NEW RULES FOR CORPORATE GOVERNANCE IN THE UNITED STATES AND GERMANY – A MODEL FOR NEW ZEALAND?

LLM RESEARCH PAPER

MASTERS LEGAL WRITING (LAWS 582)

LAW FACULTY
VICTORIA UNIVERSITY OF WELLINGTON

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ABSTRACT
This paper surveys the possibilities for implementing new rules for corporate governance in New Zealand. It focuses on the new rules issued in Germany (the German Code of Corporate Governance) and the United States (the Sarbanes-Oxley Act). The paper analyses both regulations in order to find out which rules might be applicable for New Zealand. It is argued that New Zealand has to adopt a code of corporate governance in order to keep up with international developments, otherwise it risks repelling local investors and fails attracting international investors. It is concluded that most importantly New Zealand should adopt a principles-based "comply-or-explain" approach rather than strict rules, as it offers greater flexibility, which is particularly important in the New Zealand context. The paper further concludes that many of the rules issued in Germany and the United States could improve corporate governance in New Zealand and hence should be implemented. However, some of the rules implemented in Germany and the United States either overshoot the mark or do not fit into the New Zealand context.

STATEMENT ON WORD LENGTH
The text of this paper (excluding abstract, table of content, footnotes, bibliography and appendices) comprises approximately 13290 words.
INTRODUCTION

Currently corporate governance is one of the hottest topics of corporate law. Throughout the world new systems are discussed and developed. Predominant countries like the United States, Germany and the United Kingdom have issued new rules in recent years. Most notably for New Zealand, its closest neighbour Australia has adopted a code of corporate governance as well as smaller players, like Slovakia, Denmark, and Kenya. The question for smaller countries is, how to keep up in the global competition for international investors’ capital. This question will be researched considering the example of New Zealand. Does a small country like New Zealand need special rules at all? Can it afford to find an individual way without its system being labelled out of fashion? And which way would be the most desirable? These are questions, which arise in this context.

At the moment, New Zealand is in the final stage of developing new corporate governance principles. Therefore, it is timely to analyse and discuss certain rules and approaches from other countries. This paper will focus on recent changes in the United States and Germany, for these countries represent two entirely different corporate structures. The purpose of the paper is to analyse the new rules for corporate governance in the United States – the Sarbanes-Oxley Act – and in Germany – the German Code of Corporate Governance – in order to find out which of these rules might be applicable for adopting in New Zealand.

The paper will introduce the different corporate systems in the United States and Germany and point out their most significant differences. It will take a closer look at the new rules issued in both countries, emphasising the different purposes. After that, the status quo of New Zealand corporate governance will be briefly outlined. It will be concluded that New Zealand needs to issue a code of corporate governance in order to keep up with international developments and to attract international investors. The main part of the paper will focus on the most discussed topics and analyse, which of the rules implemented in Germany and the United States are suitable for New Zealand, keeping in mind its specific needs. It will be shown that some rules do not serve their purposes and therefore are not worth copying. Most notably, the paper will argue that a principles-based approach is preferable for New Zealand (rather than strict regulation). It will be concluded, that
New Zealand should adopt several of the internationally favoured rules as a principle-based “comply-or-explain” approach, in order to achieve a flexible solution, but still respond to international investors’ demands.

II LIMITING THE SCOPE

In recent years corporate governance became the most discussed issue in boardrooms, governments and among scholars. Following the corporate collapses of Enron and WorldCom in the United States, HIH Insurance and OneTel in Australia, and others, people throughout the corporate world began to rethink the fundamentals of corporate governance. Enron has been analysed to be a failure of corporate governance. Enron’s management consistently used “the most aggressive” accounting methods that were misleading and veiled Enron’s true financial situation. Its board failed to supervise and monitor Enron’s management effectively. Its accountants were deeply involved in other business with Enron and therefore lost their objectivity. Since Enron was not an isolated incident, it provided an incentive to analyse and rethink the way of how business should be governed and managed. In response, new regulations were developed around the world.

Due to the huge number of new codes and regulations the scope of this paper has to be limited in order to permit for sufficiently deep discussion of some of the most important questions. The influences and implications of the Australian and United Kingdom regulations on New Zealand have been analysed by various entities. Therefore, this paper will take a different approach. Instead, the paper will focus on the German and the United States regulations and analyse their approaches in order to draw conclusions for New Zealand. These systems are chosen for two main reasons. Firstly, they represent the two basic different possible approaches. While the United States response to corporate failures was a rule-based approach, the German response represents a principles based “comply-or-explain” solution.

3 For an overview, containing corporate governance codes or codes of best practice from more than 35 nations, see http://www.kceven.com.au/governance/codes.htm (last accessed 9 March 2004).
Secondly, the two systems also represent the two most different corporate systems in capitalist economies. While the United States corporate system represents a shareholder value dominated approach, the German system is the model system for a stakeholder dominant approach.

It is impossible to cover all topics within the scope of this paper. Therefore, the paper will focus on certain topics that have been approached in the recent discussion about New Zealand corporate governance reform and certain issues that particularly arise from the comparison between German and United States rules.

III CORPORATE GOVERNANCE IN THE UNITED STATES

In order to understand the new rules for corporate governance in the United States, the general situation before their implementation will be explained briefly. After that, the reasons for their implementation will be highlighted.

A The Situation pre Enron

The United States corporate system is characterised by a single-tier board (board of directors). Stock is widely held. There are usually no majority shareholders. Therefore directors are very powerful, especially the Chief Executive Officer ("CEO"). In other words, there is a separation between ownership and control. Consequently, one of the major goals of the United States corporate legislation is to control the power of directors and protect minority shareholders' rights. Many rules of United States corporate law are designed for that purpose.

The predominant concept of United States corporate law is shareholder primacy.

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4 Mark J Roe “Some Differences In Corporate Structure In Germany, Japan, And The United States” (1993) 102 YLJ 1927, 1936.
5 Butler, above, 587.
The purpose of the corporation is to earn money for the shareholders. Other stakeholders’ rights are not taken into account\textsuperscript{12}.

Prior to the recent scandals, United States scholars saw United States corporate law as superior\textsuperscript{13}. United States economy had seen a decade of continuing growth\textsuperscript{14}. Hence, the shock about apparent failures in the system was even more startling. That may explain in part the radical reaction, implementing several new regulations in a very short period of time. The most significant one was the implementation of the Sarbanes-Oxley Act, which is outlined below.

\textit{B The Sarbanes-Oxley Act}

The situation in the United States changed significantly with the implementation of the Sarbanes-Oxley Act 2002 (the “Act”).

The Act is a response to the latest scandals in United States companies, involving Enron, WorldCom and Tyco (to name just the larger ones). After these scandals there was high pressure on the legislator to improve corporate law in order to avoid such scandals in the future\textsuperscript{15}. A United States Senator, Paul A. Sarbanes\textsuperscript{16}, and Representative, Michael Oxley, developed a catalogue of new rules designed to avoid scandals in the future and improve corporate governance. The Act was the result of these efforts\textsuperscript{17}. In order to fulfil the desires of angry investors this Act implemented many new rules very strict requirements\textsuperscript{18}.

The Act represents the most comprehensive securities legislation in the United States since the 1930’s\textsuperscript{19}. It extends beyond securities law and corporate governance and affects many areas of business conduct. The rules affect managers and directors as well as accountants and even lawyers. In sum, it can be said that

\begin{footnotesize}
\begin{enumerate}
    \item[16] Who was the main contributor; Hamilton, above, 3.
    \item[17] Stewart Lehman, above, 2117-2118.
\end{enumerate}
\end{footnotesize}
every person that is in a position to monitor a company, is now responsible to do so. It was the first time, the Federal government reached into the area of corporate governance which before was only a matter reserved for the States and the State courts. The government wanted to install more control over all responsible persons in order to prevent corporate governance failures in the future.

The Act is a very strict rule-based approach and was signed into law on 30 July 2001. It was drafted without further surveys and without involving the business community. The most important rules will be discussed in detail when evaluating the sense of implementing them in New Zealand. As will be shown, some of them overshoot the mark.

IV CORPORATE GOVERNANCE IN GERMANY

Before discussing the new rules in German corporate governance, the general situation as well as the reason for their implementation will be outlined.

A The Situation before the Corporate Governance Code 2002

German corporate law is characterised by a two-tier board system. Beside the managing board ("Vorstand") there is a second board, called the supervisory board ("Aufsichtsrat"). The managing board is responsible for representing the company and conducting its affairs. For the day-to-day conduct of business it often appoints executives. The supervisory board is not involved in day-to-day business. Its main function is monitoring the managing board. Its further statutory responsibilities include approval of certain management decisions, examining the

19 Stewart Lehman, above, 2118.
21 Kim, above, 235-236.
26 Chantayan, above, 441.
company’s books, and reviewing its assets. Apart from that, the supervisory board appoints members of the managing board and reports to the shareholders. The supervisory board consists of half of members elected by the general shareholder meeting. The second half of the supervisory board consists of employee representatives. This reflects the German system of co-determination. However, despite the fact that there is an even number of employee- and shareholder-elected representatives on the board, there is only “quasi-parity”, because the chairman, who is elected by the shareholders, has a casting vote. Nevertheless, the mandatory involvement of employees in governing a corporation shows that German company law goes beyond the interest of shareholders and takes other stakeholders’ interest into account as well.

Apart from that, the shareholder structure is worth mentioning. As in some other European countries, stock in Germany is held by some large, often majority, shareholders. For example, eighty per cent of the top 170 firms listed in Germany had at least one shareholder owning at least twenty-five per cent of the shares in the late 1990’s. Fifty-seven per cent even had a majority shareholder. The shareholding structure influences corporate governance. The large shareholders have

28 Chantayan, above, 437.
35 For example France and Italy; Gustavo Visentini “Compatibility And Competition Between European And American Corporate Governance: Which Model Of Capitalism?” (1998) 23 Brook J Int’l L 833, 836.
38 Mahmut Yavasi “Shareholding And Board Structures Of German And UK Companies” (2001) 22(2) Comp Law 47, 50.
significant control over directors’ powers. Consequently, one of the big problems for German corporate law is to control these major shareholders’ power.

B The German Code of Corporate Governance

There have been several changes in German corporate governance in recent years. The most interesting change was the enactment of the German Code of Corporate Governance (the “Code”) in 2002.

In Germany, so far there have been no corporate scandals comparable to the Enron disaster in the United States. Although some scholars take the view that such scandals occurred, but were not published as broadly, the general opinion was that German corporate governance was well functioning. Consequently, the reasons for the development of the German Code lay elsewhere.

Germany has decided that attracting international investors is the key to overcome its economical crisis. Most of this money is located with institutional investors in the United States. The problem is, that these investors have trouble understanding Germany’s system of corporate governance, because it is significantly different from the United States system. According to studies, there is a direct relationship between investor confidence in capital markets and effective corporate governance. Some main criticisms against German corporate governance have been revealed. These contain a lack of transparency; a lack of focus on shareholder interest; the two-tier board structure; and, a lack of independence on supervisory

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40 Sarra, above, 191.
44 Wolff, above, 128.
boards and among auditors\footnote{Hans-Christoph Hirt “Germany: The German Corporate Governance Code: Co-Determination And Corporate Governance Reform” (2002) 23 Comp Law 349, 350.}. The German Government decided to address such criticism and thereby increase the German capital market’s attractiveness to international investors\footnote{Lutz-Christian Wolff “Law As A Marketing Gimmick – The Case Of The German Corporate Governance Code” (2004) 3 WAUGSLR 115, 128.}. Hence, the Code is a response to these main criticisms\footnote{Luca Enriques “Bad Apples, Bad Oranges: A Comment From Old Europe On Post-Enron Corporate Governance Reforms” (2003) 38 Wake For L Rev 911, 920-921.}. It tries to make the German system more transparent and understandable\footnote{Wolff, above, 128.}.

The process of developing the German Code took longer than the development of the Act in the United States. Two commissions were installed, consisting of experts from all parts of the corporate law\footnote{These included investors, managers, supervisory board members, employee and stock exchange representatives, auditors, and academics; Hans-Christoph Hirt “Germany: The German Corporate Governance Code: Co-Determination And Corporate Governance Reform” (2002) 23 Comp Law 349, 350.}. The first commission was established in May 2000 and issued a final report based on questionnaires that had been sent to more than eighty experts and institutions\footnote{Wolff, above, 121.}. The second commission was established in September 2001 and further developed the first commission’s suggestions. It finally published the German Code on 26 February 2002\footnote{Luca Enriques “Bad Apples, Bad Oranges: A Comment From Old Europe On Post-Enron Corporate Governance Reforms” (2003) 38 Wake For L Rev 911, 920.}. On 17 May 2002, the German Parliament passed the Transparency and Disclosure Act 2002, which came into force on 1 August 2002\footnote{Hans-Christoph Hirt “Germany: The German Corporate Governance Code: Co-Determination And Corporate Governance Reform” (2002) 23 Comp Law 349, 350.}. This Act inserted a new section 161 into the German Stock Corporation Act (“Aktiengesetz”), which requires each publicly listed company to annually declare whether it has complied with the German Code or report which provisions have not been complied with\footnote{Hirt, above, 350.}. The Code also recommends non-listed companies to adopt it\footnote{Lutz-Christian Wolff “Law As A Marketing Gimmick – The Case Of The German Corporate Governance Code” (2004) 3 WAUGSLR 115, 121.}. Due to its purpose, the German Code does not contain too many new rules. It contains three different kinds of provisions\footnote{Hirt, above, 351.}. Firstly, a large part simply reflects the statutory basis of German corporate law in order to summarise and explain the German system\footnote{Especially co-determination and the dual board structure.}. The new
rules included are orientated to concerns of United States investors. They are divided into "recommendations" and "suggestions". Recommendations are quasi mandatory, because they demand companies to comply with or explain non-compliance in their annual report. Non-compliance with suggestions does not have to be published. This short description of the different sorts of provisions already forebodes that the German Code is far from being easily understood. The most important provisions will be discussed in detail below.

V CORPORATE GOVERNANCE IN NEW ZEALAND

Before analysing the sense of certain regulation, the current corporate governance situation in New Zealand has to be analysed, focusing on recent developments and highlighting the question of whether New Zealand needs to reform its corporate governance regime.

A The Situation in New Zealand Corporate Governance

New Zealand’s corporate regime is a mixture of statute, code and common law principles. The Companies Act 1993 provides the fundamental framework. Directors must act in the company’s best interests and in good faith. It is the board’s responsibility to manage the company’s business and affairs. However, ultimate control is reserved for the shareholders.

New Zealand’s economy is dominated by small to medium-sized companies. 97 per cent of New Zealand firms fall into that category.
Consequently, corporate governance in New Zealand must extend beyond large publicly listed companies. It is arguable that unlisted and particularly family-owned and co-operative businesses require different management principles, as there are no public shareholders affected. Owner-managers bear the costs of their own incompetence. However, for a country like New Zealand, which has a significant number of these firms, it is important that even these companies try to adhere to a high standard of principles in general, because, due to their predominance, they significantly influence New Zealand’s corporate governance culture.

Many New Zealand companies have performed well in recent years. However, among the small number of underperforming firms were a comparatively large number of large companies. This has a significant influence on New Zealand’s economy. The international reputation of a country’s economy is dependent on its large companies. It is important to point out that the small size of an economy does not keep it from producing internationally successful large companies. Finnish Nokia or Swedish Ericsson provides good examples, despite their struggle in recent times. Furthermore, internationally successful companies offer challenging careers for New Zealand management talents. This could keep them from going overseas.

B Recent Developments in New Zealand

There has been a vital discussion within New Zealand in recent years whether and how corporate governance should be altered. Many organisations and law firms have contributed their own reviews and principles. In May 2003, the New Zealand Securities Commission (the “Commission”) started a consultation process in order to identify levels of consensus and disagreement in New Zealand corporate...

70 Healy, above, 33.
71 Healy, above, 41.
73 Healy, above, 52.
governance. The Commission published a background paper and a questionnaire that could be filled out by any interested party. The background paper identified nine key areas, on which the discussion should focus. These nine key issues were:

- Ethical Conduct
- Board Composition and Performance
- Board Committees
- Reporting and Disclosure
- Remuneration
- Risk Management
- Auditors
- Shareholder Relations
- Stakeholder Interests

The submission deadline ended 3 November 2003. The Commission issued its report “Corporate Governance in New Zealand, Principles and Guidelines” (the “Principles”) on 16 February 2004. The Commission issued nine principles, one for each key area mentioned above. However, these nine principles are very vague. They have already been criticised as “commonsense” and “self-evident”. Hence, they provide little guidance for corporate governance. Even though companies are expected to report as to how they achieved each principle, this means little for ensuring good governance, due to their vague and broad wording. The guidelines issued for each principle provide more detailed guidance. However, companies are only expected to report against the principle, not against the guidelines. There are no mandatory requirements. Hence, the Principles are very weak. The Commission

75 “Corporate Governance In New Zealand, Consultation On Issues And Principles, Background Reference Paper”, above.
77 Paul Panckhurst “Guiding Rules For Directors Sit Well” (20 February 2004) New Zealand Herald C3.
78 “Corporate Governance in New Zealand, Principles and Guidelines”, above, 8.
79 “Corporate Governance in New Zealand, Principles and Guidelines”, above, 8.
submitted the Principles to the Minister of Commerce. Whether this is the final word on New Zealand corporate governance is still unclear.  

C Is There a Need for New Rules in New Zealand?

The pivotal question is whether there is a need to issue new rules on corporate governance in New Zealand. While New Zealand provides examples of poorly managed companies and there are few examples of international corporate success stories, there at least have not been massive corporate scandals comparable to Enron. On the other hand, the same has been true for many other countries, which nevertheless reacted on the international trend to implement such rules. The question arises, whether New Zealand is supposed to react to these developments as well.

While one might argue that changes in the United States or Germany do not directly affect a small country like New Zealand, an indirect affection cannot be doubted. In a world of globalised capital markets New Zealand cannot isolate itself. New Zealand is extremely dependant on foreign capital. There is international competition to attract foreign investors. Hence, it must view its corporate governance in an international context. Shareholders are mobile. In case they are not happy with a company’s development, they can always sell their stock and take their money to invest elsewhere, including overseas. Missing out on international developments therefore implies a double danger. Firstly, New Zealand

80 This paper was mainly written before the Principles were issued. Unfortunately, the Principles were issued a few months later than previously announced. There have been no further announcements as to whether the ministry has any plans as to how to proceed with the Principles. This paper mainly takes the results of the consultation process into account.

81 Joseph Healy Corporate Governance And Wealth Creation In New Zealand (1 ed, Dunmore Press Ltd, Palmerston North, 2003) 22.


83 David Quigg “New Takeover Code To Enhance Shareholder Protection In New Zealand” (2001) 12(3) ICCLR 111, 112; in comparison, Australia – which has reacted on international developments and implemented new regulation on corporate governance - only depends half as much on international capital; Healy, above, 29/49.


loses ground in the global competition for international investors’ money. This can hardly be afforded, given the fact that the poor performance of New Zealand companies in recent years already presents a problem to attract investors. The average medium-large Australian company was almost 2.5 times more successful in the use of capital to develop growth than its New Zealand peer. Given the fact that Australia was even less successful than companies in the United States or United Kingdom, it is hard to see why an investor should consider investing in New Zealand. Secondly, New Zealand also risks losing domestic investors who might be attracted by international markets. A few numbers on the New Zealand stock market underline this danger. New Zealand’s stock market almost stagnated in the last decade, while markets around the world were growing strongly. The NZSE had a market capitalisation of $43.3 bn at the end of 1994 and was at $44 bn by the end of 2001. In contrast, the market of the nearest neighbour, Australia, managed to grow from $282 bn to $733 bn during the same period. Of course there are some explanations for the relatively underdeveloped New Zealand stock market apart from those related to corporate governance. For example, the agricultural sector is a significant part of New Zealand’s economy and not listed on stock markets. Moreover, many large sectors have not been privatised in New Zealand (for example New Zealand Post, Transpower), which contribute to market growth in other countries. Nevertheless, this poor development might force domestic investors to invest in overseas markets.

On the other hand, investors’ increased mobility also presents a chance for New Zealand. Overseas investors can be attracted to invest in New Zealand. In
order to attract international investors, New Zealand has to adopt a modern system of corporate governance.\(^{96}\) A 2000 McKinsey study among investors found that three quarters of them thought that good corporate governance was as important as the financial performance when evaluating an investment.\(^ {97}\) The importance investors put on corporate governance cannot be ignored. Improving corporate governance will make New Zealand more attractive for long-term capital.\(^ {98}\) Apart from that, a well-working stock market might be key to New Zealand's development. Stock markets play an important role in today's economy by injecting capital to enable growth.\(^ {99}\) A study of 47 countries found a strong correlation between the economic growth of a country and the size and liquidity of its stock market.\(^ {100}\)

Attracting international investors might have another, very important side effect for the long-term development of New Zealand economy. A prospering economy presents interesting and challenging careers for young and talented New Zealand academics. These talents often leave the country in order to find attractive jobs overseas.\(^ {101}\) Since these talents are thereby lost for its own economy, they cannot help developing it. This vicious circle can be stopped, once the local economy provides an incentive to stay in the country. Otherwise, New Zealand will keep losing many of its managerial talents to overseas companies.\(^ {102}\)

The fact that New Zealand has to keep an eye on international developments does not mean that it has to blankly adopt whatever the economically leading

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\(^ {97}\) Jack Davis "Good Government Pays" 17 June 2003, available online at:


\(^ {100}\) Healy, above, 32.

\(^ {101}\) According to experts, New Zealand has an equally large number of qualified managers compared to other countries. However, not all of these talents really work in New Zealand; Healy, above, 43.

\(^ {102}\) Healy, above, 52.
nations do or international investors demand\textsuperscript{103}. Doing so would not help New Zealand in the long run. In spite of that, it has to take its own unique situation and requirements into account. New Zealand is neither comparable with the United States nor with Germany. New Zealand as a smaller country, which economy is still very much based on agricultural products, has its unique requirements towards corporate governance. Therefore, it is important to critically analyse new regulative schemes in other countries in order to decide which rules are worth adapting. This is what will be done in the following paragraph in regard to the new regulations in the United States and Germany.

VI PRO’S AND CON’S OF DIFFERENT RULES IN NZ

This part deals with different questions surrounding the best approach for New Zealand corporate governance. The most important regulations in German and United States corporate governance will be discussed and weighed against the needs of New Zealand.

A Strict Rules versus a Principles-Based Approach

The basic question is how to design the system in general. This question is of outstanding importance, for it significantly influences the decision of whether to implement a certain rule or not. In the case of using a strict rule-based approach companies have to follow, one has to be much more careful to create general applicable rules than in case of using non-mandatory principles.

There is a general distinction between highly prescriptive rules and a principles-based approach\textsuperscript{104}. One possibility for New Zealand is to follow the United States example and have a strict system of rules that every company has to follow\textsuperscript{105}. An alternative would be to follow the German (and the majority of other


\textsuperscript{104} Mark Walsh and Thomas Thesing “Extraterritorial Application Of US Corporate Governance Standards In Europe” (2003) 14(5) ICLR 165, 165.

countries' example and install a principles-based approach. A third possibility is to take a middle way between the two. One could design a system in which some rules are mandatory and others are left up to the individual company.

The United States example of having mandatory highly prescriptive rules has the significant advantage of installing a mandatory system every company has to follow. This way at least following the rules is guaranteed. There is no possibility for companies to circumvent unpleasant rules. Loopholes in regulations have significantly contributed to the Enron disaster. Allowing companies to decide for themselves whether they will follow certain rules or not, knowingly creates such loopholes in the first place. Keeping in mind how clever companies are when explaining abnormal behaviour, such flexibility contains a significant risk. Mandatory rules avoid such risks. Apart from that, they provide enforceability. The state can thereby control compliance with important rules and to a certain extent guarantee good corporate governance standards. Furthermore, investors know the corporate governance structure of every company. Everyone has to comply with the same rules. There is no obligation to first analyse a company’s annual report in order to find out its style of corporate governance, which could repel international investors. It can be concluded that a highly prescriptive mandatory approach has the advantage of clarity.

However, highly prescriptive rules also have significant downsides. The most important disadvantage is the lack of flexibility. Providing a mandatory rule implies that either the same rule is good for every affected company or that all affected companies are equal. In other words, every mandatory rule implies a

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106 These other countries most importantly for New Zealand include Australia and The United Kingdom; http://www.kesteven.com.au/governance/codes.htm (last accessed 9 March 2004).
107 There is a certain irony in the fact that a country like Germany (which is notorious for its mandatory statutory law) adopts a principles-based approach relying on market pressure to enforce compliance, while at the same time the United States (which usually uses self-regulation) implements strict mandatory rules; Lutz-Christian Wolff “Law As A Marketing Gimmick – The Case Of The German Corporate Governance Code” (2004) 3 WAUGSLR 115, 120.
109 Though no system of corporate governance will ever be capable of completely avoiding corporate scandals; Brian Kim “Sarbanes-Oxley Act” (2003) 40 Harv J Legis 235, 252.
simplification\textsuperscript{112}. Corporate governance includes various different topics and areas. Each corporation is different\textsuperscript{113}. For example, a small company with a majority shareholder is not comparable to a multinational corporation with widely held stock. Hence, it is hard to believe that rules that concern the way a business is run will be equally applicable for every company\textsuperscript{114}. Sometimes companies might have fairly good reasons not to follow rules that are very important for other (or even the majority of) companies. For example, without some flexibility in regard to who is considered to be an independent director, many qualified candidates with excellent knowledge of the company’s business might automatically be disqualified\textsuperscript{115}. Apart from that, the flexibility of a principles-based approach also shows in another respect. Mandatory government regulation takes longer to alter. In today’s fast-changing global markets it is important to react on new developments fast\textsuperscript{116}. A principles-based approach enables companies to immediately respond to market changes, while keeping investors informed at the same time. The Commission’s consultation process showed strong support for a principles-based approach in New Zealand\textsuperscript{117}. Nevertheless, a number of rules generally apply to each company and are useful to ensure good governance\textsuperscript{118}. In other words, there are several rules that principally should be applied to by every company, provided there are no exceptional circumstances. A principles-based approach exactly serves that

\textsuperscript{111}Hans-Christoph Hirt “Germany: The German Corporate Governance Code: Co-Determination And Corporate Governance Reform” (2002) 23 Comp Law 349, 351.
\textsuperscript{113}Hirt, above, 351.
\textsuperscript{118}For examples, see the discussion of several rules below.
purpose\textsuperscript{119}. It sets up principles that generally should be complied with. However, in case a company has a particular reason not to follow this rule, this approach leaves it the flexibility to do so\textsuperscript{120}.

Notwithstanding the importance of flexibility, it is nevertheless important to have an enforcement tool. There is no sense in simply providing guidelines no company has to comply with. However, the New Zealand Principles do not impose any legal obligations on companies\textsuperscript{121}. Companies are simply expected to report on how they achieved the vague principles. The guidelines, which include more detailed obligations, do not have to be reported against\textsuperscript{122}. It has to be awaited if the ministry plans any further regulation. The current version only provides a very weak system. The German approach is a “comply-or-explain” regulation. Each publicly held company has to either comply with the rules provided by the German Code or explain which rules have not been complied with. There is no direct enforcement. The idea behind the approach is that market pressure will force companies to comply\textsuperscript{123}. A company that does not sufficiently comply with the rules in the eyes of investors will face disinvestment and a fall in stock price\textsuperscript{124}. The question remains whether this is sufficient enforcement. This will to a large extent depend on what exactly a company has to explain. There has been a debate in Germany whether this also implies an obligation to explain why a company does not comply with these rules. The wording of section 161 of the Aktiengesetz leaves little room for discussion. There is no such obligation\textsuperscript{125}. This is different in Great Britain for example. The Combined Code demands companies to explain why they did not

\textsuperscript{122} “Corporate Governance in New Zealand, Principles and Guidelines”, above, 8-10.
\textsuperscript{125} Hans-Christoph Hirt “Germany: The German Corporate Governance Code: Co-Determination And Corporate Governance Reform” (2002) 23 Comp Law 349, 350.
comply with a certain provision. The New Zealand regulation should also make the explanation mandatory. It has been argued that German companies will explain their reasons anyway, because they will feel pressured to do so in order to avoid negative sanctions by investors. This might be true in most cases. However, in cases where a company does not comply with a rule for no good reason it will not provide an explanation. In other words, this lack of explanation requirement leaves another loophole. This loophole can easily be closed without causing significant expenditure for the companies. Furthermore, it is important to demand such explanation in order to make market pressure a reliable enforcement tool. Finally, an explanation obligation provides clarity and forces each company to think about the reasonableness of complying with each principle.

Neither Germany nor the United States have implemented a mixed approach, combining strict mandatory rules with a set of non-mandatory principles. Though the German Code contains mandatory rules, these are not implemented by the Code, but simply repeat the existing German legal background. A mixed approach would enable the state to combine a set of very important mandatory rules with a set of principles for areas where there is less necessity for compliance or where no generally applicable rules are possible. Such an approach would combine the advantages of the United States approach (clarity, enforceability) with those of the German approach (flexibility). The consultation process for the New Zealand principles showed some support for a mixed approach. However, such a concept is very complicated. Keeping in mind that one of the main reasons for adopting a code of corporate governance in New Zealand is to attract international investors complication should be avoided. Therefore, a clear approach in New Zealand is even more important than in Germany.

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It can be concluded that a principles-based approach is preferable in New Zealand. The small size of its economy combined with the fact that there are only a few large companies make a strict rule-base approach unnecessary. Flexibility is important, because the big majority of New Zealand companies might not be interested in attracting international investors. For them, a huge set of mandatory rules would only result in unnecessary costs. Nevertheless, for ambitious and larger New Zealand companies it is important that New Zealand corporate governance is regarded as up to date with international standards. Therefore, a code of principles suits the New Zealand situation best. It should be designed as a comply-or-explain regulation, forcing a company also to explain why it did not comply with a certain principle. The current version of the New Zealand Principles is too weak and hence insufficient. The following paragraphs will analyse which principles would be applicable for New Zealand.

B Code Of Ethics For Senior Financial Executives

The Act requires every company to disclose whether, or why not, it has adopted a code of ethics for senior financial directors. It is the Act’s only comply-or-explain provision. The German Code does not address the topic. In New Zealand the consultation process showed general support for a code of ethics. It can be said that such a code of best practice for the board should be implemented. However, one should not expect too much of it. Implementing such a code by itself does not mean the company has addressed ethical topics sufficiently. Even Enron had such a code. The pivotal point is that waivers of or changes in the code have to be disclosed and thereby are made public. Waivers from Enron’s code of ethics enabled Chief Financial Officer (“CFO”) Andrew Fastow to receive generous fees.

131 “Corporate Governance in New Zealand, Principles and Guidelines”, above, 42.
from his self-designed “special purpose entities”\textsuperscript{134}. New Zealand should include a provision that waivers from the code need to be published immediately to inform shareholders.

\textbf{C Auditors}

Auditing from outside companies is key to corporate control. Though inside monitoring through independent directors is important, outside monitoring through independent auditors is crucial for obtaining an independent expert opinion. Both in Germany and in the United States new rules concerning editors have been implemented.

\textit{I Prohibition of consulting services?}

The Act focuses quite strongly on auditors and accounting. Beside the enactment of the new accounting oversight board (see below) the Act also implements a number of new obligations and prohibitions concerning auditors. Most significantly, the Act prohibits an auditing company to provide certain consulting services to the same client\textsuperscript{135}. Furthermore, an accounting firm is prohibited from providing audit services to any company whose CEO, CFO, chief accounting officer or person of similar responsibility worked for the accounting firm in the last year\textsuperscript{136}. Lastly, the Act requires rotating the lead audit partner at least every five years\textsuperscript{137}.

The German Code is less strict. It addresses the issue of independent accountants in its last part. The supervisory board by law is responsible for choosing the auditor and agreeing on its fees\textsuperscript{138}. Furthermore, the law requires the auditor to take part in all supervisory board meetings concerning financial statements\textsuperscript{139}. The Code only implements two new obligations in respect to auditors. The auditor has to declare whether any, and then which, relations to the company or its directors exist.

\textsuperscript{134} Branson, above, 1008.
\textsuperscript{135} Section 201 of the Act; Robert W Hamilton “The Crisis In Corporate Governance: 2002 Style” (2003) 40 Hou L R 1, 58.
\textsuperscript{136} Branson, above, 1009.
\textsuperscript{137} Section 203 of the Act; Hamilton, above, 58.
\textsuperscript{138} Section 7.2.2 of the German Code.
\textsuperscript{139} Section 7.2.4 of the German Code.
that could influence its independence prior to its selection\(^{140}\). The Code particularly demands not only to disclose any recent or actual (especially consulting) contracts, but also any contracts for the following year. In case such conflicts of interest arise after the auditor has been engaged, it has to inform the supervisory board immediately. The same obligation arises in case the auditor finds any facts that could be relevant for the supervisory board’s work, especially evidence of potential breach of director’s duties\(^{141}\).

The question arises, whether the prohibition of consulting services for auditors makes sense in New Zealand. The United States prohibition of consulting services beside auditing services is designed to improve auditor independence\(^{142}\). In 2000, Enron paid its auditor Arthur Andersen US $ 25 million in auditing fees, but US $ 27 million in consulting fees\(^{143}\). Such circumstances provide an incentive for the auditor not to risk the lucrative relationship to its client and undermine its independence\(^{144}\). However, there are two main arguments against the prohibition of consulting services. Firstly, these services provide the accountant with the necessary background information and enable it to understand its clients business. This is helpful for providing proper auditing services\(^{145}\). Furthermore, there would be additional costs, because this information would have to be generated by the auditor\(^{146}\). Secondly, consulting services provide additional income for accountants and thereby increase their independence\(^{147}\). Notwithstanding these concerns, the prohibition of consulting services is a necessary step. Otherwise, conflicts of interest are inevitable. An auditor, economically depending on the profits generated from performing consulting services for a client is unlikely to paint an accurate picture of its financial situation in case of crisis\(^{148}\). Financial accounting always involves a degree of inaccuracy\(^{149}\). Given that, there has to be a measure to avoid immoderate

\(^{140}\) Section 7.2.1 of the German Code.
\(^{141}\) Section 7.2.3 of the German Code.
\(^{144}\) Brian Kim “Sarbanes-Oxley Act” (2003) 40 Harv J Legis 235, 244.
\(^{145}\) Kim, above, 243-244.
\(^{146}\) Kim, above, 235, 244.
\(^{147}\) Kim, above, 235, 244.
\(^{148}\) Kim, above, 235, 244.
interdependence. The risk of losing the accounting job is financial incentive enough to issue favourable reports\textsuperscript{150}. It should be avoided to make that risk even larger by having other businesses at stake as well. Therefore, the prohibition of providing additional consulting services is a good idea in the United States, where there are several auditors to choose from. However, the question is whether the New Zealand situation requires such a drastic step. Opinion on this topic was divided among participants of the New Zealand consultation process. There was a strong view that certain services that could potentially undermine the auditor’s impartiality should be forbidden\textsuperscript{151}. It has to be kept in mind that the New Zealand market is small. Having only a limited number of auditors, a general prohibition of non-audit services is difficult. Furthermore, the additional costs involved provide a bigger burden, because New Zealand companies are smaller than their United States counterparts. Therefore, a general prohibition of consulting overshoots the mark in New Zealand. Prohibiting only certain services is difficult, because potentially every other service undermines the auditor’s impartiality, due to the fees paid. The different services mentioned in the consultation process already indicate that it will be hard to decide which services should be forbidden. Since the arising conflicts of interest are nevertheless critical in the important field of auditing, the German rules could be adopted. The company has to publish existing contracts with the auditor. This suggestion gained almost unanimous support among participants in the New Zealand consultation process\textsuperscript{152}. The publication should also include future contracts, because these provide an equal incentive to be less objective as recent contracts. An alternative would be a financial limit, allowing consultation fees only to be a certain percentage of the auditing fees. However, the majority of New Zealand professionals oppose fixed levels as too inflexible\textsuperscript{153}.

\textsuperscript{150} Keeping in mind that the audit fees Enron paid alone were US $ 25 million.


\textsuperscript{152} “Corporate Governance in New Zealand, Principles and Guidelines”, above, 66.

\textsuperscript{153} “Corporate Governance in New Zealand, Principles and Guidelines”, above, 66-67.
2 Rotation of auditors?

The second question is, whether New Zealand should implement any rules as to the rotation of auditors. German law does not prescribe anything. In the United States, the Act requires rotating the lead audit partner at least every five years. This rule is designed to avoid auditor and company of becoming too close. Such familiarity endangers the auditor’s much required independence. The question remains, whether this goes far enough. United States legislation stopped short of requiring mandatory rotation of the audit company itself.

Despite the fact that the New Zealand Securities Commission sees it as a good balance between cost losses and independency gains, the efficiency of simply changing the lead audit partner can be doubted. While there is a danger in the audit partner and the company becoming too close, there are also positive factors in a long relationship. Firstly, an auditor knowing a company’s performance (and its books) for years is more likely to detect irregularities. Secondly, a new lead audit partner would have to become acquainted, which results in unnecessary costs. A real improvement would only be to make the rotation of the audit firm mandatory. This approach serves the purpose better and would at least justify the dedication of time and money connected with changing the auditor. A different partner in the same auditor firm is unlikely to criticise a colleague anyway. Therefore, there either should be a need to change the entire audit company or no obligation at all. Due to the limited number of audit companies and qualified auditors available in New Zealand, the latter seems preferable.

158 The majority of participants in the consultation process also pointed out the small number of qualified auditors in New Zealand and opposed mandatory rotation of the audit firm; “Corporate Governance in New Zealand, Principles and Guidelines”, above, 65.
D Board Composition

One of the most discussed questions worldwide is the question of the composition of the board of directors. Since the board is responsible for monitoring management and making critical decisions, it has a crucial function in corporate governance. Consequently, assigning the board is one of the most critical decisions in order to secure good governance. The question is, whether there is a general applicable recipe how to composite the ideal board.

1 Independent directors

The standard answer in recent years has been to focus on independent directors. However, there has been some discussion about when a director can be said to be independent. A variety of definitions have been offered. However, there are some generally applicable criteria for non-independence. An executive director cannot be considered independent. Other factors regularly mentioned include the absence of recent employment for the company or as an advisor for the company, not being affiliated with its customers or suppliers or being related to such people, and not being a major shareholder. Optimally, an independent director is free from any relationship with management and any other business interests in the company that could possibly interfere with the exercise of an independent judgement. However, independency is a matter of degree. With time, a director that initially was considered independent will slowly become dependent, due to his or her involvement in the company.

162 Delga, above, 2.
In the United States, the Act requires every company to have an audit committee composed solely of independent directors. The Act also defines what constitutes an independent director. The German Code recommends that the supervisory board always has members, which have the knowledge, abilities and experience required and who are “sufficiently independent.” There should not be more than two former members of the management board. Furthermore, members of the supervisory board should not be directors or advisors for competitors. German law prohibits members to pursue personal interests in relation to the company. Any contracts between the company and supervisory board members need to be approved by the board. Members should also report conflicts of interest to the board, which should publish these and their treatment to the general meeting.

The different treatment in Germany and the United States partly results from the German system of co-determination, which requires German companies to have members on the supervisory board, who are generally not considered independent according to United States standards. However, it is significant that the German Code does not require any real independence from its supervisory board members, while the Act focuses quite heavily on them. The question arises, whether requiring independent directors makes sense at all and particularly in New Zealand.

The NZSE listing rules only require listed companies to have at least three directors.

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165 Harvey Gelb “Corporate Governance Guidelines – A Delaware Response” (2001) 1 WYLR 523, 552.
168 Section 5.4.1 of the German Code.
169 Section 5.4.2 of the German Code.
170 Section 5.4.2 of the German Code.
171 Section 5.5.1 of the German Code.
172 Section 5.5.4 of the German Code.
173 Section 5.5.2 of the German Code.
174 Section 5.5.3 of the German Code.
175 Exceptions are union representatives. However, mostly the members of the supervisory board elected by the employees are employees of the company.
including two ordinary New Zealand residents\textsuperscript{177}. It recommends a minimum of two or one-third independent directors\textsuperscript{178}.

The idea behind requiring independent directors is that they improve corporate governance by not having own interests at stake. Hence, there should not be any conflicts of interest for them. This shall enable them to act in the company’s best interest when making a decision without any conflicts\textsuperscript{179} and to monitor management effectively\textsuperscript{180}. Furthermore, they might bring fresh ideas into the company\textsuperscript{181}. Hence, they can be important for counterbalancing management’s power\textsuperscript{182}.

However, independent directors are also seen critically\textsuperscript{183}. There are two main arguments against independent directors. Firstly, it is questionable whether independent directors devote enough time to their directorship\textsuperscript{184}. Secondly, they might not really know the company’s business\textsuperscript{185} and have to rely on the information provided to them by management\textsuperscript{186}. Because of their limited knowledge, they might be unable or reluctant to ask the right questions in board meeting\textsuperscript{187}. A powerful CEO might be able to intensify this effect. On the other hand, being independent does not mean that directors do not have any qualification\textsuperscript{188}. It is crucial to choose qualified candidates. Good governance is primarily a question of substance and not

\begin{footnotesize}
\textsuperscript{179} William M Rees and Saleem Sheikh "Corporate Governance And Corporate Control: Self Regulation Or Statutory Codification" (1992) 3(11) ICCLR 370, 373.
\textsuperscript{180} Mark J Loewenstein “The SEC And The Future Of Corporate Governance” (1994) 45 Ala L Rev 783, 784-785.
\textsuperscript{181} Harvey Gelb “Corporate Governance Guidelines – A Delaware Response” (2001) 1 WYLR 523, 525.
\textsuperscript{182} Saleem Sheikh “Non-Executive Directors: Self-Regulation Or Codification” (2002) 23(10) Comp Law 296, 298.
\textsuperscript{183} Sheikh, above, 297-298.
\textsuperscript{184} William M Rees and Saleem Sheikh “Corporate Governance And Corporate Control: Self Regulation Or Statutory Codification” (1992) 3(11) ICCLR 370, 373.
\textsuperscript{186} Sheikh, above, 298.
\textsuperscript{187} Rees and Sheikh, above, 373.
\textsuperscript{188} For example, they can be financial experts or academics.
\end{footnotesize}
of form. In any case, it is important for independent directors to meet without management and non-independent directors from time to time in order to discuss issues without negative interference. The German Code contains such a provision concerning the members of the supervisory board. Unlike common practice, they shall meet without the presence of the managing board in appropriate cases.

In New Zealand another problem occurs. Due to the country’s small size and relative isolation, the number of qualified candidates is limited. It is estimated, that Australia’s new rules will force them to find 10,000 new directors to meet the independence requirements. While United States and German companies can easily find a large number of potential independent directors, a New Zealand company might find that much more troublesome. Moreover, due to their smaller size, many New Zealand companies also require a board that is more involved in management, is knowledgeable about the company, and able to support the company as it grows. Having independent directors alone does not improve corporate governance. It could be argued that the most important thing is to have the best directors on board, no matter whether they are considered independent or not. Nevertheless, the idea of having independent directors is favourable. Chosen well, they can perfectly complete the board. Here the flexibility of a principles-based

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189 Harvey Gelb “Corporate Governance Guidelines – A Delaware Response” (2001) 1 WYLR 523, 526.
190 Minter Ellison Rudd Watts “Corporate Governance White Paper” 28 May 2003, available online at: http://www.minterellison.co.nz/doclibrary/competition/CorporateGovernanceWhitePaper.pdf (last accessed 9 March 2004) 12; they also provide an example of a situation where such a meeting might have resulted in avoiding a fraud by a senior executive.
191 Section 3.6 of the German Code.
194 Quinn, Rowe and Linton, above, 2.
195 Jacques Delga “Corporate Governance And The Independent Director: The Independent Director In France” (2004) 15(1) ICLR 1, 5.
196 The danger of missing out on some of the best people in case of having a strict definition has also been pointed out by some respondents in the consultation process; “Corporate Governance in New Zealand, Principles and Guidelines” see at: http://www.seccom.govt.nz/publications/documents/governance-principles/corporate-governance-in-new-zealand.pdf (last accessed 9 March 2004) 46.
197 They can also have an important function in smaller companies by bringing experience to the board; Saleem Sheikh “Non-Executive Directors: Self-Regulation Or Codification” (2002) 23(10) Comp Law 296, 299.
approach pays. Companies have to be able to make exceptions for directors that are not independent in the sense of the definition, but where there nevertheless is a good reason to nominate them as a director. Due to the limited number of potential candidates in New Zealand the suggested number of one-third of independent directors seems reasonable.

Some scholars even go a step further and suggest the implementation of public directors. This might be an interesting idea. However, it is not suitable for New Zealand, as it would be a completely new approach and might rather repel international investors than improve their confidence in a modern New Zealand system of corporate governance.

The optimal board size is disputed. Large boards are said to be less effective. This is true in the case of extremely large boards. They also provide an opportunity for single directors to hide behind others and not becoming personally involved in discussions. However, though smaller boards may be more harmonious, the danger is that such harmony comes at the cost of sufficient depth. After all, it seems safe to assume that there is no general solution. The optimal size of the board will vary from company to company, depending on its size, business and state of development. It is much more important to create a good mix of skills and knowledge suiting the company’s particular needs. To these considerations the question of board size is secondary. Hence, there should not be any regulation regarding the size of the board. Requiring a certain number of independent directors will be enough.

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203 Franks, above, 30.
2 Separation of chairman and CEO

There is a wide agreement that the chairman of the board and the CEO should not be the same person. This is important, because the CEO already has significant power by definition. The chairman has a fundamental role within the corporate system, including the overall responsibility for the board. Combining the two positions results in an undesirable concentration of power. There is no counterpart for the CEO. Given the fact that the chairman sets the board's agenda and chairs all meetings, he or she has a great influence on the way the board works. Hence, the positions should be parted. Unlike in the United States, where the chairman and CEO are frequently the same person, the separation of both positions already is the norm in New Zealand. Nevertheless, there should be a clarification in the New Zealand principles.

3 Limitation in the number of board memberships?

With increasing complexity of today's economy, it becomes more and more important that directors allow sufficient time to effectively fulfil their job. Effective monitoring requires more than simply reading the board papers and attending meetings. The German Code addresses the problem by recommending that a person should not be a member in more than five supervisory boards. Furthermore, it should be reported in the supervisory board's annual report if a
member attended less than half of the board’s meetings\textsuperscript{213}. It is arguable that there will regularly be a correlation between the time a director devotes to his job and the level and quality of his or her control over management. In Germany it was not completely unusual that people were members of more than 10 companies’ supervisory boards\textsuperscript{214}. Keeping in mind that most of them have another full time position\textsuperscript{215} in another company, the question arises whether their function on the board exceeds pure representation. The outstanding importance of monitoring the executives requires the devotion of a substantial amount of time\textsuperscript{216}. Therefore, a limitation in the number of directorships makes sense, despite the limited number of potential directors in New Zealand, even though it has been feared that an increased demand in time will result in increasing directors’ fees\textsuperscript{217}. However, one might consider a larger number of memberships in accordance with the fact that there is a large number of small companies in New Zealand, where directorship might not be as time consuming as in larger corporations.

Apart from that, it has been suggested to limit the time an independent director spends on the board of a company\textsuperscript{218}. While the independence of a director might vanish after several years on the company’s board\textsuperscript{219}, such a fixed provision should not be implemented in New Zealand. On the other side, the director also gains knowledge and experience. It seems more important for each company to generally check its board structure from time to time either way, because a company might require a different mix of skills in different stages of its development\textsuperscript{220}. Therefore, it does not help to adopt any general applicable rules.

\textsuperscript{213} Section 5.4.6 of the German Code.
\textsuperscript{215} For example as an executive or lawyer.
\textsuperscript{216} Saleem Sheikh “Non-Executive Directors: Self-Regulation Or Codification” (2002) 23(10) Comp Law 296, 298.
\textsuperscript{218} Sheikh, above, 302.
\textsuperscript{219} Harvey Gelb “Corporate Governance Guidelines – A Delaware Response” (2001) 1 WYLR 523, 552.
\textsuperscript{220} Minter Ellison Rudd Watts, above, 11.
The German Code also recommends an age limit for members. This provision does not make sense, for the focus should be on the abilities of a candidate rather than on his or her age.

E  
Board Committees

The installation of special board committees has been broadly discussed in recent times. Looking at the regulations and codes issued around the globe, it can be concluded that especially the installation of an audit committee is regarded as essential in improving supervision.

I  
Audit committee

Both the Act and the German Code address the issue of audit committees. However, the extent to which they do it differs significantly.

In the United States, the Act requires every company to have an audit committee composed solely of independent directors. Furthermore, the audit committee has to contain at least one “financial expert”. Prior Sarbanes-Oxley, there had not been any legal provisions addressing an audit committee’s duties. The audit committee is responsible for hiring the accounting firm and will receive its reports. In other words, the Act shifts the main audit responsibilities away from the board towards an entity that solely consists of independent directors involving a financial expert.

The German Code is less specific. It states that the supervisory board shall form expert committees depending on the specific structure of the company in order to improve its efficiency. It demands the installation of an audit committee. The
only other determination the Code makes towards the audit committee is that its chairman should neither be the chairman of the supervisory board\textsuperscript{220}, nor a former member of the management board\textsuperscript{230}.

The German approach must be seen as an attempt to please international (especially United States) investors. There is not much logic in having an audit committee under the German system\textsuperscript{231}. Monitoring the management board is already the supervisory board’s key function. A separate audit committee might only make sense when it is supposed to overcome the fact that, due to co-determination, the supervisory board cannot be comprised of solely independent directors. Such an approach could only have made sense if the members of the audit committee would have to be independent. However, this is not the case. The German regulation therefore is half-hearted and does not improve corporate governance. It would have made more sense to address general criticism towards the supervisory board.

The United States approach is much more interesting. The intention is to detect any failure in a company’s accounting\textsuperscript{232}. It had been realised in the United States, that one of the reasons that made scandals such as Enron possible, was a lack of efficient control of executive directors’ powers. If independent directors with financial expertise, unbothered by management or directors with personal interests cannot prevent misleading accounting, who else could? The idea behind that rule is good. More independence inside a monitoring unit is hardly possible. However, it has been pointed out that the membership in an audit committee is almost a “full time job”\textsuperscript{233}. This is likely to result in increased costs. On the other hand, in New Zealand companies, due to their small size, if the audit committee focuses on its main responsibility of monitoring, it should not be too time consuming. Besides, directors generally have to realise that their presence on companies’ boards has a legislative purpose and involves some work, rather than being prestigious and an

\textsuperscript{220} Section 5.3.2 of the German Code.
\textsuperscript{229} Section 5.2 of the German Code.
\textsuperscript{230} Section 5.3.2 of the German Code.
\textsuperscript{231} Mark Walsh and Thomas Thesing “Extraterritorial Application Of US Corporate Governance Standards In Europe” (2003) 14(5) ICLR 165, 167.
easy way to earn some extra money. A special burden will be on the committee’s financial expert. They would be considered the person most responsible for detecting any irregularities. This should result in improved diligence compared to regular directors. The question is, whether bearing such responsibility will require increased remuneration. The expert will be the first one to be blamed in case of failure. However, such increased costs should be considered reasonable with respect to the achievement of reliable monitoring.

New Zealand should consider adopting the main United States rule as a principle. Currently, there are no mandatory requirements for board committees in New Zealand. However, audit committees are increasingly common practice in New Zealand. Besides, they have become an international standard. A separate audit committee can more effectively monitor management than the board, because of many board members’ involvement in executive decisions. This will improve corporate control in case the audit committee comprises of qualified candidates. It is a good idea to separate the role of the board and the committee’s chairman in order to have another powerful person in the company. The chairman of the board is often too involved with management. An independent director should therefore be chairman of the audit committee. However, one thing should not be overlooked in the current enthusiasm for audit committees. The installation of an audit committee does not absolve the full board of responsibility. It is important to point that out in the principles. Besides, a financial expert should not expressly be required in New Zealand.

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237 “Corporate Governance in New Zealand, Principles and Guidelines”, above, 20.
239 The Commission has suggested this as a guideline; “Corporate Governance in New Zealand, Principles and Guidelines”, above, 19.
240 Minter Ellison Rudd Watts, above, 19.
241 This Commission has done that; “Corporate Governance in New Zealand, Principles and Guidelines”, above, 19.
Zealand, due to limited financial and personal resources\textsuperscript{243}. Larger companies with international ambition should nevertheless think about appointing such an expert.

2 A separate second board as the more consequent approach?

An interesting question arising from the implementation of audit committees is, whether installing an independent second board would not be the more logical approach.

The purpose of the audit committee is to monitor management. The installation of an audit committee is seen as necessary, because the board of directors (whose job monitoring usually is) cannot be trusted to monitor effectively due to the involvement of the executives on the board. The arising conflict of interest is obvious. Executive directors monitor themselves. The idea to use an audit committee comprised of independent directors to overcome this difficulty is good. However, the members of the audit committee would be much more independent, in case they were not members of the board of directors at all. It is much more likely that they would criticise the decisions of a board they are not involved in than decisions they took part in themselves.

The installation of a separate second board has not been discussed in the United States. In theory, an independent second board has some significant advantages\textsuperscript{244}. The idea is to approve and control management’s decisions through a group without a vested interest\textsuperscript{245}. This should improve shareholder protection\textsuperscript{246}. The rigid constitutional separation makes the independent directors’ roles much clearer\textsuperscript{247}. There can be no doubt about their responsibilities.

\textsuperscript{243} Though it generally makes sense to have people with financial expertise on the audit committee. However, there should not be a requirement to name a special person as financial expert.

\textsuperscript{244} Mahmut Yavasi “Shareholding And Board Structures Of German And UK Companies” (2001) 22(2) Comp Law 47, 49.

\textsuperscript{245} Franck Chantayan “An Examination of American and German Corporate Law Norms” (2002) 16 St. John’s J Legal Comment. 431, 439.

\textsuperscript{246} Chantayan, above, 439.

In practice there are some disadvantages with German supervisory boards. The first one is their size, which makes decisions complicated\textsuperscript{248}. The average German supervisory board contains 18 people\textsuperscript{249}. However, this mainly is the result of co-determination. This should be avoided in case one implements a second board elsewhere. The main criticism is the lack of information the supervisory board has to deal with. Since it is independent, it relies on the managing board to supply information. However, in practice this information does not flow as required\textsuperscript{250}, resulting in a lack of material to monitor the board of directors efficiently\textsuperscript{251}. This problem could be addressed by having one supervisory board member regularly attending board meetings as a visitor.

It can be concluded that a separate second board could in fact be a reasonable alternative and a consequent development of the requirement of having an audit committee comprised of independent directors. The argument of cost lacks proof. Supervisory board members are not as highly paid as management board directors\textsuperscript{252}. If one takes into account that fewer (independent) directors are needed on the first board as a consequence, there might in fact be no additional cost at all. Nevertheless, this approach is not favourable for New Zealand at this point in time. Given the fact that international investors are repelled by a system unknown to them, New Zealand would be better to implement an audit committee.

3 Other committees?

The Act does not prescribe any other committees. However, at least a nomination and a remuneration committee are common in United States companies\textsuperscript{253}. Some scholars demand making at least a nomination committee

\textsuperscript{249} Burbidge, above, 652.
\textsuperscript{250} Franck Chantayan “An Examination of American and German Corporate Law Norms” (2002) 16 St. John’s J Legal Comment. 431, 441.
mandatory in order to control the CEO’s power to influence directors’ nominations. In the German Code, forming other committees is only suggested without an obligation to explain in case of non-compliance, but it is stated that the supervisory board can delegate certain topics to committees and empower these to decide instead of the whole board.

New Zealand principles should not require the installation of committees other than audit committees, though several New Zealand companies in fact already have them. This might make sense for larger companies, but the majority of New Zealand companies are small. There is not much sense in requiring a company with three directors to have a separate nomination or remuneration committee. Instead, there should be a provision that an executive director should not attend a meeting discussing his or her own remuneration. The biggest problem with committees is that they provide an incentive for non-members to rely on the committee to do all the work. While committees might save the full board some time, it should never be forgotten that ultimately the full board is responsible for all decisions. This seems to be disregarded in the German Code, where it sounds like committees should decide instead of the board. This would lead to small groups making important decisions without the participation of the whole supervisory board. This provision therefore endangers effective monitoring rather than improving it.

254 The CEO therefore shall be excluded from membership on the nomination committee; Douglas M Branson “Enron – When All Systems Fail: Creative Destruction Or Roadmap To Corporate Governance Reform?” (2003) 48 Vill L Rev 989, 1014.
255 Section 5.3.3 of the German Code.
258 Minter Ellison Rudd Watts, above, 8.
259 Minter Ellison Rudd Watts, above, 11.
Reporting and Disclosure

Transparent reporting and disclosure are vital for good corporate governance. These are the principle means by which directors and executives are accountable to shareholders.\textsuperscript{260}

1 Real-time disclosure and off-balance sheet accounting

German law requires corporations to disclose any non-public facts, which could significantly influence its stock price. In the United States, the Act requires "real time" disclosure in "plain English" on a "rapid and current base", which is supposed to mean within two business days of a trade.\textsuperscript{261} Moreover, the company also has to post the trade on its website within three further days.\textsuperscript{262} The reporting required only at the end of the year was one of the loopholes enabling Enron’s CEO Kenneth Lay selling shares back to the company without immediate disclosure.\textsuperscript{263} Furthermore, all off-balance sheet transactions that may have a material effect on the company’s financial condition have to be disclosed.\textsuperscript{264} Off balance sheet accounts were one of the major problems in Enron’s collapse. Enron’s CFO, Andrew Fastow, had hidden millions of dollars in debts in off-balance-sheet transactions, using hundreds of so-called “special purpose entities.”\textsuperscript{265} New Zealand implemented “continuous disclosure” for listed companies.\textsuperscript{266} Hence, in New Zealand the problem of immediately releasing material information has been addressed already.\textsuperscript{267}

\textsuperscript{260} Greater transparency was one of the major goals of the German Code; Hans-Christoph Hirt “Germany: The German Corporate Governance Code: Co-Determination And Corporate Governance Reform” (2002) 23 Comp Law 349, 352.

\textsuperscript{261} Robert W Hamilton “The Crisis In Corporate Governance: 2002 Style” (2003) 40 Hou L R 1, 64.


\textsuperscript{263} Branson, above, 1008.


\textsuperscript{265} For an extended overview, see Branson, above, 1000-1002.


\textsuperscript{267} The consultation process showed that a majority of respondents regard the current New Zealand system as sufficient; “Corporate Governance in New Zealand, Principles and Guidelines” see at: http://www.sec-govt.nz/publications/documents/governance-principles/corporate-governance-in-new-zealand.pdf (last accessed 9 March 2004) 56.
Quarterly reporting?

United States and German laws on accounting requirements differ significantly. Traditionally, United States legislation was much stricter. The reason for these differences lay in the different structure of shareholding. Since German banks and insurances as major shareholders were well informed about the companies situation through “their” managers on the boards, they did not require the same amount of information small United States investors depend on. United States law requires companies to provide quarterly reports. This helps keeping an actual update on the situation of the company. German law only requires companies to issue an annual report, prepared by the managing board and controlled both by the supervisory board and the auditor. The German Code recommends providing interim reports to keep shareholders informed during the year. All reports shall be prepared using generally Accepted Accounting Principles (“GAAP”). Moreover, reports shall be publicly accessible; annual reports within 90 days of the end of the financial year and interim reports within 45 days after the reporting period.

In other words, the German Code adopted more frequent reporting from the United States. However, this should not be copied by New Zealand. Quarterly reporting is extremely costly. For smaller companies, of which New Zealand has a large number, such a requirement does not seem to be of much use. Therefore, annual reporting seems sufficient in New Zealand, especially because continuous disclosure requirements keep shareholders updated in the meantime. In case larger companies are eager to report more frequently, they are free to do so.

Few New Zealand companies provide meaningful details on their corporate governance policy to their shareholders. Since good governance also includes information about governance itself, there should be a provision requiring companies to disclose their corporate governance policy. As with other reports, the companies should be required to use modern communication systems in order to

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268 Section 7.1.1 of the German Code.
269 Section 7.1.2 of the German Code.
270 The majority of respondents in the consultation process has the same opinion; “Corporate Governance in New Zealand, Principles and Guidelines”, above, 57.
271 For example in order to comply with expectations of foreign investors in order to attract them.
make such information available to all shareholders as well as potential investors. The internet provides a very cost effective method to keep all investors updated at any time.\footnote{The German Code recommends the use of the internet for various purposes to improve communication with shareholders; see Section 6.6 of the German Code.}

3 CEO and CFO certification requirements?

The Act imposes certification obligations on the company’s executives. The CEO as well as the CFO has to certify in each report that the report does not contain any untrue statements and presents a true and fair view of the company’s financial situation.\footnote{Robert W Hamilton "The Crisis In Corporate Governance: 2002 Style" (2003) 40 Hou L R I, 60.} So far, it was enough if the report of a United States company was compliant with GAAP.\footnote{Lawrence E Mitchell "The Sarbanes-Oxley Act And The Reinvention Of Corporate Governance?" (2003) 48 Vill L Rev 1189, 1201.} Aligning United States law with the law in most other English speaking countries, the report has to go beyond the requirements of GAAP so that it represent a true and fair view.\footnote{Douglas M Branson “Enron – When All Systems Fail: Creative Destruction Or Roadmap To Corporate Governance Reform?” (2003) 48 Vill L Rev 989, 1005.}

Apart from that, CEO and CFO have to ensure and certify that internal corporate controls are adequate and in place.\footnote{Hamilton, above, 60.} They are responsible for designing internal controls that ensure the flow of financial information to them. These controls have to be checked within ninety days prior to certification.\footnote{Branson, above, 1005.} Before the Act, law did not require internal controls. There are no comparable provisions in the German law or Code.\footnote{Brian Kim “Sarbanes-Oxley Act” (2003) 40 Harv J Legis 235, 247.}

The United States rules have been criticised as being too harsh. Critics have pointed out the significant stress these provisions put on executives. Substantial penalties, including imprisonment for up to twenty years, are imposed on filing a wrong statement.\footnote{Mark Walsh and Thomas Thesing “Extraterritorial Application Of US Corporate Governance Standards In Europe” (2003) 14(5) ICCLR 165, 165.} In relation to the relatively small number of incapable directors

\begin{footnotes}
\item \footnote{The German Code recommends the use of the internet for various purposes to improve communication with shareholders; see Section 6.6 of the German Code.}
\item \footnote{Robert W Hamilton "The Crisis In Corporate Governance: 2002 Style" (2003) 40 Hou L R I, 60.}
\item \footnote{Lawrence E Mitchell "The Sarbanes-Oxley Act And The Reinvention Of Corporate Governance?" (2003) 48 Vill L Rev 1189, 1201.}
\item \footnote{Douglas M Branson “Enron – When All Systems Fail: Creative Destruction Or Roadmap To Corporate Governance Reform?” (2003) 48 Vill L Rev 989, 1005.}
\item \footnote{Hamilton, above, 60.}
\item \footnote{Branson, above, 1005.}
\item \footnote{Brian Kim “Sarbanes-Oxley Act” (2003) 40 Harv J Legis 235, 247.}
\item \footnote{Mark Walsh and Thomas Thesing “Extraterritorial Application Of US Corporate Governance Standards In Europe” (2003) 14(5) ICCLR 165, 165.}
\item \footnote{Robert W Hamilton "The Crisis In Corporate Governance: 2002 Style" (2003) 40 Hou L R I, 66.}
\end{footnotes}
the regulation has been described as inefficient\textsuperscript{282}. Branson argues that less than one per cent might be affected\textsuperscript{283}. However, it is strange to criticise a punishment because of rare occurrence. The problem is that the few cases in which something went wrong might be exceptions, but thousands of people were affected\textsuperscript{284}. Besides, the majority of directors have nothing to fear. They can easily certify the statement if they stick to the rules. A big misconception about the certification rules is that it will affect the business judgement rule of United States courts that gives the directors the primacy of taking a risk when reviewing decisions\textsuperscript{285}. Critics have argued that this would lead to directors and executives avoiding risks for fear of liability and thereby diminish economic progress. However, the Act only punishes fraudulent behaviour\textsuperscript{286}. A decision made in good faith is not punishable\textsuperscript{287}. A positive effect is that the importance of the audit is emphasised. By linking the responsibility for the audit report directly to the most powerful executives of a company, the audit report comes into the focus of executives. They no longer can deny responsibility and are forced to cooperate more closely with the auditors\textsuperscript{288}.

New Zealand should also adopt a certification requirement for CEO and CFO\textsuperscript{289}. Other provisions put substantial pressure on auditors. It benefits the balance of pressure if the responsibility for the accurateness of reports lies with the executives as well\textsuperscript{290}. This way they cannot put the blame solely on the auditor.

\textsuperscript{283} Branson, above, 1004.
\textsuperscript{284} All the Enron employees who lost their jobs as well as pension funds should not be lost out of view.
\textsuperscript{285} For example, knowingly signing a false financial statement; Brian Kim “Sarbanes-Oxley Act” (2003) 40 Harv J Legis 235, 245.
\textsuperscript{287} Kim, above, 246.
\textsuperscript{289} The great majority of respondents in the consultation process were in favour of a certification requirement; “Corporate Governance in New Zealand, Principles and Guidelines” see at: \url{http://www.sec-com.govt.nz/publications/documents/governance-principles/corporate-governance-in-new-zealand.pdf} (last accessed 9 March 2004) 57.
Disclosing remuneration

The German Code recommends that Management Boards’ remuneration shall be published in detail in the company’s financial statement. The same provision exists for supervisory board members. However, it only requires disclosing the package for the boards as a whole, without breaking it down to the single member.

An argument against disclosing remuneration is that shareholders could focus on this topic and get distracted from more important issues. Nevertheless, transparency is important. Shareholders have a right to know which performance-based parts of remuneration executives have as an incentive to work successfully.

In order to judge the incentives for every single executive, such information has to be broken down by director.

G Remuneration

Directors’ remuneration has become a controversial topic after Enron. Enron’s directors earned millions of dollars at a time, when the company itself was already practically bankrupt, while employees lost their entire pension funds.

Surprisingly, the United States Act does not explicitly address the topic of remuneration. Only executive loans are dealt with. On the contrary, the German Code encourages the use of variable parts of remuneration, some of which have proved controversial during recent scandals. It is questionable whether this will benefit German corporate governance.

Section 4.2.3 of the German Code.
Section 5.4.5 of the German Code.
The use of stocks and stock option as part of remuneration

In the United States, stocks and stock options are a common part of directors’ remuneration. Though there has been a substantial amount of misuse in connection with stock options, the Act did not approach this topic.

The German Code suggests that executive remuneration shall consist of variable as well as fixed parts. Variable components shall include one-time and annual components that should be linked to business performance as well as components containing long-term incentives and risk components. The Code gives the example of company stocks with a multi-year blocking period or stock options. Changing the relevant parameters on which the variable remuneration parts depend shall be excluded, except for a limitation (cap) for unforeseen developments. The same provisions exist for members of the supervisory board.

The German Code encourages the use of stock options in order to be more in line with United States practices. With executives being increasingly searched for internationally, German remuneration policy thereby is brought in line with international standards. However, the question is whether this is a good development.

The idea behind having flexible parts of remuneration based on companies’ performance is to align managements with shareholders’ incentives. Executives only earn well in case shareholders do well. Stock options are a popular way of flexible remuneration. In the United States they account for more than 70 per cent of the typical CEO remuneration. Their popularity also derives from the fact that they are not an expense for accounting purposes, but nevertheless are deductible for tax.

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298 Christina Roschmann “Stock Option Plans In Germany” (1999) 12 SPG INGPRAC 29, 29.
300 Section 4.2.3 of the German Code.
301 Section 5.4.5 of the German Code.
purposes. However, stock options as management remuneration also have their downsides. The main problem is that they provide short-term incentives for executives. Having a substantial part of remuneration at stake, executives are likely to focus on the share price at the time options are granted. The problem is that executives can withhold news at critical points in time in order to influence the stock price. In other words, stock options provide a strong incentive for short-term focusing, which is contrary to the company’s interest in long-term wealth. At least German law should have provided for a defined period to hold the shares before they can be sold. Furthermore, granting stock options dilutes the participation of existing shareholders. Hence, the benefits of implementing stock options as a principle can at least be doubted. New Zealand should not follow the German approach and leave the decision on how to design executive remuneration to each company.

2 Executive loans

A related topic is the question of company loans to directors or executives. The German Code does not address this question. The Act generally prohibits personal loans for corporate officers and directors. Before, it was the common practice of United States companies to grant personal loans to leading employees. For example, it was alleged that Tyco’s CEO Denis Kozlowski was granted a US $19 million loan that was later forgiven. Personal loans are legal under Delaware law, which is now superseded by the federal Act. Kim however, sees some good reasons to allow such loans. Firstly, he mentions that CEO’s have a legitimate interest in receiving a loan when relocating because of the company. Secondly, in

306 Hamilton, above, 70-71.
308 Millon, above, 908-909.
309 Millon, above, 916.
313 Kim, above, 249.
his view companies profit from lending money to executives to enable them to buy companies stock, because this aligns their interests with those of the company. There is no argument to the first point. It is hard to see why a highly paid CEO should be treated differently than any other employee, who does not get any loans in such situation either; also he or she might need the money much more. Besides, the Act does allow loans for that purpose, as long as the conditions are on “market terms”. As far as the second argument is concerned, a simple number from Enron’s story should be sufficient. Enron’s CEO Kenneth Lay was able by such a credit to purchase stock options that resulted in personal gains of US $ 100 million in the year of Enron’s collapse. However, this seems to be an American problem. It would be enough if such loans just have to be published in New Zealand.

II Shareholder and Stakeholder Interests

The United States and the German system provide examples of two completely different corporate philosophies. While United States corporate law traditionally seeks to protect shareholder interests, modern German law always took other stakeholder interests into account. It is interesting to analyse recent developments. On the one hand a certain shift in German law towards strengthening shareholders’ right can be recognised. On the contrary, no shift towards greater stakeholder protection can be seen in the Act or any other new regulation in the United States. If one leaves minor changes aside, stakeholder participation in corporate governance still does not play any role in United States law. The question is, whether this is a misconception.

314 Kim, above, 249.
316 Branson, above, 1008.
319 The Code tries to implement more attention to shareholders’ concerns. Most notably, this includes facilitating the use of proxies and representatives to exercise shareholder voting that are available for shareholders during the general assembly (Section 2.3.3 of the German Code); Hans-Christoph Hirt “Germany: The German Corporate Governance Code: Co-Determination And Corporate Governance Reform” (2002) 23 Comp Law 349, 352.
320 Like the prohibition for directors to sell stock in blackout periods when employees are prohibited from selling; Susan J Stabile “Enron, Global Crossing, And Beyond: Implications For Workers” (2002) 76 St John’s L Rev 815, 832.
Burbidge argues that a scandal like Enron might not have happened, if the supervision of directors was in the hands of a wider range of stakeholders as in Germany. Referring to the German situation can only mean two groups of stakeholders: Creditors and employees. The question arises, whether stakeholders could be important and motivated monitors of the company.

The first idea is assigning a greater role to banks. In Germany, banks as large shareholders play an important role in monitoring management. In the United States, banks cannot contribute much, due to the fact that they are not allowed holding shares. Hence, they are not in a meaningful position for monitoring. Instead, the focus in the United States has shifted to institutional investors. They hold substantial assets and have the financial resources and administration to effectively monitor companies. However, until now they failed to do so and rather exited companies stock instead of becoming active in changing corporate behaviour. The question is, whether banks could play an important role in monitoring New Zealand companies? However, this cannot be prescribed by principles or law, but is a question of changing banks and other institutions’ attitudes towards their responsibility for corporate governance.

The second group of stakeholders to potentially monitor directors are employees. There are two ways to realise such participation. Firstly, employees can be stockowners and thereby have the same rights as other shareholders. However,

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322 Banks playing a major role in German corporate law; Brett H McDonnell “The Curious Incident Of The Workers In The Boardroom” (2000) 29 Hofstra L Rev 503, 516.
324 Jacoby, above, 459.
326 Harvey Gelb “Corporate Governance Guidelines – A Delaware Response” (2001) 1 WYLR 523, 523.
in times of crisis of the company this could prove fatal\textsuperscript{330}. Employees could not only lose their jobs, but also their savings. Again Enron provides a good example\textsuperscript{331}. The second possibility is giving employees a voice in the corporation, like German law does. The main criticism against employee participation in corporate governance is that their interests are contrary to those of shareholders\textsuperscript{332}. Employees are interested in higher wages and job security\textsuperscript{333}. Therefore they want to keep as much money in the company as possible\textsuperscript{334}. Shareholders are interested in obtaining dividends and rising stock prices\textsuperscript{335}. There seems to be a conflict between employees’ long-term and shareholders’ short-term interests. However, taking a closer look, it may be in the long-term interest of the company not to listen to shareholders’ short-term interests. Burbidge\textsuperscript{336} concludes that “excessive focus on ‘shareholder value’ is unhealthy for the company, the employees and ultimately for the shareholders themselves”, because it affects the company in the long run. In other words, involving employees (or other stakeholders) in governing the corporation might be in the company’s best interest\textsuperscript{337}. Especially for a country like New Zealand, where companies always had a very high dividend payout compared to international standards\textsuperscript{338}, such an approach is worth considering\textsuperscript{339}. Furthermore, there are other advantages with employees’ participation. Employees see the company from a management perspective, which should improve their understanding of decisions\textsuperscript{340}. Another advantage is improved loyalty of employees with “their” company, as can

\begin{thebibliography}{9}
\item Susan J Stabile “Enron, Global Crossing, And Beyond: Implications For Workers” (2002) 76 St John’s L Rev 815, 822.
\item McDonnell, above, 512.
\item Marsha Cope Huie “Antitrust And Corporate Dividend Policy: Revising Dividend Payment Policies To Empower Shareholders To Curb Mergers And Acquisitions” (1993) 25 St Mary’s L J 243, 259.
\item Joseph Healy Corporate Governance And Wealth Creation In New Zealand (1 ed, Dunmore Press Ltd, Palmerston North, 2003) 210.
\end{thebibliography}
be observed in German or Japanese firms. Employees will be much more likely to help their company in critical situations. This might save a company from insolvency in the event of a crisis. While United States workers might just walk away in such a situation to take the next best offer, German or Japanese employees might be willing to help their firm in such a crisis. Moreover, employees know their company in depth. This enables them, for example, to contribute to improving production processes. Apart from that, they know management from day-to-day experience and hence can judge its performance first hand. Finally, it should not be forgotten that shareholders and employees have some important common interests, like controlling directors’ powers and keeping their remuneration down.

This topic has not been addressed in the United States or the United Kingdom. While such an approach must not be as extensive as in Germany, it might be an idea worth considering involving at least one employee representative in the board of larger New Zealand companies.

I Other Topics

There are some other rules and contents in the Act and the Code, which are briefly outlined below.

I Installation of an accounting oversight board

The Act creates the Public Company Accounting Oversight Board (“PCAOB”). Each accounting firm that provides audit services to at least one public firm is subject to registration with the PCAOB. The PCAOB will establish auditing,

342 Jacoby, above, 475.
346 Burbidge, above, 662.
347 Thereby avoiding the downsides of large board size and international criticism.
ethics, independence, and other standards for auditing companies and oversee their compliance. The PCAOB will conduct yearly inspections of the “Big Four” audit companies that audit more than hundred reporting companies and control other companies at least every three years. The PCAOB can impose sanctions up to permanent suspension of non-complying audit companies. The Board itself is appointed and overseen by the Securities and Exchange Commission (“SEC”). The PCAOB’s composition reflects an attempt to establish an independent oversight unit. Only two of its five members are allowed to be current or former certified public accountants. Moreover, in case the chairperson is one of the two former accountants, she or he is not allowed to have practised within five years to being appointed.

The question remains, whether the implementation of such a body is advisable for New Zealand. Due to the outstanding importance of auditing, an independent body overseeing accounting companies has some merit. However, such a body demands some experts to run it effectively. This will prove costly. Nevertheless, the Commission suggested implementing such an entity in New Zealand, albeit the majority of respondents in the consultation process were against it. The Commission pointed out the positive contribution to the integrity of the New Zealand capital market. It remains to be seen, if government adheres to the Commission’s advice.

2 Whistleblower protection and attorney reporting obligations

The Act also contains provisions to secure that whistleblowers and analysts are not punished for unfavourable reports. Such protection is important to

351 Hamilton, above, 57.
352 Kim, above, 241.
353 Hamilton, above, 57.
355 Ibid.
356 Hamilton, above, 66.
encourage people to speak up in case of a developing crisis\textsuperscript{357}. Timely warnings can sometimes prevent more serious developments.

The Act’s obligations on attorneys go a step further. Lawyers who practise or appear before the SEC must report any “evidence” of securities law violations or breaches of fiduciary duty to the general counsel of their client or employee in the case of in-house lawyers. If those do not react “appropriately” they have to report that to the clients audit committee\textsuperscript{358}. If this still leads to no solution the attorney has to “noisily withdraw” and report to the SEC. The attorney’s position has been described as a “watchdog”\textsuperscript{359}. This regulation overshoots the mark. It causes severe problems concerning attorney client privilege. The more general question arises, whether a company’s lawyer is the “hired gun” of the company or whether an attorney has superior obligations to the public in certain cases\textsuperscript{360}.

3 \textit{Explanation of the legal system}

Large parts of the German Code do not implement any new rules, but explain the German legal system\textsuperscript{361}. While this primarily has to do with peculiarities of the German system\textsuperscript{362}, which require explanation for many foreign investors, New Zealand could nevertheless adopt the idea of explaining its corporate legal system to international investors. New Zealand could survey whether international investors are sufficiently informed about its corporate system. In case there is insufficient information, it could be a good idea to include a part in New Zealand’s code of corporate governance briefly explaining its legal background. However, New Zealand should avoid the mistakes made in the German Code. The German Code

\textsuperscript{357} A great majority of respondents in the consultation process agreed; “Corporate Governance in New Zealand, Principles and Guidelines”, above, 67.


\textsuperscript{359} Hamilton, above, 61.

\textsuperscript{360} This question is beyond the scope of this paper; for your interest, see Christina R Salem “The New Mandate Of The Corporate Lawyer After The Fall Of Enron And The Enactment Of The Sarbanes-Oxley Act” (2003) 8 Fordham Int’l L J 765.


\textsuperscript{362} Like co-determination and the dual board structure.
mixes the simple reproduction of existing legislation with the principles suggested. There is a constant change between recommendations and mandatory legislation. This results in a lack of clarity and further confuses investors\textsuperscript{363}. In spite of that, there should be a separate paragraph before the principles or as part of the foreword.

**VII CONCLUSION**

No matter how New Zealand responds to the recent events in corporate governance, one thing should be kept in mind. No code or legislation can entirely eliminate corporate failure\textsuperscript{364}. Such failures can only be prevented by a change of behaviour. However, thoughtfully designed rules may at least reduce the risk to a minimum. This is what makes them important.

This paper provided an overview over the latest changes in German and United States corporate governance. It has been shown that certain provisions from both approaches make sense for New Zealand to adopt. Most importantly, New Zealand should adopt a principles-based approach. As to the question of principles to implement, it is a fine line between achieving reasonable standards to improve corporate governance and imposing unnecessary burdens on companies\textsuperscript{365}. It will be crucial for New Zealand to find a reasonable way between the two.

One thing is important. Corporate governance cannot be regulated once and then forgotten about. Constant review is important to ensure keeping the principles up to date and suitable for the current business environment. The German Code will be reviewed and adjusted annually\textsuperscript{366}. New Zealand should do the same.

\textsuperscript{363} Hans-Christoph Hirt “Germany: The German Corporate Governance Code: Co-Determination And Corporate Governance Reform” (2002) 23 Comp Law 349, 354.


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