PRIVATE LAW

The Mannesmann Trial and the Role of the Courts

By Peter Kolla[*]

A. Introduction: *Germany Inc.* on Trial

The *Financial Times* billed the Mannesmann trial, which began on January 21, 2004 and where final arguments by the prosecution and by the defense are scheduled for June 30, July 8 and 14, 2004 before the Regional Court (*Landgericht*) in Düsseldorf, as the "biggest criminal trial in German corporate history."[1] The backdrop for the trial was the January 2000 hostile takeover of Mannesmann AG, the once massive German telecommunications and engineering company that employed over 130,000 people. Vodafone Airtouch, the British telecommunications giant, had initially offered €101 billion for Mannesmann but only succeeded in their takeover by sweetening the price to €178 billion. Consequently, the Mannesmann takeover is still the largest the world has ever seen.[2] The six defendants include towering figures in corporate Germany, most notably Josef Ackermann, the current chief executive of Germany's largest bank, Deutsche Bank and former member of Mannesmann's supervisory board (*Aufsichtsrat*). The enormity of the companies and personalities involved stretched the trial's magnitude beyond the confines of this single takeover. Reporting for their global business audience, the *Financial Times* conflated the trial to an indictment of Germany's entire system of capitalism.[3] "What is on trial here is the free market itself," wrote Wolfgang Munchau, their continental European business columnist.[4]

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[1] Patrick Jenkins, *Germany on Trial*, FINANCIAL TIMES (15 January, 2004), *available at* <http//:www.ft.com>.

[2] Peter Thal Larsen & Tim Burt, *Comcast Looks to Snatch Disney with $61.5bn Bid*, FINANCIAL TIMES [US EDITION] (12 February, 2004) 1. For the sake of comparison, the hostile takeover of Disney by Comcast was worth $61.5 billion US, or €48.5 billion, when it was announced on Feb 12, 2004.

[3] Jenkins, *Germany on Trial*, *supra* note 1.

[4] Wolfgang Munchau, *Market Economics is in the Dock in Germany*, FINANCIAL TIMES [US EDITION] (26 January, 2004) 13.

B. Executive Compensation as an Element of (Different) Corporate Culture(s)

These pronouncements seem somewhat hyperbolic, though, when placed alongside the legal issue upon which the case turns: did six former directors of Mannesmann commit *Untreue*, or breach of fiduciary duty, when in the aftermath of the takeover they approved, *in good faith*, awards and pension enhancements worth almost €60 million to 18 executives? The trial adjudicated whether lucrative "golden parachutes," typical in Anglo-American style capitalism, breached German law simply because of their size. "The prosecutors are making clear they don't want this kind of remuneration to become commonplace," said Jürgen Pauly, one of the defense lawyers in the trial. "They want to use the *Untreue* law to hold it in check."[5]

The size of an executive paycheck is admittedly an odd target of German criminal law, especially considering the severe punishment of up to 10 years in prison that could result from a conviction of breach of fiduciary duty. Although it would be a legitimate use of state power to criminalize excessively large executive salaries, the location of the line in the sand between legal and criminal salaries is extremely contentious. Due to the German Stock Corporation Act (*Aktiengesetz*), which requires that executive remuneration bears a relationship to executive responsibilities and a company's performance, some have argued that German law is well situated to judicially control executive pay, at least when compared to the Anglo-American economies.[6] Consequently, sec. 87 (1)(i) of the Stock Corporation Act has played a central role in the trial. "When determining the total remuneration of individual executive directors, the supervisory board…must ensure that total remuneration is kept in appropriate relation to the tasks of the executive director and the state of the company," reads the provision.[7] The precise definition of the word "appropriate" is particularly problematic.

The pronouncements of the enormity of this case for German capitalism did not square with the seemingly humble issue at trial. As a legal matter therefore, the Mannesmann trial appears to be a legitimate judicial exercise concerned with whether a few executive salaries are so large as to break the law. This paper explores the genesis of how the adjudication of this seemingly benign issue in a courtroom, could possibly be equated with an indictment of Germany's entire capitalist system.

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[5] Jenkins, *Germany on Trial*, *supra* note 1.

[6] Brian R. Cheffins, *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 AM. J. COMP. L. 497, 526 (2001).

[7] Jenkins, *Germany on Trial*, *supra* note 1.

C. Germany's Capitalist System

Culture and history matter when examining different national economic systems. Ronald Dore, William Lazonick and Mary O'Sullivan have demonstrated how these factors gave rise to the 20th century's unique and constantly evolving industrial arrangements.[8] In Germany at the turn of the last century for example, the role that the leading banks played in supplying venture capital afforded them seats on the supervisory boards of the burgeoning industrial companies in which they invested.[9] In the aftermath of the Second World War, the system of codetermination that ensured employee representation on the supervisory boards of corporations and a system of highly structured wage negotiations, suppressed the class conflicts of earlier in the century.[10] These, and a myriad of other factors, created the situation where at the dawning of the 21st century, and in reality throughout their respective histories, German capitalism was distinct from that of Britain and the United States.

A typical German corporation exists within a network of managers and technical personnel who, in an effort to secure financing, share reliable information between themselves and their major suppliers, cross-shareholders and industry counterparts.[11] As this financing is not dependent upon current returns, companies can maintain a skilled workforce during an economic downturn, and train their workers for projects that generate profits in the long run. From a corporate governance standpoint, the presence of supervisory boards, composed by law of employee representatives and major shareholders, reduces the discretion of the management board (*Vorstand*) at least when compared to the board of a typical Anglo-American company.[12] In theory, this structure broadly aligns the incentives of German managers with those of the firm in general.

The legal and social structures that typify Germany's system of codetermination have been broadly termed a *stakeholder* model, where labor, management and large

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[8] Ronald Dore, William Lazonick & Mary O'Sullivan, *Varieties of Capitalism in the Twentieth Century*, 15 OXFORD REVIEW OF ECONOMIC POLICY 102 (1999).

[9] *Id.* at 105.

[10] *Id.* at 108.

[11] Peter A. Hall & David Soskice, *An Introduction to Varieties of Capitalism*, *in* VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE 1, 22-23 (Peter A. Hall & David Soskice eds., 2001).

[12] Sigurt Vitols, *Varieties of Corporate Governance: Comparing Germany and the UK*, *in* VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE 337, 344 (Peter A. Hall & David Soskice eds., 2001).

strategic shareholders all have a voice in a company's management.[13] This typically results in a balancing of interests and a focus upon long term, continuous growth.[14] Contrast this to the *shareholder* model, the stereotypical model of the United States and Britain, where the decisions of management must focus upon maximizing short-term profit in order to appease shareholders.[15] In theory, linking management compensation to share price properly aligns the interests of management with the interests of shareholders.

I. The Mannesmann Trial

Almost four years after Klaus Esser, then CEO of Mannesmann, acceded to Vodafone's hostile takeover, Esser would have to appear alongside five other defendants in a Düsseldorf courtroom to answer criminal charges. Four of the defendants comprised Mannesmann's non-executive compensation committee, which included Josef Ackermann of Deutsche Bank, Klaus Zwickel of IG Metall, Joachim Funk the supervisory board chairman, and Jürgen Ladberg, a member of the supervisory board. The final defendant was Dietmar Droste, Mannesmann's personnel director. All the charges concerned the approval of over €60 million in awards and pension enhancements by the non-executive compensation committee, including a €15 million "appreciation award" that Esser received.

The factual situation, known before the trial, was as follows. On February 2, 2000, the day on which Esser and Christopher Gent, then CEO of Vodafone, concluded the takeover, Esser was awarded the €15 million appreciation award at the behest of Mannesmann's largest shareholder, Hong Kong based conglomerate Hutchison Whampoa.[16] The compensation committee approved Esser's award on February 4, along with the other bonuses, which included a €3.1 million bonus for Joachim Funk that was suggested and voted upon by Funk himself. Irregularities in the approval process for the awards prompted a recall of the compensation committee and on February 28 they re-approved all the bonuses. By this time, Düsseldorf's public prosecutor had already received complaints concerning the legality of the awards, which eventually led to a public inquiry that culminated in the 2004 criminal trial.
Allegations of bribery initially surrounded Esser's appreciation award. Esser had spent over €200 million resisting Vodafone's hostile takeover bid, and questions

[13] *Id.* at 337-339.

[14] Cheffins, *supra* note 6 at 501.

[15] *Id.* at 499.

[16] Jenkins, *Germany on Trial*, *supra* note 1.

arose as to whether the award had improperly bought Esser's support for the takeover.[17] The first month of the trial focused upon these events, and especially the role of Canning Fok, the managing director of Hutchison Whampoa who first suggested Esser's bonus. A witness testified that, as Esser and Gent finalized the price for the takeover, Fok suggested to advisers that a bribe should be offered to Esser in order to gain his acquiescence to the deal.[18] Esser's lawyers have consistently maintained that Esser and Gent agreed to the final price for the deal during a telephone call that took place at 5pm on February 2, which was two hours before Fok allegedly suggested the bribe.[19] Fok testified before the Mannesmann trial that he learned of the final price of the deal at 7pm, and that only afterwards did he suggest an "appreciation award" for Esser.[20] Prosecutors who investigated the bribery allegations prior to the trial stated that they would not form part of the case against the six defendants.[21] That bribery featured prominently in the trial and the media coverage is unsurprising, given that if substantiated, bribery would obviously have broken the law. The attention these allegations have received, however, distracts from the fact that the trial's mandate is to examine the legality of the awards in the absence of any bribery.

II. The Ambivalence of Legal Language and Criminal Law

The criminal code provision at the heart of the trial, sec. 266 of the German Criminal Code, gives a short definition of *Untreue*. It reads:

Whosoever abuses the right accorded him by law, official instruction or legal transaction to manage the property of a third party, or violates the duty entrusted him by law, official instruction or legal transaction to safeguard the property of a third party and thereby disadvantages whomsoever's property interests had been entrusted to him, shall be imprisoned for up to five years or fined. In especially serious cases, the punishment is anything from six months to 10 years in prison. In an especially serious case, the accused will have…triggered a large-scale loss of property or acted with intent.[22]

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[17] *Id.*

[18] Patrick Jenkins, *Judge Revisits Vodafone Links in Esser Trial*, FINANCIAL TIMES (11 February, 2004), *available at* <http//:www.ft.com>. Fok's precise words, allegedly: "Let's do it the Chinese way."

[19] *Id.*

[20] Patrick Jenkins, "Fok Gives Long-distance Testimony, FINANCIAL TIMES [US EDITION] (27 February, 2004) 17.

[21] *Id.*

[22] Jenkins, *Germany on Trial*, *supra* note 1.

The prosecution's argument was that by paying out the almost €60 million in bonuses, the defendants breached their duty to the broader interests of the company, which consequently damaged the company.[23]

The defendants countered the accusations with many arguments that have been widely reported in the *Financial Times*. The defendants have consistently attacked the *Untreue* definition as vague and much too broad.[24] Moreover, since the Corporate Stock Law allows "appropriate" remuneration, their arguments involved justifying the bonuses in relation to the almost €77 billion in value for shareholders that Esser created during the takeover.[25] In the opening days of the trial, Josef Ackermann's testimony focused on how the courtroom was an inappropriate venue to resolve the issue of manager remuneration.[26] Ackermann even argued that even a €1 billion bonus for Esser would have been appropriate given the astonishing rise in the share price that took place during the takeover battle.[27] Indeed, Esser presided over a 120 percent rise in Mannesmann's share price between mid-October 1999 and the beginning of February 2000.[28] Ackermann also made it explicitly clear that the interests of shareholders should be the ultimate concern for management. "The idea of a company's best interests does not put shareholders on a par with staff, customers and creditors. The interests of shareholders, as owners, should come first," Ackermann said.[29] This repudiates Germany's stakeholder model that views corporations as vehicles for advancing the common interests of workers, managers and shareholders. By attacking the basis of Germany's stakeholder system and vaunting the shareholder model, Ackermann implicitly supported another tenet of that model, namely the linking of management pay to share price. Esser's testimony focused upon the fact that relative to other executive bonuses in both Germany and elsewhere, his own €15 million bonus was not unique.[30] Expert testi-

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[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] Patrick Jenkins, *Esser "should have received €1bn,"* FINANCIAL TIMES (23 January, 2004), *available at* <http//:www.ft.com>.

[27] *Id.*

[28] MARTIN HÖPNER & GREGORY JACKSON, AN EMERGING MARKET FOR CORPORATE CONTROL? THE MANNESMANN TAKEOVER AND GERMAN CORPORATE GOVERNANCE 39 (2001), *available at* <http://www.mpi-fg-koeln.mpg.de>.

[29] Jenkins, *Esser*, *supra* note 26.

[30] Patrick Jenkins & Tony Major, *Experts Back up Esser's Bonus Claim*, FINANCIAL TIMES (28 January, 2004), *available at* <http//:www.ft.com>.

mony presented at the trial indicated that up to 50 such bonuses had already taken place in Germany, and that nearly 100 current contracts gave managers the opportunity to earn similar amounts.[31]

III. The Merits and Complexities of Comparison

By Anglo-American standards, executive pay in Germany is not excessive. For example, a 1999 study put the average annual pay for a German CEO at $391,000 (US) versus $1.06 million (US) for a CEO in the United States.[32] American executive pay continues to accelerate as figures from 2003 show that executive bonuses are back to the same levels as in the late 1990s.[33] Many Americans, however, are openly critical of this system. In his annual letter to shareholders, Warren Buffett, the billionaire investment guru, criticized the high levels of executive pay, claiming that it remained the "acid test" as to "whether corporate America is serious about reforming itself."[34] Although criticism extends to the magnitude of the payments, commentators recognize that bonuses deservedly reward managers for the precipitous rise of American profits and share prices in 2003.[35]

The case in Germany is different, because a popular aversion to high executive remuneration exists even when executives create value. For example, Josef Ackermann's €6.9 million paycheck for 2002 caused friction among Deutsche Bank's shareholders. The disclosure, in the midst of the Mannesmann trial that he earned €11 million in 2003 was predicted to anger the public and shareholders alike.[36] This 60 percent rise in pay, however, broadly matched Deutsche Bank's 50 percent rise in share price in 2003. On the whole, corporate Germany has suffered from disappointing results for a few years, and there has been a very recent trend for executives to trim their salaries in response to growing investor pressure.[37] Companies such as Daimler-Chrysler, Volkswagen and Deutsche Telekom have all recently announced cuts to executive pay.[38] Deutsche Telekom claimed that the move was to

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[31] *Id.*

[32] Cheffins, *supra* note 6 at 508.

[33] Dan Roberts, *Executive Bonuses Set to Match Boom Levels*, FINANCIAL TIMES [US EDITION] (22 March, 2004) 1.

[34] Dan Roberts, *Buffett Holds on to "gusher of cash,"* FINANCIAL TIMES [US EDITION] (8 March, 2004) 1.

[35] Roberts, *Executive Bonuses*, *supra* note 33.

[36] Patrick Jenkins, *Deutsche Chief's Pay Risks Backlash*, FINANCIAL TIMES [US EDITION] (9 March 2004) 13.

[37] Patrick Jenkins, *Germany Searches its Soul on Pay*, FINANCIAL TIMES [US EDITION] (7 April, 2004) 20.

[38] *Id.*

show "solidarity" with employees subjected to cost cutting at the firm, but analysts comment that the real problem is a system that does not sufficiently link executive pay with performance.[39] Whatever the motivations for these pay cuts, the average German is pessimistic about the state of the economy given the last decade of stagnating disposable income and rising unemployment.[40]

The fact that Ackermann was only one of five German blue-chip chief executives to disclose their pay last year highlights another important issue raised at the Mannesmann trial.[41] In his testimony during the trial, Esser stressed that it was not the magnitude of the bonus, but its public disclosure, that had resulted in the criminal charges.[42] Although there are many executives earning bonuses similar to those earned by Esser, it's unlikely that the German public knew the identity of these "fat cats" and, as commentators have noted, this hardly casts the Mannesmann trial as just.[43] Until recently, German disclosure rules only required that stock corporations disclose the total salaries of all those on management boards, rather than the details of individual awards required of American or British companies.[44]

Controversies in America and Britain in the 1990s over executive pay prompted regulatory changes that resulted in strict disclosure rules, a move welcomed by shareholders eager to evaluate the validity of executive pay.[45] The situation about disclosure is slowly changing in Germany, however as ten companies will publish details of what their executives earn this year.[46] Although mandatory disclosure might keep the issue of excessive executive compensation in the public eye and potentially shame companies into restraint, the counterargument is that disclosure could increase executive pay as companies match the higher salaries of competitors.[47]

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[39] Ralph Atkins, *D-Telekom Board Shows "solidarity,"* FINANCIAL TIMES [US EDITION] (1 April, 2004) 16.

[40] Bertrand Benoit & Tony Major, *Lack of Faith in Upturn Keeps Gloomy Nation From Shops*, FINANCIAL TIMES [US EDITION] (10 February, 2004) 7.

[41] Jenkins, *Deutsche Chief's Pay*, *supra* note 36.

[42] Jenkins & Major, *supra* note 30.

[43] Patrick Jenkins, *Düsseldorf Provides an Antiquated Location for Germany's Show Trial*, FINANCIAL TIMES (24 January, 2004), *available at* <http//:www.ft.com>.

[44] Cheffins, *supra* note 6 at 534.

[45] *Id*. at 534-35.

[46] Jenkins, *Germany Searches*, *supra* note 37.

[47] Cheffins, *supra* note 6 at 535.

D. Shareholder Value and the Law

The Mannesmann trial's ability to generate interest from the international press resulted from the trial's interaction with larger and more contentious issues that are even engaging Germany's popular culture. How else to explain a German play that sold out a month and a half of performances, which in one particular scene openly calls for the death of Josef Ackermann?[48] The Mannesmann trial's very public examination of executive pay, important as the issue may be in both Europe and North America, in isolation does not justify the attention it has received. Once the Mannesmann trial began to adjudicate the larger issues of Germany's economic future, a question as to the amenability of any judicial remedy appears. Before addressing that question, it is helpful to examine a trial that on the surface appears to adjudicate the same issues as in the Mannesmann trial.

I. Hollinger International Inc. v Conrad Black

In February 2004, the American case of *Hollinger International Inc. v Conrad Black* pitted Lord Black of Crossharbour, the Canadian-born media magnate turned British peer, against the very media empire he founded.[49] The case is an excellent example of the growing movement within Anglo-American capitalism that is concerned with shareholder rights and possibly with adopting facets of a stakeholder model. But it also bears similarities to the Mannesmann trial, since both involve allegations of executive mismanagement concerning executive remuneration, and they both involve recourse to the courts. Despite these similarities, the overriding difference between *Hollinger* and the Mannesmann trial is the actual ability of the courts to provide a *legal* solution to the problems that generated the litigation in the first place.

Conrad Black faced charges of breach of fiduciary duty resulting from his actions as chairman and chief executive of Hollinger International, in a case that drove to the heart of the shareholder model of Anglo-American capitalism and the responsibility a corporation owes to its minority shareholders. Like the Mannesmann trial, *Hollinger* received a significant amount of press coverage, but the viewpoint of the coverage was quite different. As a single event, the Mannesmann trial was purported to represent an indictment of Germany's entire corporate structure. The Hollinger trial never achieved this universal billing, but did represent an important example of a changing Anglo-American investing climate.

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[48] Patrick Jenkins & Bertrand Benoit, German Drama Lifts Curtain on Consultants, FINANCIAL TIMES [US EDITION] (14-15 February, 2004) 2. The play is "McKinsey kommt" (McKinsey comes) by Rolf Hochhuth.

[49] Hollinger International Inc. v. Conrad Black [2004] WL 360877 (Del. Ch.) (WL) [*Hollinger*].

Hollinger International is the Delaware-based company that controls the newspapers at the heart of Black's media empire. Black in turn, controls Hollinger International through a Canadian-based company called Hollinger Incorporated, which is the controlling shareholder in Hollinger International. In addition, Black sat as both chairman and chief executive of both companies. In May of 2003, Tweedy Browne, the American investment group that was one of Hollinger International's biggest shareholders, demanded an investigation into $70 million (US) in non-compete fees that had been paid to Black and other members of Hollinger International's board of directors.[50] Tweedy Browne's allegations not only targeted those who had benefited from the fees, namely Black and other members of Hollinger International's board of directors, but also the outside directors who had allowed the fees in the first place. Hollinger International appointed a special committee to investigate the fees, which uncovered troubling evidence that the non-compete fees had been improperly awarded. The committee confronted Black with these allegations, and after intense negotiations, Black signed an agreement with Hollinger International on November 15, 2003. Among his many commitments in the agreement, Black agreed to repay the non-compete fees and resign as CEO of Hollinger International.[51] Most significantly, Black made two commitments to Hollinger International. First, he pledged to work upon a "Strategic Process" the purpose of which was to investigate tactics that would maximize the investment of shareholders, possibly through a sale of Hollinger International's assets. Second, he agreed to refrain from independently attempting to sell his interest in Hollinger Incorporated. The relevant clause in the agreement read as follows:

During the pendency of the Strategic Process, in his capacity as the majority stockholder of [Hollinger Incorporated], Lord Black will not support a transaction involving ownership interests in [Hollinger Incorporated] if such transaction would negatively affect [Hollinger International's] ability to consummate a transaction resulting from the Strategic Process unless the [Hollinger Incorporated] transaction is necessary to enable [Hollinger Incorporated] to avoid a material default or insolvency. In any such event, Lord Black shall give [Hollinger International] as much advance notice as reasonably possible of any such proposed [Hollinger Incorporated] transaction.[52]

As part of the Strategic Process, the investment bank Lazard LLC was responsible to receive and evaluate all offers to buy Hollinger assets, and Black remained as the

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[50] Stephanie Kirchgaessner, *Showdown in Delaware: Does Conrad Black Have the Right to Sell his Stake in the Hollinger Newspaper Group*, FINANCIAL TIMES [US EDITION] (10 February, 2004) 13.

[51]Hollinger, *supra* note 49 at 13-14.

[52] *Id.* at 14.

chairman of Hollinger International's board to further this process.[53] But despite these commitments, earlier that week Black had already offered to sell his stake in Hollinger Incorporated to the Barclay brothers of the United Kingdom. The Barclay brothers, Sir David and Sir Frederick Barclay who are media tycoons in their own right, had previously approached Black about purchasing some or all of Hollinger. Despite the express prohibition to sell his stake in Hollinger Incorporated, Black continued negotiations with the Barclay brothers in an attempt to, in the words of Judge Leo Strine who delivered the *Hollinger* decision, do an, "end-run around the Strategic Process."[54] Black purposefully maneuvered to prevent the Barclay brothers from dealing with Hollinger International, and even used confidential information from Lazard and Hollinger International for his own benefit.[55] In mid-January 2004, Black announced a deal to sell his interest in Hollinger Incorporated to the Barclay brothers for $466.5 million (US).[56]

Hollinger International disputed the legality of the proposed sale to the Barclay brothers, and took Black to court to prevent the sale. The legality of the transaction rested upon whether Black had breached his fiduciary duty to shareholders when he subverted the board's Strategic Process and attempted to independently sell Hollinger Incorporated. Put differently, the case turned upon a determination of whether the rights of minority shareholders could trump the interests of Black's majority interest.[57]

In light of the evidence, the ruling was quite sensible. Judge Strine of the Delaware Court of Chancery found that as Hollinger International's chairman, Black was legally bound to act in the interest of all of the shareholders.[58] Through his dealings with the Barclay brothers, Black breached his fiduciary duty to those same shareholders. Judge Strine concluded:

Black intentionally subverted the [Hollinger International] Strategic Process he had pledged to support through a course of conduct involving misleading and deceptive conduct toward

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[53] *Id.* at 32.

[54] *Id.* at 17.

[55] *Id.* at 32.

[56] Compare the initial $466.5 million deal with the $1.2 billion that the Barclay brothers subsequently agreed to pay for the UK arm of Hollinger International after participating in a public auction of Hollinger's assets. Tim Burt and Stephanie Kirchgaessner, *Barclays to Acquire Telegraph for £665m*, FINANCIAL TIMES (23 June, 2004), *available at* <http//:www.ft.com>.

[57] Kirchgaessner, *supra* note 50.

[58] *Hollinger, supra* note 49 at 31.

his fellow directors, all designed with the goal of presenting them with a "fait accompli." Most critically, the Restructuring Proposal did exist and constricted Black's, and therefore [Hollinger Incorporated's], range of action. It is difficult to conceive of a meaningful definition of the duty of loyalty that tolerates conduct of this kind.[59]

The "meaningful definition of the duty of loyalty" was the standard by which Conrad Black's actions were judged, and ultimately found wanting. The systematic presentation of evidence in the verdict demonstrated that Black neglected the interests of shareholders, and that a remedy was required that would uphold the integrity of the legal system.

Recent events in Anglo-American corporate history must be the genesis of such an evident duty of loyalty. In the wake of the high profile corporate scandals involving Enron, Worldcom, Tyco, and HealthSouth to name only an unfortunate few, many people were shocked at how managers enriched themselves at the expense of the shareholders: a perverse reversal from the conception of management effort for the benefit of shareholder enrichment.

II. Widening the Spectrum

Conrad Black's experience is not unique, as in recent months shareholders have staged a number of high-profile revolts in order to exert their control over the executives supposedly working on their behalf. In 2003 Calpers, the California state employees' pension fund that controls over $170 billion of assets, demanded the resignation of Dick Grasso over the $188 million pay package he received as chairman of the New York Stock Exchange.[60] Grasso is now the target of a lawsuit launched by New York Attorney General Eliot Spitzer to recover at least $100 million of that pay package.[61] A shareholder revolt at Walt Disney Company, the American entertainment company, in March 2004 forced Michael Eisner to split the role of chairman and chief executive, and loosened his 18-year hold over the company.[62] Based on these and other events, analysts predicted a growing interest on the part of shareholders in the actual management of corporations that would ex-

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[59] *Id.* at 32.

[60] Simon London, *Calpers Chief Relaxes in the Eye of the Storm*, FINANCIAL TIMES [US EDITION] (2 June, 2004) 8.

[61] *N.Y.'s Spitzer: Won't Settle Grasso Suit*, REUTERS (8 June, 2004), *available at* <http//:www.reuteurs.com>.

[62] Tim Burt & Christopher Parkes, *A "Resounding Victory" for Shareholders*, FINANCIAL TIMES [US EDITION] (5 March, 2004) 20.

tend beyond the traditional myopic focus on a rising share price.[63] "The big change would be these guys [institutional investors] are suddenly saying we're not just going to buy and sell stock, we're going to exert our influence," said Jay Lorsch, a professor at Harvard Business School.[64]

The growing influence of institutional investors on corporate governance is not a new development, but it harbors the possibility to change the Anglo-American economies. The ultimate direction of this change is uncertain, although it will undoubtedly disappoint shareholders looking for a panacea to corporate governance problems. Despite this uncertainty, what the shareholder rights movement certainly represents is a departure from the much-vaunted Anglo-American shareholder model of corporate governance. In fact, the efforts on the part of shareholders to exert influence on management bears a resemblance to Germany's stakeholder model, where formal codetermination laws require strategic shareholders to sit on company supervisory boards. The literature on institutional change in Germany might then provide insights into these new developments. Christel Lane has recently examined changes to German corporate governance and the convergence of the German stakeholder model to the Anglo-American shareholder model.[65] Lane is quite pessimistic about the prospect for a hybridized marriage of codetermination and maximizing share price, especially given his prediction of labor's marginalization in this new system.[66] The conclusions for an Anglo-American flirtation with a stakeholder system seem broadly aligned with Lane's predictions, given that the glaring difference between the shareholder's ebullient predictions after Disney and the stakeholder model in Germany is the absence of any voice for labor. It seems only logical that the interests of labor would weaken if shareholders got a stronger voice in Anglo-American capitalism, a system already focused upon delivering short-term value to shareholders.

E. Conclusions

From the perspective of a North American who is relatively unfamiliar with Germany's capitalist arrangements, it is somewhat difficult to assess the significance of the Mannesmann trial. This difficulty is common to most issues viewed from a dis-

[63] Elizabeth Wine, *Rise of the Corporate Crusaders*, FINANCIAL TIMES [US EDITION] (5 March, 2004) 20.

[64] *Id*.

[65] CHRISTEL LANE, CHANGES IN CORPORATE GOVERNANCE OF GERMAN CORPORATIONS: CONVERGENCE TO THE ANGLO-AMERICAN MODEL 4 (2003), *available at* <http://www.cbr.cam.ac.uk/research/programme2>.

[66] *Id*. at 2.

tance, and results from a basic human tendency identified in the 18th century by the Italian philosopher Giambattista Vico. "It is another property of the human mind that whenever men can form no idea of distant and unknown things, they judge them by what is familiar and at hand," Vico wrote.[67] Germany's economy is shaped by the complex inter-linkages of the stakeholder model that equalizes the stature of managers, employees and shareholders within corporations, and is influenced by a larger society that also embodies these values of equality. Anglo-American pay practices and the effect this has on corporate governance therefore threatens Germany's historic capitalist arrangements, which is precisely why the Mannesmann trial is purported to decide the fate of Germany's entire capitalist system.

Before the Mannesmann trial began, the trial's judge, Brigitte Koppenhöfer, denied press passes to all major international publications.[68] Technicalities as to the number of places available were cited as reasons for the decision, but the reaction by the international business press was one of astonishment, given the importance of the issues involved for international investors. "To treat this trial as a domestic matter misunderstands the increased role of global equity markets. There are international shareholder interests at stake," was Frederick Kempe's response, who is editor of the Wall Street Journal Europe.[69]

On the eve of the trial, when the judge reconsidered the denial and admitted the foreign media, the business press welcomes the decision as allowing US investors, confused by the Mannesmann case, the opportunity to gain the information they needed to invest intelligently.[70] But it is not simply the Mannesmann trial that is confusing to US investors. A shocking example is the following commentary about the Mannesmann takeover, written in an article that explores the effects of German tax law on German corporate governance.[71]

Mannesmann executives may be the only people not to benefit long-term from Vodafone's acquisition of their company. Unlike their American counterparts, German executives do

[67] GIAMBATTISTA VICO, THE NEW SCIENCE OF GIAMBATTISTA VICO 60 (Thomas Goddard Bergin & Max Harold Fisch trans., 1984).

[68] Tony Major & Patrick Jenkins, *Business Press Kept from Directors' Trial*, FINANCIAL TIMES (10 December, 2003), *available at* <http//:www.ft.com>.

[69] *Id.*

[70] Patrick Jenkins, *Court U-turn on Press Exclusions*, FINANCIAL TIMES (15 January, 2004), *available at* <http//:www.ft.com>.

[71] Benjamin W. Johnson, *German Corporate Culture in the Twenty-First Century: The Interrelation Between the End of Germany Inc. and Germany's Corporate Capital Gains Tax Reform*, 11 MINN. J. GLOBAL TRADE 69 (2002).

not have golden parachutes and many of them do not own substantial stakes in the companies that they run. After the takeover by Vodafone, Mr. Esser will lose much of the social prestige and power that came with running one of the largest German corporations, and he will be out of a job. It seems ironic that a German CEO who will not benefit from a golden parachute accomplished exactly what most American CEOs with large buyout clauses would hope to do in the same situation.[72]

Apparently, the author was unaware of both the bonuses awarded to the Mannesmann executives after the takeover, and the subsequent investigation that led to the trial. But more importantly, an Anglo-American shareholder view of capitalism and management colors the assessment of German executives and leads to the bewilderment concerning their motivations. It also completely ignores the role that a *lack* of management bonuses would play in Germany to align the interests of management, shareholders and workers.

Information gleaned from the *Financial Times* forms a substantial part of this paper, and were it not for the international press coverage, it would have been practically impossible to complete. One drawback to a publication such as the *Financial Times* that reports on issues from around the globe, results from Vico's "property of the human mind." All too often, difference go unnoticed, and we judge the world by "what is familiar and at hand." In the case of Mannesmann, the *Financial Times* viewed the events through the lens of a shareholder model that is intuitively accepted and understood by an Anglo-American readership. The *Financial Times* coverage focused upon and sympathized with the arguments of Esser and Ackermann, based as their arguments were upon a shareholder perspective of executive pay. Writing presumably for American shareholders looking to invest internationally, the *Financial Times'* viewpoint is perfectly appropriate, but also perfectly inadequate to convey the conflicting ideologies that the Mannesmann trial represents. The American investors reading about the Mannesmann trial in the *Financial Times*, with their shareholder perspective, will likely remain confused as to the professed importance of the Mannesmann trial.

Though expected to last six months, speculation began less than two months into the Mannesmann trial that it might come to a premature end due to the weakness of the prosecution's case.[73] The predictions came somewhat true when on March 31, 2004, ten weeks after the trial began, Judge Koppenhöfer threw out all the criminal charges of *Untreue* against the six accused, because she found that a breach of fidu-

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[72] *Id*. at 89.

[73] Patrick Jenkins & Nicola de Paoli, *Mannesmann Trial Might End Early*, FINANCIAL TIMES [US EDITION] (4 March, 2004) 22.

ciary duty had not occurred.[74] In the same interim judgment, however, she maintained that although no violation of the criminal law had occurred, the bonus awards had been "inappropriate and thus breached Germany's Stock Corporate Law."[75] Remember, the law states: "When determining the total remuneration of individual executive directors, the supervisory board…must ensure that total remuneration is kept in appropriate relation to the tasks of the executive director and the state of the company."[76] "The willingness to sanction Anglo-American standards of pay is even more questionable than ever today," was Esser's response to the interim judgment.[77]

On the very significant point of what constituted "appropriate" remuneration, the interim judgment did not specify. There is evidently a line drawn somewhere between appropriate pay and inappropriate pay that once crossed, breaches the Stock Corporate Law. There is another line between inappropriateness that only breaches the Stock Corporate Law, and inappropriateness that breaks the criminal law of *Untreue*. Until the court issues a final decision, with reasons clarifying the definition of "appropriateness", the location of these lines is highly uncertain.

Ronald Dore has written that the debate on executive pay essentially debates normative questions about social justice.[78] On the one side, epitomized in the Mannesmann trial by the prosecution, the argument is that material inequality out of proportion to effort "ought" to be prohibited. On the other side, represented by Esser, Ackermann and the four other defendants, remuneration "ought" to be linked objectively to the market. Dore himself makes an argument as to which system he thinks is more appropriate.[79] His argument, however, is simply that, an argument based on his personal and subjective feelings about social justice that has no more evidentiary weight in a court than the opposite argument.

"Clarity needed," was the title of a *Financial Times* editorial concerning the interim judgment in the Mannesmann case, which advocated in favor of Esser, Ackermann

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[74] Patrick Jenkins, *Judge Throws Out Criminal Charges in Mannesmann Case*, FINANCIAL TIMES [US EDITION] (1 April, 2004) 15.

[75] Patrick Jenkins, *Mannesmann Verdict Leaves Questions*, FINANCIAL TIMES [US EDITION] (1 April, 2004) 16.

[76] Jenkins, *Germany on Trial*, *supra* note 1.

[77] Jenkins, *Mannesmann Verdict*, *supra* note 75.

[78] Ronald Dore, *Comment: Papers on Employees and Corporate Governance*, 22 COMP. LAB. L. & POL'Y J. 159, 160-161 (2000).

[79] *Id.*

and the other Mannesmann defendants.[80] This demand for clarity demonstrated the important philosophic image that legal decisions represent for corporations. The legal issues on trial, such as defining breach of fiduciary duty, are certainly important, but an analysis of *Hollinger* and the Mannesmann trial cannot ignore the instrumental function of the law as it applies to businesses. Amongst a myriad of other potential possibilities, clarity about the future is certainly an outcome that a trial specifically, and the law in general, is supposed to deliver. A paradigmatic example of such a clear result for investors is the decision from *Hollinger International v. Conrad Black*. The purely legal question of whether Black breached his fiduciary duty, of obvious importance to lawyers and law professors, is an issue that at this level of legal abstraction is practically meaningless to investors. It is the concrete decision reached at trial that is important to them, and not the particular direction of the courts decision.

Turning to the Mannesmann trial, theoretically there are two possible clear outcomes, at least from the perspective of international investors. Either Germany will tolerate large executive payments typical in Anglo-American economies, or they will reject them as criminal. The consequences of these two outcomes for investors however, are much more difficult to understand. Does a clear outcome in favor of the defendants signal an embrace of Anglo-American pay and Germany's hospitableness to the concerns of international shareholders looking for investment opportunities? Conversely, does a clear outcome of the defendants' guilt signal a rejection of these same standards, and a hostile investment climate that will scare international investors away from German markets? If these are the two drastic options available for Judge Koppenhöfer, then it would be understandable to bill the Mannesmann trial as putting "Germany on trial." Either of these two conclusions would certainly deliver clarity to investors.

But the case of Mannesmann cannot be distilled down to these two simply choices, because the question at its heart, namely the definition of an *appropriate* salary, is what Felix Cohen would call "transcendental nonsense."[81] In his 1935 paper, Cohen explained that transcendental nonsense arises where courts create definitions that are only functions of what the particular court defines them to be.[82] Specifically Cohen calls them, "peculiar concepts which are not defined either in terms of empirical fact or in terms of ethics but which are used to answer empirical and ethical questions alike, and thus bar the way to intelligent investigation of social fact and

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[80] *Clarity Needed*, FINANCIAL TIMES [US EDITION] (5 April, 2004) 14.

[81] Felix Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809 (1935).

[82] *Id.* at 818.

social policy."[83] The complex social questions concerning, at the most fundamental level, what sort of society Germany should be, are obviously of vital importance. The variety of research papers and the pages of newssheet devoted to the topic would indicate as much. They represent intelligent investigations into questions that do not really have concrete answers. Or if they do have simple and concrete answers, as Dore emphasizes, it is a matter of personal conviction.[84] The question of the "appropriate" level of executive compensation is transcendental nonsense, because factors that are independent from the judgment of the court do not refer to the definition of "appropriate." The invention of a legal concept of "appropriate" pay defines away the important ethical questions concerning what actually makes that pay appropriate in Germany. It is unsurprising that the trial and the media focused upon the bribery allegations, given that these questions are referable to actual events that took place during Vodafone's takeover of Mannesmann. A society's understanding of bribery is sufficiently clear to adjudicate in a courtroom. The question of what constitutes "appropriate" pay is another matter, and the fallacy that courts can provide a good answer has conflated the Mannesmann trial into one concerning all of Germany.

Cohen advocates for a functional approach to solving legal problems that emphasizes the practical nature of legal inquiries.[85] He proposes two questions, which are the only questions the law should ask. "One is, "How do courts actually decide cases of a given kind?" The other is, "How ought they to decide cases of a given kind?"" Cohen writes.[86]

Hollinger fits these criteria well. In respect of the first question, the Delaware court examined the evidence of the parties and made findings of fact as to credibility. The court found Conrad Black to be an un-credible witness, and therefore Judge Strine discounted his evidence. Based on this finding of fact, Judge Strine adjudicated a very narrow issue with respect to breach of fiduciary duty, namely whether the agreement that Black signed with Hollinger International bound him to respect the interests of minority shareholders. The language of the agreement obliged Black to perform certain duties, which the court ruled he did not perform. Therefore, to respect the rights of minority shareholders, the court barred Black from selling his stake in Hollinger Incorporated to the Barclay brothers. As to Cohen's second question, how ought these cases to be decided, Judge Strine gave a perfect answer in his

[83] *Id.* at 820.

[84] Dore, *supra* note 78.

[85] Cohen, *supra* note 81 at 812.

[86] *Id.* at 824.

judgment. "It is difficult to conceive of a meaningful definition of the duty of loyalty that tolerates conduct of this kind," Judge Strine wrote.[87] A "duty of loyalty" with a "meaningful definition" protects minority shareholders, allows mendacity to go unrewarded, and by doing so, sets standards for future decisions upon which investors can use to make decision about the future.

Again, turning back to the Mannesmann case, the court cannot intelligibly answer either of Cohen's two questions. Take for example the following sentence from an article written in the aftermath of the interim judgment: "Several defendants said there was a clear need for corporate law to be clarified, since even academic experts who have spent months debating the issue cannot agree on whether the near €60m of bonuses at the centre of the Mannesmann case were appropriate or not."[88] It is unclear how the courts will be better suited than "academic experts" to adjudicate how the case "ought" to be decided. Drawing an arbitrary line that defines "appropriate" pay is inadequate. Such a line simply uses transcendental nonsense to define away the ethical questions at the heart of the trial. The courts cannot really answer the first question of how they actually decided corporate cases of breach of fiduciary duty with respect to executive pay in Germany, because the evidence needed to decide this issue is absent from to the particular events surrounding the takeover of Mannesmann. Such evidence would include detailed examinations of codetermination, of a shareholder model, and of Germany's entire social welfare state. It is simply inadequate to substituting, in their stead, a simple fact about the magnitude of executive bonuses. That the executive bonuses were not uncommon erodes the credibility of the judgment even further. As a result, any conclusion that the court reaches will be untraceable to the facts that should ground such a conclusion. This is precisely the sort of transcendental nonsense that Cohen castigated almost 70 years ago.

Even though the reasons supporting the interim judgment will be released after this paper is completed, they will likely be quite useless in resolving the real question that prompted the substantial interest in the Mannesmann trial. It is the same question that Dore, Lazonick and O'Sullivan are unable to answer in their paper on the Varieties of Capitalism: what does the future hold for the structure of capitalist economies that constantly change due to the pulls of contemporary pressures, and the push of a relentless history?

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[87] Hollinger, *supra* note 49 at 32.

[88] Jenkins, *Mannesmann Verdict*, *supra* note 75.