Proposals for Corporate Governance Reform: Six Decades of Ineptitude and Counting

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I have a preference for taking the long view of matters, be they
corporate, white collar, or similar investigations,1 or proposals to
shorten law school education.2 So, too, I take the long-term view
with regard to proposals for corporate governance reform or
solutions for the separation of ownership and control which Adolf
Berle and Gardiner Means first espoused in 1932.3 My
predilection for the long view also stems from my authorship of the first legal
treatise on corporate governance in 19934 and my involvement in
governance of large corporations for over forty years.

Taking the long view, tracing the history of proposals for
improvement from 1932 to the present reveals support for several
propositions. One, the putative reformers seem to advance a
different proposal with clocklike regularity. When the previous
proposal evinces its character as a nonstarter, which happens
approximately every five years, the reformers, composed of a small
circle of academics, do an about-face. They begin to write prolifically
about an entirely new reform proposal which, talking to one
another, they concoct, usually out of whole cloth.

Two, all of these reform measures have, indeed, been
nonstarters. This Essay attempts to demonstrate that, insofar as it
can, the best evidence is the abandonment by the proposals’ authors

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2. See Letter from Douglas M. Branson, Professor, Univ. of Pittsburgh, to the Editor, N.Y. TIMES (Jan. 19, 2013) (on file with the Wake Forest Law Review) (pointing out that, in the long view, many universities that awarded a law degree after 3 years undergraduate study and 2 years law study in the 30s, 40s, and 50s later eliminated such programs).
and other leading lights, who then move on to the next idea. Advocates of the earlier reform proposal seem to abscond into the darkness with more alacrity than a defaulting homeowner in a jingle foreclosure. Thus, we have moved from the nationalization of large enterprises and sectors of the economy (the 1950s and 1960s), to social responsibility proposals (the early 1970s), to advocacy of federal charting or of federal minimum standards for large corporations (the late 1970s). From there, in the early 1980s, we moved onward to agency cost theory and the law and economics movement (positing that the separation of ownership and control represented rational apathy and was efficient rather than a problem). The radical leap from left to right, that is from federal chartering to economic analysis, overlapped and competed with the American Law Institute Corporate Governance Project, which emphasized structure and formulistic statements of first principles (the mid-to late 1980s).

In the 1990s, in metronome-like succession, proposals marched forth for institutional investor activism, for globalization of corporate governance, for regulation of gatekeepers, and for a rediscovered emphasis on independent (non-executive) directors. At last, corporate governance reform came to pass and led to movements for renewed shareholder activism. These reform proposals sallied forth much like soldiers marching onto a parade ground, at an intermediate distance, one from another.

Three, and perhaps most important, is the question, "Why is this so?," an inquiry left for consideration at the end of this jeremiad.

So this Essay begins with a scroll through time, starting with Berle and Means's 1932 postulate, and ending with Harvard University Professor Lucian Bebchuk's Shareholder Rights Project in 2013.

5. "The separation of ownership and control is... a false issue. Separation is efficient, and indeed inescapable, given that for most shareholders the opportunity costs of active participation in the management of the firm would be prohibitively high." Richard A. Posner, Economic Analysis of Law 180 (1973).


7. "The SRP works on behalf of public pension funds and charitable organizations seeking to improve corporate governance at publicly traded companies in which they are shareholders, as well as on research and policy projects related to corporate governance." Shareholder Rights Project, Harv. L. Sch., http://www.law.harvard.edu/academics/clinical/clinics/srp.html (last visited September 17, 2013). So far the SRP represents eight institutional investors (seven public employee pension funds and one foundation). The SRP has concentrated on shareholder initiatives to declassify boards of directors.
I. THE BERLE AND MEANS THESIS

Prior to the teens and the twenties, most of the great manufacturing and mercantile entities were privately held. Only the railroads and the canal companies floated shares to the public. Thus, the corporation and the publicly held corporation, along with stock trading and the extensive public ownership that went with it, did not become widespread until after World War I.\(^8\) Not surprisingly then, the first thoughtful and comprehensive study of the new corporate form did not emerge until 1932. What is surprising, though, is that this study by two Columbia University professors, one of law and the other of business, has remained the seminal work for eighty years.

Adolph Berle and Gardiner Means documented the widespread dispersion of corporate shareholders and the atomization of corporate shareholdings. They noted that in the then-modern corporation "ownership has become depersonalized."\(^9\) The result was that a new form of property came into being. The person who owned the property no longer controlled it, whereas the farmer who owned the horse had to feed it, teach it to pull the plow, and bury it when it died. "[I]n the corporate system, the 'owner' of industrial wealth is left with a mere symbol of ownership while the power, the responsibility and the substance which have been an integral part of ownership in the past are being transferred to a separate group in whose hands lies control."\(^10\) This was the fabled "separation of ownership and control."\(^11\)

The next question Berle and Means asked themselves was "What has moved into the vacuum created by this separation?" The answer was self-perpetuating boards of directors, hand-picked by self-perpetuating and oft-times greedy managers, who disregarded the wants of shareholders and consumers alike.

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\(^8\) See BERLE & MEANS, supra note 3, at 47 (demonstrating that the number of publically held stock increased dramatically following WWI). The number of public shareholders was basically flat from 1913 to 1917 (7.4 million to 8.6 million) but then accelerated (to 18 million) by 1928. \textit{Id.} at 56 tbl.VIII.

\(^9\) \textit{Id.} at 352.

\(^10\) \textit{Id.} at 68.

\(^11\) \textit{Id.} at 69–71, 90.
The ensuing years have seen seemingly endless debate about what is the solution to the Berle and Means problem, with one lengthy hiatus (the economic analysis of law era) in which scholars questioned whether the separation of ownership and control was a problem at all. For the most part, though, corporate governance reform efforts have opined as to what would render unaccountable managers, no longer answerable to rank-and-file shareholders, accountable. Would nationalization, installation of public interest directors, mandatory social accounting and disclosure, federal chartering of larger public corporations, market forces (including the market for corporate control), activism by institutional investors, the forces of globalization, or reinforced powers for gatekeepers, to name a few, align managers' interests with those of owners and other constituencies?

II. EARLY STIRRINGS ON THE REFORM FRONT

A deep depression, followed by a world war, forestalled implementation of any belief that regulation or legislation could check the power of large corporations and their managements. But after the War, governments became concerned over the might of large industrial complexes, especially in key industries. Great Britain nationalized the coal industry as well as the Bank of England in 1947, followed by the nationalization of electric generating in 1948. Nationalization of the steel industry and of the railroads followed those opening salvos. The government controlled those and other key sectors of the British economy until it privatized them again, primarily in the 1980s.

III. BEGINNING OF ECONOMISTS' RESPONSES TO THE PERCEIVED PREPARATION

Paul Krugman, an economist of our times, has termed John Kenneth Galbraith, an economist from the 1950s through the 1970s, "a policy entrepreneur" and a "media personality" whose works proved Galbraith to be "remarkably ill-informed." But wide segments of the public read Galbraith's books and considered him

not only to be an economist but by far the most influential economist of his day.

In one of his best known books, *American Capitalism: The Concept of Countervailing Power*, Galbraith rhetorically posed a number of solutions to the problem of unchecked corporate power, including the separation of ownership and control, although he generally did not use the Berle and Means terminology. He did not propose nationalization, as the British had done. Instead, he theorized that, indeed, corporations had grown too large. Their shareholders no longer controlled them, competitive market forces no longer constrained them, and the potential for abuse was great. That potential would be checked, however, by the growth of countervailing power inherent in the growth of labor unions, consumer groups, and government agencies. Galbraith pointed to the growth and influence of consumer cooperatives, which enjoyed great growth in Scandinavia, at least in the post-War years. Essentially, those newly empowered groups would supply the controls that, historically, owners had provided.

Later, Professor Galbraith confessed error. Consumer groups never achieved anything like the promise which the post-War experiences in Norway and Sweden had presaged. Once their members had garnered collective bargaining rights and achieved a certain level of wages and benefits, labor unions and their members came to empathize with and even share many of the goals and methods of corporate managements.

In the *New Industrial State*, Galbraith admitted that the concept of countervailing power was not the answer, in part because the power did not always exist and in part because forces did not work in the ways he had envisioned. But not to worry. The power of management was much more limited than he had previously thought. Instead, power resided in the “Technostructure,” that group of technicians, scientists, engineers, and middle managers within large enterprises who, by their actions, control the company.

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18. See, e.g., id. at 24 (discussing the problem of power).
19. See id. at 114–15.
20. See id. at 114 (“The operation of countervailing power is to be seen with the greatest clarity in the labor market where it is also the most fully developed.”); id. at 117 (“The labor market serves admirably to illustrate the incentives to the development of countervailing power . . . .”).
21. Id. at 126–27 (discussing the Swedish Kooperative Forbundet).
22. JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE 274–81 (3d ed., rev. 1978); see also JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE 332 (1985) [hereinafter GALBRAITH (1985)] (“The natural tendency of man . . . is almost certainly to work until a given consumption is achieved. Then he relaxes . . . .”).
and influence the economy. Most members of that group shared the values with and had objectives similar to other citizens in the communities in which they lived and worked.

Galbraith ultimately gave up the notion of the Technostructure and the way it was supposed to fill the vacuum the separation of ownership and control created. Looking back on the ideas he had espoused in Economics and the Public Purpose, Galbraith not only confessed error, but threw in the towel. He confessed that maybe the only workable solution to the accumulation and abuses of unchecked power in modern corporations was some form of central planning, akin to what the British had done in the late 1940s. In the meanwhile, he had become the U.S. Ambassador to India, and his writing turned to other subjects.

IV. THE CORPORATE SOCIAL RESPONSIBILITY MOVEMENT OF THE EARLY 1970S

Earth Day on April 22, 1970, marked a sudden awakening in the American consciousness, with all night teach-ins and extensive hand-wringing over the effects of too many phosphates from detergents in our streams, smoke and other particulates in our air from factory smokestacks, and the rapacious unchecked quest for sales and profits that corporations pursued. The calls for reform that ensued coincided with the peak of dissatisfaction with the Vietnam War. "Respect for authority, or for one's elders, had not completely disappeared but everybody (young that is) seemed prone

23. See, e.g., GALBRAITH (1985), supra note 22, at 84 ("Effective power of decision is lodged deeply down in the technical, planning and other specialized staff."); id. at 87-88 ("This latter group is very large.... It embraces all who bring specialized knowledge, talent or experience to group decision-making.... I propose to call this organization the Technostructure.").

24. See generally JOHN KENNETH GALBRAITH, ECONOMICS AND THE PUBLIC PURPOSE (1973) (discussing the problems of our modern consumer economy and the need to realign with the public interest).

25. Id. at 322 ("The only remedy is the coordination of planning policies... [P]lanning systems... also require a measure of international planning.").


27. See, e.g., MARC MOWREY & TIM REDMOND, NOT IN OUR BACKYARD: THE PEOPLE AND EVENTS THAT SHAPED AMERICA'S MODERN ENVIRONMENTAL MOVEMENT 13 (1993) ("Earth Day was a stunning event, the largest demonstration in the nation's history. Its size and scope dwarfed the largest of the Vietnam War protests...."); see also id. at 39-43.

28. But see id. at 39 ("[T]he only major political figure who wasn't going to celebrate Earth Day was the president, Richard Nixon...").
to question assumptions and long-held beliefs, about everything," including the role of corporations in our society.

The social responsibility movement called for government intervention, as the nationalization movement had, but on discrete fronts rather than on a plenary basis. One scholar urged replacement of the one share, one vote standard prevalent in U.S. corporate law with a graduated scale so that with the acquisition of additional shares, owners, particularly institutional owners who were perceived to be excessively mercenary, would receive less and less voting power. A "power to the people" mandate would augment the power of individual owners, who generally held fewer shares but were thought to be more socially conscious.

Calls for required installation of public interest directors on publicly held corporations' boards sometimes included subrecommendations that legislation also require that the public interest directors be equipped with offices and staffs at corporate expense. Others proposed requirements for social auditing and for mandatory disclosure of social audit results. A law professor at Georgetown University led his students in the submission of public interest proxy proposals at General Motors Co. for three successive years. Based on the experience, the professor advocated for the liberalization of the SEC shareholder proxy proposal rule.

Previously, however, critics had pointed out that public interest directors had been mandated for the boards of Communications Satellite Corporation ("Comsat") and the reorganized Union Pacific railroad. The Union Pacific public interest directors complained

30. See David Ratner, The Government of Business Corporations: Critical Reflections on the Rule of "One Share, One Vote," 56 CORNELL L. REV. 1, 12–13, 32, 45 (1970) (arguing that the German system might be more "palatable" if the United States were to change its approach).
31. Id. at 45.
that not only were they given little information but that they were "treated as spies and antagonists... kept in the dark about many things."\(^{36}\) While resigning from the eight boards of directors upon which he served, retired Supreme Court Justice Arthur Goldberg stressed that even independent directors cannot do an adequate job, at least without independent staffs and plenary access to information.\(^{37}\) The implication for so-called public interest directors was clear.

Advocacy for weighted voting scheme ideas and expanded public interest proxy proposals never seemed to catch fire. The corporate social auditing and disclosure proposal went nowhere as well, although several decades later legal scholars purported to plow new ground by essentially dusting off and advocating the same ideas.\(^{38}\)

V. MEGA-REFORM PROPOSALS: FEDERAL CHARTERING AND FEDERAL MINIMUM STANDARDS

Toward the second half of the 1970s, while discrete reforms such as social auditing and expanded public interest proxy proposal faded from view, two more drastic reform proposals moved onto and occupied center stage. These proposals eclipsed completely the corporate governance reform proposals of the social responsibility movement. Former SEC Chairman and Columbia University law professor William Cary proposed the least drastic reform. He envisioned federal legislation that would trump state corporate law on key points should state law standards prove to be too lax or pro-management.\(^{39}\) Thus, Congress would enact minimum standards on such subjects as interested director transactions, usurpation of corporate opportunities, directors' standard of care, the fiduciary duty of controlling shareholders, and so on.\(^{40}\)

The Corporate Accountability Research Group, created and promoted by consumer advocate Ralph Nader, gathered evidence, marshaled arguments, and advocated the other, more drastic reform of the 1970s: federal chartering of large corporations.\(^{41}\) In certain

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40. Id. at 702.
41. The academic-like work was RALPH NADER ET AL., CONSTITUTIONALIZING THE CORPORATION: THE CASE FOR THE FEDERAL CHARTERING OF GIANT
CORPORATE GOVERNANCE REFORMS

incarnations, chartering advocates expanded the proposal's reach, from the five hundred largest enterprises to the two thousand largest U.S. corporations by revenue, to any corporation that did a significant amount of business with the federal government, and then to certain categories of companies whose businesses were thought to be infected with the public interest.  

Whatever the universe of such corporations, these companies would have to reregister with a new federal entity, the Federal Chartering Agency. In addition, these corporations would no longer have perpetual existence as they had under state law. Instead, the new federal statute corporations would have only limited life charters, good for a limited twenty or twenty-five years. The federal statute would direct the Federal Chartering Agency to condition the grant of the original charter and all renewals upon compliance with federal anti-concentration standards that the new legislation would contain. In addition, the Agency would condition the issuance of a charter upon compliance with all applicable federal laws: transportation safety, occupational health and safety, securities, consumer statutes, environmental standards for clean air and clean water, and so on.

Intrusive as it may have been, federal chartering of corporation gained traction, possibly because of the star power of its chief advocate, Ralph Nader. Chaired by Senator Howard Metzenbaum, the Senate Commerce Committee held hearings on the federal chartering proposal, not once, not twice, but in three successive congresses.


42. See, e.g., Joel F. Henning, Federal Corporate Chartering for Big Business: An Idea Whose Time Has Come?, 21 DEPAUL L. REV. 915, 922 (1972) ("[I]t becomes necessary to require] a national franchise . . . of a smaller corporation if it wishes to do a significant amount of business with the federal government, to operate subsidiaries or factories in foreign countries, or to engage in certain industries where there is an overriding federal interest, such as energy . . . ").

43. See Ralph Nadar, How to Tame the Corporation, HUFFPOST BUS. (Feb. 25, 2013, 12:47 PM), http://www.huffingtonpost.com/ralph-nader/corporate-charters_b_2759596.html (arguing that the next step is for a Federal Charter).

44. See, e.g., BRANSON, supra note 4, at 659–62 (summarizing the federal chartering proposal).

VI. A SEISMIC SHIFT: THE SWIFT RISE OF LAW AND ECONOMICS JURISPRUDENCE

Perhaps only once in a lifetime will one see as pronounced a jurisprudential shift as that from the corporate social responsibility and federal chartering movements to the minimalist, noninvasive law and economics take on corporate law and corporate governance. Judge Richard Posner's groundbreaking treatise appeared in 1973.46 In the corporate field and in many other areas, however, Dean Henry Manne was the father of the law and economics movement.47 Corporate law scholars harked back to his work, *The Market for Corporate Control*, which appeared in 1965,48 as well as to other seminal articles Dean Manne wrote earlier in his career.49

Law and economics pointed to a minimalist corporate jurisprudence. The core theory was that market forces regulated corporate and managerial behavior much better than regulation, laws, or lawsuits ever could. Specifically, law and economics adherents pointed to the product market and a corporation's success or failure in it as a superior form of regulation for corporations.50 Adherents also found superior as a regulator the market for corporate control in which, as a result of a falling share price, a corporation might find itself to be a takeover target. A bidder might succeed with a tender offer or takeover bid, ousting underperforming managers and moving the target corporation in a different direction.

A subgroup of law and economics adherents became zealots, actively proselytizing that corporate law had no role other than to provide an off-the-rack contract approximating the contractual bargain the parties would have struck on their own had no transaction costs existed. These "contractarians" preached that each and every aspect of corporate law, including fiduciary duties,

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46. POSNER, supra note 5.
50. See, e.g., POSNER, supra note 5, at 183 ("[T]wo forces . . . operate to keep managers in line. One is competition in the market for the firm's product, which penalizes mismanagement. The other is competition in the market for corporate control.").
could be contractually negated. Corporate law should have no mandatory content: by contract, participants in a venture could opt out of any regulatory provision they wished. Corporate law's rules only function was to provide "default rules."  

VII. AN ANTIDOTE: THE GOOD GOVERNANCE MOVEMENT

At Airlie House in Northern Virginia in 1975 the germ of an idea began to sprout. What issued forth was the idea that the prestigious American Law Institute ("ALI"), author of the well-known restatements of the law, would undertake a restatement of corporate law, large portions of which traditionally had been left to judge-made law rather than to statutory codifications. In "black letter," with extensive commentary and reporters' notes, the ALI would attempt to distill the better of the common law rules, incorporating an incremental improvement here and there. Several subsequent symposia seconded and fine-tuned the proposal.

The ALI named Professor Stanley Kaplan of the University of Chicago Chief Reporter. Under his guidance, assistant reporters assembled the first tentative draft upon which ALI members deliberated in their 1982 annual meeting. The early drafts emphasized independent directors and a minimum-director committee structure with audit, nominating, and compensation committees. The boards of directors of large publicly held companies should have a majority of independent directors, that is, directors free of financial or other ties to the corporation and its senior managers. Smaller public companies should have, as a minimum, three independent directors.

The early ALI drafts ignited a furor. The Business Roundtable, comprised of the CEOs of the largest one hundred U.S. corporations, formed a study group whose main objective was to oppose the ALI.

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53. The author is a Life Member of the American Law Institute and has been a member since 1980. He had a personal relationship with the late Professor Stan Kaplan of the University of Chicago. The material in this section of the article relies heavily on the author's active participation in the ALI Corporate Governance Project.
55. See, e.g., EDMUND T. PRATT, JR., THE ALI CORPORATE GOVERNANCE PROJECT: A RADICAL CURE FOR A HEALTHY PATIENT (1989). The Roundtable titled its study group with the official-sounding name "The National Legal Center." Pratt was the Chairman of the Business Roundtable and the Chief Executive Officer of Pfizer, Inc.
The Roundtable accused the ALI of initiating a movement of corporate governance by litigation. Large firm corporate lawyers and in-house counsel of major corporations joined the ALI in droves. The ALI annual meeting morphed from a somnambulant affair, in which a reporter would review the black letter provisions of the Restatement of Trusts to a score or two of dozing ALI members, into a beyond-lively scene. In-house counsel packed the meeting in droves. Not a single seat remained vacant in the ballroom of the Mayflower Hotel in Washington where the ALI conducted most meetings. Overflow participants sat in the aisles and on the steps at the rear of the room. Television film crews interviewed key players in the wide corridor outside the ballroom.

Blowing past the maxim that in law reform a lawyer leaves her client at the door, in-house counsel openly hawked self-serving positions. They insisted that a body such as the ALI had no business attempting to dictate how large corporations should structure their boards of directors.

Vilified, and after receiving thinly veiled threats, Stan Kaplan resigned as chief reporter and was replaced by Professor Melvin Eisenberg of the University of California at Berkeley. Under pressure, the ALI removed Restatement from the enterprise's title, renaming the project Principles of Corporate Governance: Analysis and Recommendations. Those were heady and exciting times, at least in the corporate law world.

After those turbulent years, in the latter 1980s, the ALI Project settled into a pattern of yearly tentative drafts that the house then debated at annual meetings held once in Chicago, once in San Francisco, and otherwise at the aforesaid Mayflower Hotel in Washington D.C. The house approved the final product at its 1992 annual meeting. The ALI Corporate Governance Project appeared in print in two bound volumes in 1994.

The ALI Corporate Governance Project constituted an implicit rejection of and an antidote to the law and economics movement. Succinctly, the ALI evinced a strong belief that, yes, corporate law does have a role to play. That belief, sometimes characterized as the constitutionalist approach, in contrast to the contractarian approach, underlines and buttresses the entire ALI Project.

The ALI crafted recommended rules for corporate objectives: structure, including board composition and committee structure; duty of "fair dealing" (duty of loyalty); duty of care and the business

56. See DONALD V. SEIBERT, THE ALI AND ITS "LITIGATION MODEL" OF CORPORATE GOVERNANCE (1989). Donald Seibert was the Former Chairman of J.C. Penny Co., Inc.
57. See 1 AM. LAW INST., supra note 6.
58. 1 AM. LAW INST., supra note 6 (totaling 432 pages); 2 AM. LAW INST., supra note 6 (totaling 477 pages).
judgment rule; roles of directors and shareholders in control transactions and tender offers; and shareholders' remedies, including the derivative action and appraisal remedies. Discrete fair dealing provisions dealt with such subjects as interested directors' transactions, definitions of which opportunities are corporate opportunities, competition with the corporation by officers and directors, compensation of corporate officials, and the like.

On one level, the ALI Corporate Governance Project has had mixed success. The high courts of several states have expressly adopted the ALI's business judgment rule as a safe harbor rather than the Delaware business judgment rule as a presumption.59 Given the glacial pace at which corporate law evolves, at least in states other than Delaware, several states' adoption constitutes a win for the ALI. Several other states have followed the ALI approach in defining which opportunities are corporate opportunities, layering several tests one upon the other rather than adopting a single rule or test. Indeed, one can argue that Delaware's leading case, Broz v. Cellular Information Systems, Inc.,60 mimics the ALI approach. By contrast, only one state, Pennsylvania, has adopted the ALI approach to derivative actions and corporate boards potential treatment of them.61 Among those states which have decisions on point, most follow the highly deferential, pro-management approach of the New York Court of Appeals in Auerback v. Bennett,62 or the only slightly less deferential Delaware decision in Zapata Corporation v. Maldonado.63

On a deeper level, though, the ALI has been a very successful precedent for at least three reasons. First, the ALI Project recommendations for board composition and governance through committee structures have become the standard all major corporations follow and, indeed, exceed. At first controversial and extreme, those norms are "old hat" by now. Second, the ALI Project was the first comprehensive corporate governance blueprint, giving inspiration to a host of governance blueprints which have followed, including the Cadbury Code, the OECD Code, Richard Breeden's "Points of Light," and many more.64 Third, and most importantly,
the ALI Project represented an alternative to the law and economics movement, striving for ascendancy at the time, pontificating that law had little or no role to play in the governance of corporations. The ALI Project itself is a strong statement that law does have such a role. The ALI Project then goes on for 909 pages, in great detail describing what that role should be.65

VIII. THE EARLY 1990s: THE EMPHASIS ON INSTITUTIONAL INVESTOR ACTIVISM

Most individual investors practice what has been termed “rational apathy.” Thus, often individual shareholders do not read annual proxy statements that, under traditional SEC rules, public corporations must publish and distribute.66 Indeed, if they do invest directly in corporate shares, rather than indirectly through mutual funds or exchange-traded funds (“ETFs”), many individual shareholders do not even vote the shares they own. In contrast, institutional investors have fiduciary duties that require them to read and analyze proxy statements and to vote the shares they hold.67 Many institutions hire independent consultants such as Glass Lewis or Risk Metrics to make recommendations on how those institutions should vote shares they own.

Traditionally, though, institutional investors followed the “Wall Street Rule,” meaning that if they developed an aversion to a portfolio company’s performance or governance, they simply sold the stock rather than become embroiled in a corporate governance issue. Institutions voted with their feet. That is, they did so until portfolio positions had become so large that if an institutional investor liquidated even a sizeable portion of the portfolio’s stake in a company, the institution’s sales alone would push down the stock’s price. Thus, in the modern era, institutional investors are faced


65. 1 AM. LAW INST., supra note 6 (totaling 432 pages); 2 AM. LAW INST., supra note 6 (totaling 477 pages).

66. In 2007, the SEC began rollout of its “Notice Equals Access” initiative, which incorporates an “access equals delivery” theory and which relieves corporations from the affirmative obligation to send out proxy statements and annual reports. Corporations may now send shareholders a thin envelope directing them to telephone numbers and Internet portals through which they may obtain written documents if they want them. See, e.g., Internet Availability of Proxy Materials, Exchange Act Release No. 34-55146, 89 S.E.C. Docket 2489 (Jan. 22, 2007); see PINTO & BRANSON, supra note 63, at 185–86.

with more of a buy-and-hold strategy than they otherwise might prefer.

So was born an opening to push for yet another proposed reform that would fill the vacuum created by the separation of ownership and control, namely, institutional activism, or "agents watching agents."68 The case for institutional oversight was that because "product, capital, labor, and corporate market control constraints on managerial discretion are imperfect, corporate managers need to be watched by someone, and the institutions are the only watchers available."69 From a comparative viewpoint, "financial institutions are active monitors in other countries, notably Germany and Japan. This suggests they could play a similar role here."70

The gainsayers, from elite academic institutions similar to the leading proponent, debated this theoretical proposal, at least until the same academics moved on to another set of proposals in the next half decade. One critic opined that, second to investment performance, institutional investors' primary concern was liquidity, which would militate strongly against a strategy of buy, hold, and try to influence the course of events though share voting.71 The leading critic pointed out that a vogue prevalent among a large group of institutional money managers was "indexing," which translated into assembling a portfolio of stocks whose performance would match the performance of a broad stock market index, no more, no less.72 Such an indexing strategy was the antithesis of purchasing individual stocks to be followed by a pattern of attempting to influence events at particular portfolio companies through share voting and efforts at persuasion.73

This critic (Professor Ed Rock at the University of Pennsylvania) further observed that corporate pension trusts, whose trustees' appointments are controlled by corporate sponsors, managers, and directors, would have near zero interest in an institutional investor strategy of activism.74 Then, among the likely

69. Agents Watching Agents, supra note 68, at 815.
70. Id. at 820.
73. Id. at 473–74.
74. Id. at 474.
suspects, labor union and public employee pension trusts, only a
subgroup of those (such as CALPERS) would have an interest in the
shareholder activism strategy suggested. Many, perhaps most,
union and public employee pension trust managers' sole or primary
concern would be investment performance, not improvements in or
fine tuning of corporate governance at portfolio companies.

Nonetheless, other corporate governance gurus hopped on the
bandwagon, publishing views about the ins and outs of shareholder
activism. At least they did so until the leading players in the band
put down their instruments, preparatory to taking up an entirely
new tune.

IX. THE SHIFT TO AN EMPHASIS ON “GLOBAL” CONVERGENCE IN
CORPORATE GOVERNANCE

One observation that can be made about self-styled corporate
governance advocates in the United States is that they never let the
gress grow under their feet. In fact, they do not even permit the
fescue, or whatever, to take root. Thus, in the second half of the
1990s, the governance prognosticators did an abrupt about-face,
abandoning talk about the prospect of institutional shareholder
activism in favor of pontification on the prospect of global
convergence.

The thesis went something like this. Through the process of
globalization the world had become a much smaller place. Through
use of media such as email and the Internet, governance advocates
in Singapore now knew, or knew how to find out, what was
happening on the corporate governance front in the United Kingdom
and the United States. The law or business school professor in
Canada was abreast equally on what had occurred in New Zealand
or in France. In fact, through the ease of international jet travel,
the bloke in New Zealand or his counterpart in Australia might even
have met the professor from Canada or the colleague from France,
either in one or the other’s home country or at a conference at
which both had been in attendance.

Through these and other interactions, a consensus would
develop and a collection would emerge of what governance practices
were acceptable practices or best practices. The world of

75. See, e.g., Joseph A. Grundfest & Michael A. Perino, The Pentium
Papers: A Case Study of Collective Institutional Investor Activism in Litigation,
38 ARIZ. L. REV. 559, 559–61 (1996); James E. Heard, Institutional Investors:

76. A few, of course, came to the dance late, albeit with an interesting
comparative view. See, e.g., Bruce E. Aronson, A Japanese Calpers or a New
Model for Institutional Investor Activism? Japan’s Pension Fund Association
and the Emergence of Shareholder Activism in Japan, 7 N.Y.U. J.L. & BUS. 571,
governments, bar associations, accountancy professionals, and larger corporations would pressure the legislatures and parliaments to enact laws in order to be compliant with international best practices standards. Influential international organizations such as the World Bank, International Monetary Fund ("IMF"), Organization for Economic Cooperation and Development ("OECD"), or Asian Development Bank would ratchet up the pressure. Why? The enactment of user-friendly, modern economic laws and compliance with "best" governance practices would promote stability and predictability, leading to increased direct foreign investment and similar capital flows. The world would then become an even smaller, more hospitable place.

Thus, the global consensus, together with the pressure to comply with or adopt it, or at least its salient features, would fill the vacuum created by the separation of ownership and control. Rather than nationalization, authoritative pronouncements such as those by the ALI, discrete governmental interventions, or increased institutional activism, the primary push for improved or good governance would be a global one.

So far, so good, at least in theory: the remaining question was what would the global consensus, the core of best practices, look like? Enter the U.S. governance academic, or at least the more chauvinist ones. According to U.S. academics, the global model of good governance would replicate the U.S. model of corporate governance, of course. In one of the more arrogant pieces written, law professors from Harvard and Yale posited "the end of history" for corporate law. An international contest had quietly unfolded and, according to the professors, the U.S. corporate governance model had won, hands down. "[W]e are witnessing rapid convergence on the standard shareholder-oriented [US] model as a normative view of corporate structure and governance. We should also expect this normative convergence to produce substantial convergence in the practices of corporate governance and in corporate law."  

The seconders found this to be a "strong convergence position," which was "boldly argue[d]." Corporations the world over would conform to the U.S. model of two-fisted independent directors, willing and able to remove underperforming CEOs. Boards, comprised of a majority of such independent directors, would supervise and govern through an advanced committee arrangement. Ruggedly independent shareholders would file derivative and class

78. Id. at 443.
79. CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 6-7 (Jeffrey N. Gordon & Mark J. Roe eds., 2004) (internal quotation marks omitted).
actions to vindicate management shortfalls and other imbroglios. Takeover players would turn bidder if target managers and their boards allowed share prices to languish, seizing control and ousting the underperforming management.

The talisman for convergence advocates was efficiency. The "fundamental force is efficiency. If there is one efficient corporate governance mechanism, competitive pressures push firms around the world toward that structure." 80

Of course, cultural and political forces, which differ greatly from region to region and even country to country, will always act as culverts that shoot economies and political systems off in different directions. Corporate governance in the Muslim world will not always succumb to the lure of efficiency. Among Pacific Rim countries, the Chinese dominate the economic sphere: extended familial and social considerations rather than efficiency are uppermost. The European psyche and attitude toward governance is not congruent with the American one. The elite and high-handed U.S. reformers never acknowledged these cultural differences between regions and nation-states or blithely ignored them. Instead, once more, the reformers side-stepped, moving onto the next new theory they had concocted.

X. SHIFT OF THE EMPHASIS TO THE GATEKEEPERS

Enron imploded in the second half of 2001, entering bankruptcy in December. 81 WorldCom unraveled in Spring 2002, entering bankruptcy in July. 82 An A to Z list of corporate debacles took place, putting paid to the notion that U.S. corporate governance had achieved a near perfect or even advanced state, as The End of History for Corporate Law had postulated. 83 Whatever the U.S. system was, it had a great many defects and it did not do the job for which it had been devised. In addition, of course, no sign existed that the predicted convergence had taken place. 84

Given that glaring failure, corporate governance advocates seemingly would have modified or retracted their convergence hypothesis. They did not. Indeed, they took no notice whatsoever of any naysayer or critic. Without batting an eye, they simply shifted

80. Id. at 27.
83. Id.; see supra note 77 and accompanying text.
course yet again. One commentator summed up the new direction for governance reform with the infelicitous title, "It's About the Gatekeepers, Stupid!"  

That author, Professor John Coffee, defines gatekeepers as "reputational intermediaries who provide verification and certification services to investors." I would define gatekeepers as a subset of monitors of corporate operations and behavior, namely, those "monitors who supply essential verification and certification services to corporations." Either way, the new thing was to strengthen gatekeepers or put them back in the positions they perhaps once occupied so that newly energized and empowered gatekeepers would fill the vacuum created by the separation of ownership and control. One can count a number of monitors who perform essential services for each corporation with whom they have contact: audit committees, independent directors, auditors, debt rating agencies, state and federal securities regulators (including the SEC), and more specialized state and federal agencies (in insurance, banking, energy production, and so on). One can also count a number of other monitors who often do not rise to the level of gatekeepers: financial analysts, members of the financial press, and relational investors (institutions and other investors who have large holdings). "Having analysts and institutions interested in your corporation can be very nice, but it is not essential."  

One corporate governance piece counted no fewer than thirteen types of entities that monitor corporate performance, several of which rise to the level of gatekeepers. The Sarbanes-Oxley Act of 2002 ("SOX") heads off in varying directions, but a careful reader can discern that one of the legislation's dominant themes is strengthening gatekeepers as a means of enhancing watchfulness over corporations. Thus, for example, SOX requires public corporations to have audit committees composed of independent directors, one or more of whom must be

86. Understanding Enron, supra note 85, at 1405.
88. Id. at 996.
XI. EMPHASIS ON INDEPENDENT DIRECTORS AND INDEPENDENT BOARD COMMITTEES

The tea leaves may still be swirling in the bottom of the cup and thus impossible to read clearly, but the newest "new thing" in the second half decade of the new century may be the independent director movement. An independent director, of course, is one who is free of material financial, or familial contacts with the corporation or its senior managers. The archetypical non-independent would be a director who is also an insider, most often from having a contractual or employment relationship with the company. Non-independents would also include "gray insiders," such as the attorney, investment banker, or other professional who also serves on the board.

The emphasis on strengthening gatekeepers seems to have faded from the scene stage left almost as quickly as it entered the scene stage right.

It is true that the emphasis on independent directors began much earlier with the earliest drafts of the ALI Project, but those early drafts, which seem ho-hum today, were controversial. They were so controversial that the ALI downgraded its prescriptions from being a "Principle of Corporate Governance" to being one of the "Recommendations of Corporate Practice Concerning the Board," assigning those recommendations to a special subsection of the final draft, as it appeared in 1994.

The ALI Principles recommend (but do not require) that "[t]he board of every large publicly held corporation...should have a majority of directors who are free of any significant relationship...with the corporation's senior executives." Smaller...
publicly held corporations "should have at least three directors who are free of any significant relationship with the corporation's senior executives."97

The movement for independent directors gathered steam with the 2002 SOX legislation, which required that SEC reporting companies, that is, most publicly held corporations, have an audit committee comprised exclusively of independent directors.98 The New York Stock Exchange followed by amending its Listing Manual, which listed public companies that have a majority of directors who are independent,99 making the 1994 ALI recommendation for good practice into a hard-and-fast requirement. In 2010, the Dodd-Frank Act100 jumped on the independent director bandwagon with its requirement that exchanges refuse to list the shares of corporations who disclose that they do not have a compensation committee comprised of independent directors.101 Observers who have written about the issue assume that the Dodd-Frank disclosure requirement is a de facto requirement that corporations have compensation committees, albeit a backhanded sort of requirement.102

The movement toward a majority, or indeed a supermajority, of independent directors may be a reform which leads nowhere, all for naught, as all the previously suggested reforms have, if Professor Myles Mace's thesis continues to hold true.103 Even though they may be independent, "directors who do not direct" (the title of Professor Mace's examination of directors) and very often merely rubberstamp the express or implied wishes of senior management do little to improve governance.104 Thus, the predilection of corporate America to name the same individuals over and over again to

its equity securities [§ 1.20] and $100 million or more of total assets [§ 1.37]."

Id. § 1.24.

97. Id. § 3.A.01(b).

98. SOX § 301, 116 Stat. at 775–77.


101. Id. § 952, 124 Stat. at 1900–03.


104. See William O. Douglas, Directors Who Do Not Direct, 47 HARV. L. REV. 1305, 1322–23, 1330 (1934) (arguing that there needs to be a solution to the problem of directors whose decisions do not serve or represent the needs of the shareholders).
various corporations’ boards results in a cadre of “trophy directors,” who may be independent but are, at most, totems, as opposed to effective, hands-on directors. A 2007 census of the U.S. Fortune 500’s boards revealed that the fastest growing segment of women directors has been trophy directors, those holding four or more directorships. The number rose dramatically, from thirty in 2001 to seventy-nine in 2005. In this day and age, no person, man or woman, can function properly on more than two or perhaps three publicly held corporations’ boards of directors. So again, reformers push for another governance reform that has little, if any, chance of improving the governance of publicly held corporations.

CONCLUSION

Again, in refrain of a question first raised in the introduction, “Why is this so?” Why does reform proposal after reform proposal end up effectively going nowhere? One tentative observation is that all, or most all, of these proposals come from the top down rather than the bottom up. Second, the proposals come from an alarmingly small circle of academics, all of whom hang their hats at elite academic institutions and talk largely with only one another. The result is inbreeding and disconnect from the real world.

In turn, the disconnect results in promulgation of governance reform proposals that are less than fully responsive to what the real world problems may be, such as federal chartering, institutional investor activism, gatekeeper enhancement, and so on. Third, in some cases, such as in the postulation of “global convergence” in corporate governance, the reform proposals result in downright scorn, at least in foreign lands. Fourth, when proposals are made from the bottom up, as for instance, the women’s organizations’

108. See, e.g., CONVERGENCE AND PERSISTENCE IN CORPORATE LAW, supra note 79; but cf. Douglas M. Branson, The Very Uncertain Prospect of “Global” Convergence in Corporate Governance, 34 CORNELL INT’L L.J. 321, 323 (2001) (“Today the academy has become much enamored with the notion of ‘global’ convergence in corporate governance. That is to say, in the opinion of a number of the elites in the United States corporate law academy, the governance structure and practices of larger corporations all over the world soon will take on a resemblance one to another.”).
109. Branson, supra note 84, at 365; see Cally Jordan, The Conundrum of Corporate Governance, 30 BROOK. J. INT’L L. 983, 985–88 (2005) (arguing that the convergence theories that have been posited are more confusing than anything and do not in fact answer the issues at hand).
continued push for increased representation of women and other minorities in senior management positions and governance, nary a word will be written or otherwise uttered by those who control the corporate governance reform agenda in this country.110

A large portion of the blame may also lie with a near-universal failure to rethink the problem or predicament with which corporate governance reform proposals must deal. For six decades, the question to be answered has been how to substitute for the lack of accountability and control that results from the separation of ownership and control as Berle and Means first hypothesized. A few scholars have pointed out that the Berle and Means corporation, with dispersed share ownership, may predominate only in the United Kingdom, the United States, and perhaps a few other developed nations. Instead, corporate governance in most other countries of the world faces the challenge of dominant shareholder capitalism, be it family capitalism, state-owned enterprise, or some other form, rather than dispersed share ownership and the separation of ownership and control.111 Nonetheless, the erstwhile governance reformers press on as though the Berle and Means corporation were universal.

The purpose of this symposium, titled as it is (Agency Theory: Still Viable?), is to do exactly that, examine new ways of looking at

110. The growing impetus to place women on boards of directors and in senior executive positions dates at least from the early 1990s and has “legs” today. See, e.g., Douglas M. Branson, Initiatives to Place Women on Corporate Boards of Directors—A Global Snapshot, 37 J. CORP. L. 793, 802–13 (2012) (describing several programs put forth in an attempt to increase women’s participation within corporations). The first woman chief executive officer took office in 1997. See DOUGLAS M. BRANSON, THE LAST MALE BASTION: GENDER AND THE CEO SUITE IN AMERICA’S PUBLIC COMPANIES 3–12 (2010) (describing Jill Barad’s role at Mattel, Inc.). There are twenty-one female chief executive officers in the Fortune 500 today. SHERYL SANDBERG, LEAN IN—WOMEN, WORK, AND WILL TO LEAD 5 (2013). The attention and publicity given to Sheryl Sandberg’s 2013 book, Lean In, has been nothing short of astounding. See, e.g., Belinda Luscombe, Confidence Woman, TIME (March 2013), http://ideas.time.com/2013/03/07/confidence-woman (“Don’t Hate Her Because She’s Successful; Facebook’s Sheryl Sandberg and Her Mission to Reboot Feminism.”). The push for increase in the pathways to and appointment of more women and other minorities to corporate positions is, in this author’s opinion, a corporate reform push from the bottom up rather than from on high (from the top down).

111. See, e.g., Brian R. Cheffins, Corporate Law and Ownership Structure: A Darwinian Link?, 25 U. NEW S. WALES L. J. 346, 353–54 (2002) (“[T]here are limits on the extent to which share ownership dispersion will take place in small countries.”); id. at 367 (explaining that from the empirical evidence reviewed, the U.S. and UK “are the two countries where the Berle-Means corporation clearly dominates”); Cally Jordan, Family Resemblances: The Family Controlled Company in Asia and Its Implications for Law Reform, 8 AUSTL. J. CORP. L. 89, 94 (1997).
the situation. Led by Professor Michael Jensen of the Harvard Business School, a group of distinguished scholars from the United States and Europe will express their views on "thinking outside the box." Although these efforts should have been undertaken twenty, twenty-five, or even thirty years ago, better late than never.