at 150-51.

\textsuperscript{17} Doc. Com. (70) 600 final, Partie I-III Arts. 62-82.
the harmonization of the company law of the member states of the E.C. and submitted it to the Community Council for approval. This proposed directive involves the structure of stock companies organized according to national law and would require that all member states enact amendments to their respective laws instituting the two-tier system for all stock companies.\(^8\)

In view of the continuing vitality of the two-tier idea, its serious study is merited in the United States. It may well be that future reform of American corporation laws will be along the lines of developing a two-tier form for publicly-held corporations over a certain size, analogous to the movement in many states toward enacting a separate regime for decisionmaking in close corporations.\(^9\) The legally required corporate model, originally the same for the family business and the largest public enterprise, may in the future become three distinctive models, one for the close corporation, another (the unitary board system) for intermediate corporations, and still another for the large publicly-held enterprise.

II. THE PROCESS OF CORPORATE DECISIONMAKING UNDER THE TWO-TIER MODEL IN GERMANY

The two-tier model existing under German law posits three centers of power and decisionmaking, the managing board (Vorstand), the supervisory board (Aufsichtsrat) and the shareholders' assembly (Hauptversammlung). All three centers have clearly defined legal duties, rights and responsibilities which are interrelated. The following analysis will concentrate not only on the statutory scheme, but also on available empirical data as to their actual role in practice.

A. The Managing Board

The central role in corporate decisionmaking under the German system is accorded to the managing board. It consists of full-time managers who by statute are granted independent power to initiate and carry out decisions. In matters over which

\(^8\) Vorschlag einer fünften Richtlinie über die Struktur der Aktiengesellschaft, Bull. der Europäischen Gemeinschaften, Beilage 10/72, Kapitel I-II.

\(^9\) For a summary of special corporate law provisions relating to the close corporation see W. Painter, CORPORATE AND TAX ASPECTS OF CLOSELY HELD CORPORATIONS (1971).
they are given control, they may act independently and even against the wishes of the shareholder assembly and the supervisory board since they derive their power from statute and not from the shareholder assembly or the supervisory board. In order to safeguard their independence, the managers may be elected for up to 5 year terms and may only be removed for cause (wichtiger Grund).

1. Method of Election

Managers are elected by majority vote of the members of the supervisory board. There is no requirement that they be shareholders or fulfill other formal prerequisites. The only important limitation the supervisory board must fulfill in choosing managers is in the mining and steel industries, where in order to assure worker codetermination of management policies, the managing board must contain a labor manager with the special task of handling personnel and labor matters. Empirical studies of the approximately 100 companies required to employ labor managers have cast doubt on the workability of this institution. Systematic interviews of managing board and supervisory board members showed that severe problems of conflicts of loyalties and strife between the labor manager and the other board members are avoided only because the special labor manager requirement is largely circumvented. As a practical matter no labor manager is elected who is not acceptable to the managing board; if the attempt is made, the position is merely left open for a long period. Once elected, he functions merely as any other member of the board. All the persons interviewed, including the


21 AktG. § 84.

22 Id.

labor directors themselves, believed strongly that a homogeneous managing board, without special interest groups, was absolutely necessary for the success of the decisionmaking process.\textsuperscript{24}

2. **Duties and Responsibilities**

The statutory duties and responsibilities of the managing board are quite broad. They include representing the corporation and making decisions vis-a-vis third parties (Vertretung) and making and carrying out internal decisions relating to the management and economic performance of the business (Geschäftsführung).\textsuperscript{25} The latter responsibility includes those matters which are in the domain of the inside director-officers in the American public corporation, such as deciding what investments are to be made, what goods and services are to be bought and sold, what prices are to be paid and charged, where production is to take place, where financing is to be obtained and what employees are to be taken on and how much they are to be paid.\textsuperscript{26} The managers are also responsible for fulfilling financial reporting and other public and social tasks required by law\textsuperscript{27} and are given the power of initiative in basic corporate changes such as corporate divisions and mergers.\textsuperscript{28} Such basic changes, however, are subject to the approval of the shareholder assembly.\textsuperscript{29}

Although some specialization of function occurs in practice, the entire managing board is subject to liability for negligence or breach of loyalty regarding these functions.\textsuperscript{30} This liability cannot be avoided by getting the approval of the supervisory board.\textsuperscript{31} The managers must run the business in the interest of the enterprise as a whole as well as for the benefit of the shareholders who have provided the capital.\textsuperscript{32} They are also responsi-

\textsuperscript{24}This empirical data was compiled by a special commission appointed in 1968, by Chancellor Kurt Kiesinger to make a comprehensive study of codetermination (Mitbestimmung), in the context of the two-tier board model. The chairman was Kurt Biedenkopf, then Professor at the University of Bochum. See \textit{Mitbestimmung im Unternehmen-Bericht der Sachverständigenkommission 87-89} (1970) [hereinafter cited as Biedenkopf Report]. See \textit{also K. Biedenkopf, Mitbestimmung, Beiträge zur ordnungspolitischen Diskussion 83} (1972).

\textsuperscript{25}\textit{AktG.} §§ 77-78.

\textsuperscript{26}\textit{Grosskommentar} 582-83.

\textsuperscript{27}\textit{Id.} at 582.

\textsuperscript{28}\textit{AktG.} § 83; \textit{Grosskommentar} 582.

\textsuperscript{29}\textit{Grosskommentar} 586-87.

\textsuperscript{30}\textit{Id.} § 93.

\textsuperscript{31}\textit{Id.} §§ 93(4), 111.

\textsuperscript{32}\textit{Grosskommentar} 586-87.
ble, however, for the welfare of the workers and must respect the public interest. The latter responsibility, which most commentators admit is impossible to define precisely, means that the corporation must respect relevant public laws and policies, such as social policies, economic, antitrust and fair competition legislation, tax laws and environmental regulations. It must be pointed out, however, that concrete instances of liability of managing board members are relatively rare. Whether this is due primarily to the failure and inability of practical application of German liability concepts or to the success of the two-tier system as an early warning system cannot be stated with certainty. There is an empirical basis, however, for the latter view.

B. The Supervisory Council

All German stock companies (Aktiengesellschaften), except certain family companies, as well as limited liability companies (Gesellschaften mit beschränkter Haftung) with over 500 employees are required to have a supervisory board. It must include at least three and no more than 21 persons and the number must be divisible by three except in companies in the

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33 Id. at 587; see Mertens, *Politisches Programm in der Satzung der Aktiengesellschaft?*, 23 *Neue Juristische Wochenschrift* 1718 (1970) [hereinafter cited as Mertens].
34 Mertens, *supra* note 33, at 1719; Grosskommentar at 586. Until the revision of 1965, the German Stock Company Law contained an express provision requiring corporations to act in the public interest. This was dropped as unnecessary since acting in response to the public interest is implied in existing law. Grosskommentar at 586. For a critical view of the provision see Vagts, *supra* note 11 at 40-43; see also Duden, *Uher Unternehmensziele, in Recht und Rechtsleben in der sozialen Demokratie, Festgabe fur Otto Kunze zum 65. Geburtstag* 127 (1969), who argues that specific and different purposes should be developed for every large corporation.
35 It is common for the managers to regularly ask for and get a shareholders resolution largely absolving them from liability for business decisionmaking. The shareholders' derivative suit is weaker than its counterpart in American law. Grosskommentar at 740-41. See also Rittner, *Zur Verantwortung des Vorstandes nach § 76 Abs. 1 AktG. 1965, in Festschrift fur Ernst Gessler zum, 65 Geburtstag* 139 (1970); Frels, *Die Geschfstsverteilung im Vorstand einer Aktiengesellschaft, 8 Zeitschrift fur das gesamte Handelsrecht und Konkursrecht* 122 (1996).
36 The limited liability company or GMBH is a special German corporate form for companies whose shares are not traded on the stock exchanges. It does not correspond exactly to the American close corporation since many large enterprises operate in this form. The supervisory board requirement was designed to prevent evasion of the supervision requirement through the choice of the GMBH form. The supervisory board requirement must also be observed by Limited Partnerships with Shares (Kommanditgesellschaften auf Aktien), Reciprocal Insurance Cooperatives (Versicherungsvereine auf Gegenseitigkeit), Cooperatives (Genossenschaften) and some special mining associations (Bergrechtliche Gewerkschaften).
37 See text accompanying notes 102-03 infra.
38 AktG. § 95.
mining, coal and steel industries where different rules apply. Any natural person may serve on the board, but no member can take an active part in the management of the business or serve on the supervisory council of more than 10 companies. The term of office is a maximum of four years, but reelection is permitted.

1. **Method of Election**

One of the most distinctive features of the German supervisory board is the method of its election. Although the board is elected by the shareholders, only two-thirds of the members may be freely chosen by the shareholders. Agreements for the pooling of votes are enforceable, and it is common for this portion of the board to be nominees of banks, other companies and dominant shareholders. No conditions or instructions can be attached to the election of board members, however. As to the other one-third of the board members, the shareholders must elect persons named in an election by the labor force of the company. At least two of the worker representatives must be employees of the enterprise; the others are frequently national union officials.

The makeup of the supervisory board of mining, coal and steel companies is subject to different requirements. These corporations must possess a supervisory council with an equal number of worker and shareholder representatives. To break possible tie votes, the board in these industries must have an odd or neutral member who is elected by a process of "cooptation" by the agreement of the shareholder- and worker-elected factions of the board. The neutral man functions primarily as an arbitrator between the two sides; he is not a specific representative of the public interest as one writer seems to have supposed.

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39 See text accompanying notes 49-53 infra.
40 AktG, § 100(1) and (2).
41 Id. § 102(1).
42 Id. § 101(1).
43 Grosskommentar at 800-07.
44 Id. at 799-800.
45 Id. at 768.
46 Id. at 860-61.
47 Law on the Constitution of Enterprise (Betriebsverfassungsgesetz) of October 11, 1952, § 76, BGB1, I, 681, as last amended January 15, 1972, BGB1, I, 13 (1972) [hereafter cited as BetriebsVG].
48 BetriebsVG, § 76(2).
50 Id. §§ 4, 8.
51 Biedenkopf Report 69.
52 Vagts, supra note 11, at 67.
The labor members of the supervisory board in coal, steel and mining companies are chosen by an elective committee formed by the plant councils of the company.\textsuperscript{53}

The justification for this unique election procedure is found in the German theory of "codetermination" (Mitbestimmung)\textsuperscript{54} of workers, of which labor representation on the supervisory board is just one aspect. Codetermination, which will be more fully treated later in this article,\textsuperscript{55} is based upon the theory that workers in an enterprise should be provided the opportunity to "co-decide" questions which affect them individually and the work-force of the enterprise as a whole.\textsuperscript{56} Although labor representatives do not directly participate in the management of the enterprise (Geschaftsfiihrung),\textsuperscript{57} they have as much right as the shareholders to take part in the supervision of the company through representation on the supervisory board.\textsuperscript{58} The separation between the supervisory board and the management allows the representation of particular interests, the large shareholders, banks and the workers, without destroying the relative homogeneity of the management. It should be pointed out, however, that, despite their ties to particular interest groups, the members of the supervisory board are required to give priority to the interest of the enterprise as a whole. Breach of this duty of loyalty as well as breach of the duty of care gives rise to liability.\textsuperscript{59} Severe problems of loyalty can occur when there is a strike. German case law permits worker representatives to take part passively in a legal strike, but imposes liability for active participation and even passively accepting an illegal strike.\textsuperscript{60}

\begin{footnotes}
\item[53] MitbestG. § 6.
\item[54] It is unfortunate that the concrete and dynamic German word "Mitbestimmung" is translated into English by use of the abstract and static word "codetermination". Mitbestimmung in German carries the connotation of active participation in the process of decision making; this is absent from the English term.
\item[55] See text accompanying notes 114-42 infra.
\item[56] K. Biedenkopf, Mitbestimmung, Beiträge zur ordnungspolitischen Diskussion 90 (1972). For a more complete discussion of the theoretical basis of codetermination see Koch, Die Mitbestimmung der Arbeiter in Deutschland: Entstehung, Bewährung und weitere Entwicklung, in Mitbestimmung in der Unternehmung (C. Lättman and V. Ganz-Keppeler eds. 1972).
\item[57] Except in the coal, steel and mining industries, where a "labor manager" is mandatory and very controversial. See text accompanying notes 23-24 infra.
\item[58] See Schilling, Macht und Verantwortung in der Aktiengesellschaft (oder das Prinzip der Interesseneinheit), in Festschrift für Ernst Gessler zu 65 Geburtstag 159, 164 (1970).
\item[59] AktG. § 116.
\item[60] For a summary of the German case law see Grosskommentar at 768-69; (Continued on next page)
\end{footnotes}
However, Professor Vagt’s view that board members would be impaled on conflicts of interest is allayed by empirical studies of the problem carried out by the Biedenkopf Commission determining that in practice such conflicts are surprisingly rare; managing board members have confidence in the loyalty of the labor supervisory board members.\footnote{Biedenkopf Report at 72-84.}

2. Duties and Responsibilities

The supervisory council has two principal tasks. First, the council elects the members of the managing board and may remove them for cause.\footnote{Biedenkopf Report at 72-84.} Second, the council is responsible for the continual supervision of the management of the enterprise.\footnote{Id. § 111(4).} In its supervisory capacity, the board is charged with overseeing and advising on the policies of the company, its profitability, its economical operation, its treatment of social and labor questions and its compliance with public laws, regulations and social policies, although the supervision and advice may not extend to disturbing the initiative of the managing board or taking over the operation of the business.\footnote{Id. § 87(1).}

In addition to these two major tasks, the council has other important duties. It fixes the wages, pensions and deferred income of the members of the managing board.\footnote{AktG. § 87.} Each member’s total compensation must be in proportion to his activities and position in the company.\footnote{Id. § 87(1).} The company may extend credit to a member of management only with the approval of the supervisory board.\footnote{AktG. § 89.} These rules go far to eliminate the inherent conflict of interest regarding compensation in American law, where inside directors sit on the board which fixes their salary and fringe

\footnotesize{(Footnote continued from preceding page)}

\footnotesize{Fischer, \textit{Minderheiten-Vertreter im Aufsichtsrat}, 11 \textit{Neue Juristische Wochen-}
\footnotesize{schrift} 1265 (1958).}
\footnotesize{\footnote{See Vagt, \textit{supra} note 11 at 74-75.}}
\footnotesize{\footnote{Biedenkopf Report at 72-84.}}
\footnotesize{\footnote{Id. § 111(1). This separation of supervision from active management is the most distinctive feature of the two-tier system. In Germany the unitary board system has been rejected because under the latter this separation of functions would no longer exist. See K. Biedenkopf, C. Clausen, G. Geilen, H. Koppensteiner, A. Kraft, H. Kronstein, M. Lutter, H. Mertens and W. Zollner, 5 \textit{Kolner Kommentar zum Aktiengesetz} 805 (1973).}}
\footnotesize{\footnote{AktG. § 111(4).}}
\footnotesize{\footnote{Id. § 87.}}
\footnotesize{\footnote{Id. § 87(1). Supervisory board members can be personally liable for breach of this rule. Grosskommentar at 676.}}
\footnotesize{\footnote{AktG. § 89.}}
The council also checks the annual report of the independent auditors and makes a yearly report to the shareholders on the state of the enterprise. By majority vote it can call a special meeting of the shareholders.

The corporate charter can also provide that certain management decisions such as major investments, financing, acquisitions and changes in the business require the approval of the supervisory council. If the council withholds its consent, and the managers wish to go through with the measure, they can do so only by obtaining the approval of three-fourths of the shareholders. Such a provision is common in German corporate charters. This provides a check on management power and consideration of important decisions by a separate body that can avoid unwise decisions.

3. Practical Effectiveness

The effectiveness of the supervisory board is a subject of great controversy in Germany. It is charged that such a body is unnecessary since it is dominated by banks, which are often the dominate voting blocks in Germany, and by the large shareholders aligned with management. This contention has been at least partially rebutted by empirical studies. The Biedenkopf Commission, which was set up to study codetermination and the supervisory board, examined the membership of the boards of a representative sample of German industry and found that, although shareholders dominate the supervisory councils of smaller companies, the board membership in publicly-held companies is drawn primarily from universities, politics and administration. The commission also determined that surprisingly few members come from the banking industry. Approximately half of the sample

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69 The compensation of the members of the supervisory board is in turn fixed by the shareholders. Id. § 113.
70 Id. §§ 111, 170-73.
71 Id. § 111(3).
72 AktG. § 111(4); Grosskommentar at 581, 880-85. As a general rule, before taking any important decision, the managing board will consult with the supervisory board members. Interview with leading German banking official in Frankfurt, West Germany, June 8, 1973 [hereinafter cited as Interview].
73 See text accompanying notes 108-09 infra.
74 See GUTENBERG, FUNKTIONSWANDEL DES AUFSCHEITATES, ERGANZUNGHEFT, ZEITSCHRIFT FUR BETRIEBSWIRTSCHAFT 1-10 (Dec. 1970).
75 See note 24 supra.
76 Biedenkopf Report at 57.
had no bank representative. The commission concluded that the advisory and supervisory functions of the supervisory board were especially important in large publicly-held companies.

A more serious criticism of the supervisory council is that it tends to be a weak body dominated by the management of the company. It tends to be a part-time body whose busy members meet only a few times a year. There is serious question whether such a group can exercise independent judgment on the policies of the corporation.

The empirical evidence compiled by the Biedenkopf Commission lends some support to this view. Its study of supervisory board decisionmaking showed that in practice differences of view between the managers and the supervisory council as well as within the council itself are rare. Much of the time, decisions of supervisory councils are taken without dissent.

The commission, however, extensively interviewed supervisory council members and others to determine why this situation exists. It found that differences of opinion between council members and between the council and the managers are usually resolved prior to the formal decisionmaking in informal discussions and negotiations. Information is transmitted to the council and they are asked their opinion. The council members are given at least an opportunity to shape the decisions of the managers. The Biedenkopf Commission judged these informal negotiating sessions to be beneficial both to the managers and the council. Others, however, have taken a more negative view, maintaining that the negotiations give the managers the opportunity to dominate the council, endangering its independence.

Perhaps this difficulty can be best resolved by strengthening the powers of the supervisory board. A more detailed enumeration

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77 Id. at 57, 220.
78 Id. at 56.
79 The foremost proponent of this argument has been R. Wiethölder, Interessen und Organisation der AG im amerikanischen und deutschen Recht 295-314 (1961). Professor Wiethölter believes that as a result the unitary board system should be adopted in German law. See also E.J. Mestmacker, Verwaltung, Konzerngewalt und Rechte der Aktionäre 83-88 (1958); Vagt, supra note 11 at 52-53.
80 Biedenkopf Report at 62, 221.
81 Id. at 221.
82 Id. at 62-64.
of its statutory powers and responsibilities may be needed.\textsuperscript{84} Moreover, the council could be transformed by requiring a certain number of its members to be full-time professionals with their own staff and with continual access to information independent of that provided by the managing board.\textsuperscript{85} This would go far to guarantee and protect the council’s independence.

Still another problem exists with respect to the process of decisionmaking within the supervisory council. At present there are few legally required formalities. Decisions are taken by majority vote, and the chairman must prepare and sign a statement of the decision taken.\textsuperscript{86} In practice, however, most matters are delegated to committees.\textsuperscript{87} Although this delegation of power cannot be used to discriminate against any group of members\textsuperscript{88} and some decisions, such as the election of the managing board, cannot be delegated,\textsuperscript{89} there should be a requirement of common participation in all decisions.

4. Sources of Information

If the supervisory board is to function properly, it must be adequately informed about the enterprise. German law requires the managing board to provide information to the supervisors. At least once a year, the supervisors must be given an account of the business operations of the past year. This includes financial statements and a report on the success of the business.\textsuperscript{90} In addition, at least once every quarter, the supervisors are provided with an account of the present state of the business including workers employed, price and wage developments, orders received and financial liquidity.\textsuperscript{91} The managers must also provide an annual report on their plans for the future encompassing basic plans and policies, market analyses and trends, advertising,

\textsuperscript{84} See Hillert, Gedanken zur Erweiterung der Mitbestimmung der Arbeitnehmer, 1970 Betriebs-Berater 1258, 1259.
\textsuperscript{85} See Mertens, Unternehmensverfassung: Aufsichtsrat oder board system, 25 Wirtschaftswoche 31, 84 (1971). It is presently the practice of some German companies, especially banks, to employ full-time supervisory board members. Interview, supra note 72.
\textsuperscript{86} AktG. § 107-08.
\textsuperscript{87} Grosskommentar at 849-50.
\textsuperscript{88} Id. at 850, 861.
\textsuperscript{89} Id. at 851.
\textsuperscript{90} AktG. § 90(1).
\textsuperscript{91} Id.
investments and financing, and projected sales and profits. Members of the council have a right to information on the details of the business at any time, but this is seldom exercised.

It is evident that, despite the statutory guarantee of adequate information, all information that the supervisors receive is filtered through the managing board. This dependence on management is not conducive to the supervisory council's role of providing independent advice and supervision. It is thus important to strengthen this aspect of the council's role by giving the supervisors original and continuing access to information about the enterprise. In large companies the supervisors should have independent access to information through the use of modern computer technology. Furthermore, to enhance the participation of the individual worker through their representatives on the supervisory council, channels for the direct and frequent exchange of information and ideas between the supervisors and the individual workers could be set up using modern methods of communication. It is evident that full implementation of these ideas would be impossible without also requiring a certain number of supervisors to be full-time professional employees. A possible solution for reform of the German law would be to require three professional full-time supervisors, one named by the workers, one selected by the white-collar employees and one by the shareholders. The remaining part-time council members could be elected one-half by labor and one-half by the shareholders. There should be, in addition, a requirement that the full-time supervisors have certain qualifications as experts in a relevant field to assure that they would be able to do more than merely represent the interests of the respective groups.

5. The Supervisory Council and the Public Interest

In the German two-tier model, although the managers have a duty to act with regard to the public interest and social poli-
cies, it is the supervisory board that is designed to play the key role in seeing that the company fulfills this responsibility. Thus any evaluation of the supervisory board must consider how well it carries out this function.

There is no lack in the German literature of commentary on the responsibility of the managers and supervisors to act in the public interest. It is the herrschende Meinung (dominant opinion) that the obligation to respect the public interest remains "immanent" in German corporate law despite the 1965 omission of the express corporate law provision relating to the public interest which had existed since 1937. German scholarship admits that the concept "public interest" cannot be precisely defined, but it is looked upon as the responsibility of the corporation to implement all relevant public and social laws and public policies. Non-adherence to a public obligation provides sufficient cause (wichtiger Grund) for the removal of a manager by the supervisory board, and, if the corporation suffers damage, the managers are liable.

Beyond the theoretical exposition of responsibility to the public, however, it is very difficult to detect concrete cases of application of these principles in German law. There are no examples of classic confrontations between valiant public-minded supervisors fighting for the public interest against obdurate managers.

It may be too rash to conclude that the supervisory model has entirely failed, however. There is some empirical evidence that would indicate that the supervisors in the German system succeed in asserting the public interest, although through ways more subtle than complete confrontation with management. Two findings of the Biedenkopf Commission are relevant in this regard. First, in its study of the membership of supervisory boards, it found that, at least in publicly-held companies, the dominant

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96 See text accompanying notes 33-34 supra.
97 Mertens, supra note 33, at 1719.
98 For the most recent see Duden, supra note 34; Mertens, supra note 33, at 1719; Saage, supra note 92, at 42-43; Schilling, supra note 58; Winkler, Nichtge
99 Grosskommentar 586.
100 Id.
101 Mertens, supra note 33, at 1719.
influence was exercised by people drawn from public professions, universities and administrative backgrounds, persons ideally suited to exercise an influence in favor of public responsibility.\textsuperscript{102} Second, in systematic interviews of supervisors and managers, the commission found that the supervisors tend to "filter" management initiatives and to exert influence in favor of social and public policies, although this is no substitute for adequate control of the corporation by relevant state agencies and other public officials.\textsuperscript{103} The influence of the supervisors is most effective when the interest of the public happens to coincide with the interest of the company, as it often does, if for no other reason than that the company may be subject to civil or criminal liability or adverse publicity for failure to carry out a public duty. It may be utopian to expect more than these subtle effects from any internal corporate institution.\textsuperscript{104}

C. The Shareholders Assembly

The shareholders under the German two-tier model are responsible for electing the members of the supervisory board, selecting the independent auditor, amending the charter, raising and lowering the capital of the company, approving basic corporate changes such as mergers and dissolution and deciding the use of the yearly profits of the business.\textsuperscript{105} The shareholders may also, at the request of the managers, pass on the business policies of the company, but the shareholders' decision is not binding on the managers and the procedure is used chiefly to assure that the managers will not be liable to the company for the decision involved.\textsuperscript{106}

In actual practice, the shareholders in smaller companies tend to dominate the supervisory and managing boards and to identify with management, while in larger public companies the position of the shareholders is very weak. In the latter, as in their American counterparts, the shareholders generally do not contest the initiatives of the managers in such matters as basic corporate changes

\textsuperscript{102} Biedenkopf Report at 56-57.
\textsuperscript{103} Id. at 64, 73, 191.
\textsuperscript{104} K. Biedenkopf, Mitbestimmung, Beiträge zur Ordnungspolitik der GmbH-Diskussion 30-31 (1972).
\textsuperscript{105} AktG. §§ 119, 319, 340, 359.
\textsuperscript{106} Id. § 119(1); Grosskommentar at 582.
and selection of the independent auditors. The central task of the shareholders is the election of the supervisory board, but even here the individual shareholder in a publicly-held company has very little say. German law allows the voting rights of individual shareholders to be exercised by banking and credit institutions, which in the German system exercise underwriting and broker-dealer functions and act as depositaries of the shares of clients.

Much has been written about the evil influence of the banks in the two-tier system and the healthy lack of such in the American law. Certainly to proponents of shareholder democracy, the German situation is anathema. However, certain factors have generally been overlooked in evaluating the bankers depositary vote. First, it may be preferable to give voting power in publicly-held corporations to credit institutions with power, interest and a financial stake as underwriters and broker-dealers in the business, than to allow it to be exercised by management through its control of the proxy solicitation machinery as in the American system. If the German system is not perfect, at least the managing board is not given control of its own election. Secondly, although the credit institutions in Germany certainly have a great influence on the supervisory councils, empirical studies have shown that, at least in larger corporations, the control by the banks is less than had been supposed. It is further diminished by the mandatory representation of labor representatives on the supervisory board. Third, the natural competition between banking institutions and their desire to satisfy their clients tend to act as checks on any attempt by the banks to run corporations exclusively in their own interest.

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107 See Zimmerer, *Die Organe der Aktiengesellschaft und die Stellung des Wirtschaftsprüfers*, 1966 NEUE BETRIEBSWIRTSCHAF 44.

108 For a complete account see Vagts, *supra* note 11, at 53-58.

109 *Id.;* H. Busse, *Depotstimmberecht der Banken* (1962); *see also* Von Falkenhausen, *Das Bankenstimmberecht im neuen Aktienrecht*, 1966 DIE AKTIENGESELLSCHAFT 69.


111 Biedenkopf Report at 57.

112 See text accompanying notes 47-53 *supra*.

113 See Möhring, *supra* note 110, at 137.
III. Worker "Co-Decisionmaking" (Mitbestimmung) Under the German Model

Although worker codetermination in Germany is an integral part of the two-tier model, it is also much more than that and requires separate treatment. Mandatory worker representation on the supervisory board, treated above, is only one of many German corporate and labor law institutions designed to assure the cooperation of capital and labor and to give the individual workers a voice in decisionmaking. It exists on several other levels independent from the supervisory board.

A. The Institutions of Codetermination

At the enterprise level (Unternehmensebene) German law provides for codetermination through worker representation on the supervisory board and, in coal, steel and mining companies, through the labor manager. Almost as important is codetermination at the plant level (betriebsebene) and at the level of the individual worker (Ebene des einzelnen Arbeitnehmers). At the plant level, the chief institution of codetermination is the plant council (Betriebsrat), which represents and is elected by the workers of each plant. It must be consulted regarding the social, personal and economic interests of the workers, including such matters as lay-offs, firings, vacations, plant relocations and working hours.114 A quota system insures the representation of younger workers and minorities on the plant councils.115 Where an enterprise has several plants, there is provision for the formation of a council consisting of representatives from the individual plant councils (Konzernbetriebsrat).116 In addition, larger enterprises must appoint an economic committee (Wirtschaftsausschuss) with members drawn from the plant councils. It has little decisionmaking power, but it must be consulted regarding questions of business policy.117

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114 BetriebsVG. §§ 7, 87. German collective bargaining contracts are normally less comprehensive than American agreements and leave such matters to the plant councils. See K. Biedenkopf, Mitbestimmung, Beiträge zur Ordnungspolitischen Diskussion 90-91 (1972).
115 Id. § 10.
116 Id. § 54.
117 Id. §§ 106-13.
A 1972 revision of the law dealing with codetermination strengthened the workers' individual rights and increased codetermination at the plant level. The representation of interest groups and minorities was strengthened, the job security and personal rights of the workers were guaranteed, provision was made for more adequate channels through which complaints and ideas of individual workers could be heard and the voice of the plant councils was strengthened as to personnel policy and social matters.\textsuperscript{118}

B. Evaluation of Codetermination in Germany

Although the institution of codetermination overlaps partially with the two-tier system, it is analytically distinct and must be evaluated separately. A fairly complete evaluation is possible because of the amount of empirical data that has been gathered in Germany, but the working of codetermination cannot be measured with scientific exactitude. The effects are not dramatic and conspicuous, but are subtle and hidden among other factors. Neither the extreme fears nor the equally extreme expectations which were voiced when the initial codetermination laws were passed have been realized. The institutions have proved to be compatible with the German constitutional guarantee of private property as well as the market economy in Germany. Although it has not produced a "new day" for workers, it has contributed to their material and social welfare.

One of the foremost advantages of the codetermination institutions, including worker representation on the supervisory boards, has been greater cooperation between labor and management. This has been confirmed through extensive interviews. The obligation of both sides to work together in common institutions has produced an increased understanding of the problems and arguments of each side and has contributed to better informed individual workers.\textsuperscript{119} An opinion poll conducted in 1966 with a view toward examining the individual worker's opinion of codetermination showed that within German industry less than 10\% of the workers feel "badly informed" as to the organization,

\textsuperscript{118} For a complete summary and analysis of the changes made by the 1972 revision see Hromadka, \textit{Betriebsverfassungsgesetz 1972}, 25 \textit{Neue Juristische Wochenschrift} 183 (1972).

\textsuperscript{119} Biedenkopf Report at 118-19.
production, social relationships and technology in their plant.\textsuperscript{120}

Through better communication and exchange of information, codetermination seems to have had an indirect effect on higher wages and fringe benefits, although it is not possible to posit a direct cause and effect relationship because wages in Germany are generally negotiated at the industry level.\textsuperscript{121} Codetermination can result in greater social benefits which are negotiated at the plant level, however,\textsuperscript{122} and a significant percentage of German workers believe higher wages to be a result of codetermination.\textsuperscript{123}

Regarding worker job security and lay-offs, there is evidence that codetermination, especially through the presence of worker representatives on the supervisory board, tends to delay employment cut-backs until arrangements can be made to ease the impact of he measures on the workers involved. In this manner, codetermination acts as a social corrective on management decisionmaking.\textsuperscript{124} A poll of 1000 industrial workers in 1966 showed that 59% were of the opinion that through codetermination layoffs would be avoided and 23% believed that they would be laid off only after very careful consideration by management. Only 11% responded that they would be completely unprotected while 7% had no opinion on the matter.\textsuperscript{125}

A further advantage of codetermination in Germany is the institutional setting and obligation it provides for the otherwise abstract legal duty of management to be responsible to the workers of the enterprise.\textsuperscript{126} Interviews of managers conducted by the Biedenkopf Commission showed that through the institutions of codetermination managers considered their obligations

\textsuperscript{120} Erdmann, Der Mythos von der Mitbestimmung-Eine Emnid Umfrage klärt Tatbestande, 13/14 Der Arbeitgeber 351, 381-82 (July 20, 1966).
\textsuperscript{121} Biedenkopf Report at 161-62; Vagts, supra note 11, at 69-70.
\textsuperscript{122} Biedenkopf Report at 162.
\textsuperscript{123} An opinion poll by the Allensbacher Institute in 1968 showed that 51% of the workers in the coal and steel industry (with parity representation on the supervisory board) believed codetermination results in increased fringe benefits and 22% believed it results in higher wages. REPRÄSENTATIVVEREIBUNG ZUR PARTITATISCHEN MITBESTIMMUNG DES INSTITUTES FÜR DEMOSKOPIE ALLENSBACH 5 (October, 1968).
\textsuperscript{124} Biedenkopf Report at 80-82.
\textsuperscript{125} Erdmann, supra note 120, at 382. The corresponding figures for mining, coal and steel industry workers were 42%, 20%, 28% and 10% respectively. Id. It is interesting to note that in the latter industries, while there is equal representation of workers and shareholders on the supervisory board, the individual workers do not directly elect these representatives; they are named by the plant councils. See text accompanying note 53 supra.
\textsuperscript{126} See text accompanying note 33 supra.
to the employees to be an integral part of their job.\textsuperscript{127} This has had a positive effect on workers morale. A recent opinion poll of workers in the mining, coal and steel industry showed that codetermination helps them identify with their company and feel a measure of satisfaction with their work.\textsuperscript{128}

The institutions of codetermination seem to have a beneficial social effect without harming the profitability of the enterprise. The Biedenkopf Commission concluded from interviews and questionnaires that while the principle of maximization of profits still reigns as the leading corporate purpose, the profit motive is tempered by the worker representatives' call for legal and social responsibility. The Commission also found that codetermination had not harmed management initiative regarding the financial, investment, dividend, production or product policies of German enterprises. The worker representatives tend to let the managing board have a free hand in these matters while merely supervising the social effects of board policies. The presence of the worker-supervisors also facilitates collective bargaining and avoids strikes because of the freer access of the workers to information about the enterprise.\textsuperscript{129}

C. Proposals for Extending Codetermination in Germany

Codetermination of workers, including their representation on the supervisory boards, is now well-accepted in Germany. All significant political parties and groups affirm its place in German society. This acceptance has led to proposals for its further extension, many of which have been the source of great controversy. These proposals may generally be divided into two categories: first, ideas for greater participation by the individual worker and second, the demand that workers be given greater representation on the supervisory councils.

Proposals for greater participation by the individual worker are based on a very real defect in the institution—the personal involvement of the individual employee is relatively slight. The system is basically representative. Once every three years, the

\textsuperscript{127} Biedenkopf Report at 120.

\textsuperscript{128} 21% of the workers stated they were very satisfied in their job, 51% were quite satisfied, 12% were not very satisfied and 12% were dissatisfied (4% had no response). Erdmann, \textit{supra} note 120, at 382.

\textsuperscript{129} Biedenkopf Report at 78-84, 188-46. No significant problems of keeping corporate industrial secrets were found. \textit{Id.} at 146.
individual casts his ballot in the election of the plant council, and he participates also in the direct election of members of the supervisory board in enterprises which have one-third worker representation. In the coal, steel and mining industries, which have parity worker representation on the supervisory board, the individual has no right to vote in this second election since the worker-supervisors are elected by the plant councils. Moreover, approximately one-third of the labor members of the supervisory board can be and usually are officials of the national unions who do not have to be employees of the company. Thus, despite changes in the 1972 law providing better handling of the complaints and ideas of the individual worker, great numbers remain basically outside the system. To correct this, some German writers have called for the formation of smaller councils closer to the level of the individual worker and his problems. Through the better use of modern methods of communication and even computer technology, the individual workers and such smaller councils, as well as the plant council, could be kept informed about the policies of the company and given an opportunity to express opinions and ideas. The influence of the national unions on the supervisory board should be decreased; all supervisory board members should be elected directly by the workers of the company.

Demands that workers be given greater representation on the supervisory councils are based on the argument that real “co-decisionmaking” by workers requires that they be given parity representation with the shareholders. The national labor unions are in the forefront of this movement. Relying on the empirical material amassed by the Biedenkopf Commission, they call for parity worker representation (plus a “neutral” member to arbitrate and break possible tie votes) and a labor manager for all enterprises with over 2000 employees, a balance sheet total

130 BetriebsVG. § 18(1).
131 Id. § 76(2).
132 MitbestG. § 6(1).
133 BetriebsVG. § 76(2); Biedenkopf Report at 57-61.
134 See note 118 supra and accompanying text.
(Bilanzsumme) of more than 75 million DM and annual sales of over 150 million DM. The Social Democratic Party (SPD) has supported the unions' call for parity between workers and shareholders, but their proposal omits the requirement of a labor member of the managing board. The Free Democratic Party (FDP), which together with the SPD forms the present ruling coalition in Germany, agrees in principle with the idea of parity representation, but would allocate some of the seats on the supervisory board specifically to white-collar workers. The Christian Democratic Party (CDU) has been the leading opponent of parity representation. The CDU's position is in a state of flux, however, and it is expected that a new proposal will be approved at the party convention in October, 1978.

One of the most complicated proposals for the extension of codetermination was made by the Biedenkopf Commission. It calls for greater worker representation but not parity. For every twelve supervisory board members, four would be elected by the workers, six by the shareholders and two others would be chosen by majority vote of the worker and shareholder representatives. To compensate for the greater number of shareholder representatives, the labor minority would be given a few compensating rights. The supervisory board would be forbidden to form committees without worker representation. The minority in any vote would be allowed to explain their position in a report to the shareholders and could compel the majority to state the basis for its decisions to the other corporate organs. A special committee with parity representation of workers and shareholders would select the members of the managing board.

It is somewhat surprising that in Germany the question of

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139 See Arbeitnehmermitbestimmungsgesetz: Gesetzentwur der Fraktion der CDU/CSU, in LIESER, supra note 135, at 126-40.


141 For a full explanation of the proposals see Biedenkopf Report at 171-74.
codetermination has been treated as separate from the reform of the supervisory board since codetermination should take place on several different hierarchial levels, from small groups at the sub-department level up to the worker representation on the supervisory board. Information and ideas should pass freely not only from the lowest level to the highest but also from the highest to the lowest. Each level should have appropriate decisionmaking powers. It is obvious, then, that reform or the extension of codetermination should not be considered apart from reform of the supervisory board. The professionalization of the supervisory board, as suggested above, would increase the effectiveness of worker codetermination not only at the supervisory board level but, because of increased information gathering and dissemination, at the lower levels as well.

IV. THE RELEVANCE OF THE TWO-TIER MODEL AND CODETERMINATION FOR AMERICAN LAW

In the United States, an increasing number of scholars are seriously examining the need for restructuring the American corporation. The two-tier German model is an alternative structure which has operated successfully, although not flawlessly, in another legal system. Would the two-tier system work in the United States? Is it compatible with our existing law and institutions?

The foregoing analysis of the two-tier model and codetermination shows that the German system should not and cannot be inserted into American practice without substantial modification. This would do violence to the many American corporate, securities, and labor law concepts and practices that have no counterpart in German law. Furthermore, the weaknesses of the German system must be avoided.

In particular, it should be stressed that the two-tier model is not appropriate for all corporations. It should not affect close corporation practice, and it is not suited to medium-sized corporations which are dominated and controlled by a few major shareholders. The German experience shows that in the latter companies, the supervisory board tends to be an unnecessary body, controlled by the dominant shareholders who also manage

142 See text accompanying notes 85, 94 supra.
the corporation. On the other hand, the supervisory council has been shown to work best in corporations with large and widely dispersed shareholder groups. In American law, then, it would seem that consideration of the two-tier system should focus on its possible use as a special legal form for large, publicly-held corporations.

It is also highly questionable whether the entire machinery for worker codetermination can be carried over into American law. American labor law has a distinctive character and is much more comprehensive than its German counterpart. There are indications that distinctive institutions in the United States accomplish at least a substantial part of what codetermination provides under German law. The scope of collective bargaining is particularly narrow in Germany, being carried out on the industry level and seldom involving more than just wages. In contrast the United States tends to have strong local unions which are well organized within individual plants. Collective bargaining agreements and the duty in American law to bargain in good faith regulate most of the areas such as vacations, working conditions, hours, lay-offs and plant relocations that are taken care of by codetermination in Germany.

There is no American institution, however, which is analogous to German codetermination at the enterprise level (accomplished through labor representation on the supervisory board). This might be introduced in the United States; however, the German experience, which shows the necessity of a relatively homogeneous management group, indicates that worker representation should not be introduced in the United States without a

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143 Biedenkopf Report at 56.
144 Id. at 56-57.
146 Bok, supra note 145, at 1406-11.
147 Id. See also K. Biedenkopf, Mitbestimmung, Beiträge zur ordnungspolitischen Diskussion 90-91 (1972). It is true, of course, that in the United States only about one-fourth of the employees that could avail themselves of unionism under Federal law have actually done so. As to non-unionized employees there is still unilateral employer determination of the terms and conditions of employment except as regulated by statute. Thus there is room for further study of codetermination at the plant level under German law and its appropriateness for American law. Such a study would have to focus on the labor law aspects of codetermination which is largely beyond the scope of this article, which is concerned primarily with codetermination as an institution of corporate law.
148 See text accompanying note 23-24 supra.
Two-Tier Board Model

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corresponding introduction of the two-tier system. By providing a homogeneous management and an independent supervisory board, an American two-tier model would allow management's responsibility to the employees of the company to be institutionalized without disrupting management's prerogative to initiate action on such things as investment, financing, pricing and product determination.

The best focus for grafting the two-tier system onto American law would seem to be to change the role and make-up of the outside directors of the American large publicly-held corporation. At present the outside directors, despite the fact that under corporate statutes they have as much responsibility for the management of the corporation as the insider director-officers, exercise a weak and subsidiary role. In theory their purpose is to supervise and advise management, but in practice they tend to be loyal and to represent the insiders who gave them their jobs. Since outsiders have little contact with the corporation except at infrequent directors' meetings, they rarely voice strong objections to management policies and let the insiders control the direction of the corporation. In the past few years there has been the beginning of a trend in the courts to ameliorate this situation, giving outside directors new responsibilities for safeguarding investor interests.

The use of the two-tier model could accentuate and strengthen this trend by transforming the outsiders into a truly supervisory body and assuring both their independence from active management and their practical effectiveness. The first step could be to do away with the legal fiction which under present corporate statutes makes outsiders, at least under the language of the statutes, equally responsible with the inside board for the management of the corporation. Instead, their duties should be separate from the insiders' duty to manage. Second, new con-

150 Mace, Functions of Directors under the Existing System, 27 Bus. LAW. 32, 33-35 (Special Issue 1972).
151 Conard, supra note 13, at 917.
152 See Mace, supra note 150, at 35-37; see generally M. MACE, DIRECTORS: MYTH AND REALITY (1971).
cepts should be developed to define their duties, responsibilities and functions as supervisory and advisory. American law should define these duties and the decisionmaking process in more detail than the German law, which is very vague and weak in this area.\textsuperscript{154} Third, at least some of the members of the supervisory body should be required to be full-time employees, expert in a relevant discipline, to avoid the pitfall in German law of a weak supervisory council.\textsuperscript{155} Fourth, the outside supervisory board could be required to be a pluralistic group, including perhaps employee representatives directly elected by the work force of the company, so that people of differing backgrounds would be included.

This latter point would be very controversial in the United States. It is possible, of course, to adopt the two-tier form through strengthening the role of the outside directors without mandatory worker representation. But German studies seem to prove the value of worker representation. The conflict of interest problem is not so severe as had originally been thought; workers have a stake in and are interested in furthering the profitability of the company, and this institution has been particularly useful for protecting the workers’ social and individual interests. The large corporation has developed into a socio-political bureaucracy in which the workers’ individual desires are often ignored by union and company alike. The development of an institution to safeguard such matters coincides with the long term trend of the law to emphasize individual rights as compared to the historical preoccupation with property rights.

The exact number of worker representatives would be a source of much discussion, as it has been in Germany. Parity representation of workers and shareholders might seem desirable since this would recognize the equality of both factors of production—labor and capital. Moreover, in the large corporation the worker is more closely associated with the corporation than are the shareholders. On the other hand, the Biedenkopf Commission found that the advantages of codetermination on the enterprise level can be obtained without parity.\textsuperscript{156} Perhaps the best solution

\textsuperscript{154} See note 84 supra.
\textsuperscript{155} See text accompanying notes 79-85.
\textsuperscript{156} Biedenkopf Report at 182-84.
would be to deemphasize the "interest group representation" on the supervisory board and to provide that all the members, no matter how or by whom elected, have the clear responsibility of assuring the well-being of the organization as a whole, not just the interests of their narrow constituencies.

Fifth, to further strengthen the outside directors and to transform them into a true supervisory group, they could be given control of the proxy solicitation machinery. This would be analogous to the German practice in which the supervisory council has the power to select and remove members of the managing board. This would provide a curative effect to our present system which, although based on the theory of shareholder democracy, allows management to control its own election through its control of the solicitation of proxies.

This transformation of the outside directors in the publicly held corporation into a supervisory body with real strength should not, of course, replace external regulation by the SEC and other governmental agencies. Such external governmental control and supervision has proved its worth and should continue. The supervisory group could, however, provide a valuable supplement to the work of the public agencies in addition to its role of providing correctives to management's business decisions. In contrast to government agencies, which are removed from the decision-making process and whose staffs are often overburdened, the supervisory group would be close to the process of decisionmaking and able to influence its formative stages.

The separation of the managerial and supervisory-advisory functions would have many advantages. The supervisors could exercise preventive control and give independent advice on the wisdom of business and financial decisions. In addition, the functional separation of active management and supervisors could ameliorate the presently vague and overly-broad liability standards of American corporate law. Instead of liability concepts so indeterminate that they are rarely applied, the liability of directors could be more closely defined in relation to their respective functions. The supervisory group could

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157 Conard, supra note 13, at 918.
158 See text accompanying note 63 supra.
159 See Conard, supra note 13.
also be given the task of deciding matters such as management salaries, corporate opportunity, conflicts-of-interest, and other matters in which the managers have a self-interest. This would seem to be a better solution to conflict-of-interest problems than the present American doctrine of approval by the disinterested directors, which opens the way for reciprocal dealings.\textsuperscript{160}

Strengthening the role of the outside directors could also influence the corporation to act more responsibly in relation to the public interest. This need not mean that the supervisory groups would relegate the growth and profitability of the enterprise to a subsidiary status. Instead the role of supervision would be to assure that public, consumer, safety and environmental laws and public policies be strictly adhered to by the corporation and that profits be maximized within the confines of public laws and policies.\textsuperscript{161} The naming of specific "public interest" directors may not be necessary and may be counterproductive. A pluralistic board of supervisors, including employees of the company, could be expected to assert different kinds of public responsibilities without the necessity that individuals specifically have a responsibility to assert the interests of any one group, be it the public or the workers.\textsuperscript{162} They should all individually and collectively have the responsibility of weighing and balancing the competing factors and interests involved in the process of decisionmaking.

\textbf{V. Conclusion}

The two-tier model for the structure of the modern corporation is an interesting focal point for corporate law reform both in Germany and the United States. In Germany, although the model has proved its value, reform is needed. The supervisory board of the German corporation should be strengthened to assure its independence from active management and its practical effectiveness through the requirement that a certain number of its


\textsuperscript{161} This necessity is admitted by the most die-hard adherents of the profit maximization principle. See Rostow, supra note 1, at 67.

\textsuperscript{162} This is borne out by the German practice. See text accompanying notes 102-04 supra. The Biedenkopf Report rejected the idea that in Germany the supervisory board should contain specific "public interest" members. Biedenkopf Report at 191-93.
members be devoted full-time to their duties and be qualified experts in an area relevant to their function. The number of worker representatives on the supervisory board should be increased, and a greater effort is necessary to involve individual workers in the "co-decisionmaking" process.

In the United States, the two-tier system should not be introduced without greatly modifying it and adapting it to American legal institutions. The two-tier model can, however, point the way to American corporate law reform through strengthening the role of the outside directors in the large, publicly-held corporation and transforming them into a true supervisory and advisory body.