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PERCEPTIONS BEARING ON THE PUBLIC POLICY DYNAMICS OF CORPORATION LAW

Richard Saliterman[1]

I. BACKGROUND

A. The Setting of Corporate Law

The approach to this essay may represent a substantial departure from traditional articles and practice materials which discuss corporate governance. Corporation law scholarship was, until very recently, directed at looking at its totality. However, the author sees corporation law as a totality of both internal corporate governance concepts and rules as well as external concepts and rules. The combination of internal and external concepts and rules now defines the new, supplanted body of corporate law.[2]

American corporate law, from approximately 1930 through the 1980s, has been defined by lawyers, scholars, and jurists alike as consisting of the provisions of statutes, judge-made law, and Securities Exchange Commission (SEC) rules and regulations.[3] The corporation, for the most part, has been and presently is governed by a highly theoretical and, arguably, a non-reality oriented framework of perceptions: 1) that shareholders–the principal corporate investors–control the corporations and reflect their shareholder sovereignty by electing boards of directors; and 2) that these boards of directors select or otherwise carefully govern the activities of corporate executives who are subservient to both the board and the shareholders. An assumption operates that by giving free rein to this framework or "model," capitalism survives, allowing competitive forces to advance the social responsibility and responsiveness of corporations.

In order to facilitate a more complete understanding of the dynamics driving this the transition to a new definition of corporation law, the author has made generous use of direct quotes from both central players and their keenest observers. Both the players and the observers articulate well the essential con-

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1. Richard Arlen Saliterman received his B.A. degree *summa cum laude* and Phi Beta Kappa from the University of Minnesota in 1968; his J.D. degree from Columbia Law School in 1971; and an LL.M. degree from New York University School of Law in 1974. He is senior partner at Saliterman & Siefferman law firm, Minneapolis, Minnesota. The author would like to express appreciation for the direct assistance of Arthur B. Carlson, CPA; Professor Harvey Goldschmid of Columbia Law School and Frank Grad of Columbia Law School; Professors Linda J. Rusch and Peter E. Olson of Hamline University School of Law; Professor Dan Kleinberger of William Mitchell College of Law; Bartholomew Ward; Karen Cody-Hopkins, Esq.; Robert J. Karon, CPA; Jonathan Gorden, CPA; and the indirect assistance and encouragement of former Senator Rudolph E. Boschwitz, George and Sally Pillsbury, and Diane Boller and Alice Everett of Michie-Butterworth Publications. The basic framework of this article is taken from a larger work by the author entitled Advising Minnesota Corporations and Other Business Organizations (Michie-Butterworth 1995).

2. Throughout American history, corporations have very much been defined by the words of their charters and enabling statutes, and by much inquiring into their nature, both by the legal profession and by academians who focused on these now quite narrow purviews.

3. *See, e.g.*, Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819) (describing corporations). In *Trustees of Dartmouth College*, Chief Justice John Marshall described the corporation as:

> [A]n artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created.

Id. at 636.

cepts. Perhaps as importantly, their individual presentations demonstrate the attitudes and feelings involved better than any other analysis could provide.

Many of the following quotations are drawn from a series of symposiums jointly sponsored by the American Law Institute (A.L.I.) and American Bar Association (A.B.A.) on Corporate Governance;[4] these symposiums culminated in the American Law Institute's Proposed Final Draft Principles of Corporate Governance.[5] Many initially hoped that the Principles of Corporate Governance (Principles) would have a utility for and impact on formal corporate law somewhat akin to the impact the Model Business Corporation Act[6] (M.B.C.A.) had after its introduction in the perhaps more quiescent legal and business environment of forty-two years ago.[7] At the time of this writing, many have concerns about whether the Principles, which are arguably the most authoritative single exposition of where American corporation law is and ought to be, either significantly reflect the earlier symposiums or indeed are sufficiently responsive to current problems. At the least, however, the Principles do make some key inroads and reflect recent scholarship.[8]

A basic theme throughout this essay is that capitalism functions best when there is only minimal federal regulation. Yet, with the unresponsiveness of present corporate rules and law, corporations have lost many of their equilibrating qualities and dynamics and run the risk of enhanced regulation, especially on a federal level. This essay's thesis is that equilibrium is the state which minimizes the dysfunction caused by stress in the corporation by litigation, by unhappy shareholders, or by the public; permits a reasonable flow of revenue and profits to the corporation; and embodies the desired value of prediction and planning. Equilibrium is preferred over disequilibrium. Much current scholarship, however, implies or expresses that other values may also be critical for corporations to flourish. For instance, Ronald J. Gilson, Professor at the Business Schools of both Stanford University and Columbia University, examines the economic efficiency of and compares the laws of other countries such as Japan and Germany with the United States. He concludes:

> [A]s we increasingly realize that history and politics, and therefore institutions, matter, we expect that the next generation of corporate

4. COMMENTARIES ON CORPORATE STRUCTURE AND GOVERNANCE: THE ALI-ABA SYMPOSIUMS 1977-1978 23 (Donald E. Schwartz ed., A.L.I-A.B.A. 1979) [hereinafter COMMENTARIES]; *see also* Committee on Corporate Laws, A.B.A. Section of Corporation, Banking and Business Law, *The Overview Committees of the Board of Directors*, 34 BUS. LAW. 1837 (1979); *The Role and Composition of the Board of Directors of a Large Publicly Owned Corporation*, 33 BUS. LAW. 2083 (1978); 1978 Committee on Corporate Laws, A.B.A. Section of Corporation, Banking and Business Laws, *Corporate Directors Guidebook*, 33 BUS. LAW. 1591 (1978). For more current discussions of this topic, see F. Hodge O'Neil, *Corporate and Securities Law Symposium: Path Dependence and Comparative Corporate Governance*, 74 WASH. U. L.Q. 317 (1996); Melvin Aron Eisenberg, *The Modernization of Corporate Law: An Essay for Bill Carey*, 37 U. MIAMI L. REV. 187 (1983).

5. PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (A.L.I. Proposed Final Draft 1992) [hereinafter PRINCIPLES]; *see generally Symposium on Corporate Governance*, 48 BUS. LAW. 1267 (spec. ed. 1993).

6. MODEL BUSINESS CORP. ACT (1984); *see* RALPH J. BAKER & WILLIAM L. CAREY, CORPORATIONS, CASES & MATERIALS 10-11 (Foundation Press 1959).

7. The Model Business Corporation Act itself in considerable part stems from the Illinois Business Corporation Act adopted in 1933.

8. *See, e.g.*, Bayless Manning, *Principles of Corporate Governance: One Viewer's Perspective on the A.L.I. Project*, 48 BUS. LAW. 1319 (1993).

> governance scholarship will be dynamic: How do existing institutions come to respond to a change in array of problems? The shift in emphasis reflects an altered scholarly agenda–how a system moves from one equilibrium to the next may come to attract more interest than the characteristics of a particular equilibrium. More important, it may turn out that equilibria are increasingly less important as the pace of change reduces the time span and equilibrium and, hence, increases the importance of disequilibrium.[9]

In addition, George W. Coombe, Jr., former Chair of the Business and Banking Law Section of the American Bar Association and General Counsel for Bankamerica, has said:

> Until recently, the public has never really understood the corporate entity, the allocation of responsibilities among board, management, and shareholders, or existing legal constraints on corporate conduct. Over the years, the public has depended primarily upon lawyers and courts *for assurance that the corporate house was in order* and that directors were discharging their responsibilities pursuant to law.[10]

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9. Ronald J. Gilson, *Corporate Governance And Economic Efficiency: When Do Institutions Matter?* 74 WASH. U. L.Q. 327, 345 (1996). The norms or values reflecting the role of capitalism in corporation law are reflected in Dean Ashbrook's observation:

> The first part of the 20th century, corporate financial theory and corporate law espoused a profit maximization paradigm. In microeconomics the theory of the firm is that firms are profit maximizers. If competitive firms did not maximize profits, they would be inefficient; therefore, they would be forced out of business by the efficient firms. Monopolies are presumed to be profit maximizers by virtue of their position. Moreover, if the shareholders could directly run the corporation, they would offer profit maximization and its corresponding cost minimization. Corporate financial theory further holds that maximizing profits maximizes firm value which in turn maximizes shareholder wealth.

E.C. Ashbrook, *Divergence of Corporate Finance and Law in Corporate Governance*, 46 S.C. L. REV. 449, 453 (1995). Also relevant in this regard is the holding from Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919), where the Michigan Supreme Court stated:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised and the choice of means to attain that end, and does not extend to a change in the law itself, the reduction of profits, or to the nondistribution of profits among the stockholders in order to devote them to other purposes.

Id. at 684. More recent scholarship uses the metaphor of the firm or corporation as a "nexus of contracts," both express and impliedly suggesting that immediate profit maximization needs to be factored in as an abstract presumption. *See* Marcel Kahn & Michael Kamsner, *Path Dependence in Corporate Contracting: Increasing Returns Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347 (1996).

However, some commentators increasingly suggest that the role of "social responsibility" is a more worthy direct or immediate goal than the pursuit of capitalism per se, and have indeed incorporated this paradigm in recent corporation law scholarship. *See* MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE 21ST CENTURY (1995) and book reviews reviewing the book: Martin Lipton et al., *Corporate Governance in the Era of Institutional Ownership*, 70 N.Y.U. L. REV. 1144 (1995); Margaret M. Blair, Book Note, *Stakeholders as Shareholders*, 109 HARV. L. REV. 1150 (1996); Jai K. Chandrasekhar, Book Note, *Worker Empowerment Through Corporate Law?*, 105 YALE L.J. 1707 (1996).

10. George W. Coombe, Jr. & Herbert Wechsler, *Welcome on Behalf of the American Bar Association*, *in* COMMENTARIES, *supra* note 4, at 23 (emphasis added). J. Willard Hurst, Villas Professor of Law at the University of Wisconsin Law School recognized the shifts in perceptions regarding corporation law upon which this essay is based. He said:

> In the first place, it is quite plain that events of the past 50 to 75 years have generated among both policymakers, and to a considerable extent, general public opinion, a sense that a large enterprise today has much wider social effect than the 19th century was typically prepared to recognize. The result is that activities of a large-scale corporate enterprise are appraised in the light of a much wider range of possible impacts than occurred previously. This is in some ways a revolution or phenomenon from the standpoint of the subject-matter in these symposiums. I think it has meant that public policy affects large-scale corporate business more and more through law external to corporation law proper than it does through the law of corporate structure and governance itself.

J. Willard Hurst, *The Presence of the Past: A Legal Historian's Perception*, *in* COMMENTARIES, *supra* note 4, at 38.

Perceptions regarding corporate conduct are almost invariably and directly associated with the conduct not just of public corporations with a large number of shareholders and very substantial assets. They are almost equally associated with the conduct and governance of small, private corporations which are not publicly traded and often are comprised of only a small group of investors or a single person. While these small enterprises have adopted the corporate form for sound legal and taxation reasons, with regard to governance, they instead remain sole proprietorships or partnerships.

The external forces on corporate law are aroused and inspired by the public's perceptions, laden with confusion and frustration, and have resulted in a more complicated intertwining of legal rules and bases for legal rules. These forces have led to very difficult and still unresolved conceptions of what are the causes and what are the effects of corporate internal decisions as well as judicial and other governmental decisions affecting corporations.

This essay intends to familiarize readers with some current literature and thinking on the legal issues surrounding corporations in American society; inspire additional thought; and serve as a "public-policy guide" for rulemaking by jurists and decisionmaking by practitioners and their clients. It is only intended to be a suggestive, not exhaustive, discussion.[11]

B. The Setting of Corporations in Society

Corporations, perhaps more than any other phenomenon connected with post-modern human existence, have de facto governance over our day-to-day lives and conduct. It is possible to assert that they may even have more of a fundamental impact than the family unit itself. Corporations have stewardship over the production of most of the Gross National Product (G.N.P.)[12] that we consume, employ a majority of the work force, are integral members of our communities, and use a bulk of available resources in these efforts. When American corporate law was being formulated, America was still largely an agrarian economy. Most citizens, subtly imbued with Jefferson and indeed Biblical approaches to governance, were agricultural producers or proprietors. Americans were independent and individualistic and, perhaps more so than any society in the world, capitalistic. These traits clearly influenced the present formulation of corporate law. The lot of the individual, however, has changed.

The problems confronting corporation law and corporations are the problems of American society and, to a measurable extent, of Western civilization. They are a concern for every American. The productivity of corporations, or the lack of it, is what makes the United States strong or weak, and what makes United States citizens affluent and whole or stricken with poverty. Small business corporations defined as firms with under 500 employees contributed forty-eight percent of nonfarm United States employment and thirty-eight per-

11. Dean Bayless Manning has indicated, "American corporation law is complex and immense in scope, and so are its problems and likely cures." Manning, *supra* note 8, at 1321.

12. The current term used by federal government agencies is Gross Domestic Product (G.D.P.).

cent of the G.N.P. in 1982, compared with fourteen percent contributed by the government.[13] Ownership by corporate business accounts for at least 28.7% of the $2.01 trillion of tangible wealth of the United States;[14] this is not greatly different than the 28.2% share of the $588 trillion of tangible worth of the United States in 1922.[15] Interestingly, however, direct charitable giving by publicly-traded Fortune 500 corporations is not great.[16] Finally, institutional investors have had their impact, especially in current court decisions and in legal scholarship. These institutional investors are publicly-traded corporate entities and issue investment units. Today institutional investors own over fifty percent of the common stock of most major corporations in the United States.[17]

United States District Court Judge Constance Baker Motley observed that corporations often wield power and influence greater than many sovereign nations, much of which is unreviewable power.[18] Mark Green, one of the pioneering critics of contemporary corporate law, has commented:

> [Corporations] are in a very real sense private governments. Many citizens of our country relate closely to, and are anxious about, the company they work for, which affects their lives. Exxon, which is incorporated in Delaware, has more shareholders than Delaware has citizens. Its revenue is 160 times that of Delaware's tax revenues. It is big both in size and impact on employees, on communities, on future generations, and on taxpayers in terms of direct and indirect subsidies–which is another entire area.[19]

As already mentioned, this essay suggests that capitalism is a valued component of human existence and is well worth preserving. Capitalism, more than any other form of enterprise, constructively engages the more pernicious, acquisitive, insecure, or even heinous instincts of humankind, which are

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13. STATE OF SMALL BUSINESS 74 (A Report of the President Transmitted to Congress, March 1984). For an additional perspective, see ELLIOT CURRIE & JEROME H. SKOLNICK, AMERICA'S PROBLEM-SOCIAL ISSUES AND PUBLIC POLICY 23-54 (2d ed. 1988).

14. STATE OF SMALL BUSINESS, *supra* note 13, at 74.

15. *Id.*

16. PRINCIPLES, *supra* note 5, § 2.01 reporter's note 3. The reporter states:
The Conference Board data is drawn from a survey of the Fortune 500 manufacturing companies, the Fortune 500 service companies, and certain other corporations. For 1990, median contributions represented 1.0 percent of worldwide pretax income and 1.2 percent of United States pretax income. Based on Internal Revenue Service data, contributions by all corporations represented 1.97 percent of total corporate income.
Id.

17. *See* Lipton et al., *supra* note 9, at 1145. Lipton notes:
'Institutional investors today own over 50% of the common stock of most major corporations in the United States. By acting in common, institutional investors thus have voting control of these corporations. This basic fact explains why, in the short period from its inception in 1984 to the present, the Council of Institutional Investors ("Council"), an organization that is virtually unknown to the general public, has become one of the most powerful forces in the business and financial world. The extent of institutional equity ownership has allowed the Council, and the institutional investor generally, to affect a massive shift in power from management to shareholders, a shift that has attracted and deserves close attention.
Id.

18. *See* Constance B. Motley, Moderator's Introduction, *in* COMMENTARIES, *supra* note 4, at 251.

19. Mark Green, *Attainment of Social Goals Requires Corporate Reform*, *in* COMMENTARIES, *supra* note 4, at 265, 268.

endemically interwoven in human character and temperament.[20] This characteristic–the desire for acquisition and the desire for importance–has been commented on in the Bible and by social philosophers and social scientists for years.[21] If individuals have hard-driving urges, and sometimes heinous urges, it is better that these be worked out and sublimated through capitalistic checks and balances than in more direct forms by the government through pervasive and overriding control over human conduct.[22]

Capitalism also contributes to innovation, efficiency, and the effectiveness of business organizations generally. Capitalism has powerful incentives that directly promote good human proclivities, including but not limited to productivity, creativity, and innovation. Although capitalist societies are certainly not free from anxiety, pressures, and harms, capitalism imposes relatively less burdens on individuals. Professor James Lorie of the University of Chicago may have had these qualities in mind when he stated:

> All the emphasis, in the discussion of corporate governance, is on the issue of constraints. This, I think, is characteristic of too much of the public debate today: We are more interested in restricting, constraining, watchdogging, than we are in enabling, encouraging, liberating, inspiring our people and our institutions to creative achievement.[23]

Creative achievement is not always tangible nor even related to the economic sector. A society with these qualities is a more secure society and one more able to adapt and advance. The profit motive, which is integral to capitalism, may be the most effective method for actually creating employment–long articulated as the major benefit of socialist and communist economies.[24] The late Professor Donald Schwartz of Georgetown University School of Law commented on the intellectual dialogue about the goal of creating jobs: "The difference in corporate purposes was also brought out by Mr. Brown's comments on English corporate law developments and his observation that many Europeans and Englishmen saw the main corporate purpose as 'providing employment.'"[25] Schwartz then introduced a potential salient counterpoint: "[I]f they would only concentrate on improving profitability, there would be plenty of jobs for everyone."[26]

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20. *See, e.g.*, LIONEL TIGER & ROBERT FOX, THE IMPERIAL ANIMAL (1971); DESMOND MORRIS, THE NAKED APE (1967); ROBERT ARDREY, THE TERRITORIAL IMPERATIVE (1966).
21. *See generally* sources cited *supra* note 20.
22. *Id.*
23. James H. Lorie, *An Economist's Perception I: A View on the Need to Revise Corporation Statutes*, *in* COMMENTARIES, *supra* note 4, at 60.
24. *Id.*
25. COMMENTARIES, *supra* note 4, at 93. Professor Schwartz was responding to the comments of Eric Brown and Ray Garrett, Jr., formerly the head of the S.E.C. *Id.*
26. *Id.*

C. Evidence of Serious Breakdowns in Present Corporate Law

Twenty-five years ago, the Fifty-Fourth American Assembly meeting at Arden House in Harriman, New York involving top business leaders from all over the United States, concluded in its Preamble that:

> Dissatisfaction with American corporations is evident enough, however, that it should not be ignored. Many believe that those who have a stake in corporate plans and actions lack adequate influence over the choice of managers and the decisions they make. With the growth of the pension funds, more people than ever are "owners" of corporations, but the voice of shareholders, filtered through institutions and proxy mechanisms, seems feeble. Many customers, dissatisfied with product and marketing practices, are organizing as "consumers" to redirect corporate priorities. Employees are concerned about their job security and the quality of work life.[27]

At about that time, the Penn Central collapse occurred.[28] This event unfortunately did not serve as the call to action that it should have. J. Daughen and P. Bizen indicated:

> [T]hey sat up there on the 18th floor in those big chairs with the [brass name] plates on them and they were a bunch, of well, I'd better not say it. The board was definitely responsible for the trouble. They took their fees and they didn't do anything. Over a period of years, people just sat there. That poor man from the University of Pennsylvania [Gaylord P. Harnwell], he never opened his mouth. They didn't know the factual picture and they didn't try to find out.[29]

Despite these forewarnings, corporation law academians and practitioners refused to recognize the breakdowns in the law. Now they must recognize them due to a string of major dysfunctions in the corporate law system. A top-flight national corporate practitioner, Victor Futter, who for several years served as Vice President and Secretary of Allied Corporation, now Allied-Signal, Inc., has drawn attention to current evidence of a radical deterioration in corporate conduct and corporate governance generally.[30]

One concrete issue that has arisen in corporate governance is the criminal conduct of some corporate officials. Professor Norwood P. Beveridge has recently indicated:

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27. Coombe, *supra* note 10, at 22.
28. *See* Walter H. Brown, *A Review of the Penn Central Reorganization Proceedings*, 36 BUS. LAW. 1903-15 (1981).
29. Harvey J. Goldschmid, *The Governance of the Public Corporation: Internal Relationships*, *in* COMMENTARIES, *supra* note 4, at 171 (quoting J. DAUGHEN & P. BIZEN, THE WRECK OF THE PENN CENTRAL 303 (1971)).

> One need only glance at a newspaper to see that criminal wrongdoing by corporations is commonplace. In fact, it might be said that there is no such thing as a corporation, or other business for that matter, in compliance with law; rather, there are only corporations (and businesses) out of compliance with the law to varying degrees. Despite that fact, there are no modern cases holding [corporate] directors liable to shareholders for breaking the law. There may be reasons why directors are innocent of most [corporate] criminal behavior, but obviously there are times when they are not. Some explanation is needed for the absence of decided cases supporting the conventional wisdom.[31]

The following scenarios are representative of such instances of corporate director criminal wrongdoing.[32]

One of the criminal activities that has received national recognition involves violations of securities regulations. For example, Michael R. Miliken, head of Drexel Burnham Lambert, Inc.'s junk bond department, was convicted of illegal trading activities;[33] and Ivan Boesky, Dennis Levine, and Robert M. Wilkis were convicted of insider trading.[34] The savings and loan scandal also resulted in various criminal investigations. The Dallas Bank Fraud Task Force charged fifty defendants and obtained thirty-two convictions in its two-year fraud investigation.[35]

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30. Vincent Fuller, *An Answer to the Public Perception of Corporations: A Corporate Ombudsman*, 46 BUS. LAW. 29 (1990). Interestingly, Fuller quoted the Chairman of Johnson & Johnson as saying, "A recent New York Times poll said that only 1/3 of Americans believe that business does an excellent or even pretty good job of behaving ethically. A Harris poll says 82% of Americans believe business is primarily motivated by greed." *Id.* at 30 (citing James J. Burker, Speech Before the Harvard Business School Club of Greater New York (Mar. 30, 1987)). Burker, however, thought the more salient point was that "while the public clearly has a generic mistrust of business, and that should cause all of us deep concern, it is important to draw a distinction between that generic lack of trust and the fact that individual corporations can and do overcome that attitude." *Id.* Sanford N. McDonnell, Chairman of McDonnell Douglas Corporation, stated it more succinctly when he said,

> I think the average man in the street right now things we're all a bunch of crooks. A lot of that is the result of . . . shows like 'Dallas' and 'Dynasty'. And the news, of course, always emphasizes the negative. It doesn't tell about the vast majority of people who are honest.

Id. at 30 (quoting *The Code a Company Lives By*, DIRECTORSHIP, Apr. 1986, at 1, 2).

31. Norwood P. Beveridge, *Does the Corporate Director Have A Duty Always To Obey The Law?*, 45 DEPAUL L. REV. 729, 732 (1996) (citations omitted); *see also* Manning, *supra* note 8, at 1319-20 (indicating that one of the principle reasons behind the A.L.I. Corporate Governance Project which culminated in the *Principles* was the public outcry resulting from the news that U.S. corporations were actively and wilfully involved in bribery of foreign officials).

32. Fuller, *supra* note 30, at 32-35 (the article sets forth the examples provided in the text more fully and also offers additional examples). Columbia Law School Professor Melvin Eisenberg has also commented that the Watergate debacle prompted the development of the ALI's *Principles*. He stated:

> An element of Watergate was the revelation that some of our largest corporations had been engaged in widespread violations of domestic law, and some others had paid bribes to persons at the highest levels of foreign governments and thereby recklessly endangered our national security by putting at risk the political stability of our closest allies . . . . In the long term, they needlessly shook the public's confidence in one of the pillars of legitimacy of the American corporate system–the premise . . . that placing control of the factors of production and distribution in the hands of privately appointed managers maximizes our national wealth without entailing substantial nonfinancial costs.

Melvin A. Eisenberg, *Modernization of Corporate Law: An Essay For Bill Carey*, 37 U. MIAMI L. REV. 197, 209-10 (1983) (citations omitted). For further discussion of corporate criminal conduct, see generally Beveridge, *supra* note 31, at 733-45 (discussing case law on director liability for misconduct).

33. Ann Hagedorn & Betty Wong, *Jones Convicted of Lying to Jury in Drexel Probe*, WALL ST. J., Mar. 23, 1989, at A3; Laurie P. Cohen & Stephen J. Adler, *Indicting Milken, U.S. Demands $1.2 Billion of Financier's Assets*, WALL ST. J., Mar. 30, 1989, at A1.

34. Stephen Labaton, *Business and the Law; I.R.S. vs S.E.C. on Insider Funds*, N.Y. TIMES, Apr. 3, 1989, at D2. Drexel Burnham Lambert, Inc. pled guilty to six counts of mail and securities fraud and paid $673 million in fines, penalties, restitution, and interest to the government as well as to a fund to compensate stockholders. Stephen Labaton, *Drexel, as Expected, Pleads Guilty to 6 Counts of Fraud*, N.Y. TIMES, Sept. 12, 1989, at D1.

35. Thomas C. Hayes, *3 Plead Guilty to Fraud in Texas Savings Case*, N.Y. TIMES, July 6, 1989, at D8.

Another area of concern is price-fixing. For example, the state of Florida recovered more than thirty-three million dollars from dairy companies in settlement of price-fixing charges.[36] In addition, the Panasonic Company settled a price-fixing suit with New York State costing as much as sixteen million dollars.[37]

Some other recent criminal acts include fraud against the public.[38] Hertz pled guilty to a thirteen million dollar customer fraud in overcharges for car repairs.[39] The Beech Nut Nutrition Corporation paid a two million dollar fine for selling phony apple juice plus $7.5 million to settle a class action suit; in addition, two top executives were convicted on numerous counts of fraud and FDA violations carrying both prison terms and substantial fines.[40]

Finally, racketeering and related incidents have also been investigated. For example, Hutton pled guilty to laundering money for unidentified clients who had previously been reported to be organized crime figures.[41] Young & Rubicam pled guilty to paying kickbacks to win a Jamaica tourist account.[42]

These examples demonstrate the recent problems that some corporations have had with criminal conduct. Minnesota has seen similar manifestations of this problem as demonstrated in several local scandals. For example, Endotronics sold millions of dollars of equipment to distributors even though products languished in warehouses because users found developing the technology to

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36. Georgia, Alabama, and seven other states are expected to institute similar suits. *Id.*

37. Constance L. Hays, *Panasonic to Return $16 Million to Consumers*, N.Y. TIMES, Jan. 19, 1989, at A1.

38. While the text discusses fraud against consumers and stockholders, another major area of concern is fraud against the government. Boeing pled guilty and agreed to pay the government more than $5 million for illegally using classified Pentagon documents. Andy Pasztor & Rick Wartzman, *Boeing Pleads Guilty in Use of Documents*, WALL ST. J., Nov. 14, 1989, at A4. Other Pentagon fraud cases include a case in which Sundstrand Corporation pled guilty to charges that it conspired to bill the United States Defense Department for millions of dollars in cost overruns it should have born and fraudulently charged the government for a variety of executive perquisites–for which it paid fines and penalties of $231.1 million–and was the largest fraud settlement in the history of the United States Justice Department. Judith Valente, *Sundstrand to Plead Guilty to Fraud on Defense Work, Pay U.S. $115 Million*, WALL ST. J., Oct. 13, 1988, at A3.

In another case, Bell Helicopter Textron, Inc., agreed to pay the federal government $88 million to settle a dispute with the army for allegedly fraudulently overcharging for helicopter spare parts. *Bell Copter and Army Settle Case*, N.Y. TIMES, Mar. 11, 1988, at D1. As part of the settlement, the company agreed to put into effect a business ethics program for its employees. *Id.*

The United States filed suit against Singer Company accusing it of overcharging the Pentagon by $77 million by falsifying cost estimates on contracts for flight simulators. In this civil suit, the government accused Singer's Link Flight Simulator Division of keeping two sets of books, routinely adding a secret amount or "kitty" to its charges, and alleged that top officials of Link Flight, including the president or his designee, routinely approved the overcharges. Jeff Gerth, *U.S. Sues Singer on Contracts*, N.Y. TIMES, Mar. 15, 1989, at D1.

In another case, Teledyne agreed to plead guilty and to pay more than $4 million to settle charges arising from a Pentagon procurement scandal, and a jury convicted two of its vice presidents for conspiring to defraud the government. Andy Pasztor & Edward J. Pound, *Teledyne Unit Is Said to Agree to Plea, Pay over $4 Million in Pentagon Case*, WALL ST. J., Mar. 23, 1989, at A4. As part of the settlement, Teledyne "agreed to strengthen management controls and tighten internal ethics guidelines." *Id.*

A former vice president of Unisys Corporation pled guilty (for which he was sentenced to jail for thirty-two months and fined $40,000) to bribery of a Defense Department official, drawing for this purpose from a secret $5 million fund set up with Unisys money. The eventual suits and settlements may cost Unisys at least $130 million. Andy Pasztor, *Prosecutors Close in on Unisys, Other Contractors as Arms-Procurement Inquiry Gains Momentum*, WALL ST. J., Jan. 8, 1990, at A14; *Former Unisys Officer Gets Jail Term of 32 MONTHS*, WALL ST. J., Sept. 18, 1989, at B8.

In another case, General Electric agreed to pay a fine of $16.1 million to settle charges that it had overcharged the Defense Department. *Accepting the Blame*, N.Y. TIMES, July 30, 1990, at D1.

39. Richard Levine, *Hertz Concedes It Overcharged for Car Repairs*, N.Y. TIMES, Jan. 26, 1988, at A1.

40. Leonard Buder, *2 Former Executives of Beech-Nut Guilty in Phony Juice Case*, N.Y. TIMES, Feb. 18, 1988, at A1. Fraudulent conduct can also lead to civil suits. For example, the S.E.C. brought a civil suit against Eddie Antar, former chairman of Crazy Eddie, Inc., which accused him of engaging in a "massive financial fraud" in overstating the company's earnings over a three year period. Arthur S. Hates, *SEC Suit Charges Crazy Eddie Ex-Chief, Others with Fraud Linked to Share Sales*, WALL ST. J., Sept. 7, 1989, at A4. Some fraudulent allegations also result in internal investigations such as when MiniScribe Corporation determined that senior management had perpetrated a "massive fraud" on the company, its directors, outside auditors, and the investing public. *Miniscribe Report Describes 'Massive Fraud'; Ex-CEO, Others Said to Have Fabricated Financial Statements*, WASH. POST, Sept. 13, 1989, at C3.

41. *Hutton Pays Fines to U.S.*, N.Y. TIMES, May 17, 1988, at D11.

42. Joanne Lipman, *Young & Rubicam Pleads Guilty to Settle Jamaica Case*, WALL ST. J., Feb. 12, 1990, at B4.

utilize the equipment slow and difficult.[43] Endotronics also realized significant revenue on a research contract with its primary shareholder.[44] Criminal activities such as those discussed above are not the only concern that the public has.

To many, another manifestation of the problem with corporate governance, even in corporations which are not beset with litigation or scandalous conduct, is the increasing disparity of corporate compensation. Executives of the top 200 United States corporations make approximately 143 times more annual income than their employees; this represents a major change from the 1970s when the executive's salary was thirty-five times the average worker's pay.[45] Productivity and overall profitability of American corporations have not necessarily grown, but executive salaries have grown disproportionately in the past ten years.[46]

George F. Will, a conservative commentator, stated:

> The compensation of CEOs is generally disproportionate and often ludicrous in light of corporate performance. Often it is difficult to determine how much CEOs are paid. Compensation packages can be wondrously-and purposely-difficult to decipher. (The 1990 compensation of International Telephone and Telegraph Corp.'s CEO has been estimated at between $7 million and $11.4 million.) But America's CEOs are paid two to three times more than Japan's or Germany's.
>
> In Japan, the compensation of major CEOs is 17 times that of the average worker; in France and Germany, 23 to 25 times; in Britain, 35 times; in America, between 85 and 100-plus times. The U.S. CEO-worker disparity doubled in the 1980s-while the top income-tax rate was cut and workers' tax burdens increased because of Social Security taxes.
>
> In 1990, CEO pay rose 7 percent while corporate profits fell 7 percent. How does this happen? CEO compensation is approved by company directors the CEO helps to choose. Sixty percent of all outside directors of the 1,000 largest corporations are themselves CEOs. They are raising the floor beneath themselves.[47]

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43. Maura Lerner, *Endotronics Charged with S.E.C. Violations*, STAR TRIB. (Minneapolis), May 4, 1988, at 1D.

44. *Id.* The research was directed at establishing new uses for Endotronics equipment, and, when it was successful, was sold back to Endotronics for additional shares of stock. *Id.*

45. Ron Suskind, *Two Brothers' Lives: Both White Collar, Yet Worlds Apart*, WALL ST. J., Aug. 18, 1993, at 1 (quoting Graef Crystal and Steven J. Davis, employment compensation experts).

46. *See* George F. Will, *CEO Mega Salaries May Provoke New Bout of Antibusiness Fever*, STAR TRIB. (Minneapolis), Sept. 1, 1991, at 17A (noting that a CEO's salary is disproportionate to corporate performance); *see also* Glenn Howatt, *$1 Million Pay Package Not Uncommon: 50 Executives Top That Mark at Publicly Held Firms in State*, STAR TRIB. (Minneapolis), Oct. 18, 1993, at 1D; Susan Feyder, *Twin Cities CEOs Second On Forbes List*, STAR TRIB. (Minneapolis), May 10, 1993 at 9D; Thomas McCarroll, *Executive Pay, The Shareholders Strike Back*, TIME, May 4, 1992, at 46.

The remainder of this essay discusses corporation law in light of the foregoing concerns. The next section identifies the major underlying causes of the overall dysfunctionality of corporations. This essay next identifies and analyzes the factors that have produced the scandals and dysfunction plaguing corporation law. Then this essay identifies some of the major actors who have responded to the dysfunctions, identifying their basic views and the most relevant criticisms of these views. Finally, this essay sets forth a number of recommendations that might address the identified problems. The essay borrows heavily from the public debate that wages in professional, judicial, legislative, and academic contexts. The author suggests that lawyers should have an enhanced role in corporation law. This essay concludes by suggesting some overall working rules or values that address the breakdown in corporate law.

II. SOME UNDERLYING CAUSES AND MANIFESTATIONS OF OVERALL PROBLEMS IN ENSURING RESPONSIVE CORPORATE LAW

This section identifies major problems and the manifestations of these problems that the author describes as dysfunctionality in corporations or corporate law. Normal interdependencies and the complications in identifying and analyzing conduct make it hard to distinguish causes of problems from consequences or symptoms of problems. This itself represents difficulties in the development of responsible corporation law. Due to this, underlying causes are not presented herein in any quantitative format. Indeed, the suggestive tone set forth in the presentation could be mistaken as a poor index of thought by the author. Social science techniques, including quantitative analysis and comfort with numbers for rulemaking, are not the forte of this author or others who contribute to this area. However, the lack of such evaluations has been a problem in developing corporation law, and many important decisions are based on anecdote rather than on valid or tested data. This process of lawmaking gives great weight to the impressionistic and articulatory qualities with which the inputs are presented.

This essay does not contend that any particular cause or problem is more important than another, or even that all of the following matters are even rightly considered problems. There is fierce public debate about whether many, if not most, of the following are even legitimate concerns. The debate and literature, however, increasingly suggest that these issues should be acknowledged as problems.

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47. Will, *supra* note 46, at 17A; *see also* Feyder, *supra* note 46, at 9D ("The median total pay of chief executive officers of Minneapolis-based companies nearly doubled last year, putting the city second in the executive compensation sweepstakes .... CEOs at Minneapolis-based firms had median total compensation of $1.9 million. CEOs based in Columbus, Ohio, had the highest median total compensation of $2 million. The national median was $1.2 million."); McCarroll, *supra* note 46, at 46.

A. The Traditional View of Corporation Law Involves a Narrow View of Corporations as Legal Phenomenon

Joe Seligman, Professor at Northeastern University School of Law, commented on Bayless Manning's 1958 depiction of the state of corporate law. Seligman said:

> We have come a long way since 1958, when Bayless Manning, in his celebrated review of Mr. Livingston's book on the American stockholder, could announce that as a field of intellectual endeavor corporations law was dead. The statement is no longer true, since many crucial corporate questions are being treated by laws enacted at the federal level.[48]

Seligman then mentioned the Civil Rights Act of 1964,[49] various water and air pollution acts, and the Occupational Safety and Health Act as among such federal statutes.[50] Unfortunately, corporate law continues to be perceived narrowly and as operating on the same plane as Dean Manning's comment reflects. Many critics indicate that corporate lawyers take a far too narrow perspective and are uniplanar or one-dimensional in understanding their responsibilities. Corporation law reflects this, ultimately to the detriment of corporations and their independence.

Although corporate law scholarship, it would appear, has fixated for several years on the precepts or paradigms of analysis established by statutory regimes and outdated commentary written over fifty years ago, the present status of thought regarding corporate governance is less static.[51] Professor Ronald Gilson has commented, "Much of the existing corporate governance literature is static in character . . . . As we increasingly realize that history and politics, and therefore institutions, matter, I expect that the next generation of corporate governance scholarship will be dynamic: How do existing institutions respond to a changing array of problems?"[52]

Indeed, much of the recent scholarship in corporation law reflects a kind of wandering in the desert. Professor Gilson indicates that until the 1980s, "corporation law was 'trivial,' or, as Bayless Manning so evocatively portrayed it, simply 'great empty corporation statutes–towering skyscrapers of rusted girders internally welded together and containing nothing but wind.'"[53] Gilson then states that the 1980s provided an era where corporate governance was brought out of the "shadow of purely legal analysis."[54] He indicates that econo-

48. Joel Seligman, *Emphasis on Disclosure Reform*, *in* COMMENTARIES, *supra* note 4, at 274; *see generally* Bayless Manning, 67 YALE L.J. 1477 (1958) (reviewing J.A. LIVINGSTON, THE AMERICAN STOCKHOLDER (1958)).
49. Civil Rights Act of 1964, Pub. L. 88-352, 78 Stat. 241.
50. Occupational Safety and Health Act of 1970, Pub. L. 91-596, 84 Stat. 1590.
51. Gilson, *supra* note 9, at 345.
52. *Id.*
53. *Id.* (quoting Bayless Manning, *The Shareholders Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n.37 (1962)).
54. Gilson, *supra* note 9, at 327.

mists were brought more directly into the discussion for the specific purpose of investigating a possible link between corporate governance and corporate performance.[55] The hypothesis, as Gilson indicates, was that better governance would yield greater production and profits.[56]

Another breakaway approach that is still a primitive social science or political science approach is described as "comparative systems." This approach compares German, Japanese, and American corporation law. The "comparative systems" scholarship hypothesizes that German and Japanese systems are oriented to look for long-term effects.[57] These commentators further state that the American system uses corporate resources to provide for short-term, readily recognizable returns on equity or stock market investments.[58] This school of thought concludes that the difference results from the financial intermediaries present in the German and Japanese systems and from tax differences.[59]

Interestingly, with respect to this comparative analysis, Edward B. Rock of the University of Pennsylvania Law School has commented:

> In the past few years, comparative corporate governance–German and Japanese corporate governance in particular, has been a hot topic in U.S. law reviews and conferences. Some of the best contemporary corporate law scholars have focused on German bank centered corporate governance structures, as well as the Japanese bank centered keiretsu structure, for alternatives to traditional U.S. forms. What is one to make of this development? The intuition that one can fruitfully transplant legal rules or institutions from one system to another is as old as the law itself. The temptation is to try to get something for nothing, or at least at a discount.[60]

This approach, therefore, offers some suggestions for American corporation law practitioners and academians.

Perhaps even more primitive, and potentially as removed from corporate rule making, is the whole branch of highly theoretical and far from lucid rules best described as a study of cultural context or historical analysis set forth by the concept described as "path dependence." In addition to these approaches which discuss the factors influencing the development of corporation law, some commentators attempt to explain why corporations have had problems with corporate governance, including the public's perception. For example, Professor Hurst of the University of Wisconsin sheds light on this phenomenon, stating:

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55. *Id.*
56. *Id.* at 327.
57. *Id.* at 332-33.
58. Gilson, *supra* note 9, at 332-33.
59. *Id.* at 333.
60. Edward B. Rock, *America's Shifting Fascination with Comparative Corporate Governance*, 74 WASH. U. L.Q. 367, 367-68 (1996) (citations omitted).

> Corporations need generalists at the top-individuals capable of the instincts of a capable politician and diplomat, as well as a market bargainer. Below these people are a growing number of specialists, including lawyers, personnel people, and collective bargainers. This hierarchy is a source of real tension for modern corporate governance. Where is the corporation going to recruit its generalists if most of the individuals most familiar with the working problems of a corporation come up the ladder by specialist roots? Where do you find these generalists? This is a very real problem for modern corporate governance.[61]

The words of Peter H. Aranson, uttered approximately twenty-five years ago, are just as applicable today. Aranson, formerly with the Center for Law and Economics of the University of Miami, has said:

> I could suggest . . . . that to me and for the preponderance of economists that I believe I could speak for, the thrust of this conference [on the structure and governance of corporations] is illegitimate and unacceptable. That might bother you, or might not, I don't know. If those in the legal profession would study the political economy of the corporation, they would find themselves today to be intellectual relics. They are using 40-to-50-year-old sociology, and that sociology is being used by political muckrakers and is being accepted and credited by many in the legal profession to discredit an institution on which contemporary economists are in nearly full accord.[62]

Some others indicate that lawyers' plumber-like, mechanistic, and not fully sensitive use of labels, names, and legal fictions[63] for matters such as fiduciary duties, shareholder democracy, and empowerment add to the problems that corporations currently face. These concepts are very weak and inconsistently employed.

Corporate lawyers and scholars have not integrated contemporary social science techniques and, for the most part, employ deductive rather than inductive reasoning. Where inductive analysis seems to be increasingly required, the profession and institutions of American law seem propelled to rely on deduc-

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61. Hurst, *supra* note 10, at 38.

62. Peter H. Aranson, *A Political Economist's Perception: Corporations are More Legitimate Than Government*, in COMMENTARIES, *supra* note 4, at 81, 83.

63. Professor Fuller of Harvard Law School has discussed legal fictions as follows:

> [W]e may liken the fiction to an awkward patch applied to a rent in the law's fabric of theory. Lifting the patch we may trace out the patterns of tension that tore the fabric and at the same time discern elements in the fabric itself that were previously obscured from view. In all this we may gain new insight into the problems involved in subjecting the recalcitrant realities of human life to the constraints of a legal order striving toward unity and systematic structure.

Lon L. Fuller, *Introduction* to LON L. FULLER, LEGAL FICTIONS at viii-ix (1967). Professor Fuller further explains that these fictions are encouraged by those who are not members of the bar. He states, "Laymen frequently complain of the law; they very seldom complain that it is founded upon fictions. They are more apt to express discontent when the law has refused to adopt what they regard as an expedient and desirable fiction." *Id.* at 2.

tive methods of problem analysis. In a dynamic environment that presents pressures that are constantly new and equally difficult to perceive or anticipate, reliance upon primitive social science techniques devoid of quantitative analysis may be out of order. Decisions need to be grounded in hard data and methodologies developed to elicit such data. Jack Davies, Minnesota Court of Appeals judge and former law professor, has indicated that legal education does not equip lawyers to comprehend what he defines as the "lawmaking role" inherent in their work.[64] He suggests that lawyers tend to be passive caretakers when, on some critical issues, proactive builders are required.[65]

Many pressing issues suggest other ways to search for truth and justice. The law's, and much of academia's, present reliance on deductive analysis on an almost entirely verbal terrain restricts further development as well as present effectiveness. Attention to the basic problem-solving processes inherent in the legal system reveals the only explicit steps that need to be taken. Optimistically, a well functioning decisionmaking system would evolve corporate law to eliminate the present areas of corporate dysfunctionality.

Professor Harold C. Martin of Harvard University offers the following definitions which serve to make lawyers a little more cognizant of what they are doing. He says:

> Starting from the definition of "statement" as "a sentence that is either true or false," modern logicians proceed to make a distinction between (1) those statements whose truth or falsity is determined by their relationship to other statements and (2) those whose truth or falsity is determined by reference to the facts of experience . . . [T]he distinction is one between statements whose truth is arrived at *deductively* and those whose truth is arrived at *inductively*. Statements arrived at deductively are judged to be true if they are valid consequences of postulated statements, false if they are incompatible with such statements. Their truth or falsity, therefore, is dependent on the verbal structure of which they are a part.[66]

Martin indicates that use of inductive reasoning may be less certain, and perhaps more agonizing and painful than deductive analysis.[67] The law has an obligation to confirm its precepts by reference to actual experiences, and has not yet fully fulfilled this obligation.

The late Professor Donald E. Schwartz of Georgetown Law School offered penetrating criticism of the state of the law in a brief commentary presented at the landmark A.L.I./A.B.A. symposiums on Corporate Governance. He stated:

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64. JACK DAVIES & ROBERT C. LAWRY, INSTITUTIONS AND METHODS OF THE LAW xi xxi (1982).
65. *Id.*
66. HAROLD C. MARTIN, THE LOGIC AND RHETORIC OF EXPOSITION 45 (1959).
67. *Id.*

> Largely as a result of the competitive federal system, the striking fact about corporation law in the United States is that it lacks policy content. Even as to the internal relationships among competing interests in the corporation, by and large, corporation law does not act as a regulator. Bayless Manning has attributed the lack of policy content to the fact that "since the mid-19th century we have not had any idea what we wanted to accomplish with corporation law. . . ."
>
> Professor Cary has analyzed the nature of corporation law from the standpoint of how state law fails to protect investors. This is seen as an economic dysfunction, since Professor Cary views the corporation and its failings almost entirely from the perspective of economic man. However, one can question whether the analysis explores the social dysfunction of corporation law.[68]

Another aspect of the more narrow, one-dimensional approach to corporation law is evidenced by a naïveté or self-righteousness which reflect that the system is good and works, and by an overwhelming trust in good manners and good motives. This means that corporate practitioners and the courts judge people largely by external qualities and how they present themselves. In the alternative, other presumptions hold that lawyers, regulators, and the public are essentially feebleminded and easy to outwit. Those who have positions of corporate trust and rulemaking often unwittingly rely on this presumption.

Lowell E. Sachnoff of the law firm Sachnoff, Schrager, Jones & Weaver of Chicago, in a discussion of the Equity Funding fraud, pointed out that while simple schemes insult the intelligence of the public, the more important power corporate officials have is to cause costly damage to the public:

> Equity Funding was hardly a sophisticated fraud. In fact, it had many of the aspects of some mad comic opera. People in the company truly sat around and made up Bob and Ray names for nonexistent policyholders, and these policies were then reinsured with legitimate reinsurance companies. All this would be funny except that the public suffered over $300 million dollars of loss in the value of the company's public securities. Over all of its lifetime Equity Funding never made one cent of profit and never had any real value. The conventional fraud relief was easy to establish against the principal malefactors–except that they had little or no money. The problem was with secondary parties–the accountants, underwriters, actuaries, and others–and it was only through a massive effort by a team of skilled and diligent plaintiffs' attorneys that a recovery of nearly $65 million

68. Donald E. Schwartz, *The Paradigm of Federal Chartering*, *in* COMMENTARIES, *supra* note 4, at 325, 333 (citations omitted); *see generally* GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES (1982) (discussing the invalidity of statutory laws under a constitutional and common law application scheme).

> dollars for the class of securities holders was achieved-primarily from the secondarily liable defendants.[69]

Another problem, separate from, yet related to the above methodologies and techniques, adds to the difficulties facing corporations. This danger arises from the piecemeal approach to addressing corporation problems which neglects the ramifications of corporate governance on society as a whole. Dean Bayless Manning commented:

> It may be hoped-although, in this I am not wholly optimistic-that the nation's corporate managers and directors will have learned from the experience of recent years that in the long view reprehensible business conduct can only arouse the latent antibusiness animus that is harbored by so many journalists, academics, legislators, and general citizens. If that lesson is not learned, the nation's enterprises will certainly experience a continuing pile-on of government regulations, mandates, and constraints. The ultimate danger is, of course, *that at some point the patient will not be able to survive the therapies*. At some point, the internal efficiency and flexibility that have made American enterprises such a successful institutional adoption can be diluted or burdened to a degree where they can no longer function effectively. At that point, the real victim will be not the corporations but the economy of the United States, our citizenry that relies upon the economy, and the interdependent economies of other nations.[70]

The foundations of corporate law are tradition and precedent. Their influences may be exaggerated as law continues to develop purely short-sighted patchwork resolutions unless better means are found to bring hard data about the social, economic, and legal realities of this diverse, dynamic, and global community to bear on the questions. The current strength of the foundation is in doubt. Continued development of the law on this base without an adequate inspection hardly seems prudent.

B. Emphasis of Corporate Law on Rule-Making Directed to Issues Confronting Public Corporations Rather than Private or Close Corporations

One of the most widely recognized problems in corporation law is what appears to be the failure to acknowledge the existence of, and to address, behavioral problems, authority, and operational nuances of the close corpora-

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69. Lowell E. Sachnoff, *The Present System Does Not Prevent Large-Scale Fraud*, *in* COMMENTARIES, *supra* note 4, at 230, 231; *see also* Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 (1962).

70. Bayless Manning, *A Taxonomy of Corporate Reform*, *in* COMMENTARIES, *supra* note 4, at 109, 112 (emphasis added).

tion or incorporated partnership. As many, including President Clinton, have observed, more jobs are presently being created, more corporate opportunity is developed, and more innovation and risk-taking is done by closely-held corporations than by publicly-held ones.[71] However, for the most part, the problems of close corporations are not investigated or addressed.[72] Common law pronouncements are often inconsistent, hard to understand or determine if they apply, and difficult to use. Common law precedent must be used in light of the fact that the statutes for the most part have not been responsive to the specific problems which trouble closely-held corporations. More troubling than the use of common law is the fact that the idealized policies enunciated during the development of publicly-held corporation law are imposed on the close corporation.

Unfortunately, most of the commentators and other academians who discuss corporations write about giant corporations without pointing out how eccentric and unique they are. For example, Adolf Berle and Gardiner Means studied the 200 largest corporations.[73] This practice is similar to spending six months investigating Muhammad Ali's training camp, and then writing a book on the American boxer without giving any attention to the other classes of boxers and ignoring their unique experiences.

A few figures will put the matter in perspective. In 1970, there were about 1,700,000 corporations reporting to the Internal Revenue Service (IRS).[74] Of these, about 300, or 2/100ths of one percent were billion dollar companies.[75] About 105,000, or seven percent, were million dollar companies.[76] The other ninety-three percent had less than a million dollars in total assets and were "small businesses" under every test provided by the IRS.[77] These differences have both affirmative and negative implications for our thoughts on structure and governance. What may be good for billionaires may not be good for mil-

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71. Much has been written in recent years on transferring entrepreneurship to the publicly held corporation. Already a number of examples exist suggesting this may be one of the more fruitful developments in corporate enterprise. However, this only serves to point out the inherent advantage the close corporation may have. The shareholder-owner is the one who is truly at risk-limited liability not withstanding-and who will reap the rewards. In the close corporation, the relationship of the owner(s) and those controlling corporate policy and operation is direct enough, if not identical, so that a personal profit motive will influence and color the decisions being made on the corporation's behalf.

72. *See* Joseph E. Olson, *A Statutory Elixir for the Oppression Malady*, 36 MERCER L. REV. 627 (1985); Joseph E. Olson, *Statutory Changes Improve Position of Minority Shareholders in Closely-Held Corporations*, 35 HENN. LAW. 10 (1983).

73. *See* ADOLF AUGUSTUS BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 20-27 (rev. ed. 1968). Berle and Means state:

> Though the American law makes no distinction between the private corporation and the quasi-public, the economics of the two are essentially different. The separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear. Size alone tends to give these giant corporations a social significance not attached to the smaller units of private enterprise. By the use of the open market for securities, each of these corporations assumes obligations towards the investing public which transform it from a legal method clothing the rule of a few individuals into an institution at least nominally serving investors who have embarked their funds in its enterprise. New responsibilities towards the owners, the workers, the consumers, and the State thus rest upon the shoulders of those in control. In creating these new relationships, the quasi-public corporation may fairly be said to work a revolution. It has destroyed the unity that we commonly call property. . . .

Id. at 7.

74. Alfred F. Conrad, *Business Corporations in American Society*, *in* COMMENTARIES, *supra* note 4, at 41, 43-44; *see also* ELLIOT CURIE & JEROME H. SKOLNICK, AMERICA'S PROBLEMS-SOCIAL ISSUES & PUBLIC POLICY 25-31 (2d ed. 1985).

75. Conrad, *supra* note 74, at 43-44.

76. *Id.*

77. *Id.*

lionaires and may be utterly irrelevant to others. Looking at it from the other side, measures that would be preposterous if applied to hundred-thousand-dollar corporations, and even to hundred-million-dollar corporations, may conceivably make sense for fifty-billion-dollar corporations.

Perhaps the single most important aspect of the failure to recognize the differences in corporation size is the cost of litigation as it affects shareholders in a close corporation. Often coercion, brinkspersonship, localized community power, and access to important figures in the legal system weigh in more heavily than the application of rule of law.[78] Litigation in close corporations which develops into irreconcilable shareholder differences usually produces the traumatic effects resulting from divorce or death, and more often than not results in irreparable harm to the corporation and dissolution or destruction of the business.

Another aspect of the preoccupation of rulemaking with publicly-held corporations relates to the management of corporation affairs. John F. Lubin, Chairman of the Department of Management at the Wharton School of the University of Pennsylvania, has said:

> Melvin Eisenberg's book *The Structure of the Corporation* has some interesting themes. One is that it is unrealistic to manage the affairs of a company as specified in most legal statutes. The board simply cannot perform the functions required by legal statutes. It is just as unrealistic to expect the board to be a policy making body and to really participate in strategy making function.[79]

Also, on the scholarship level, there is a strong preoccupation with public corporations. As the time of this writing, perhaps the single most intense scholarly debate on corporation governance pertained to the favorable or unfavorable impacts and significance of the phenomenon of the "institutional investor," who now controls a majority of the shares in over fifty-one percent of the largest publicly held corporations.[80] Institutional investors present a specific difficulty with traditional corporation law due to the relationship between the shareholder and corporate officials. Professor Randall S. Thomas of the University of Iowa College of Law, recently described the traditional view:

> A central issue in contemporary corporate law is the effectiveness of shareholders as monitors of corporate management. For example, in a series of recent articles, legal scholars have debated whether the

78. The dysfunctions of the publicly-held corporation, with able assists from the securities industry and the regulatory authorities, readily find their way to the public eye and have been frequently reviewed and/or cited here. Experienced practitioners and jurists will recognize that events in close corporations can be and often are every bit as scandalous. The players are seldom as luminous nor the dollars as large, but the conduct can be a full magnitude more egregious. As power tends to be more focused, failures in the exercise of such power may need more surgical legal remedies than are required in the publicly-held corporation.

79. John F. Lubin, *A Managerialist's Perception: How the Board Really Operates*, *in* COMMENTARIES, *supra* note 4, at 85, 88; *see generally* MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION (1976).

80. *See supra* note 17 and accompanying text.

> rapid growth in equity ownership positions of institutional investors, the relative stability of their shareholdings in each company, and their increased activism in corporate governance matters, will lead to better monitoring by shareholders and improved corporate performance.[81]

Other authors have joined this debate indicating that institutional investing in the overall system may be inherently dysfunctional since institutional investors are not individual shareholders who need the protection provided by common law and regulatory statutes. In addition, institutional investors are themselves corporations or operate under some form of governance structure and can force mergers or takeovers or block such moves; these investors also have a powerful and pervasive influence on board selection. The problems of control as they relate to these institutional shareholders are in fact little different than control of the investees when taking into account long term shareholder needs and corporate equilibrating alternatives.

Since most of the current scholarship is concerned with such matters, closely-held corporations have fallen even farther away from the front burner of investigation and concern. Such corporations do not generally face the problems presented by institutional investors because these investees are not invited to participate in the closely-held management of such corporations.

Even though closely-held corporations are not given adequate consideration by practitioners or academians, the real problem is with the lack of attention given to the middle range corporation or small publicly-held corporations. Large publicly-traded and small closely-held corporations both are numerous enough to warrant some scrutiny. Not so with the medium-sized corporation. Ray Garrett, Jr., formerly Chairman of the Securities and Exchange Commission, has indicated:

> [P]erhaps there is a greater need for protection for investors in the smaller corporations–those of the awkward size, not closely held but not too big to attract public attention–and that, perhaps, they should be subject to more regulatory laws than are necessary or appropriate for the larger widely held corporations. This object is achieved in sort of a rough way, since it is the small companies that stay home and the big ones that go away to Delaware.[82]

Robert L. Knauss, former Dean of the Vanderbilt University School of Law, has also commented on this issue:

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81. Randall S. Thomas, *Improving Shareholder Monitoring of Corporation Management by Expanding Statutory Access to Information*, 38 ARIZ. L. REV. 331, 331 (1996) (footnotes omitted).

82. Ray Garrett, Jr., *The Limited Role of Corporation Statutes*, *in* COMMENTARIES, *supra* note 4, at 95.

> The structure I suggest is that future corporate regulations should be determined with regard to the objectives of the regulation and with regard to the particular type of corporation to be regulated. A general corporation statute, which attempts to regulate all corporations, will do nothing very well. A three-tiered structure of corporate regulation can be effective–at least in the areas where the greatest need exists. Specifically, I suggest that state corporation provisions designed to apply to all corporations incorporated in a state should be limited to defining standards of conduct for directors, fiduciary duties, questions of identification, and basic housekeeping provisions. Companies with publicly traded securities, which are regulated by the Securities and Exchange Commission, could opt out of the remainder of the corporate regulatory pattern. The small close corporations could also opt out and determine their operating procedures by contract among the shareholders. This leaves the key operating procedures and structures of the state corporation act to apply to the middle group of companies.[83]

The observations of Erwin O. Smigel of New York University and H. Laurence Ross of the University of Denver, are worth reviewing in this context:

> The size, wealth, and impersonality of big business and governments are attributes which make it seem excusable, according to many people, to steal from these victims. Theft appears to be easier to excuse when the victim has larger assets than the criminal, as exemplified by the Robin Hood myth. Congruent with this thesis is the tactic frequently used by bureaucracies: the attempt to "personalize" the loss. Witness this sign in a Midwestern motel: "If any towels are missing when you leave, the maid cleaning the room will be responsible for them." The notice attempts to deter theft by invoking sympathy for an individual rather than for the bureaucracy. Some bureaucratic organizations attempt to personalize the impersonal and to make the large corporation appear to be a family business. Another reason why crimes against large organizations are more acceptable to the public than are other categories of crime may be that *our system of ethics lacks rules which specifically apply to relationships between individuals and large organizations*. All major historical religions originated in small communities, in which obligations concerned relatives, friends, and neighbors.[84]

In addition to the lack of ethical tradition recognized by Smigel and Ross,

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83. Robert L. Knauss, *The Problems of Smaller Corporations*, in COMMENTARIES, *supra* note 4, at 141, 145.
84. ERWIN O. SMIGEL & H. LAURENCE ROSS, CRIMES AGAINST BUREAUCRACY 7 (1970) (emphasis added).

there exists in Western culture a historic antipathy to the corporate idea. Abraham Chayes writes about the modern corporation: "As it emerged from the seventeenth century it was by history and tradition at odds with the advancing spirit of individualism and rationalism."[85] This is still true, if C. Wright Mills, William H. Whyte, and Sloan Wilson are to be believed.[86]

Other factors add to the dislike of the large organization. A survey at the University of Michigan noted that "the bulk of the arguments in disfavor can be reduced to criticism or distaste for big business's power or misuse of power over the worker, the competitor, the consumer, or other societal institutions."[87] Also, a large majority of the people surveyed regarded big business profits as excessive.[88] Size and the related issues of impersonality, bureaucratic power, and red tape are the main reasons given for the preference to steal from large organizations.[89] However, the relationship between size and stealing preference is not a simple one, for our culture is ambivalent toward bigness, rather than unalterably opposed.[90]

The owners of the publicly-held corporation are often far removed from the control of operations and even from policymaking. This problem demonstrates one more reason why the regulators and academians have focused their energy on publicly-held corporations rather than closely-held ones. Closely-held corporations have not demanded the same concern or interest because they do not pose the same number of problems.[91]

C. *Diasporization as a Possible Underlying Problem Leading to Damages and Dysfunction*

The third possible cause of problems might be described as the combination of the element of oligarchy with the natural cult or "group can do no wrong" instinct. Both oligarchical forces and the herding instinct have been around a long time. These relate to humankind's natural fears and insecurities, the tangible actions of human beings in addressing them, and the fundamentals of our gathering as community and society. Drs. Mark L. Taft and Lauren R. Boglioli wrote:

> Members of cults relinquish their individuality and conform to the practices and beliefs of the group . . . . In fact, three common threads exist in the aggressive conversion of individuals involved in tradi-

85. Abraham Chayes, *Introduction* to CORPORATIONS 14 (John P. Davis ed., 1961).

86. *See* C. WRIGHT MILLS, THE POWER ELITE (1956); WILLIAM H. WHYTE, JR., THE ORGANIZATION MAN (1956); SLOAN WILSON, THE MAN IN THE GRAY FLANNEL SUIT (1955).

87. BURTON R. FISHER & STEPHEN B. WITHEY, BIG BUSINESS AS THE PEOPLE SEE IT (1951).

88. SHIGEL & ROSS, *supra* note 84, at 8.

89. *See* PRINCIPLES, *supra* note 5, § 5.02 reporter's note 14 ("The subjects of business ethics and corporate codes of conduct have been the focus of attention in the business community for many years. *Based on surveys conducted, the larger the corporation, the more likely it is that a code of conduct will have been adopted, and in the largest corporations the existence of such a code is almost universal.*") (emphasis added) (citations omitted).

90. SHIGEL & ROSS, *supra* note 84, at 7.

91. In 1959, Professors Baker and Carey cited the following six major differences between public and close corporations: 1) stock ownership; 2) control and management; 3) authority of officers and directors; 4) financing; 5) fiduciary principles; and 6) shareholder suits. WILLIAM L. CAREY & MELVIN A. EISENBERG, CORPORATIONS, CASES AND MATERIALS 17-18 (5th ed. 1979).

> tional rites of passage, religious orders, prisons, the armed services, political movements, religious cults, and *even the professional white collar groups and businesses.* When an individual wishes to become part of a larger group, he or she must undergo conversion designed to break down preexisting beliefs and loyalties and replace them with new values and commitments. In general, three states of conversion exist, including (1) *isolation* of the individual from his or her past life and physical *detachment* from significant others, (2) psychological abandonment from one's former self through humiliation and guilt, and (3) assumption of a new identity and a new world view. Many Victorian fraternal rituals made use of props, such as blindfolds. An individual's identity and their faculties are believed to be submerged by the wearing of a mask or other being, such as an ancestor, spirit, or totem animal. This other being is then unable to manifest itself in his or her body and voice.[92]

Relevant in this analysis is evidence of racial and gender exclusion in corporation policymaking. It was recently reported:

> Less than 3 percent of the top jobs at Fortune 500 companies were held by women in 1990 . . . . Only 175, or 2.6 percent, of the 6,502 corporate officers employed at the nation's largest companies last year were women . . . . "At the current rate of increase in executive women, it will take until the year 2466–or over 450 years–to reach equality with executive men," said Eleanor Smeal, the former president of the National Organization for Women who now heads the Feminist Majority.[93]

There are some signs that this situation may be changing, but not substantially.[94]

While the word "cult" appears severe and even abusive in describing a possible reason for the breakdown of corporate rules, historians have observed that our society has increasingly taken on the configurations of subcultures or "diaspores," as historian Arnold Toynbee has used the phrase.[95] Such diaspores maintain distinct systems of communication and patterns for perceiving and understanding law.[96] One of the most important and beneficial diaspores to the American system of law has been the capitalistic system. However, even this most widely accepted diaspora supports some outlooks and perspectives which

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92. MARK L. TAFT & LAUREN R. BOGLIOLI, *Fraternity Hazing Revisited Through A Drawing by George Bellows*, 269 JAMA 2113-15 (1993) (emphasis added).

93. Karen Ball, *Few Women in Top Jobs, Fortune 500 Still a Man's World*, RECORD (N.J.), Aug. 28, 1991, at E3.

94. *Women Pass Milestone in the Board Room*, N.Y. TIMES, Dec. 12, 1996; *see also Women Slowly Gaining Corporate Board Seats*, STAR TRIB. (Minneapolis), Dec. 12, 1996.

95. *See generally* ARNOLD TOYNBEE, A STUDY OF HISTORY 65 (1972) (discussing development of diaspore among Jewish population).

96. *Id.*

regulate conduct, both legal and moral, which often are distorted or unrealistic.

One manifestation of the diaspora that corporations exhibit is reflected by the lack of systematic democracy that permits boards and, potentially more critically, top executives, to proceed in business endeavors, not only without the consultation and advisement of others, but also often oblivious to law, ultimately leading to their own and the organization's downfall.[97] This centralization of decision making may be the single most important specific concern regarding the state of modern corporations. Increasingly, corporations across America, including Minnesota, seem to be losing their autonomy to less understanding and sympathetic external forces, especially the government, whose proper place is not running businesses.[98]

Milton P. Kroll, a Washington, D.C. attorney, indicates that this situation will only get worse.

> The public perception of American corporations is at a very low point. They are not deemed to be sufficiently or effectively accountable for the economic, political, and social impact of their decisions. That being the case, as this point of view has it, those interested in the future of our corporations must soon take or support affirmative and constructive steps that will provide greater accountability–more effective monitoring of decisional processes–or run the risk that possibly excessive measures may eventually be taken by legislative bodies reacting to the social expectations.[99]

This problem seems to decrease with the size of the corporation. As we traverse the continuum of corporate size, blocks of ownership get larger and managing groups more secure, but nonmanagement shareholders have even less frequent opportunities to choose.[100] In the close corporation, the shareholders who are not officers become poor relations of the managers, whom they may treat quite well through considerations of family, friendship, and decency, or very badly.[101] We have all seen the plight of shareholders in close corporations who have incurred the enmity of the managers and have virtually no recourse except to invest money they do not have in a hazardous lawsuit to compel dividend payment or a ruinous dissolution.[102]

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97. *See supra* text accompanying notes 27-47 (discussing evidence of present breakdowns in corporate law).
98. *Id.*
99. Milton P. Kroll, *Introduction by the Chairman*, *in* COMMENTARIES, *supra* note 4, at 30, 31.
100. The influence that shareholders have on governance through the election of the members of the board of directors may not alleviate the problem of lack of accountability. Robert Townsend, President of Avis, once offered management's view of directors:

> I've never heard a single suggestion from a director (made by a director *at* a board meeting) that produced any result at all. Ostensibly the seat of power and responsibility, directors are usually the friends of the chief executive put there to keep him safely in office. They meet once a month, gaze at the financial window dressing (never at the operating figures by which management runs the business), listen to the chief and his team talk superficially about the state of the operation, ask a couple of dutiful questions, make token suggestions (courteously recorded and subsequently ignored), and adjourn until next month.

ROBERT TOWNSEND, UP THE ORGANIZATION 49 (1970).
101. Conrad, *supra* note 74, at 45-46.

Even in those instances when shareholder approval is obtained by corporations, it is often done in a ritualistic, fictitious fashion. Ray Garrett, Jr., said:

> A proposal being entertained by management that will ultimately require the approval of shareholders is shaped from the very beginning by that fact. Many proposals that simply do not stand up or look very good when explained in writing for all the world to see are quickly abandoned. While one can certainly find examples in which shareholders seem to have approved a proposal against their own best interests, on the whole I think it probably more accurate to say that managements of widely held companies simply do not put to their shareholders proposals that do not seem attractive to most reasonable persons. If this is true and at least to the extent that it is true, a requirement of shareholder approval can be an important safeguard, which is not disapproved by the high rate of success in obtaining approval. It may be that our typical corporate law today bases the requirement of shareholder approval too much upon formal aspects rather than upon substance, and this might bear reexamining.[103]

Professor Adolph A. Berle and Professor Gardiner C. Means, back in the 1930s, attacked the vitality of democracy and shareholder approval in many significant aspects of corporate governance and operations. They hypothesized that corporate operation and governance and relationship between the corporation and outsiders are governed not by shareholders, but by management or other "centralized groups."[104] They claimed shareholders do not have the power to limit the unbridled control of corporations or corporation management.[105]

This point of view suggests that the government might have to intervene in order to curtail unbridled use of power as part of corporate governance. However, the net effect of this may create more problems than it would solve. While unbridled director power may be checked, the careful monitoring and other traditional duties performed by shareholders may be diluted or weakened from disuse. Institutional investors would not perform the long-term guardian role and may even distract or divert managers from sound long-term profit building ventures. If smaller shareholders are released from their responsibility to check director power by the government, they may not take up the remainder of their duties.

Developments over the past decades have not improved the situation, and democracy seems to be an even more distant goal than ever. It has been demonstrated, for example, that institutional investors are not actively engaged in

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102. *Id.*
103. Garrett, *supra* note 82, at 103.
104. BERLE & MEANS, *supra* note 73, at 7-8.
105. *Id.*

corporation and democratic decisions for the most part. They are passive, yet vigilant, and make their decisions in subtle ways by simply reinvesting elsewhere after they review structured quantitative data.[106] This disinvestment results in a lower share value, so these decisions do provide a form of control over management. Some argue that these investors should do more to ensure that decisions are made democratically. The effect is somewhat analogous to people simply deciding to leave the country rather than to participate to improve and correct institutions.

As demonstrated above, control of the corporation, especially the public corporation, becomes vested and then may be exercised by those holding the reigns of power with only superficial regard to the formalities of law or any and all other sets of overriding principles. In many regards, a purpose of the corporation becomes the preservation or even enhancement of the investiture.

D. *Geography and Technology as Problems and as a Mode to Help Identify Problems*

Geographical and technological changes to the organization of civilization have their own intertwined impacts on corporate governance. These changes present issues worth attempting to define and reconcile within the corporate governance context. Some of the important multi-cultural aspects of corporate governance have been noted above. However, the blurring of governmental jurisdictions and corporations' weakened geographical ties have at least caused a disillusionment as to the social role of corporations. This, ultimately, poses a problem for governance. James H. Lorie, Professor of Business at the University of Chicago, wrote:

> Corporations sometimes move manufacturing operations from one place to another. Abandoning a location creates unemployment–the costs of which are obvious. The benefits, however, are also obvious though less visible. Employment will be created a the new location. Among the presumed advantages of the move is increased efficiency, which is beneficial to prospective customers and to shareholders.[107]

Thus, Professor Lorie believes that corporate moves clearly benefits society as a whole.[108] Accordingly, Lorie states, "The move would be undertaken to produce profit, which is the measure of the value to society of an economic

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106. Pamela A. Vlahakis recently commented that:
> Institutional investors have traditionally found it difficult to act as owners. Diverse portfolios, indexing and conflicts of interest between an institution's role as fiduciary and its role as an owner have been cited as reasons why institutions do not always communicate their views to the corporations they own. When institutions have chosen to communicate, they have not always done so effectively. Many of the early efforts by activist institutions were symbolic expressions of frustration.

Pamela A. Vlahakis, *Directors Under the Spotlight: Corporate Governance Update*, at 495 (PLI Corp. Law & Practice Course Handbook Series for the 27th Annual Institute of Securities Regulation, Nov. 1995).

107. Lorie, *supra* note 23, at 53.

108. *Id.*

activity. Social responsibility, therefore, consists in maximizing profits."[109]

E. Poor, Eroding, Vague, and Significantly Too Low Standards for Corporation Care and Accountability of Officers and Directors; Potential Erosion of Criminal Law or Constructive External Governmental Controls

The standards governing corporate care and management have been strongly criticized as being vague, misleading, and poorly developed. Commentators indicate that these standards have now reached a juncture of operability and discernability too low to be functional. The standards may even be so low as to encourage corporate mismanagement and abuse of a corporation's internal and external constituencies.

Professor Marvin A. Chirelstein has suggested in this regard that "[t]he problems are complicated, and in most instances the best solutions lie beyond the competence of courts acting under a vague and general standard of fiduciary duty . . . . What is needed, therefore, is detailed and specific legislation based on an analysis of recurring problems."[110]

Stanley A. Kaplan, a former Professor at the University of Chicago Law School and respected Chicago corporate practitioner, has stated:

> I also feel, however, that the fiduciary obligation is too broad, too elusive, and too amorphous a concept to serve its function at the optimum unless we attempt to put some content in it. Realistically, the fiduciary principle is a generality in search of a specificity in content. Consideration should be given to the wisdom of expressing some aspects of that content in express and narrow terms to the extent that it is feasible. Without adequate definition or comprehensive job description, the roving nature of the fiduciary principle is made to carry too much baggage. Indeed a case can be made that an overemphasis upon the efficacy of fiduciary principle as an almost exclusive corrective in the corporate field may divert attention from other structural changes, procedural controls or other machinery which might serve as a substitute in achieving corporate benefit.[111]

S. Samuel Arsht, a leading Delaware corporate practitioner, also commented on

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109. *Id.*

110. COMMENTARIES, *supra* note 4, at 13 (quoting Speech by Marvin A. Chirelstein, *Legislative Solutions for Fiduciary Problems*, AMERICAN ENTERPRISE INSTITUTE (June 1976)); *see also* PRINCIPLES, *supra* note 5, § 4.01 reporter's note 16 (discussing the problems created by loose judicial language as to the applicable culpability standard).

111. Stanley A. Kaplan, *Fair Treatment of Shareholders*, *in* COMMENTARIES, *supra* note 4, at 215, 218. Professor Kaplan also stated:

> The fiduciary duties of majority shareholders are even more complex and uncertain. Putting aside the problem of defining a majority shareholder, the general impression at the present time is that a majority shareholder owes a fiduciary duty to the minority shareholder. Most courts and state statutes define the duty as one of fairness. The cause of clarity was not advanced when the vague term "fairness" was substituted for the term "fiduciary."

Id. at 221 (footnotes omitted).

this same issue:

> Let me first discuss briefly the standard of care. That standard, derived from the law of trusts, is established for the most part by the common law. Overshadowing specific powers and duties vested in directors by the Delaware corporation statute, a long and unchallenged line of Delaware cases makes clear that the primary duty of a director is, as a fiduciary, to deal directly and justly with the entrusted assets of the interest of the corporation. Delaware cases extend that duty to officers and controlling shareholders as well.[112]

One problem with fiduciary duties is that federal courts have systematically retreated from attempting to define fiduciary duties, thereby deferring to the state courts. However, as Lowell E. Sachnoff, a leading Chicago corporate practitioner, has observed, the state laws and the state courts have not filled the gap:

> The simple fact is that the states have not done their job of protecting shareholder interests. Whether or not there is a 'race to the bottom,' no one can seriously contest the fact that state laws do not adequately protect shareholders from overreaching and subtle forms of greed and rapaciousness. State court opinions have been patchwork and quixotic. A good example is how Delaware undercut *Singer v. Magnavox* by the decision in *Tanzer v. International General Industries, Inc.*[113]

There is some question whether any rule can provide guidance to be proactive rather than reactive with respect to corporate wrongdoing.

Another commonly used standard is the standard of due care, which, like the fiduciary standard, is based on common law. The standard of due care is now incorporated in most state statutes, especially those mirroring Model Business Corporation Act.[114] As with the fiduciary standard, very little guidance is provided by the statutory language, leaving only the guidance provided by disjointed and patchwork common law doctrines. On this issue, Arsht has said:

> The standard of due care, as declared by the Delaware Supreme Court in *Graham v. Allis-Chalmers Mfg. Co.*, is that a director or

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112. S. Samuel Arsht, *In Staunch Defense of Delaware*, in COMMENTARIES, *supra* note 4, at 238, 239 (citing Warshaw v. Calhoun, 221 A.2d 487 (Del. 1966); Sterling v. Mayflower Hotel Corp., 93 A.2d 107 (Del. 1952); Johnston v. Greene, 121 A.2d 919 (Del. 1944); Guth v. Loft, 5 A.2d 503 (Del. 1939); Keenan v. Eshleman, 2 A.2d 904 (Del. 1938); Petty v. Penntech Papers, Inc., 347 A.2d 140 (Del. Ch. 1975); Condec v. Lunkenheimer, 230 A.2d 769 (Del. Ch. 1967); Yasick v. Wachtel, 17 A.2d 309 (Del. Ch. 1941); ERNEST L. FOLK, THE DELAWARE GENERAL CORPORATION LAW 76 (1972)).

113. Lowell S. Sachnoff, *The Present System Does Not Prevent Large-Scale Fraud*, in COMMENTARIES, *supra* note 4, at 230, 233 (citing Singer v. Magnavox, 380 A.2d 969 (Del. 1977); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977)).

114. *See* MODEL BUSINESS CORP. ACT § 8.42 (1984).

> officer must take such care as an ordinarily prudent person in a like position would use under similar circumstances. The standard is supplemented by statutory provisions, such as those permitting good faith reliance on corporate books and records, reports of officers, and independent public accountants. Such reliance, however, is qualified by a good faith standards, which means that a person may not rely in such sources if he is aware of facts or circumstances suggesting either that the source is unreliable or that further inquiry is needed before placing reliance on such a source.[115]

A third commonly used rule is the business judgment rule. Among the various state court decisions and statutes, there are also problems with defining the business judgment rule. According to Stanley Kaplan:

> I think the business judgment rule is due for an overhaul in order to ensure that business judgment is reasonably exercised and that the parties attempt to get the facts on which a business judgment can reasonably be made. Is every decision that a board of directors makes within the category of decisions protected by the business judgment rule? Or should only those business judgments that are arrived at in accordance with adequate standards be protected? In *Kaplan v. Centrex Corp.* the Delaware Chancery Court took the position that before a decision would be protected under the business judgment rule, there had to be some showing that the parties making that judgment had really focused on the question rather than come to an ill-considered hasty conclusion. That raises the question of whether there must be adequate inquiry and some reasonable basis for reaching a particular conclusion if the business judgment rule is to apply . . . .[116]

With the business judgment rule, it is uncertain whether application of the rule presupposes or does not presuppose the exercise of due care.

Statutory concepts of accountability have been eroding quite rapidly over the past several years. As indicated above, Professor Cary, joined by public crit-

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115. Arshi, *supra* note 112, at 239 (citations omitted); *see also Introductory Note* to PRINCIPLES, *supra* note 5, at 178, which provides:

> Historically, courts have not applied duty of care standards harshly. Judges have recognized the dangers inherent in making post hoc judgments about the care exercised by directors and officers and have allowed them considerable leeway. Relatively few cases have imposed personal liability for damages.

Id. Nevertheless, since 1985, more than 35 states have adopted legislation aimed at reducing or eliminating the exposure of directors (and, in a few instances, of officers) to personal liability for monetary damages for certain kinds of violation of the duty of care. *See id.* § 7.19 reporter's note 6.

116. Kaplan, *supra* note 111, at 221-22 (citing Kaplan v. Centex Corp., 281 A.2d 119 (Del. Ch. 1971)). Professor Schwartz has stated:

> [T]he business judgment rule in effect says that courts will not impose liability on directors because they made an incorrect decision. Critics do not argue in favor of making directors insurers or even in favor of producing markedly different results, but express concern that the business judgment rule is too quickly applied and that thereby it encourages too low a standard of behavior.

COMMENTARIES, *supra* note 4, at 210.

ics such as Ralph Nader and Mark Green, who desire to go further, has commented that there is a race to the bottom with respect to state statutes attempting to accommodate management of corporations who desire not to be inhibited in any respect. States are competing, many assert, to provide a habitat for ill-governance while there are significant pressures on a federal level and in the prosecutorial realm to deter these behaviors. There is a set of mixed signals and a dichotomy in American law on the federal and state level in this regard. While internal standards of corporate governance are confusing, there are also mixed signals in external standards guiding corporations, all adding potentially to a state of lawlessness.

The lack of policy and planning in the development of corporate law, discussed above, suggests that external standards for corporate governance cannot be decided until the public policy debate is somewhat settled. This lack of public debate is not the only challenge facing the use of external standards, however.

All indications suggest that external governance standards are no less complex, confusing, or ineffective than internal governance standards and rules. Public policy formulators are increasingly challenged to obtain adherence by Americans in all spheres of legal regulation. An article on this subject appeared in the *Wall Street Journal*. The authors claimed:

> We are a nation of lawbreakers.
>
> We exaggerate tax-deductible expenses, lie to customs officials, bet on card games and sports events, disregard jury notices, drive while intoxicated–and hire illegal child-care workers.
>
> Janet Reno wouldn't have been in the position to be confirmed unanimously as attorney general . . . if Zoe Baird had obeyed the much-flouted immigration and tax laws. But the crime of the moment could have been something else, and next time it probably will be.[117]

Professor Beveridge has indicated that this sense of lawlessness applies equally to the corporate world:

> Principles of Corporate Governance has a vision of the corporate world that is a vision of uniform compliance with law, although allowances are made for instances where laws are unenforced,

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117. Stephen J. Adler & Wade Lambert, *Common Criminals, Just About Everyone Violates Some Laws, Even Model Citizens*, WALL ST. J., Mar. 12, 1993, at 1. The article further provides:

> One reason for so much lawbreaking, criminologists say, is that there are so many laws, with new ones being added every year. A state's statutes, including regulations of businesses, can fill 40 volumes or more. State criminal codes average about 1,000 pages each. And on top of the state tomes sit the U.S. laws: Federal criminal provisions fill some 800 pages. Town and city ordinances add to the list.

Id.

> ambiguous or invalid, or rightly regarded as a cost of doing business. This is not a vision of the real world, where the norm of general compliance with law is an aspirational one rather than a realistic one. The United States is a nation with a superabundance of laws: laws that have been forgotten, laws that are rarely or selectively enforced, laws that no one understands, and laws that are regarded by everyone as more of a nuisance than a moral command. We are constantly reminded of this state of affairs when our moral, political, business, professional, religious, educational, judicial and other leaders are found to have the same weaknesses as society at large with respect to income tax compliance, use of controlled substances, employment of undocumented aliens or unconventional sexual preferences. The situation is exacerbated by the contention of law enforcement personnel that criminal conviction should not require proof of intent to violate the law, a very problematic notion that greatly confuses the moral and legal issues.[118]

Corporate governors are subject to several internal rules and regulations such as fiduciary duties to shareholders, the standard of due care, and the business judgment rule. When these internal checks and balances fail to produce legal as well as fair and equitable results, the behavior of corporate governors is regulated by external rules as well. Reality poses problems for both internal as well as external factors even though public policy demands compliance with these standards.

F. Lack of Quantitative and Social Science Input Into Corporate Law and Lack of Data and Tools for Approaching Corporate Problems of Internal or External Corporate Governance

The twentieth century is an age when mathematics and technological advances have been applied successfully to social and economic issues. Only limited inroads have been made employing the same advances to the law, particularly corporate law.[119] Decisionmaking in contemporary American corporate law is still highly subjective and based on anecdotal evidence, precedent, and the over-employment of legal fictions. When normal legal processes,

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118. Beveridge, *supra* note 31, at 776-77 (footnotes omitted). It is interesting that Professor Beveridge cites a Sunday Blue Law which has not been enforced for many years and does not receive community support. *Id.* at 735 n.42. This is the type of law that can be legitimately violated without departing from the principle corporate governance norm of compliance with the law. This example "invites evasion or avoidance [of the law], corruption of public authorities, and inconsistent enforcement [of the law]." *Id.*

119. Certainly there are empirical and quantitative works in the corporate law area. For the most part, however, they are relatively scarce, hard to locate, not keyed in to or directed at major issues, not in user friendly format, dated, or lack a standardized methodology and universally recognized controls. They are still good beginnings, but there is a very long way to go. *See* Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261 (1986); Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155 (1990); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 61 (1991); John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS. 5, 26-33 (1985); Bryant G. Garth et al., *Empirical Research and the Shareholders' Derivative Suit: Toward a Better Informed Debate*, 48 LAW & CONTEMP. PROBS. 137, 146 (1985); Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 500 (1991).

heavily grounded in deductive rather than inductive reasoning, are unable to absorb social pressures, resort is often made to legislative or executive intervention. This resort to mechanisms outside of corporate law upsets not only the equilibrium and internal integrity of the capitalistic system, but also the governmental process itself. The subjects of governmental regulation find it increasingly incumbent upon them to influence the governmental processes which regulate them; such lobbying efforts are often unknown to shareholders and directors, as well as the public electorate.

At some Midwestern universities, social science technique has developed an increased applicability to public policy decisionmaking over the past few decades. Very little, if any, of the technique has been applied to judicial decisionmaking, which, ironically, is one area where the real, tangible world converges with intangible concepts and ideas. Basic quantitative data in this area are either nonexistent, largely unknown, not easily accessible, or very incomplete.[120] Without accessible, consistent, and reliable data, it is difficult for decision-makers to act responsibly. The mathematical determinations, even simple correlation analysis, have not been ventured, perhaps because lawyers and policymakers are simply afraid of numbers or are ill-equipped to deal with conceptual approaches and numbers together.

Parliamentary approaches, based largely on the *appearance* of knowledge, quick-thinking, and deductive reasoning, dominate most of the legislative debate and executive discussion. These approaches similarly dominate the development of rules in judicial opinions affecting corporations. As indicated, legal scholarship and law schools seem to be slow and hesitant in adopting and integrating into their disciplines any significant statistical or social science techniques. The realm of debate and the scope of the discussions within the journals and in classrooms is not significantly different than it was one hundred years ago and remains in an insipid stage, as previously discussed.

Professor James H. Lorie of the University of Chicago suggests that, without hard quantitative evidence, it is difficult or impossible to even discuss corporation law issues. For example, Professor Lorie has stated, on the issue of corporate governance:

> [S]tockholders can protect themselves as well as impose a sanction on management by not investing or by disinvesting . . . . Professor Cary [in his article] suggests that corporation statutes are devised to be attractive to corporate managers and that the result is somehow disadvantageous to investors. I would argue that corporation statutes that give great freedom to managers are more attractive to investors

120. The number of close corporations as opposed to publicly-traded corporations, the various categories of corporate assets, shareholder numbers within publicly-traded corporations, and so on, have not been widely, thoroughly, or systematically quantified. The nature of corporate democracy asserted by institutional investors has not been carefully or conclusively measured. The number and proportion of corporations committing violations of important federal statutes has not been determined. Data regarding the aggregate amount of corporate funds wilfully taken or converted by corporate managers to the detriment of shareholders and creditors has not been accumulated, and the positions of the wrongdoers and the nature of their acts have not been investigated.

> than statutes that require managers to have frequent recourse to the stockholders or boards of outside directors . . . . Undoubtedly, Professor Cary would argue to the contrary. Neither of us *has any evidence*. In order to shed light on the issue, Professor Kaplan has suggested a study of the behavior of stock prices of corporations that have moved their charters from California and Illinois, states with the most restrictive corporation statutes, to Delaware, a state that certainly is among the least restrictive.[121]

The nature, the degree, and the trends in any imbalances which exist in the current structure of corporate governance and the broader realm of corporate law can hardly be responsibly addressed unless and until some of their basic attributes are measured and monitored.[122] The techniques for doing just this are available but appear largely to remain foreign to the process by which corporate law now develops.[123]

G. *Intellectual and Public Policy Gridlocks or Constraints of Institutions Otherwise Able to Respond*

A problem, as suggested in the immediately preceding section and elsewhere, has been that available public policy information and data is largely anecdotal, conjectural, hypothetical, and representative of old-line social science, and has created an impasse for decisionmaking. Much of the intellectual or legal means of addressing this, even those on the cutting edge in legal scholarship which has developed over the past decade, are still at the embryonic stages of locating hypotheses for further proof and are still very much derivative. The techniques for substantially more responsible decisionmaking are available, but appear largely to remain foreign to the process in which corporate law develops.

Unfortunately, it is not only corporate policy makers and those affecting corporate policy directly, such as the courts and legislatures; that use outdated anecdotal approaches. The same can also be said of portions of the academic community and members of the bar. Sadly, the resulting gridlock takes on two characteristics: 1) on fundamental issues, there is disagreement as to whether, indeed, there are issues or problems and how they should be addressed; and 2) major institutions that would be capable of addressing them have not been effectively engaged in the process.

The problem may be directly related to the lack of reliable data and research methodology. That is, the gridlock is perhaps a manifestation of irrelevant and dysfunctional methodologies. However, gridlock is, in itself, a problem

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121. Lorie, *supra* note 23, at 57.

122. While business schools, including notably the University of Chicago, have adopted quantitative methodologies for analysis of corporation behavior, law schools have rarely adopted quantitative methodologies for either research or teaching.

123. Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 COLUM. L. REV. 1335, 1361-62 (1996).

that results in conflict on some mainstream issues. The following sections present some such issues.

1. Intellectual and Public Policy Gridlocks

a. Corporate Democracy as a Worthy Goal

Many important commentators and other figures have considered corporate democracy and more immediate shareholder sovereignty as a critical, important, and necessary attribute. This concept is sometimes referred to as "legitimacy."[124] Others have discarded legitimacy, not only as a legal fiction, but as an unnecessary legal fiction and claimed that corporate democracy is not important. The legitimacy concept is roughly related to theories advanced by John Locke and later reflected in such documents as the Declaration of Independence. Essentially this philosophy states that governance and government in any context are legitimate only to the extent that power is derived from the consent of the governed after they are provided with sufficient information.

One critical attack on the legitimacy theory is set forth by Alfred F. Conrad, Professor at the University of Michigan Law School. Professor Conrad has questioned the inference that whatever is not legitimate must automatically be illegitimate or unwise. He writes:

> This inference, however, suggests the question whether the democratic postulate applies to all organizations which, in contrast to governments, are essentially voluntary. If AT&T is illegitimate because its governors are not chosen by the governed, what would be said about the Roman Catholic Church, Harvard University, and perhaps even The American Law Institute?[125]

Professor Conrad's view is that there is already built-in self-governing, self-equilibrating mechanisms in corporations and certainly not a need for greater shareholder control.[126] Shareholders have absolute control through their ability to disinvest.[127]

Professor James H. Lorie of the Graduate School of Business of the University of Chicago has also offered criticism regarding democracy as a necessary postulate for corporate rulemaking:

> My view of corporate government leads me to a different conclusion. The literature on the subject that has come to my attention neglects several important things. First, there is inadequate recognition of the

124. *See* JAMES WILLARD HURST, LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES, 1780-1970 (1977).
125. Conrad, *supra* note 74, at 46.
126. *Id.*
127. *Id.*

> near identity of the interests of corporate management and corporate stockholders *as well as the effectiveness of the sanction which stockholders can impose on management by failing to invest or by disinvesting*. The interest of stockholders is to enjoy a high rate of return on their investments, most of which comes from capital appreciation. Managers, too, have a keen interest in having the price of the stock of the corporation that they manage go up. Typically, the compensation of managers is importantly influenced by the corporation's profitability and by the price of the corporation's stock. Managers are often large holders of the stock of corporations that they manage; they frequently hold stock options; they sometimes participate in phantom stock schemes of compensation; and their bonuses are often associated with corporate profitability. Further, the tenure of management is jeopardized by poor profitability and declining stock prices.[128]

Supporting the criticism of corporate democracy and reflecting the deadlock is the fact that other industrial nations, such as Japan, do not utilize democratic corporate governance schemes. Harold Marsh, Jr., an established Los Angeles practitioner, stated: "[W]hatever advantages the Japanese may presently have over us, which are fairly evident in certain areas of industrial production, those advantages clearly were not achieved through an excess of corporate democracy."[129]

Indeed, Professor Edward B. Rock has indicated that the takeover era of the 1980s, extending into the present decade, reflected a shift from legal and institutional mechanisms of corporate governance and control over management discretion, to market mechanisms for such control.[130] Professor Rock has indicated that "[w]hile academists disagreed on the details, they shared a common and fundamental belief that the market for corporate control was the single most important constraint on corporate management and that the law should be striving to maximize its effectiveness."[131] Professor Rock then chronicles what may be deemed a movement away from the economic market-based approach of academic corporate law, and indicates that the view that "the fragmentation . . . and traditional passivity of American shareholders [related to abuses by corporate management] was *not* the inevitable result of economic growth, but was rather the result of political choices."[132]

This intellectual debate is partially based on hypotheses as well as the most primitive social science approaches and quantitative techniques. No new truths or near truths have been proven or even substantially confirmed. The debate, as chronicled by Professor Rock, seems to have the net effect of produc-

128. Lorie, *supra* note 23, at 56 (emphasis added).
129. Harold Marsh, Jr., *"If It Ain't Broke, Don't Fix It"*, *in* COMMENTARIES, *supra* note 4, at 293, 308.
130. Rock, *supra* note 60, at 374.
131. *Id.*
132. *Id.* at 376 (emphasis added).

ing a gridlock.

b. The Purpose of the Corporation in Society

Another problem arising out of the apparent gridlock caused by feuding methodologies is the definition of the purpose of the corporation in society. With respect to the societal purpose of the corporation, Professor Milton Friedman states, "There is one and only one social responsibility of business–to use the resources and engage in activities designed to increase its profit so long as it stays within the rules of the game, which is to say, engages in open and free competition[133] without deception or fraud."[134]

In contrast to this, Professor Neil W. Chamberlain demands that corporate governors take on a more socially responsible and positive role in their communities.

> [O]nce we recognize the management of a large corporation today is as much a political office as an economic function, the lack of standards would cease to surprise us and should worry us less. To what standards of social responsibility can we hold any political office holder, the mayor of a city, the governor of a state, the president of a nation?. . .[135]

These two separate ideas about the true role of the corporation are not easily reconciled. The conflict between commentators also adds to the gridlock preventing corporation law from developing beyond its present borders.

c. The Concern of Whether Corporation Standards Are Being Watered Down In a Race Among States to "The Bottom"

The issue of whether there is a watering down of standards or a lessening of corporate statutory sanctions also adds to and results from the academic as well as practical gridlock surrounding corporate law. The commentary in this regard need not be repeated here but might be summarized in this remark by Dean Bayless Manning: "Professor Cary points out with some asperity that

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133. The concept of competition seems to be invested with a paradox. The essence of enterprise is that every available advantage is to be gained and taken. As the distinctions grow, consumers are presented with choices which both enhance the value they might receive for their money and decrease the choices of prices to pay for receiving a particular value. This paradox means that the enterprise might receive a premium price simply for being different, rather than being better.

Gaining advantages and taking them produces direct costs for the enterprise. However, the advantage may be that the enterprise has found ways in the market which allow it to transfer some of its costs to others. Such a transfer is legitimate to the degree it is based on a fair bargain between the parties. If the transfer is to a community or society, striking the bargain becomes political as well as economic. Fortunately or not, the body politic is not so constrained with regard to changing its mind as to a bargain and may choose to change what it changes, after the fact.

Every business enterprise is a guest of its community and subject to its whims as to how costs are to be borne between the two. Economic decisions based on cost allocations must bear in mind the political process within the community which is setting the allocation. Communities continue to rethink the allocations of cost associated with their heritage, including primitive waste disposal methods, slavery, and subsequent racial discrimination, and the need for a social net to provide necessaries for the members who can no longer obtain adequate food, shelter, or health care. These costs are neither trivial nor avoidable.

134. MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962).

135. Neil W. Chamberlain, *The Greening of the Board Room: Reflections on Corporate Responsibility*, 10 COLUM. J.L. & SOC. PROBS. 15, 36-37 (1973); *see generally* NEIL W. CHAMBERLAIN, THE LIMITS OF CORPORATE RESPONSIBILITY (1973).

many members of the Delaware judiciary came out of corporate practice. To my mind that is an enormous advantage."[136] In other words, it appears that it may not necessarily even be a race to the bottom as those states which have permissive statutes, as some commentators insist, also have a strong and knowledgeable judiciary and body of case law which balances out the statutory deficiencies.

d. The Debate Over Fiduciary Duties

The intense debate over fiduciary duties–what they are, what they should be, and whether they are being observed–signifies another area of gridlock. According to Dean Bayless Manning:

> As for the claim that Delaware's courts have little compassion for minority shareholders and underestimate the importance of high fiduciary standards for corporate management, it must be said that no demonstration to that effect has been made. And no evidence has been adduced to show that shareholders or the treasuries of Delaware companies have been visited by disaster as a result of misbehavior condoned by that state's judges.[137]

This view lies in stark contrast to the views of Professor Marvin A. Chirelstein who said: "The problems are complicated, and in most instances the best solutions lie beyond the competence of courts acting under a vague and general standard of fiduciary duty . . . . What is needed, therefore, is detailed and specific legislation based on an analysis of recurring problems."[138]

These two quotations represent polar opposite opinions. Again, corporation law cannot develop further within the confines of a system that is affected by such a gridlock in views.

e. The Need for Checks and Balances

Another major issue that contributes to the academic and practical gridlock facing corporation law also has two diverging opinions. On the need for checks and balances or countervailing forces, there are many who assert that external forces provide sufficient equilibrium.[139] Professor James H. Lorie identifies several external forces that influence corporate managers. "In sum, those who argue that managers exercise power without effective checks overlook the following: (1) Competition in the markets for the corporations' goods and services; (2) Labor unions; (3) Federal, state, and local laws of astonishing variety;

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136. Manning, *supra* note 70, at 118.
137. *Id.* at 119.
138. Speech by Marvin A. Chirelstein, *Legislative 'Solutions for Fiduciary Problems*, AMERICAN ENTERPRISE INSTITUTE (June 1976).
139. These commentators also debate whether corporate governance is even a legitimate concern for debate given the external forces that regulate the behavior of management.

(4) Derivative and class action suits; and (5) Disclosure requirements."[140] Richard J. Farrell, Vice President in charge of the Legal Department for the Standard Oil Company, agrees with Professor Lorie. Farrell states:

> I categorically reject the notion that these corporations [which are suggested to be running amok and therefore in need of reform] are, on the whole, poorly managed. I know personally too many intelligent, dedicated, and honest board members to accept the notion that directors always act at the whim of their chairman without independent thought. I know too many good plaintiffs' lawyers to believe that there is widespread undisclosed self dealing, corruption, or disregard for shareholder interest. As to what is going on, Professor Vagts has correctly noted the growth of outside directors and audit committees. These trends have developed from *within* the business community.[141]

This essay has provided an overview of the problems and breakdowns facing corporation law. Public opinion towards corporate governors has steadily retreated, and many consumers have expressed dissatisfaction with corporate products and marketing practices.[142] Even more distressing is the number of criminal investigations and civil complaints that have been made against directors or other corporate insiders.[143] This author does not suggest that even a majority of corporate governors make unscrupulous, illegal, or questionable decisions. However, the public has voiced some doubt as to the honesty and responsibility of corporate governors.

While these two divergent viewpoints do not rely so much on commentators with different philosophies, they do represent a conflict in the discussion of the need for checks and balances in corporate decisionmaking procedures. This conflict represents just one more cause of the gridlock surrounding corporation law.

f. The Issue of Independent Directors

On an issue perceived by many as critical-the role of independent legal actions against corporations or their directors-there also seems to be gridlock.[144] On one side of the conflict, Professor John F. Lubin of the Wharton School of Business, has stated:

> He who claims an injury has more and more sought relief by bring-

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140. Lorie, *supra* note 23, at 58.
141. Richard J. Farrell, *Corporations are Already Overgoverned*, *in* COMMENTARIES, *supra* note 4, at 188, 189 (emphasis added).
142. *See supra* note 27 and accompanying text.
143. *See supra* notes 32-44 and accompanying text.
144. This issue also calls into question the value of any oversight role for the judicial system.

> ing an action against the board of directors. Are such actions fair, however, to the members of the board (particularly the outside directors) who are honestly trying to exercise their best business judgment and to meet their fiduciary responsibility to the shareholders? Moreover, will such actions cause the quality of boards to inevitably decline, or will boards increasingly bring all potentially "dangerous" matters directly to shareholders, thus minimizing their risk but probably making for ponderous and inefficient management?[145]

In today's world, many advise against serving as a board member, whether as an independent director or not, because such a position creates a risk for personal liability.

In an article regarding the effectiveness of outside directors as corporate governance mechanisms, Laura Lin has indicated that:

> Despite this important tool that the law and reformers have assigned to outside directors, substantial disagreements remain regarding whether outside directors are effective monitors. Currently there are two opposing schools of thought. According to the managerial hegemony theory (drawn from organization and management science literature), management may support regardless of its composition. Contrary to the foregoing, the "effective" monitor theory (drawn from financial economics), argues that outside directors are motivated to protect shareholders' interests because of their desire to protect their reputation capital as "experts in decision control."[146]

Just as with the other issues, the divergent opinions represent a gridlock in the development of corporate law. The true value of independent directors has not been quantitatively investigated and the two schools of thought appear to remain diametrically opposed.

2. *Constraints of Institutions Otherwise Able to Respond*

The foregoing issues only provide a very brief sampling of a some issues that are currently generating debate within the legal profession and the business community. The inability of this profession to resolve the gridlock on its own may interfere with, or decrease the effectiveness of, any material efforts for change within the corporate legal community. This may ultimately lead to change that is motivated, and perhaps determined, by outsiders such as the public at large or the government.

Private non-governmental institutions that are in a position to respond

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145. Lubin, *supra* note 79, at 86-87.

146. Laura Lin, *The Effectiveness of Outside Directors Is A Corporate Governance Mechanism: Theories in Evidence*, 90 NW. U. L. REV. 898, 901-02 (1996).

and could be expected to respond have not effectively done so. These institutions include lawyers' professional associations and the stock exchanges. In other professions or industries, these groups would normally be considered the most likely to identify problems and advocate solutions. This situation is reflected by Professor Donald E. Schwartz in his conclusion:

> [O]ne conclusion that drew the strongest, most broadly based support was that a real need existed for a major study of the duties and liabilities of officers and directors of corporations and for the further study of possible changes in the governance structure. Moreover, it was the overwhelming consensus of all groups that this was a role to be played by the American Law Institute.[147]

Importantly, even *after* the comprehensive Symposiums–which were somewhat akin to a Constitutional Convention–some assert that questionable progress has been made. In 1978, Professor Herbert Wechsler, former Director of the American Law Institute, attempted to summarize the predicament facing corporation law practitioners and academics. He made these comments several years *after* the Model Business Corporation Act was enacted in most states, including Minnesota. Professor Wechsler said:

> By this time Dr. Lewis, who was in his old age, had become very bold. He now thought that the Institute should be concerned, not only with the law that is but also with the law as it ought to be and, as he put it, "as it will be." Dr. Lewis felt strongly that the Institute should *undertake to develop something in the corporate field that would be a projection for the future*. By this time, he was on the left, but the Council was solidly on the right, however, as it has always been, and Lewis' forward-looking view was not adopted . . . .
>
> This is the *third time that the idea has been before the Institute*. I think that there is, perhaps, more receptivity to it now than there has ever been before.[148]

Finally, on March 31, 1992, after eleven tentative drafts, the American Law Institute issued a quasi-Restatement of the law or a set of norms for attorneys and other corporation law principals that provided an excellent review and summary of scholarship and case law in the corporate governance area.[149] The words of Geoffrey C. Hazard, Jr., Professor of Law at Yale Law School and Director of the American Law Institute at that time, aptly describes the

147. Donald E. Schwartz, *Introduction* to COMMENTARIES, *supra* note 4, at 3, 7.
148. Wechsler, *supra* note 10, at 18 (emphasis added).
149. *See generally* Geoffrey C. Hazard, Jr., *Foreword* to PRINCIPLES, *supra* note 5, at ix.

expected response to and reception of this undertaking.

> The work taken as a whole is a formidable treatment of a complex subject that has many controversial aspects. Apart from its contribution to the law the draft is a contribution to legal scholarship in corporate law and to the economic and institutional analysis of corporate governance. Comment directed to the project has ranged from assertions that its formulations would work great legal change harmful to corporate enterprise, to assertions that it would insulate corporate directors from established legal responsibilities, to assertions that its formulations have yielded little change after much effort. It seems not incautious to suggest that these assertions cannot all be correct.[150]

Dean Bayliss Manning has offered the following commentary on the process that members of the American Law Institute used when creating the comprehensive regulatory work:

> All the more credit is owing to the President if one discerns that, as became increasingly apparent as the Project wore on, the parliamentary deliberative processes of the ALI were ill-suited to cope with the ever-growing Tome [the developing draft]. Those processes of open town hall floor debate were splendidly democratic, open, and even-handedly administered by the Chair. So why the unkind term ill-suited.
>
> As a generalization, during the floor debates on the Project at the annual meetings, some 350 to 400 people were present, participating, and voting. That is hardly an optimum number to tackle the delicate drafting of over 800 pages of complex regulations. While there is no doubt of the aggregated outstanding professional quality of the professors, judges, and practitioners that make up the membership of the ALI, it was apparent throughout the fifteen years of floor proceedings that only a minority of those present had a working familiarity with corporation law, and even fewer were acquainted closely with the institutional functioning reality of corporate management and the boardroom.[151]

The ALI experience may not have been the most efficient method of gathering

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150. *Id.*

151. Manning, *supra* note 8, at 1326-27. Dean Manning also described the decisionmaking process utilized by the ALI. He said, "The first possible option would be to debate the macro-issue-whether to scrap the whole Project (a motion that was never made or debated). The second possible option was to debate proposed minutiae of drafting-here and there inserting a 'substantially' or changing a 'will' to a 'should' or the black-letter text." *Id.* at 1327.

knowledgeable people together to create a regulatory scheme. However, the Principles were accepted by corporate practitioners and academics alike.

The ALI is not the only public institution that has affected the rules regulating corporate governors. Harold Marsh, Jr., a respected Los Angeles practitioner, has recognized the very valid role that the New York Stock Exchange has provided in enforcing basic shareholder rights and promoting the active supervision of management personnel by directors. Notwithstanding these minor influences, the overall efforts have been unsuccessful:

> The [stock] exchanges have shown an inability in some cases to adopt rules over the opposition of the managements of the listed companies, for example, in connection with the amendments to the articles of incorporation relating to mergers or other acquisitions, which count a person's vote one way if he is a "good guy," that is, favored of management, and count his vote another way if he is a "bad guy." Presumably, this problem might be overcome by more prodding from the Securities and Exchange Commission; and the Commission could even order the adoption of certain rules. But then we are really talking about SEC action and not action by the stock exchanges as such.[152]

Many issues pose problems for corporation law practitioners and academics to ponder. Due to the polar-opposite nature of opinions on most of these issues, the decisionmaking process has reached an impasse. The legal profession and business community have failed to adequately respond to the challenges facing corporation law professionals. While the ALI demonstrated concerted and steadfast effort, the process it adopted was relatively lengthy and inefficient. In addition, the New York Stock Exchange has attempted to influence corporate governors but has met primarily with failure.

H. The Endemic Problems of Corporate America: the Perception of Helplessness in Itself Is a Problem

Overall societal problems wind their way into corporation law and have helped cause corporate irresponsibility. Corporations are just one manifestation of the general malaise affecting the nation; commentators relate that public confidence in all institutions is "on edge" or distrustful. The underlying theme of this work is that the problems of American corporations and society at large and the resolutions of these problems are increasingly interrelated and interdependent.

On this subject, Milton P. Kroll wrote:

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152. Marsh, *supra* note 129, at 304.

> An overriding consideration, however, is that the American *public demands accountability from all power sources in our society.* The corporations *are* such a source. The public perception of the American corporations is at a very low point. They are not deemed to be sufficiently or effectively accountable for the economic, political or social impact of their decisions.[153]

Government has inherent limits and can be used as a scapegoat in response to all kinds of society's problems. Corporations are also used as scapegoats–by the government and the public. Dean Bayliss Manning indicates a wide range of species of corporate critics.[154] His views in this regard are discussed in greater depth in the next section.

One criticism focuses on the primary function of corporations and its effectiveness historically in this regard. Richard J. Farrell, former Vice President for Law and Public Affairs of Standard Oil Company, stated:

> People tend to lose sight of the fact that the large publicly held corporation was not created to solve society's ills–but rather to serve as a means of accumulating enough capital to provide the facilities and jobs needed to produce goods and services–our first and foremost social responsibility. Corporate America does its primary job very well and [adds] to the general well-being of the entire society. Government, education, church, and any other institution you care to name has benefitted from the efficiency of our industrial base.[155]

As previously indicated, others challenge this limited criterion for the evaluation of the contribution of corporations. Constance Baker Mottley, United States District Court Judge for the District of New York, has written:

> There are good reasons for this [negative] corporate attitude, and it is not because corporate managers are insensitive to their communities. It is by now common knowledge in the corporate and economic community that the operations of corporations result in "negative externalities" to the community, that is, costs to the community, which are not generally chargeable to the corporation. The most

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153. Kroll, *supra* note 99, at 31. Professor of Economics Peter H. Aronson at the University of Miami has indicated that the public's perception of corporate America may not be valid.

> It seems to me that the current criticism of the corporate sector has nothing to do with the fact that the putative culprits are organized in corporate form. There is nothing in corporateness that generates these kinds of problems. There are in the Soviet Union examples of pollution far greater than anything that we have known in the United States. We have cases of bribery and fraud, or whatever other form of illegal activity that is supposed to be the special province of corporations, and yet we know that the corporate manager cannot retain the residuals from such activity, unlike an organization that is formed as a partnership or sole proprietorship.

Aronson, *supra* note 62, at 81.

154. *See* BAYLESS MANNING, CORPORATIONS AT THE CROSSROADS: GOVERNANCE AND REFORM 9-36 (DeMott ed., 1979).

155. Farrell, *supra* note 141, at 191.

> obvious is pollution. In addition, our society has recently placed new and renewed emphasis on certain goals, such as the elimination of employment discrimination on account of race, sex, and age. *Corporations cannot be expected to further these goals on their own, especially if these goals conflict with the pursuit of profit.*[156]

These two approaches to the question of how well the corporation is filling its role need to be reconciled. Professor Schwartz stated:

> Those who give the kaleidoscope a few turns have a different picture of corporate problems, or more particularly problems caused by the corporation. They focus on the externalities of economic activity, and since the corporation pervades virtually every aspect of our life, the social problems that relate to economic activity are the sum total of society's social problems. Thus the reformers who share this perception focus on the problems of the environment, racism, sexism, and consumerism. . . .
>
> . . . Do we seek economic efficiency or do we seek social justice? The answer, of course, is that we seek both, and indeed that we more or less seek both within the structure of the corporation.[157]

Mark Green suggests that the very perception by the public of widespread endemic wrongdoing by corporate insiders is itself a significant externality:

> [T]here is a shocking level of illegality committed by major companies . . . . But to ignore this fact is to ignore certainly the public hostility that is now being generated by such corporate behavior. And that public lack of faith is a very important element in the entire dialogue in which we are engaged. It cannot be ignored that over 400 companies have admitted to criminal or illegal or, in the most euphemistic terms, improper payments, payoffs abroad or at home. These are not Ma and Pa groceries. More than one third of the 500 largest industrials have admitted these violations to date. The Antitrust Division of the Department of Justice says they have 100 grand juries probing into price-fixing, an issue that conservatives and liberals alike agree should be the target of the antitrust laws.[158]

Corporations do not suffer governance difficulties alone. The federal government has also sustained several recent failures including Watergate, Iran-

156. Motley, *supra* note 18, at 250 (emphasis added).
157. Schwartz, *supra* note 68, at 326.
158. Green, *supra* note 19, at 267.

gate, Abscam, White Water, and the Savings and Loan failures. These governmental examples illustrate how endemic such perception problems really are. The fact that the public has knowledge of these difficulties, on the other hand, may be a sign of the success of our overall social and political institutions to find, investigate, and effectively deal with internal problems. However, justifiably or not, these perceived failures contribute to a feeling of futility in individuals and small groups desiring even modest reform.

Just as the scandals facing politicians at the federal and local level can create disharmony among constituencies with resulting cries for change, so can public perceptions of corrupt corporate insiders. Corporate governors face a problem posed by public opinion itself, in addition to the actual moral inconsistencies that they have provided.

I. The Rejection of Shareholder Role and Shareholder Democracy

Many believe that with shareholder democracy, corporations would be guided in decisionmaking matters so as to respond to the express needs of particular shareholders as well as bridge their perceived insularity from the constituencies in which corporate operatives transact business. Shareholders, in other words, could provide a bridge to reality. This is one of the main themes in contemporary theory urging more shareholder democracy. The absence of shareholder input has resulted in poor decisions, wholly apart from the wrongdoing of individual corporate insiders. In addition, the voting system has broken down and become ineffectual. Managers can regulate which matters will be presented to shareholders through a proxy vote and which require more democratic participation. They also control the flow of information.

In contrast, Ray Garrett, former Chair of the Securities and Exchange Commission, has suggested that shareholders do not want additional power. He said, "In the past it has been popular in certain circles to view shareholders on the whole as pretty dumb and careless. They do not know what is in their own interest to begin with, and they are too lazy to read the information provided for them and too unsophisticated to understand it if they do."[159]

Garrett, and other like-minded commentators, deny any real progress to be made by increasing shareholder participation in the governance of the corporation. These diverging views represent another difficulty facing corporation law practitioners and academics alike.

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159. Garrett, *supra* note 82, at 104. Garrett also commented on the controversy over shareholder democracy:
> It leads me to wonder whether the arguments in favor of greater shareholder initiative reflect a struggle between investors and an autocratic and unresponsive management or whether they are a manifestation of the desires of those whose involvement as shareholders is tangential to a desire to shape corporate conduct closer to their own special concerns as to what is good for us and society. The question is made more cogent by the striking absence of any pressure from shareholders in general, *including institutional shareholders with professional management*, for any such enhanced role.

Id. at 106 (emphasis added).

J. Misplaced Reliance on the Justice and Governmental Agency Systems, Which, for the Most Part, Are Ill-Adapted to Address the Situation Effectively

Many blame corporate problems on the legal justice system, the legal profession, and the failure of government agencies to follow mandates. Related criticisms are that even when government mandates are followed, the response is so slow and expensive for those asserting rights that the process is ineffective. Deficiencies in the statutory law as well as the unclear rules set out in the case law that developed independently of or in conjunction with statutory law has already been discussed herein. This indecipherable and constantly changing set of rules fails to create predictable results for practitioners and corporate insiders.

Some commentators suggest that the only clear rules governing corporations in Minnesota and elsewhere originate in the federal court system, and that they are coming too slowly. Harold Marsh, Jr. has argued:

> I suppose there could be added to this list [of problems with governmental authority] the entire federal judiciary. The story has been told about the European attorney who was asked to speak on the subject of European business regulation and whose entire speech consisted of the following:
>
> > In England anything is permitted that is not expressly prohibited. In Germany everything is prohibited that is not expressly permitted. In France everything is prohibited, but anything can be arranged.
>
> One might add to this litany a statement that in the United States nothing is permitted until it has been approved as wise social and economic policy by a federal judge after nine years of litigation.[160]

It is interesting to note that case law has been deemed more and more important in the corporation law context. For instance, Professor Donald E. Schwartz has indicated that "[s]tatutory law is only one aspect of corporation law; the more significant content of corporation law may be that which is made by judges."[161]

This essay has already reviewed the problems inherent in attempting to define fiduciary duty, the duty of due care, and the business judgment rule through case law development. However the judicial system is not the only governmental branch that has come under attack by commentators for its addition

160. Marsh, *supra* note 129, at 297.
161. Schwartz, *supra* note 68, at 332; *see also* Manning, *supra* note 70, at 119.

to the body of corporation law.

With respect to federal regulatory agencies, the following comment has been made by Professor James H. Lorie:

> It's undoubtedly true the Food and Drug Administration has prevented the marketing of harmful products. It has also prevented the marketing of helpful products. If penicillin were discovered today, it would be about 20 years before it would be judged safe for distribution. When a federal agency such as the FDA has a regulatory power, it can make two kinds of mistakes. It can certify the distribution of something that's harmful. And it can fail to certify the distribution of something that's helpful. Their conservatism causes them to almost maximize avoidance of the first kind of mistake, which causes them almost to maximize the commission of the second kind of mistake.[162]

Separate from being overcautious or slow, the judicial and regulatory systems, and governmental systems generally, have been criticized as having the inherent limitations of not being proactive and, perhaps, being altogether inattentive. According to Harvey L. Pitt, former General Counsel of the Securities and Exchange Commission, and now a prominent Washington corporate lawyer:

> The regulatory approach, as distinguished from the enforcement approach, has a different set of perspectives. First, I think that it has to be recognized that the Commission, given its perspective, has to be sensitive to the fact that fine tuning with respect to corporate governance and structure is a difficult task and one to be undertaken only after great consideration. We are in the process of doing that through well-articulated hearings of corporate governance.[163]

Pitt further stated that government has a limited role in corporate governance issues. He said, "[T]he Securities and Exchange Commission was not created to regulate the internal affairs of industrial corporations. That function has been left to state law."[164]

The courts on all levels, including the United States Supreme Court, have been accused of being insensitive and naive on many fundamental corporate governing issues. For example, Professor Donald E. Schwartz has drawn attention to an overly optimistic view of shareholder democracy and reality that may exist on the highest federal level:

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162. *Panel Discussion*, COMMENTARIES, *supra* note 4, at 150.

163. Harvey L. Pitt, *The SEC and Corporate Governance*, *in* COMMENTARIES, *supra* note 4, at 182, 186; *see also* Exchange Act Release Nos. 34-13482 and 34-13901 (1977).

164. Pitt, *supra* note 163, at 182-83.

> For example, the law must not attribute nonexistent power to the stockholders and make the mistake of believing that checks and balances really exist. Thus, we should not pretend that stockholder ratification of corporate action should alleviate self-dealing managers from the burden of demonstrating the fairness of their conduct. Lest you think we have stopped kidding ourselves about where corporate power lies, allow me to point out . . . the recent Supreme Court Decision of *First National Bank of Boston v. Bellotti* . . . .[165]

The exact language at issue in the decision of Justice Powell in *Bellotti* reads:

> Ultimately shareholders may decide, through the procedures of corporate democracy, whether their corporation should engage in debate on public issues. Acting through their power to elect the board of directors or to insist upon protective provisions in the corporation's charter, shareholders normally are presumed competent to protect their own interests.[166]

Professor Schwartz indicated that the very pinnacle of American jurisprudence may be lagging significantly behind reality in assuming that in dysfunctional instances, all other indications of normalcy will be attendant. By the very essence of dysfunction, problems affect the entire structure and demand that far more than empty assumptions be applied.

The role of criminal law must also be considered in this regard. Its penalties serve as a deterrent to the prohibited activities and also remove offenders from the situations in which they can commit such actions. Bayless Manning, former Dean of Stanford Law School, has stated:

> To enact laws against these different categories of blameworthy corporate and managerial behavior is helpful, but not in itself enough. Prosecution can catch only a few evildoers, and it also has the disadvantage of coming after the fact. The criminal sanction is also clearly inappropriate to deal with simple managerial inefficiency. What is needed is a set of built-in institutional arrangements that on a daily, ongoing basis prevent, or at least contain within tolerable limits, undesirable conduct or ineffective performance by corporate managers, directors, and their companies.[167]

Finally, litigation has become extremely expensive, and for shareholders

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165. Schwartz, *supra* note 68, at 334.
166. First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 794-95 (1978).
167. Manning, *supra* note 70, at 128; *see also* Beveridge, *supra* note 31, at 729.

in close corporations and public corporations alike, resources are limited. Few people can afford an attorney, even on a simple claim against a corporation, and there is evidence that contingency fee arrangements as an incentive for attorneys to take on such actions are threatened.[168]

The above discussion demonstrates that the methods of response envisioned and practiced by the judicial and executive branches through the court and regulatory systems do not resolve the problems faced by corporate governors and practitioners. The process does not respond to the bigger problems facing corporation law, but rather addresses single instances of bad dealing or other criminal acts by corporate insiders. In addition, these governmental systems take too long to respond to conflicts because of the very nature of rulemaking and the extensive litigation schedules.

K. Truncated Development of Constitutional Law as Pertains to Corporate Activity and Governance

Some have drawn attention to the fact that the United States Supreme Court, in attempting to avoid making corporate governance a federal matter, has caused severe problems with the states by interfering with state processes. The federal attempts at preemption have influenced state legal systems which now also accommodate corporate law abuses. The states' race to the bottom has occurred almost simultaneously, arguably, with the unwillingness of the United States Supreme Court to get involved in corporate affairs. Constitutional law concepts of equal protection and property rights have not been applied to corporate governance for over fifty years. This lack of federal response leaves damaging effects. J. Willard Hurst, Vilas Professor of Law at the University of Wisconsin Law School, has said:

> In the late 1930s the Court returned to the presumption of constitutionality with a vengeance. I think it is a good lawyer's prediction that it would be extremely difficult to persuade the Supreme Court of the United States to hold an economic regulatory statute unconstitutional under the Fourteenth or Fifth Amendment. Although the Court has not abolished judicial review of economic regulatory legislation, it has raised the presumption so high as to leave a wide range of options for legislators. While this leaves the door open to legislative invention and ingenuity in the public interest, it also leaves the door open even wider to the ingenuity of lobbyists for special interests.

168. Alternative dispute resolution (ADR) measures are now slowly beginning to impact corporate law. In some areas, such as securities law, arbitrations have become standard practice; in other areas, ADR is in its infancy. United States courts at all levels often require pretrial ADR, and the federal and state executive branches are incorporating ADR processes in more and more regulatory schemes. The American Arbitration Association offers arbitrators for use in commercial disputes and a number of nonprofit and for-profit arbitration and mediation services exist in most major cities. The Center for Public Resources in New York, New York promotes a pledge by corporations to include ADR provisions in all contracts. Over 500 major corporations nationwide have signed the CPR pledge. *See* Barbara McAdoo, *The Minnesota ADR Experience: Exploration to Institutionalization*, 12 HAMLINE J. PUB. L. & POL'Y 65 (1991) (comprehensive overview of ADR in Minnesota); *see also* John C. Coffee, *Derivative Litigation Under Part VII of the ALI Principles of Corporate Governance: A Review of the Positions and Premises*, CA53 ALI-ABA 237, 263-64 (1995).

> Given the frame of the present presumption of constitutionality, it is not difficult to present to the Court a convincing argument that some reasonable public justification exists for a particular statutory regulation and that, therefore, it ought to stand even though it also yields a very special and private benefit to a specific group. Thus, one must recognize that the current strong presumption of constitutionality in the economic regulatory field opens the door to special interest lobbies, thereby putting the ultimate moral responsibility for watching out for the public interest back on the legislature. The presumption of constitutionality is thus ambiguous in its public interest implications.[169]

Corporate insiders face an increasingly hostile public image with little or no regulatory help. The federal judiciary needs to take a more proactive role in corporate governance issues or otherwise signal the state systems to pick up the slack.

L. *Infancy of Corporate Regulatory Law, Corporate Impact on Communities, and the Need for Time to Experiment*

The infancy of the whole subject of corporations' widespread impact on our society can be seen as a problem, or at least an impediment to developing solutions. Slightly over fifty years ago, our economy switched from consisting largely of independent, sole practitioners or partnerships and family farms to its present corporate industrial orientation. Only in recent decades have individuals and communities felt the social impacts of this industrial orientation. Due to this infancy, any immediate and strong reform would be ill-advised. Suggested reforms may have detrimental and irrevocable side effects worse than the illness they are intended to cure. The concept of corporate governance and the phenomenon of corporate misdeeds must be placed in historical perspective. Social science and quantitative techniques have, at best, made only modest inroads into this area of public policymaking and only negligible inroads into law and American jurisprudence. The modern corporation, which did not evolve into the present form of the publicly-traded corporations until perhaps the 1920s, has had almost no time to establish adequate tools for action.

J. Willard Hurst has recognized many of the problems caused by the relatively rapid growth of the modern corporation. He stated:

> As we move into the first quarter of the twentieth century and into our own time, we see a virtual disappearance of the captain of industry figure. In its place we have a professional, a bureaucrat, an institutional career man or woman. It is quite clear that part of our current inheritance includes questions that center about this trans-

169. Hurst, *supra* note 10, at 37-38.

> formation from the captain of industry who seemed to validate himself by his own immediate creative will, to the institutional man. Adolph Berle took heart from this .... Other critics doubted this and suggested that the institutionalization of corporate leadership would produce its own varieties of vested interests, conflicts of interests, and interests in maintaining the executive status as such, with dubious results to investors and the general society.
>
> Another factor in the small nineteenth century corporation, which was an incorporated partnership in functional reality, was that the board of directors was an involved group. When considering the boards of today's large corporations, it is quite clear that we inherit from the last 50 to 75 years of development questions about the function and effectiveness of the board .... This cluster of problems raises a wholly new type of question in this field–the issue of legitimacy of the governance of the large scale corporation.[170]

Despite this problem of newness, it is quite clear that forces are working to resolve the conflicts that have arisen in a manner that is favorable to society, while salvaging the corporation from society's total control over governance issues. For example, self-policing has made tremendous progress, including use of outside directors, audit committees, enhanced charitable giving to the community at large, loaned executives, and corporate-based ombudspersons. If corporation management is indeed insular, it is conceivable that measures such as these will serve to bridge gaps and provide for the flow of information to enable responsiveness. Even external criticism, as scathing as it is from internal sources, necessarily requires time for responses.

Professor Harvey J. Goldschmid has stated: "Considerable activity and experimentation in board rooms has been spurred by the securities law explosion . . . and by the critiques of Cary, Nader, Green and Seligman, [and others]. But studies to date indicate . . . that the experimentation has been limited and certainly not broad enough in scope."[171]

A. A. Sommer, Jr., former Commissioner of the Securities and Exchange Commission, and a leading Washington, D.C. corporate lawyer, has indicated that plenty of laws already exist that can and must be enforced before radical change is imposed on corporations. He stated:

> I would suggest that using the corporation laws to correct either the deficiencies of present legislation or deficiencies in enforcement is to seek remedy in the wrong place. The right way to correct those deficiencies [in the law]. . . is by tightening up the laws, if they are too

170. *Id.* at 34.
171. Goldschmid, *supra* note 29, at 172.

> loose, by substituting new laws if the old ones are conceptually inadequate, and by stepping up enforcement with a larger commitment of money and people, if the fault lies there.[172]

While some recognize that current internal and external policies allow room for corporations to grow, others have suggested that corporate governors need to anticipate a more competitive international business world. These commentators call for further relaxation of the laws regulating the administration of corporations. While abuses may occur, there may be even greater detriment if remedies are impulsively or single-mindedly imposed. John F. Lubin, Professor at the Wharton School, has indicated: "A remaining problem is the multinational firm problem. There is this peculiar difficulty about the differences in laws, the imposition of American values and standards in actions taken against competition from corporations that are built on different systems."[173]

Even within American society, corporate institutions may have a higher standard of governance than other institutions, including government. Victor Palmieri has stated:

> Even with all the recently exposed corporate failings, I ask whether the standards of performance, viewed objectively, are comparable to those of our public agencies. I suggest that our standards of private governance are higher than our standards of public governance and that there is, therefore, no automatic solution in public control. It is obviously a political problem in which the lawyers have the greatest leverage in forming the solution.[174]

Palmieri's quote suggests, separate from an international balancing out, that there is a need to review the American corporation in light of governance of other institutions in our society.

The corporation infancy problem and the need for time to experiment relate not only to the development of corporation law and legal scholarship, but also serves as a call to arms for states to abandon the "race to the bottom" and instead race upward with their legal systems.[175] If action is taken at a federal level, it is conceivable that innovation and prerogatives will be irreparably harmed. Harvey L. Pitt, former General Counsel to the Securities and Exchange Commission, and others have indicated that the major federal institutions were

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172. A.A. Sommer, Jr., *Should Corporation Laws Function to Restrain Antisocial and Illegal Conduct?*, *in* COMMENTARIES, *supra* note 4, at 255, 257.

173. Lubin, *supra* note 79, at 88. There is a whole new challenge, beyond the scope of this essay to accommodate, posed by the multinational business world whose business conduct is based upon mores or values different than our own. As we set up self-equilibrating mechanisms within present corporate governance, it would appear wise to also bear in mind the nature of the world in which we move. Various moralities exist world-wide and may inject themselves into American corporate law governance. It will be a challenge to determine, over time, which of these moralities are genuine and which are mere pretexts.

174. Victor Palmieri, *Lawyers are the Key to Corporate Governance*, *in* COMMENTARIES, *supra* note 4, at 365, 366.

175. States which impose a franchise tax on corporations chartered in their state have a potentially significant incentive to attract incorporators to their jurisdiction even though the inducement may be, on balance, detrimental.

not developed to address such problems, but state statutes were established for this purpose.

State statutes have gone undeveloped in recent years and perhaps the race to the bottom could be at least slightly reversed to a race to the middle. The viability of state government itself is threatened, separate from that of corporations, by immediate forceful federal regulation. This automatic and equilibrating check and balance aspect of our Constitution may not yet have clicked into action.

Some suggest the present slowness and adapting processes are a reflection of the good faith and expeditious attempts to reconcile conflicting objectives. Working out conflicts takes time, especially in the private sector. In the long run, the highest level of benefits would occur by resolving these issues within the context of the private sector and its market forces.

M. Geography and Technology as Problems and as a Mode to Help Identify Problems

Geography and technological changes to the organization of civilization have their own intertwined impacts on corporate governance. These changes present issues worth attempting to define and reconcile within the corporate governance context. Some of the important multi-cultural aspects of corporate governance have been noted above. However, the blurring of governmental jurisdictions and corporations' weakened geographical ties have at least caused a disillusionment as to the social role of corporations, and ultimately pose a problem of governance. James H. Lorie, Professor of Business at the University of Chicago, wrote:

> Corporations sometimes move manufacturing operations from one place to another. Abandoning a location creates unemployment-the costs of which are obvious. The benefits, however, are also obvious though less visible. Employment will be created at the new location. Among the presumed advantages of the move is increased efficiency, which is beneficial to prospective customers and to shareholders. How does one balance the cost imposed on the community that is to be abandoned against the benefits that are to be conferred on employees at the new location and on customers and shareholders?[176]

Lloyd N. Cutler, of Wilmer, Cutler, and Pickering of Washington, D.C., has drawn attention to the international aspect of geographic boundaries. He stated:

> We are in an interdependent world, as evidenced by the fact that of

176. Lorie, *supra* note 23, at 53.

> the world's 50 largest industrial multinationals, less than half are based in the United States. And our standards, poor as they may be and as close to the bottom as they may be, are infinitely higher with respect to disclosure, marketing organization, duties of directors, and rights of shareholders and investors to sue than the standards of any of the other industrial democracies. It is very important that we try to create a corporate entity that does not look to most of the world as if it is owned and controlled from abroad.[177]

J. Fred Weston, of the Graduate School of Management of the University of California, has also indicated that the issues facing corporations in the United States might also have importance when viewed on a global basis. He stated:

> Concentrated industries are characterized by higher degrees of capital intensity than less-concentrated industries. This is a worldwide phenomenon not limited to the United States. Concentration does not mean the absence of competition because the dimensions of competition are so numerous that it would be difficult or impossible to achieve collusion on all of the dimensions of competition. At this point it may be conceded that concentrated industries are more efficient from an economic standpoint, but may be undesirable because of power and social responsibility considerations . . . .[178]

This discussion suggests that corporate governance problems require analysis that takes into account geography, technology, and cultural considerations. Concentrated industries, when viewed from a global perspective, have advantages. Yet their social impacts, which also cross jurisdictions and cultures, must be evaluated from multiple perspectives.

III. A BRIEF ATTEMPT TO CATEGORIZE AND IDENTIFY GROUPS OF PARTICIPANTS AND THOUGHTS IN CORPORATION PUBLIC POLICY DEBATE

This part of the essay identifies some of the groups who apparently propound theories about corporate law and offer particular resolutions to problems affecting corporate law. By identifying these groups and theories, responses can better be weighed and formulated. For the most part, groups reflecting schools of academic thought have already been identified. There certainly seems to be some overlap between these groups. Despite some previous commentary to the contrary, there is, has been, and continues to be a significant merger of positions between academic and legal communities as well as the rulemaking authorities of our society, namely the judicial and legislative

177. Lloyd N. Cutler, *Economic Efficiency as the Focus of Structural Reform*, in COMMENTARIES, *supra* note 4, at 346, 348-49.
178. J. Fred Weston, *Economist's Perception II: Large Corporations and Corporate Governance*, in COMMENTARIES, *supra* note 4, at 61, 71.

branches of the government.

A. Some Groups

There are many ways to characterize and catalog groups and the cataloging is subject to change over time. Even more importantly, it is difficult to determine the segment of the population represented by each group, either number or nature; the degree of support for their position within both the sphere of corporate insiders and that of interested others cannot be determined either. Indeed, there are probably more groupings than are discussed herein. This difficulty in determining the real impact of these groups is one reason to update corporate law methodology.

This section attempts to identify categories–a necessary first step. As with much corporate governance debate, there has been moderate discussion on the relative significance of each group and very little systematic, quantitative analysis applied in measuring the strengths of any particular group. Some of these groups now exert a subtle and implicit influence, yet are very loosely organized and only occasionally appear to have their presence noted in current intellectual discussions.[179] Some categories of actors advocating changes policy, and in some instances implementing such solutions, or otherwise active in the debate follow.

1. Those Who Support Strong Anti-Trust Law

One category of thinkers includes those who believe that only strong employment of antitrust law will keep matters at bay. This group finds strong public support through many sources of legislation.[180] This group assumes a kind of "trickle down" effect will somehow operate to make corporations responsible to society as a whole, if not to shareholders specifically. This group has current voice in the work of Berle and Means who, in many respects, are ancestors of the original antitrustors.[181]

This author identifies several weaknesses in this group's position. First, the group fails to consider all of the externalities faced by corporations, including labor and employment law as well as environmental impacts. In addition, the group operates under the false assumption that scaling down size alone will produce benefits. Internal governance rules and shareholder rights are not important to this group, while they play a vital role in the reality of corporation law.

2. Those Who Support Governmental Intervention on a Limited Basis

People belonging to this category of thought encourage governmental

179. Manning, *supra* note 70, at 109-31; *see also* Bayless Manning, *Thinking Straight About Corporate Law Reform*, *in* CORPORATIONS AT THE CROSSROADS: GOVERNANCE AND REFORM 9, 9-36 (Deborah A. DeMott ed., 1980).

180. *See, e.g.*, Sherman Antitrust Act, 15 U.S.C. §§ 1-7 (1994); 7 U.S.C. § 19 (1994) (agriculture antitrust legislation).

181. *See* BERLE & MEANS, *supra* note 73.

intervention on a case by case basis. This group tends to have an ad hoc, piecemeal approach that does not identify with any systematic methodology. This group has proposed several changes in corporation law over the years.

For example, this group heralded a movement towards national incorporation utilizing some form of minimum standards to be applied in selected areas of corporation law.[182] Under this proposed legislation, any matter not addressed at the national level would have been within the province of the State to regulate. This group also introduced the Foreign Corrupt Practices Act of 1977[183] which was directed at corporations and bribes made by officers to foreign officials.[184] This legislation resulted from the perception that such bribes affected our national security and the political stability of the United States.

This author recognizes the impact that this category of critical thought has had on modern corporation law. However, this approach is not systematic and responds to specific pressures and wrongdoing rather than corporate and shareholder issues.

3. Those Who Focus on Independent Directors

This category represents people who emphasize the role of independent directors and other codeterminations on corporate governance decisions. This group places great weight on the nature of the board of directors, which is perceived as having significant powers for good governance in (1) ensuring that management is doing its job on a day-to-day basis in the interest of the corporation and the shareholders; and (2) ensuring the board itself is responsive and receptive to shareholders' needs.[185]

While the goals sought by the proponents of the use of independent directors may be admirable, some critics refer to the influence that management continues to have on even independent directors.[186] This author questions whether independent directors are effective in that split board philosophies are difficult to integrate into something with any meaning. In addition, there are difficulties with identifying who should take seats on the board and who should be represented. Finally, one other criticism is that heightened judicial scrutiny of directorial decisionmaking will result in making the role of independent director undesirable.[187]

4. Those Investors Who Want Adequate Information Flow

This school of thought is influenced by the SEC's philosophy that an

182. *See, e.g., Protection of Shareholders Rights Act of 1980, Hearings on S. 2567 Before the Subcomm. on Securities and the Comm. on Banking, Housing and Urban Affairs*, 96th Cong., 2d Sess. (1980) (discussing the Protection of Shareholders Rights Act of 1980 and the Corporation Democracy Act of 1980).
183. Pub. L. No. 95-213, 91 Stat. 1494 (1977) (codified at 15 U.S.C. §§ 78dd-1, 78dd-2 (1978)).
184. *See* 15 U.S.C. §§ 78dd-1, 78dd-2 (1978).
185. For a discussion of independent directors, see *supra* notes 144-46 and accompanying text.
186. Lin, *supra* note 146, at 901-02.
187. *Id.* at 963-66.

informed investor is the cure to the ill that plagues corporations. However, this idealogy is greatly criticized. Dean Manning indicates that "it is simply not supportable to contend that the deficiencies that [proponents of the group] . . . see constitute a crisis that calls for radical reform."[188] This author also suggests that existing disclosure rules achieve the results that this group desire, but that additional problems and dysfunction continues to exist.

5. *Those Who Emphasize Minority Shareholder Rights*

This category of people believe that increasing minority shareholder rights will avoid oppression by the majority.[189] This position also asserts that minority shareholders are not sufficiently protected at the present time.[190] While the last fifteen years has seen an increase in the number of institutional investors and a decrease in this position, some protection has been provided to minority shareholders.[191]

6. *Those Who Stress Managerial Accountability*

This group is also known as the hegemony theory group. This theory proposes that anyone whose power goes unchecked is a problem and therefore needs to be controlled.[192] This group acknowledges the efficiency of the corporate enterprise, but iterates that everyone should be accountable to someone else, just to keep people honest.[193] Finally, this group propounds that leaders with unchecked power will lose contact with reality which isolates them from unpleasant information and encourages erratic judgments, creating misery for everyone involved and ultimately leading to disaster for the corporation.[194]

7. *Those Who Rely on the Judicial Branch*

This category also advocates national level action, but prefers the experience of the judiciary. This group suggests that case by case analysis and good judgment will ultimately protect and equilibrate corporate insiders. Dean Manning stated:

> [C]ase by case process has the advantage that lawsuits involve real circumstances rather than hypothetical scripts and are addressed to disputes over real economic interests rather than abstract "oughts".

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188. Manning, *supra* note 70, at 114.

189. *See* Joseph R. Olson, *Representing Minority Shareholders in Close Corporations Under the 1984 Revised Model Business Corporation Act*, 65 WASH. L. REV. 507 (1986); Olson, *supra* note 72, at 627 (*A Statutory Elixer*); Olson, *supra* note 72, at 10 (*Statutory Changes*).

This group asserts that the cumbersome costs of shareholder derivative suits, the ability to manipulate proxy votes, and the practice of diluting shares have largely survived. These practices were identified in F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS §§ 3:01-3:20 (2d ed. 1975 & Supp. 1996).

190. Olson, *supra* note 72, at 627-29 (noting that non-controlling shareholders in closely-held corporations are in a "great position of vulnerability").

191. O'NEAL & THOMPSON, *supra* note 189, at §§ 5:28-5:30.

192. Lin, *supra* note 146, at 912-17.

193. *Id.*

194. Manning, *supra* note 70, at 124.

> When in such a case a judge articulates or refines a legal proposition condemning certain conduct by the enterprise or by its managers, directors, or professional advisors, he has the advantage of seeing before him a real rather than imagined example of behavior. Such step by step development is not dramatic and does not satisfy the urge of some for publicly spotlighted corporate change. But surely, steadily and soundly reforms the law.[195]

This position insists that the judiciary tailors the nuances of law to each particular case set in front of it.

This author recognizes several problems with this position. Judges are simply overworked. In addition, the judiciary is reactive rather than proactive in scope. While the judiciary's impact continues to grow due to increased shareholder derivative actions, class actions, and other litigation, legal rules should not be created in this ad hoc, situation specific manner.

8. Those Who Rely on Market Forces

This group increasingly relies on the use of the marketplace for corporate reform. They focus on such avenues of change as increased flow of information, independent directors, and institutional investors. Professor Rock commented:

> Beginning in the 1980s, with the widespread dramatic emergence of hostile takeovers in the United States, the focus of corporate law scholarship shifted dramatically away from the Eisenberg approach of focusing on legal and institutional mechanisms for controlling management discretion. In its place, scholars looked to the market, and particularly to the so-called "market for corporate control" to protect shareholders from management and managerial abuse. . . . While academics disagreed on the details, they shared a common and fundamental belief that the market for corporate control was the single most important constraint on corporate management and the law should strive to maximize its effectiveness.[196]

In addition to the use of the marketplace, this group also injects more of a social science technique.

One criticism of this category has been propounded by the "path dependency group" and they suggest that no institution should be considered perfect just because it results from the ungoverned operation of the marketplace.[197] In

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195. *Id.* at 119.
196. Rock, *supra* note 60, at 374.
197. Ronald J. Mann & Curtis J. Milhaupt, *Introduction* to F. Hodge O'Neill, *Corporate and Securities Law Symposium: Path Dependence and Comparative Corporate Governance*, 74 WASH. U. L.Q. 317, 320 (1996); *see also* Mark Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641 (1996).

addition to the market, history, ideology, and behavior settings determine how institutions are formed and what their values will be.[198]

The groups discussed previously do not exhaust the various categories of people that have proposed solutions to many of the problems facing corporation law academics and practitioners. However, they do suggest some of the schools of thought. The following section turns to a discussion of the general philosophical underpinnings that also influence those in the academic and legal communities.

B. Theoretical Understandings

It is worth noting that many of the preceding groups, to varying extent and often unconsciously, derive their theoretical or legal underpinning from various schools of legal thought as to how law should relate to humankind. Responsible corporate law decision making would seem to require an appreciation of this. Indeed, they are varying ways of searching for "truth" or for "justice." There are at least four or five major schools of jurisprudence, one running back to ancient Greece.

In a somewhat different vein, yet perhaps relevant to understanding present problems that corporation law faces, some would assert that attention to well-reasoned and articulated judicial philosophy or the broad theoretical underpinnings of the law have been, and are, largely absent from the forefront of corporate law decisionmaking and from contemporary debate on corporate law public policy. This absence may in some ways be akin to the absence of such contemporary and widely-used disciplines as quantitative technique and social science, perhaps to the detriment of all. This point was perhaps suggested by Morris R. Cohen and Felix S. Cohen in the preface to their work.[199] They also show concern over how legal philosophy is appreciated and introduced to practitioners-to-be. They write as follows:

> There is still a powerful drive among many contemporary philosophers to keep their philosophies pure and unpolitical by avoiding contact with the realities of human controversy and social disorder. As strong, or even stronger, is the opposition of many practical men to critical reflection upon existing legal institutions. Both these views result in a view of jurisprudence as a maze of inert ideas, a museum of intellectual curiosities far removed from logic or practice. What follows is that analytical, historical, metaphysical and sociological jurisprudence and the various hybrids and offshoots are exhibited before innocent students like a series of butterflies, all neatly labeled, pinned to their proper cards, and thoroughly dead. The history of law, its logical analysis, the scientific study of the social con-

198. Mann & Millhaupt, *supra* note 197, at 320.

199. Morris R. Cohen & Felix S. Cohen, *Preface* to MORRIS R. COHEN & FELIX S. COHEN, READINGS IN JURISPRUDENCE & LEGAL PHILOSOPHY iii (1951).

> sequences, and the evaluation of those consequences, instead of being viewed as related problems posed by a common subject matter, come to be viewed as mutually exclusive objectives of conflicting "schools."[200]

The Cohens' further provided:

> The teaching of jurisprudence, so conceived, commonly results only in the suppression of curiosity and the turning of clean cutting minds into intellectual junk shops. The human product of this process, distrustful of all generalizations and abstractions, is likely to be quite incapable of projecting ideas into the future, since the future itself is an abstraction. But the long-range problems of social order in competition with rival ideas can certainly not be solved by those who fail to understand the force of ideas. And it is ancient wisdom that in the long run nothing is so powerful as an idea when its time has come. In that moment the "proud men of action" as Hein remarked, are "nothing but unconscious instruments of the man of thought."[201]

Legal jurisprudence has been influenced by a variety of philosophical underpinnings. The academics who provide practitioners-to-be with a legal foundation rely on their own backgrounds and schools of thought. The following discussion provides some important influences.

1. Natural Law

Natural law theory is the view that legal principles are not the product of reasoning, scientific method, or even precedent. This theory is based on the premise that law is discernible by determining certain moral and ethical absolutes. Law is conceived as not advancing any particular group, theory, or system. Aristotle has stated that natural law has the same force everywhere and that it exists independently of human thought.[202] For example, there is a universal moral principle that murder is bad and wrong. Murder is a violation of natural law, according to Aristotle, as it is universally regarded as a fundamentally bad act.[203] The natural law view was strong during the Middle Ages, and even today natural law has not entirely died out.

2. Positivist Law

The positivist perspective is not a simple and easy one to articulate. Legal

200. *Id.* at iv-v.
201. *Id.* at v.
202. ARISTOTLE, THE BASIC WORKS OF ARISTOTLE 1014 (Richard McKeon ed., 1941).
203. *Id.*

positivism, according to H. L. Hart, puts forth the view that "it is in no sense a necessary truth that laws reproduce or satisfy certain demands of morality."[204] In other words, "the existence and content of the law can be identified by reference to the social sources of the law (e.g. legislation, judicial decisions, social customs) without reference to morality except where the law thus identified has itself incorporated moral criteria for the identification of the law."[205]

In light of the consequences of unresolved issues in corporation law, the causes, and the pressures of groups advocating change, where does this leave public and business policy variables that might be injected into law? Certainly, to an extent, natural law concepts would be applicable. There are universal absolutes that have governed the affairs of humankind since the time of Aristotle and before. Certain positivist concepts based upon acceptance and capacity for enforcement also present possibilities for reforming corporate governance. Both theories seem to be heavily based on a faith in humankind; either that universal, fundamental rules of law apply, something like the law of gravity, or that human nature is essentially good (including the natures of those charged with making and administering the law), and that in either case, there will not be fundamental disruptions.

However, some critics of contemporary corporate jurisprudence suggest that much of the dysfunction of present corporate law is from being too heavily based on positivist and naive predicates of human nature, or universal moralities often arising from European morality assumptions. Further, one can argue that both positivist and naturalist theories are largely based on a deductive analytical framework.

3. *Realist, Sociological, and Social Science Jurisprudence*

The general legal theories discussed above have favorable and usable attributes. However, at the present time, if only to also enable use of these attributes, the regimen for corporate law jurisprudence that presently seems most practicable is that of legal realism, ascribed to Oliver Wendell Holmes and directly related to sociological and social science methods. Justice Holmes did not automatically rely on universal themes or theories from which deductions could be made, but based advances in legal theory on how the legal systems really work and on how all forces, including sociological, psychological, and purely whimsical, come into play.

Holmes and the school of legal realism believe that judges, lawyers, and juries are influenced by their own values, beliefs, and attitudes. Realists believe that the dominant belief system or contemporary morality of the time will substantially substitute for the natural laws or positivist values. Judges, juries, and lawyers all draw on their own ethics and perspectives. They tend to believe that law is entirely the workings of mankind and perhaps thereby, indirectly,

204. H.L. HART, THE CONCEPT OF LAW 185-86 (Penelope A. Bullock & Joseph Roz eds., 2d ed. 1994).
205. Penelope A. Bullock & Joseph Roz, *Postscript* to H.L. HART, *supra* note 204, at 269.

the workings of God. Humankind's role is the most immediate touch to the law. Realists tend to abhor the focus of legal education on pure abstract reasoning and suggest a more pragmatic approach-an approach which assesses the objectives of applicable rules and the associated risks, weighing risk versus benefit in the process of adopting them.[206]

The recent propounding of various corporate governance hypotheses, including the recent thrust into comparative corporation governance, the all encompassing "path dependency" approach, and the economic market approach to governance, would suggest that the social science school of jurisprudence is now beginning to influence legal scholarship in the corporate governance area and may ultimately be reflected in laws and rule making.

4. Critical Legal Studies School

There are presently footings underway known as critical legal studies which see strong and inappropriate biases in our present legal system in favor of the rich and powerful. Critical legal studies theorists believe that affirmative and expeditious modifications of existing law that would advance economic equality and eliminate distinctions based on class, race, and sex are long overdue. Adherents of this system are now in major law schools, and the numbers of adherents appears to be growing. The advocates of critical legal studies are not an insignificant school of legal thought, and, like the others, employ aspects of the other schools of legal thought.[207]

The previous discussion identified some of the groups of critics of corporate governors and their main concerns. In addition, this part also discussed the major philosophical underpinnings in legal jurisprudence. These factors, together with the other sections of this paper, have demonstrated some major problems facing corporation law practitioners and academics. The next section identifies some possible solutions.

IV. SOME WIDELY URGED IMMEDIATE PROPOSALS

There would appear to be benefits to the use of the concepts of all schools of jurisprudence, or the various schools in the search for truth or justice, which are not necessarily incompatible with corporate law. Based upon limited past experience, limited quantitative data, and logic, there may be some identifiable lowest common denominators for change in corporate law that would help create an ever-renewing and self-equilibrating body of law requiring minimal governmental involvement, and with protection of shareholders and society at large. At the very least, it would appear that these common denominators should be implemented pending the emergence of more effective and worthy replacements, if any. The most often considered as promising candidates are

206. *See* Oliver W. Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 460 (1897); *see also* Karl N. Llewellyn, *A Realistic Jurisprudence–The Next Step*, 30 COLUM. L. REV. 431 (1930); JEROME FRANK, COURTS ON TRIAL (1949).

207. *See generally* BARTLEY A. BRENNAN & NANCY KUBASEK, THE LEGAL ENVIRONMENT OF BUSINESS 7-8 (1988).

selected and presented here. Regardless of the relative merits of the immediately following proposals, without the implementation of the broader proposals such as methodological modification, it is questionable whether the denominations will be sufficiently effective. The following is not intended to be an exhaustive discussion or listing.

A. Modify the Character of Boards of Directors

Boards of directors face many difficulties, including ill-defined duties to shareholders and increased criminal activity among some notorious insiders. Some proposed changes that can be implemented on boards are: more outside directors; direct director selection by shareholders absent influence by management or current board members; term limits on directors; a requirement that no board member of a publicly-traded corporation be permitted to run for election unopposed; stricter rules for screening board members and their conflicts of interest, especially during and after service on the board; means for expedited removal of board members who act irresponsibly or fail to respond to shareholder concerns; and more increased diversity of representation on boards of directors.

Any proposal for reform that seeks to enhance the effectiveness of boards of directors would require more support resources. For example, it has been urged that the board of directors should not be dependent upon corporate legal counsel or corporate accountants for their information, but should have available independent support services to counter-weigh and be less influenced by management. With such resources, the board should have the capacity to generate their own information, hold management responsible, and provide their own report to shareholders. This system would be somewhat akin to a trustee having separate legal counsel, recognizing that grantors and separate beneficiaries of trusts are entitled to their own legal counsel. For some reason, this concept of trust and estate law, which is also the source of concepts of fiduciary duties, seems largely absent from American board relationships with both shareholders and management.

Another suggestion meriting serious consideration establishes two separate types of boards and provides for clear delineation of the duties and responsibilities of each board. The duties should not necessarily be those now set forth by management. Similarly, the agenda of board meetings should not be set by management, but rather independently, by the board and its resources.

With respect to the boards of directors, it would appear that there is presently a need for judicial rules to foster and encourage the most honest and capable of persons to serve on boards. Certainly, independent directors who exercise good judgment cannot thereby be deemed to have taken enhanced responsibilities which would not otherwise be attendant to their duty by the fact that they serve as independent directors. This is but one area where the judiciary perhaps more than the legislative branch can begin weaving a body

of common law.

B. Give Greater Rein to Judges and Expand Capacities for Shareholders to Have Judicial Access and Review

Proposals for corporate reform often center around the use of streamlined derivative actions. Derivative actions presently are very cumbersome and ineffectual as it is often difficult to accomplish standing to sue. Arguably, case law requirements to notify management allow defense mechanisms to be established. Often management is entrenched by virtue of the capacity to draw upon corporate resources to fight such litigation. This reform should be limited or balanced. When defense tactics are employed by management to contest shareholder litigation, management should, as in a security offering prospectus, label their actions as defensive actions. All shareholders then can be clearly aware of what is occurring. The range of defense tactics available to management, under this suggestion, should be more limited. Greater emphasis should be placed upon providing our federal and state judges sufficient legal resources to be able to address corporate governance issues. In the past decades, court calendars have increasingly been congested with criminal law matters which crowd out corporate law matters and sap judicial resources.

Professor Cary has indicated:

> At the same time I am concerned that federal statutes, including the securities laws, may be construed too narrowly, not based upon the merits of the issue but simply as a means of relieving the courts from an overcrowded docket. Concern over the growth of federal litigation is a separate question. And the recent case that has been troubling me most is *Piper v. Chris-Craft*. I am distressed that the concept of standing is shrinking, however, because I believe that shareholder litigation is the best way to avoid greater direct governmental intervention.[208]

In addition, some commentators have indicated an enhanced role for the federal courts is in order. J. Vernon Patrick stated:

> The question remains, however, whether state courts will provide adequate remedies in these corporate mismanagement cases. Is there a need to go into federal court? I think that federal courts still possess innumerable advantages. For example, some states, such as Virginia, do not have a class action remedy. In those states there is no reasonable alternative to federal court because the normal stockholder obviously cannot afford to litigate by himself. I think that

208. William L. Cary, *Federal Minimum Standards*, *in* COMMENTARIES, *supra* note 4, at 319, 324 (citing Piper v. Chris Craft, 430 U.S. 1 (1977)).

> serious questions exist as to the ability of state courts to adjudicate what are really nationwide controversies.[209]

Caution is urged in the use of derivative suits for helping to ensure corporate responsibility. Derivative suits are not without responsible critics.[210] Any deflection of the corporation's ability to attract responsible directors will detract from some of the other proposals.

C. *Enhance Information Flows and Disclosure From Both Corporation Management and Corporation Directors to the Shareholders*

In 1977 The Securities and Exchange Commission concluded:

> The Commission recognizes that under the existing regulations shareholders often may not be provided adequate opportunities to participate meaningfully in corporate governance or the corporate electoral process. Shareholders generally have limited information relating to certain significant corporate policies and practices on matters which are not submitted to shareholders for their approval; and, as a practical matter, limited access to corporate proxy machinery.[211]

Some have indicated that little improvement has occurred since 1977. According to former SEC Chairman Roderick M. Hills:

> Information provided to boards of directors in too many cases is entirely the product of management and no effort is made and no authority is given to outside directors to make an independent investigation.

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209. J. Patrick Vernon, *Permitting Mismanagement a Federal Forum*, *in* COMMENTARIES, *supra* note 4, at 236, 237.

210. As stated in PRINCIPLES, *supra* note 5:

> Nonetheless, private enforcement, as represented by the derivative action, should not be idealized. Experience suggests that the social costs associated with intracorporate litigation can sometimes outweigh the benefits. In overview, two problems stand out: First, the threat of liability for violations of the duty of care may reduce managerial incentives to take business risks, with resulting loss to shareholders and to the economy generally. Given that the fees received by directors are relatively modest in proportion to their overall income, the threat of litigation could also deter many qualified persons from serving as directors, especially in the case of financially troubled companies. Second, in both class and derivative litigation, incentives exist for a private enforcer to bring a non-meritorious action for its nuisance or settlement value. Even in meritorious cases, a private enforcer can reach an inadequate or even collusive settlement that exchanges a low corporate recovery for a high award of attorneys' fees that is paid by the corporation. Unlike most other forms of litigation, where the plaintiff's gain essentially comes at the defendant's expense, the derivative action is a three-sided litigation with three necessary parties: plaintiff, defendant, and the corporation. As a practical matter, the first two parties can pass the costs of the litigation on to the third by reaching a settlement that maximizes their own interests, but does not benefit the corporation.

Id. at 588-89; *see also* Saylor v. Lindsley, 456 F.2d 896 (2d Cir. 1972). "Although judicial oversight of the settlement process can reduce the severity of this problem, the court's capacity to prevent improper settlements is limited, and other safeguards are therefore also desirable." PRINCIPLES, *supra* note 5, at 589.

211. *A Statement of Issues*, *in* COMMENTARIES, *supra* note 4, at 14 (citing Exchange Act Release No. 34-13482 (April 28 1977)).

> Inside directors vote too often on salaries of employees, on questions of whether merger proposals should be accepted or on tender offers-all subjects that present some conflict of interest for management.[212]

The direction of corporate self-governance and equilibrating self-sufficiency needs to avoid federal intervention, especially by the legislative and executive branches. Some reformer shave suggested "minimum standards" regarding duties of care for officers and directors be established on a federal level. Others have advocated federal corporate charters for at least larger corporations. Some have proposed international incorporation.

However, most reformers appear to believe that policy should be geared to minimize federal intervention, and that voluntary steps should be encouraged. As Victor Palmieri has indicated:

> Even with all the recently exposed corporate failings, I ask whether the standards of performance, viewed objectively, are comparable to those in our public agencies. I suggest that our standards of private governance are higher than our standards of public governance and that there is, therefore, *no automatic solution in public control.*[213]

There are inherent limitations on criminal laws. These limitations should temper any further resort to criminal sanctions to modify corporate conduct. Dean Bayliss Manning has indicated:

> To enact laws against these different categories of blameworthy corporate managerial behavior is helpful, but not in itself enough. Prosecution can catch only a few evildoers, and it also has the disadvantage of coming after the fact. The criminal sanction is also clearly inappropriate to deal with simple managerial inefficiency.[214]

Central values of good corporation law and of rules and regulations affecting corporate governance are that they avoid active involvement of governmental authority and are self-correcting.

D. Better Use Of Private Corporate Institutions

Reforms should make better use of available private institutions. There are many self-correcting mechanisms within corporations which can be enhanced. These existing privately-centered mechanisms should be given free rein and, wherever appropriate, enhanced.

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212. *Hearings on Corporate Rights and Responsibilities Before the Senate Comm. on Commerce*, 94th Cong., 2d Sess. 327-28 (1976) (testimony of Roderick M. Hills, former Chairman, SEC), *reprinted in* COMMENTARIES, *supra* note 4, at 14-15.
213. Palmieri, *supra* note 174, at 366 (emphasis added).
214. Manning, *supra* note 70, at 128.

The New York Stock Exchange and other exchanges have had an impact upon corporate governance in a number of ways. For example, New York Stock Exchange membership requires that outside directors constitute a majority of the audit committee. The exchanges have strong incentives to act on behalf of the investors who use their services. At the same time, there is at least the perceived potential for a race to the bottom among competing exchanges.

Independent legal counsel, according to many commentators, could have a role. Commentators say that just as there are independent accountants, there could also be independent legal counsel. Detlev F. Vagts of the Harvard Law School has said:

> If other types of monitoring or investigating functions are called for, doubtless they [lawyers] could be procured from outside; management consulting firms would be delighted to adapt their functions to supply what board of directors calls for. There is, indeed, a good deal to be said for arrangements that place the staff outside of the regular corporate housing and render it more invulnerable to influence from the full-time managers.[215]

Another independent mechanism is the corporate ombudsperson. Victor M. Futter suggests that a party somewhat like federal whistleblowers but accountable directly to the board and free of reprisals could be implemented. Though the position would be independent of management, the ombudsperson would not be directly accountable to governmental authorities. These persons would be legally protected and entirely neutral. From this position, they would be able to ferret out impropriety and misgovernance. In Futter's view:

> By communicating to the entire corporate community that the ombudsperson is there, that top management has created him to insure proper corporate conduct, that there is a readily available means of communication which it is expected will be used, that there will be no repercussions for such communicators, and that one no longer has the excuse that he was told to do something and was afraid he would lose his job if he did not, the Board and top management have sent a signal to the corporate community that ethics and corporate responsibility are to be the hallmarks of corporate behavior. This should serve to encourage proper individual conduct throughout the organization.
>
> In addition, the ombudsperson would serve in an advisory capacity to the CEO and assist in the formulation of new corporate policies,

215. Detlev F. Vagts, *The Governance of the Corporation: Reality and Law*, *in* COMMENTARIES, *supra* note 4, at 159, 163.

> the modification of existing policies, and the installation of preventive measures and compliance programs.[216]

Present limited experience with ombudspersons has not been a negative one. Certainly there is a need for more fact gathering and rule formulation in the use of ombudspersons.

E. Increase Personal Responsibility

Another reform mechanism is greater officer and director responsibility stemming from a personal sense of duty and ethics. This is a more subtle and intangible mechanism, yet is perhaps the most important means of corporate reform. Good people are necessary and do serve in corporate positions. These are people of high ethics and standards and who are sensitive to both the need of corporations to make money and the needs posed by public policy externalities. Former Securities and Exchange Commissioner A. A. Sommer, Jr. sums up this important point when he says:

> [A] general notion holds that there is not a sufficient self-governor within the corporation. Now, in large measure we rely in this country for compliance with law, not upon the enforcement agencies but upon the sense that most of us have that it is important for us to be law-abiding. To some extent, we rely upon ethical concepts to control human conduct far more than we rely upon law enforcement agencies.
>
> In that regard, it reminds me of the definition of conscience as "that still, small voice within that says that if you do it, you're going to get caught."
>
> It is for this reason that there is so much emphasis today upon independent directors, audit committees, and the independence of auditors, and the responsibilities of corporate counsel in the independent governor role. These are efforts to plant inside the corporation another level of assurance that corporations are going to be law abiding. And I think that people are increasingly looking to those particular entities as the means by which law-abidance is going to be accomplished.[217]

F. Enhance Real Corporate Democracy

Another reform would enhance corporate democracy and, thus, enhance

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216. Futter, *supra* note 30, at 36-37.
217. Sommer, *supra* note 172, at 258-59.

director and management legitimacy, to the extent they are executing shareholder mandates. Even cynics who believe that corporate democracy in its present state is a sham, ineffectual, or largely a fiction, agree that if there is not corporate democracy, the public will revolt. Professor Schwartz commented:

> If corporate pundits all agree that shareholder democracy has no viability, the public may suddenly wake up to the fact that there are no effective controls and no effective accountability machinery controlling the power of corporate managers. That might strike the public as a more dangerous situation than they had believed, when that realization is coupled with the growing knowledge of the manner in which the corporations have important effects on peoples' lives. The result of that newly appreciated knowledge might mean that the public would find it necessary to impose much stricter restrictions on management's power by means of governmental control . . . .[218]

Paul M. Neuhauser, Professor at the University of Iowa College of Law, suggested:

> [W]e will need a new emperor. If shareholder democracy does not work and if there is no real accountability, logic would suggest that we abolish shareholder participation, in form as well as substance, and recognize the reality of a self-perpetuating management.[219]

Many of the commentaries regarding the enhancement and power of the board of directors are also applicable to shareholders. For example, shareholder approvals can be expanded. Many have advocated longer proxy periods, greater requirements for cumulative voting, and a greater shareholder role in the selection and voting on directors.

G. *Enforce What is on the Books*

Another reform that is not so easily seen as a reform is to enforce current law, especially judge-made law. Critics have indicated there is "plenty on the books" for intelligent corporate lawyers and intelligent jurists to apply. The problem suggested by A. A. Sommer, Jr. and others is not social responsibility, but compliance with fundamental principles learned very early in life as a matter of personal ethics and acculturation to fundamental tenets of civilized society. Unfortunately, enacting additional rules and laws will not address this.

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218. COMMENTARIES, *supra* note 4, at 249.
219. Paul M. Neuhauser, *The Limits of the Limited View*, in COMMENTARIES, *supra* note 4, at 272, 273.

V. FINAL CONCLUSIONS, AND SOME MORE BROAD MEASURES

Certain conclusions can be made regarding public policy formulations, in addition to the specific reforms that are presented herein.

First, perhaps the most important figures in corporate governance are lawyers.[220] It would appear that if lawyers are performing their role responsibly, corporations will function more effectively and society will benefit. This would appear to remain true even given widely differing views of what "responsibly" means. Lawyers–including the supposed mode of training of lawyers, the supposed thought processes of lawyers, the supposed narrow perceptions and sometimes quite insular personal backgrounds of lawyers generally, and often, sadly, the supposed greed of lawyers–have been perceived as the ultimate source of the problems causing corporate misgovernance. Lawyers are seen to contribute to misgovernance not only as it arises within the corporation but also through their role in the enactment of statutes and in the development of case law which is unresponsive and detrimental.

Victor Palmieri has indicated:

> [I]f you look at the companies that have experienced problems, you very often find a failure of function and responsibility by counsel to the company. They were not where it was at. And I would hope that there might be some attention given to how lawyers can fulfill the new needs of the economy as expressed through this critical vehicle of the corporation, which I suggest to you, they are not doing.[221]

The corporate bar has been noticeably absent from serving as jurists, and this is perceived by many as to have adversely affected the course of corporate law and jurisprudence generally. There are states, such as Delaware, which present exceptions and have been subject to the reverse criticism. This suggests that a balanced approach might be most effective.

Beyond the conclusion that the role of lawyers should be reevaluated and enhanced, there seems to be recognition by corporate and government commentators alike that corporations must recognize externalities if corporations are to be a workable productive phenomenon in our society. Former Deputy General Counsel of the United States Department of Commerce, Homer E. Moyer, Jr., has stated:

> The initial instinct, almost without exception, is that steps to improve what we might call corporate social performance must necessarily be at the expense of profits. More and more business leaders are challenging this notion, and we have done the same.

220. *See* Palmieri, *supra* note 174, at 365-68.
221. *Id.* at 366.

> Moreover, even in the short run, there are sufficient examples to challenge this assumption. One of the best examples is energy conservation, which serves both social and economic goals.[222]

On a broad level, there is a need for rules that better accommodate human nature. Historians such as Charles Beard long ago pointed out that it is conceivable that the most idealistic socially beneficial measures are also those that, while being idealistic in their content, accommodate, appeal to, and recognize self-interest and the uglier sides of human nature. Beard's thesis on the enactment of the Constitution is that enactment was much due to the fact that the principal proponents of the Constitution and many at the Constitutional Convention felt it was the only method by which they were likely to have their bonds in the fledgling and failing Confederacy redeemed. They voted for the Constitution both out of self-interest, namely ensuring bond redemption, and the lofty ideals expressed by the Federalist Papers.[223] Intelligent public policy regarding corporate governance has to better recognize the most pervasive externalities as well as internal conduct and human nature.

A third working rule seems to be that a system of checks and balances is necessary within the corporate system. There are limitations to what can be legislated or ruled upon by judges. Many deficiencies can be held in check by a self-equilibrating system. A self-equilibrating system is not only enhanced by externalities as a balancing pressure but also can be enhanced by internal systems of checks and balances. There seems to be a recognition that absolute power gravitating to corporate managers, unchecked by boards, shareholders, or other mechanisms, will diminish the control of managers in corporations in the end after the resultant governmental intervention. The role of independent and knowledgeable legal counsel in this system of oversight is significant in this regard.

A fourth broad and underappreciated proposition is that law in corporate governance is not the only answer, and that ethics must hold sway. Of course, this does not mean uncritical adherence to narrowly conceived rules by selfish or clever mechanisms to outwit or circumvent them. Ultimately, reverence for the dignity of human beings must be the prime value, if only to ensure the longevity of capitalism and corporations.

Finally, society's needs and the configuration of corporations will be changing over time. New models of regulation, both internal and external, should constantly be explored. The operative rules must be updated and done so in a non-wasteful way. The updating and reevaluation process must employ contemporary techniques and draw upon other disciplines, such as the social sciences and mathematics, both for factual data and analysis methodologies.

All in all, the corporation will continue to play a central role in capitalis-

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222. Homer E. Moyer, Jr., *Encouraging Corporate Social Responsibility*, *in* COMMENTARIES, *supra* note 4, 281, 281-82.

223. *See, e.g.*, CHARLES A. BEARD, AN ECONOMIC INTERPRETATION OF THE CONSTITUTION OF THE UNITED STATES (1929); THOMAS NIXON CARVER, ESSAYS IN SOCIAL JUSTICE (1915).

tic society and in contemporary civilization. The elegance of capitalism is that it provides an equilibrating heuristic when aspects of the society lose effectiveness or are dysfunctional. Forces are already in play in response to the matters discussed here to the extent and the degree that they actually impact the effectiveness of corporations. The real issue is whether the corporate law of the various states is so entrenched and institutionalized that it cannot now adequately respond or even has already lost its relevance. If it is or has, then it is a matter of how state corporate law is supplanted from within or without. The community at large will suffer the loss when governance of the enterprise is ineffective. The learning and adaptive aspects of the heuristic take place in the community at large. So, finally, it is here that the law must either recalibrate itself or observe its successor.