The Corporate Governance Obsession

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Corporate governance has become a central concern of our time. For a variety of problems—from corruption and economic development to systemic risk and rising inequality—corporate governance reform has surfaced as a favored policy response. This Article explores the origins and scrutinizes the implications of this extraordinary focus on corporate governance as a solution to a constellation of economic and social ills.

In a context of growing skepticism of the state, the corporate governance movement offers a midway solution between markets and government. It transposes to the corporate context mechanisms typical of government control, such as "checks and balances" and democracy. This compromise solution turns out to be politically palatable: corporate governance appeals to progressives as a path for social and economic change in the face of political resistance to state intervention, while pleasing conservative forces as an acceptable concession to deflect greater governmental intrusion in private affairs. Whether such a persistent turn to corporate governance is worth the candle, however, remains an open question.

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> *"The future may see the economic organism, now typified by the corporation, not only on an equal plane with the state, but possibly even superseding it as the dominant form of social organization. The law of corporations, accordingly, might well be considered as a potential constitutional law for the new economic state, while business practice is increasingly assuming the aspect of economic statesmanship."*
> Adolf Berle Jr. & Gardiner Means[1]

I. INTRODUCTION

Corporate governance has become a constant fixture of the academic and policy debates of our time.[2] It not only figured prominently in the Sarbanes–Oxley Act of 2002 and the Dodd–Frank Act of 2010, the sweeping regulatory reforms of the last decades, but its reach has been far broader at both domestic and international levels.[3] For a vast array of economic and social problems—from economic development and systemic risk to rising inequality—corporate governance reform has surfaced as a favored policy response.[4] As evidence of its popularity in academic circles, by 2015 there were over 11,000 papers on the website of the Social Sciences Research Network (SSRN) that make explicit reference to "corporate governance" in their title or abstract, up from about 3500 in 2006.[5]

Yet despite its extensive usage, there is no canonical definition of what corporate governance means.[6] At one extreme, corporate governance is viewed as "[a]nything and

1. ADOLF BERLE JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 357 (1932).

2. *See, e.g.*, J. ROBERT BROWN JR. & LISA L. CASEY, CORPORATE GOVERNANCE: CASES AND MATERIALS 1 (2012) ("Today. . . corporate governance is a topic of substantial public interest and controversy."); Lucian A. Bebchuk & Michael Weisbach, *The State of Corporate Governance Research*, 23 REV. FIN. STUD. 939, 939 (2010) ("Interest in corporate governance has been rapidly growing, both inside and outside academia, together with recognition of its importance."); Stijn Claessens & Burcin Yurtoglu, *Corporate Governance and Development—An Update*, 10 FOCUS 1, 1 (2012) (noting that while "the term corporate governance meant little to all but a handful of scholars and shareholders" only two decades ago, "[t]oday, it is a mainstream concern—a staple of discussion in corporate boardrooms, academic roundtables, and policy think tanks worldwide"); Mats Isaksson & Serdar Çelik, *Who Cares? Corporate Governance in Today's Equity Markets* 7 (OECD Corp. Governance, Working Paper No. 8, 2013), http://www.oecd.org/naec/Who%20Cares_Corporate%20Governance%20in%20Today's%20Equity%20Markets.pdf ("[C]orporate governance is a hot policy topic.").

3. For instance, both the World Bank and the Organisation for Economic Co-operation and Development (OECD) have ambitious programs devoted to corporate governance. *See infra* Part III.B. The United Nations Conference on Trade and Development has likewise devoted attention to the topic. *See generally* UNCTAD, CORPORATE GOVERNANCE IN THE WAKE OF THE FINANCIAL CRISIS (2010), unctad.org/en/Docs/diaeed20102_en.pdf.

4. *See infra* Part III.

5. The 2015 figures are based on the author's search on the website www.ssrn.com. For the 2006 data, see Stuart L. Gillan, *Recent Developments in Corporate Governance: An Overview*, 12 J. CORP. FIN. 381, 381 (2006). In fact, SSRN has a specific research network devoted to corporate governance (CGN), beyond those devoted to related areas such as economics (ERN), finance (FEN), and law (LSN).

6. For some prominent attempts at conceptualizations, see, e.g., OECD, OECD PRINCIPLES OF CORPORATE GOVERNANCE 9 (1999) [hereinafter OECD PRINCIPLES] (alluding to "a set of relationships between a company's management, its board, its shareholders and other stakeholders," as well as "the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined"); Luigi Zingales, *Corporate Governance*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 497 (P. Newman ed., 1998) (defining a governance system as "the complex set of

everything that influences the way that a corporation is actually run."[7] This would encompass *external* constraints on corporate behavior (such as those provided by credit markets, competition, and the market for corporate control), as well as internal ones.[8] Most works on corporate governance, however, focus primarily on *internal* governance, which relates to the balance of power among shareholders, boards of directors, and managers.[9] And most policy efforts in corporate governance since the 1970s have emphasized variations on the same formula—the independence of corporate directors, on the one hand, and the empowerment of shareholders, on the other—to address very different problems over time.

Such overt emphasis on corporate governance is relatively new. As depicted in Figure 1, the very expression corporate governance did not exist in the English language until the 1970s, but its use has exploded since.[10]

Figure 1. Google books Ngram Viewer: *corporate governance* (1900–2008)[11]

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constraints that shape the *ex post* bargaining over the quasi-rents generated in the course of a relationship"); Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. Fin. 737, 737 (1997) (referring to "the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment").

7. Jonathan R. Macey, Corporate Governance: Promises Kept, Promises Broken 2 (2008).

8. For the distinction between internal and external corporate governance, see Il Chong Nam et al., *Comparative Corporate Governance Trends in Asia*, *in* OECD, Corporate Governance in Asia: A Comparative Perspective 85, 90 (2001); OECD, Corporate Governance of Non-Listed Companies in Emerging Markets 9–10 (2006). To be sure, since the advent and judicial recognition of antitakeover defenses, which permitted boards to block hostile acquisitions, the operation of the market for corporate control in the United States became fundamentally tied to the internal balance of power within the firm. *See* Cheffins, *infra* note 112 and accompanying text.

9. *See, e.g.*, OECD Principles, *supra* note 6, at 5–6; Hillary Sale, *Delaware's Good Faith,* 89 Cornell L. Rev. 456, 460 (2004) ("The term 'corporate governance' is widely used to refer to the balance of power between officers, directors, and shareholders.").

10. On the origins of this phrase, see *infra* note 47 and accompanying text; see also Eells, *infra* note 69. Disseminated since the 1990s, the somewhat awkward foreign translations of the English expression (such as *gouvernement d'entreprise*, *gobernanza corporativa*, and *governança corporativa*) are of even more recent vintage.

11. *Corporate Governance,* Google Books NGram Viewer, https://books.google.com/ngrams/graph?content=corporate+governance&year_start=1990&year_end=2008&co

To be sure, such growing usage in part merely reflects the advent of new terminology—with "corporate governance" providing a different vocabulary to describe otherwise familiar themes.[12] Nevertheless, the very appearance of this neologism is likely not fortuitous, but rather indicative of a new mindset: one that assumes that the particular balance of power, organizational structure, and decision-making processes *within* the corporation matter deeply for economic and social life. What, then, explains this growing interest in corporate governance?

Even though the rise in prominence of corporate governance is well documented,[13] the driving forces behind it have not yet received systematic attention. There is, however, an important literature offering different accounts about the degree and direction of corporate governance change in the last few decades. For instance, Ronald Gilson ascribes the transformation of U.S. corporate governance in the last decades of the 20th century to changes in the operation of product and capital markets.[14] Jeffrey Gordon, in turn, attributes the rise of independent directors in the United States to the greater informational content of stock market prices—which, he argued, made it possible for outsiders to monitor the pursuit of shareholder value by corporate management.[15] There is also an established connection between calls for greater shareholder involvement in corporate governance and the drastic expansion of institutional (in lieu of individual) ownership of corporate stock since the mid-20th century.[16] Relatedly, Martin Gelter has

rpus=15&smoothing=3&share=&direct_url=t1%3B%2Ccorporate%20governance%3B%2Cc0 (last visited Nov. 7, 2016). For a description of the Google Ngram database and its use to trace changes in culture over time, see generally Jean-Baptiste Michel et al., *Quantitative Analysis of Culture Using Millions of Digitized Books*, 331 SCI. 176 (2011).

12. To some extent, this is certainly the case, since the entire field of corporate law is at times subsumed under the rubric of corporate governance. For our purposes, however, it is noteworthy that corporate law has also experienced a resurgence in the same period.

13. *See supra* note 2 and accompanying text (discussing the relevance of corporate governance in today's discussion of corporate policy).

14. Ronald J. Gilson, *Catalysing Corporate Governance: The Evolution of the United States System in the 1980s and 1990s*, 24 COMPANY & SEC. L.J. 143, 147–49 (2006).

15. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1474 (2007).

16. *See, e.g.*, Brian R. Cheffins, *The History of Corporate Governance*, *in* OXFORD HANDBOOK OF CORPORATE GOVERNANCE 46, 52 (Mike Wright et al. eds., 2013). Cheffins notes that "the proportion of shares in US public companies institutional investors owned rose from 16 percent in 1965 to 47 percent in 1987 and again to 57 percent in 1994," which, in turn, made them increasingly logical contenders to play a major corporate

argued that the gradual shift in pension systems from defined benefit to defined contribution plans has tied the fortune of workers to the performance of stock markets, hence increasing popular interest in corporate governance and legitimizing the pursuit of shareholder wealth maximization.[17]

Although illuminating in many ways, these accounts nevertheless fail to fully capture the growing grip of the corporate governance agenda during this period. Crucially, corporate governance change did not result from the invisible hand of the market alone. It instead resulted from the visible hand and voice of policy entrepreneurs advocating for corporate governance reform in its different stripes.[18] The contemporaneous emergence of a corporate governance industry only accentuates the self-reinforcing character of the corporate governance agenda.[19] There is, in fact, an observed disjunction between economic forces and corporate governance policy. Not only is the link between certain corporate governance best practices and desired outcomes tenuous in many instances,[20] but the corporate governance movement assumes that market forces alone do not lead companies to adopt optimal corporate governance structures.[21]

This Article offers a complementary political account of such a turn to corporate governance as an all-purpose remedy. The ascent of the corporate governance movement in the United States since the late 1970s coincided with the wave of deregulation and suspicion of government intervention. Such overlap is likely not accidental. If "government is not the solution to our problem; government *is* the problem"—as Ronald Reagan's famous slogan went—the cure for economic woes had to lie in the private sector.

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governance role since the 1980s. *Id.*; *see* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 865 (2013) (discussing the implications of the rise of institutional ownership to up to 70% of the outstanding shares of the largest U.S. firms).

17. *See generally* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909 (2013) (discussing the shift in pension plans from defined benefit to defined contribution).

18. The turn to corporate governance is not an exclusive—and likely not even a primary—brainchild of academics in law, economics, and finance. Policy entrepreneurs and think tanks in the field have also played a critical part, often advocating for solutions unsupported by, or at odds with, the scholarly literature. For a discussion of the role of policy entrepreneurs, see Roberta Romano, *The Sarbanes–Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1526 (2005) (documenting the large literature suggesting that the corporate governance mandates, backed by policy entrepreneurs and introduced by the Sarbanes–Oxley Act, were unlikely to be effective).

19. Marcel Kahan & Edward Rock, *Symbolic Corporate Governance Politics*, 94 B.U. L. REV. 1997, 2026 (2014). Take the example of Robert Monks, self-described as an "entrepreneur for the idea of corporate governance." While at the Department of Labor, he prompted the enactment of a policy initiative requiring pension funds to vote the shares held. After leaving government for the private sector, Monks founded Institutional Investor Services (ISS), a proxy advisory firm whose business is to provide voting advice to institutional investors. Cheffins, *supra* note 16, at 53.

20. *See, e.g.*, Romano, *supra* note 18, at 1526.

21. For works suggesting that private contracting alone is unlikely to produce optimal corporate governance arrangements, see, e.g., Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1326 (2013) (reviewing the extant literature and concluding that, on balance, the empirical evidence is not supportive of the proposition that "market forces promote optimal corporate governance arrangements, independent of law"); Lucian A. Bebchuk, *Asymmetric Information and the Choice of Corporate Governance Arrangements* 1–2 (Harvard Law Sch. Olin Discussion Paper No. 398, 2002), http://ssrn.com/abstract=327842 (arguing that asymmetric information leads to the enactment of suboptimal corporate governance practices). Conversely, misguided governance arrangements can in fact disable market solutions, such as the market for corporate control. MACEY, *supra* note 7, at 44.

If markets fail, and so do governments,[22] corporate governance appears as an attractive alternative. As in a hydraulic system, governance may partly substitute for government, at least in the level of discourse.[23] Figure 2—which plots the incidence of the terms "corporate governance" and "government regulation" in books between 1970 and 2008—shows an inverse relationship between the usage of both terms in the last decades.[24]

Figure 2. *Google books Ngram Viewer*: *government regulation* (red) vs. *corporate governance* (blue) (1970-2008)

Whether such skepticism of the government's ability to enhance welfare reflects sound analysis or misguided ideology is a question on which reasonable minds will differ. Either way, the growing concern with corporate governance partly compensates for the misgivings about government intervention in the policy arena.[25] Ironically, it does so by treating the corporation as a metaphor for government in two ways. First, it transposes to the corporate form the same traditional formulas for controlling and legitimizing power in the political sphere—"checks-and-balances" through strong independent boards and (shareholder) democracy—in the hope of tackling numerous economic and social problems. Second, the internal workings of the corporation become the focal point of public debate, as well as the presumptive remedy. Indeed, a key promise of the corporate governance movement is that, once the proper decision-making processes internal to the

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22. Government failures may, in turn, result from information problems, capture, or lack of concrete institutional capacity. *See, e.g.*, Jodi L. Short, *Self-Regulation in the Regulatory Void: "Blue Moon" or "Bad Moon"?*, 649 ANNALS AM. ACAD. POL. & SOC. SCI. 22, 27–28 (2013) (describing knowledge, political, and institutional factors leading to regulatory voids).

23. To be sure, deregulation did not always follow the strong deregulatory rhetoric of this time. *See* IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE 7 (1992) (describing not an era of deregulation but rather an era of regulatory flux).

24. Like "government regulation," the use of other terms denoting external constraints on corporate conduct—such as "government," "antitrust," and "unions"—have likewise sharply declined in the Google Ngram database since the 1970s.

25. For a similar argument applied specifically to the financial industry, see Brian R. Cheffins, *The Corporate Governance Movement, Banks, and the Financial Crisis*, 16 THEORETICAL INQ. L. 1, 1 (2015) (explaining "corporate governance's emergence and staying power by reference to changing market conditions and a deregulation trend that provided executives with unprecedented managerial discretion as the twentieth century drew to a close"). While "governance" first gained traction in the corporate context, it then spread to other areas as well, as in "global governance." For a prominent study in international relations, see GOVERNANCE WITHOUT GOVERNMENT: ORDER AND CHANGE IN WORLD POLITICS 5 (James N. Rosenau & Ernst Otto-Czempiel eds., 1992) (suggesting that, "given all the noxious policies governments pursue, that governance without government is in some ways preferable to governments that are capable of governance").

corporation are in place, external substantive regulation of corporate action will become increasingly superfluous, as corporations will be in the position to govern themselves.

In sum, the central claim is that focus on corporate governance as a solution to problems both within and without the corporation reflects contemporary political culture. This is, of course, a speculative proposition—a question of interpretation of culture—that is difficult to prove or disprove as an empirical matter. Other developments over the past 40 years have also contributed to turning corporate governance into a serious focus of academic and public discourse.

Beyond the factors identified in the literature,[26] one could also think of other exogenous forces that likely contributed to the surge in interest in corporate governance. For instance, the decline of unions in the 1970s removed the clash between management and labor as the dominant political issue involving large corporations, thus arguably clearing the way for the focus on internal governance. On the technology front, the emergence of easily available computing power allowed both for better pricing of securities and for the use of those prices to test the effects of different aspects of corporate structure and behavior, generating an explosion in the number of corporate finance scholars looking for variables to compare with stock prices. Corporate governance variables became attractive candidates in this context, hence fueling the growing interest in the field, which has many contributing factors.

Moreover, corporate governance is by no means the only institutional response to an era of disillusionment with traditional modes of government intervention. In the public law arena, "new governance" approaches arguably reflect the other side of the coin. Whereas "new governance" incorporates into government action forms of decentralization, collaboration, and experimentation more commonly associated with markets,[27] corporate governance makes the private sector look more like government itself.

So understood, the corporate governance agenda turned out to be particularly palatable from a political perspective. It is, after all, a compromise solution that combines a private sector focus with a reformist overtone. As such, corporate governance change appeals to progressives as a path for social and economic change in the face of political resistance to greater state intervention, while pleasing conservative forces as an acceptable concession to deflect growing governmental intrusion in private affairs. The apparent surge in the levels of stock ownership by U.S. households since the 1980s only bolstered this delicate equilibrium by seemingly approximating social welfare to measures of stock market performance in a "society of shareholders."[28]

Based on this framework, the corporate governance movement withstood the test of time in the face of the changing nature of the issues it sought to address. When it first made an appearance in the 1970s, corporate governance was a response to then dominant concerns about corporate failures and unbridled corporate power, as epitomized by corruption scandals and overt violations of law.[29] In the 1980s, corporate governance proposals were restyled as a remedy against economic complacency and underperformance vis-à-vis Germany and Japan, then booming economies with markedly different systems of corporate organization.[30] In the 1990s, as the U.S. economy recovered, the Anglo-Saxon

26. *See supra* notes 14–17 and accompanying text.

27. *See, e.g.*, Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 342, 366 (2004).

28. *See infra* notes 217–20 and accompanying text (describing the politics in corporate governance).

29. *See infra* notes 91–92 and accompanying text.

30. *See infra* notes 109–111 and accompanying text.

model of corporate governance turned into a blueprint for financial and economic development around the world, particularly in emerging markets and transition economies.[31] After the turn of the millennium, corporate governance reform surfaced once again at the top of the policy agenda, first as a reaction to the corporate scandals of this new era (as evidenced by the financial debacle of Enron, WorldCom, and the like),[32] and then as a response to the global financial crisis of 2008.[33] More recently, corporate governance became the focal point of the central social debates of our time, from the rise of income inequality to human rights violations and the stagnation of gender progress.[34]

There seems to be an oversized focus on corporate governance insofar as the same formula—checks and balances internal to the corporation—is consistently brought up as an off-the-rack solution for a variety of problems. To begin with, there are the classical agency problems, which arise when managers (or controlling shareholders) take actions that are not in the interests of shareholders as a whole. One could have difficulty conceiving the existence of a fixation in this context. After all, agency problems are the natural province of corporate governance, particularly among law and economics scholars.

Nevertheless, one may see evidence of an obsession even here, for two reasons. First, as discussed below, internal corporate governance is not the only—and possibly not even the most effective—solution to agency problems.[35] Second, the corporate governance movement is often based not only on agency cost (or investor protection) concerns per se, but also on their presumably outsized impact on economic competitiveness, growth, and development.[36]

Moreover, when the promise of corporate governance is extrapolated from mitigating agency costs (however economically significant they might be) to coping with externalities and distributional concerns as well—such as those arising from corruption, systemic risk, environmental harm, human rights, and gender inequity—the relentless emphasis on corporate governance becomes even clearer.[37] However, even if helpful for analytical purposes, such a categorization of the different problems corporate governance aims to address does not mirror actual discourse. Advocates and policymakers alike typically fail to draw clear distinctions between the diverse natures of the issues that corporate governance should serve, instead combining different objectives to portray "good" corporate governance as a generic response.[38]

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31. *See infra* Part III.B.
32. *See infra* Part III.C.
33. *See infra* Part III.D.
34. *See infra* Part III.E.
35. *See infra* notes 49 and 224 and accompanying text (describing the market for corporate control).
36. *See, e.g.*, Press Release, European Commission (Apr. 9, 2014), http://europa.eu/rapid/press-release_IP-14-396_en.htm (citing corporate governance as a key contributor "to the competitiveness and long-term sustainability of these companies"); OECD PRINCIPLES, *supra* note 6, at 11 (2004) ("Corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence.").
37. *See infra* Part III.E (describing the issues corporate governance has been applied to).
38. *See, e.g.*, ROBERT A.G. MONKS & NELL MINOW, CORPORATE GOVERNANCE xviii (5th ed. 2011) ("[Corporate] decisions can be made consistent with long-term, sustainable value creation for investors, employees, and the community or for the short-term benefit of one group regardless of the consequences for others. When corporate governance operates optimally, the three key players—the executives, the board of directors, and the shareholders—provide through a system of checks and balances a system for a transparent and accountable system for promoting objectively determined goals and benchmarks.").

Although the costs and benefits of specific corporate governance practices have been the object of an extensive literature in law, economics, and finance,[39] the determinants and general merits of this obsession with corporate governance have received much less attention.[40] In this respect, I suggest that any serious evaluation of the merits of such emphasis on corporate governance must take into account not only the effect of individual practices but also the extent to which they might crowd out more promising market or government approaches to the same problems.

Before proceeding to the core of the Article, a few caveats are in order. The narrative that follows approaches the growing concern with corporate governance from an intellectual history standpoint. In striving to situate the dominant driving forces and themes in each period, it privileges analytical clarity at the cost of oversimplification. This is emphatically not to deny that there were—and still are—dissonant and critical views on the corporate governance movement at every step of the way, in particular by those who trust market forces to solve various economic and social problems.[41] Moreover, by focusing on the evolution of the corporate governance movement in the realm of ideas and public policies, the analysis presented here addresses only incidentally the key underlying economic conditions that made the turn to corporate governance attractive or plausible. Although these considerations are critically important, they are not exactly uncharted territory.[42]

The remainder of this Article proceeds in five parts. Part II defines and traces the turn to corporate governance. Part III examines the continuing rebranding of the corporate governance movement to address a shifting array of problems through its different phases up to the present. Part IV then addresses the merits and shortcomings of this recurrent focus on corporate governance from a public policy and social welfare standpoint. Part V concludes by speculating on the future of the corporate governance agenda.

II. THE RISE OF THE CORPORATE GOVERNANCE MOVEMENT

Whether there is anything new to the fixation on corporate governance depends on what one means by it. As previously mentioned, there is no consensual definition of what corporate governance means.[43] Understood as the amalgam of responses to the agency problems and legitimacy issues that plague business corporations, corporate governance issues are as old as the corporate form itself—and perhaps even older, if ancient functional substitutes to the corporate form are taken into account.[44] Not surprisingly, there

39. The literature is too voluminous to be cited in full. For a non-exhaustive review of prominent issues, see generally Bebchuk & Weisbach, *supra* note 2.

40. *See infra* notes 218–219 and accompanying text (discussing how some of the most high-profile corporate governance disputes are actually empty controversies).

41. For an early critique of the corporate governance movement, see Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1259 (1982) (arguing that "critics have leveled charges and proposed solutions to a problem that does not exist"). For a more recent work in this spirit, see generally MACEY, *supra* note 7 (repudiating most policies traditionally associated with the corporate governance movement, such as independent boards, and praising market-based solutions to agency problems, such as the market for corporate control).

42. *See supra* notes 14–17 and accompanying text (describing different approaches to corporate governance).

43. *See supra* notes 6–8 and accompanying text (presenting the different definitions of corporate governance)

44. *See* 3 ADAM SMITH, THE WEALTH OF NATIONS 116–17 (P.F. Collier & Son 1909) (1776) (describing

is an abundance of studies on corporate governance topics broadly understood from a historical perspective, covering conflicts between shareholders and managers that date back at least to the East India companies of the seventeenth century.[45]

This piece, however, adopts a narrower focus on internal corporate governance, which relates to the balance of power among shareholders, boards of directors, and managers.[46] For our purposes, as in Richard Cyert's pioneering articulation of the concept in a 1976 U.S. Senate hearing, corporate governance "deals with the relationship of a board of directors to the chief executive officer and to the stockholders of the corporation in general."[47] As more recently enunciated in the preface to the OECD Principles of Corporate Governance, "corporate governance relates to the internal means by which corporations are operated and controlled."[48]

Such an emphasis on internal governance is not entirely arbitrary, however, for most policy efforts have favored solutions linked to internal governance over those that rely on external market forces.[49] The corporate governance movement posits that improvements in the balance of power *internal* to the business corporation matters a great deal for economic and social outcomes. Specifically, two formulas of internal governance have received the lion's share of attention over time: the monitoring role of the board of directors and the active role of shareholders.

Viewed in these terms, there is no perfect overlap between corporate governance and the reduction of agency costs. Corporate governance is not the sole possible solution to agency problems and agency problems are not the exclusive target of corporate governance. Instead, governance is but one of the possible strategies to address agency and other problems. In exploring the particular traits of the obsession with corporate governance, this Article draws on the distinction between regulatory and governance solutions.[50]

Regulatory solutions consist of externally imposed rules and standards that seek to influence the substance of corporate action, by, for instance, prohibiting insider trading, imposing capital requirements for banks, or sanctioning corruption. Governance solutions,

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Adam Smith's famous warning against the "agency problems" plaguing the corporate form); Henry Hansmann et al., *Law and the Rise of the Firm*, 119 HARV. L. REV. 1335 (2006) (providing a functional account of the predecessors to the corporate form in ancient Rome and the Middle Ages).

45. *See, e.g.*, A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD (Randall Morck ed., 2005) (for a collection of historical studies on corporate ownership and its implications); ORIGINS OF SHAREHOLDER ADVOCACY (Jonathan G.S. Koppell ed., 2011) (compiling studies on shareholder protests against managerial abuse since the Dutch and English East India Companies of the seventeenth century).

46. In current usage, corporate governance at times also encompasses the role of other private sector gatekeepers, such as auditors, lawyers, consultants, and rating agencies. Although these debates are left out of our exposition for simplicity purposes, the key tenets of the fixation with corporate governance apply to them well.

47. *Corporate Rights and Responsibilities: Hearings before the Committee on Commerce, United States Senate*, 94th Cong. 136 (1976) (statement of Richard M. Cyert, President, Carnegie-Mellon University), http://congressional.proquest.com:80/congressional/docview/t29.d30.hrg-1976-com-0007?accountid=14663; William Ocasio & John Joseph, *Cultural adaptation and institutional change: The evolution of vocabularies of corporate governance, 1972–2003*, 33 POETICS 163, 167 (2005).

48. OECD PRINCIPLES, *supra* note 6, at 5.

49. MACEY, *supra* note 7, at 10 (arguing that, while board independence has received regulatory subsidies, "the market for corporate control, has been the subject of an intense regulatory backlash").

50. The distinction is articulated in John Armour et al., *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW 39 (Reinier Kraakman et al. eds., 2009) (distinguishing between regulatory and governance strategies to address agency problems).

by contrast, concern the proper balance of power and incentive structure within the corporation; they primarily pertain to the decision-making process rather than to the content of corporate conduct. Prominent examples include director independence requirements and shareholder decision rights.

Admittedly, the distinction between governance and regulatory solutions is not clear-cut. For one, governance strategies can be—and increasingly are—legally mandated rather than voluntarily adopted. For instance, U.S. federal law now requires the audit and compensation committees of public companies to be composed exclusively of independent directors.[51] Nevertheless, independent committees still qualify as a governance solution on this account, for they interfere with the structure of corporate decision-making, but not with its substance. In fact, the distinction between governance and regulatory strategies is more of a continuum than a sharp dichotomy. For instance, corporate fiduciary duties are closer to the regulatory end of the spectrum, for they entail an externally imposed judgment about the proper standard of conduct. Disclosure mandates, in turn, fall somewhere in between.

The seminal contribution of Adolf Berle and Gardiner Means illustrates this distinction. In *The Modern Corporation and Private Property*, first published in 1932, the authors offered a famous description of the agency problems afflicting the widely-held corporations that populated U.S. capital markets.[52] In view of the growing separation between ownership and control, they warned against the risk that corporate managers could run the firm without the interests of shareholders in mind. Yet, the remedy favored by Berle and Means was not exactly a corporate governance solution as here defined. They did not argue for checks and balances within the corporation through changes in the internal balance of power. Instead, they advocated for external legal constraints,[53] specifically, by strengthening judicially-imposed fiduciary duties so as to treat managers as veritable "trustees."[54]

Berle and Means's neglect for the corporation's internal balance of power was not accidental. The impotency of the corporation's internal forces as a meaningful check on abuse was part and parcel of their model. On the one hand, the highly dispersed and disorganized shareholders of widely held corporations had little incentive and clout to exercise corporate influence in their account—a condition they viewed as inevitable.[55] On

51. *See, e.g.*, *infra* Part III (describing the mandates contained in the Sarbanes–Oxley Act of 2002 and the Dodd–Frank Act of 2010).

52. *See generally* ADOLPH A. BERLE JR. & GARDINER C. MEANS, ECONOMICS-LAW AND PLANNED BUSINESS: THE MODERN CORPORATION & PRIVATE PROPERTY (Transaction Publishers, 1991) (1932). The expression "agency costs" is however newer, dating back to the work of Jensen and Meckling. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); *see* Harwell Wells, *The Birth of Corporate Governance*, 33 SEATTLE U. L. REV. 1247, 1247 (2010) (citing various authors who attribute to Berle and Means the inauguration of the modern corporate governance debate). Wells, however, traces the origins of corporate governance to denunciations of managerial abuse of shareholders in the 1920s. *Id.* at 1248–49. The academic work and policy advocacy by Harvard professor William Z. Ripley in the 1920s, in particular, anticipates some of the elements of the corporate governance movement. *See generally* WILLIAM Z. RIPLEY, MAIN STREET AND WALL STREET (Little, Brown & Company eds., 1927). Ripley's crusade against non-voting stock ultimately led the New York Stock Exchange to institute a one-share-one-vote rule in 1926.

53. Ronald J. Gilson, *Corporate Governance and Economic Efficiency: When Do Institutions Matter?*, 74 WASH. U. L.Q. 327, 330 n.9 (1996) (portraying Berle and Means's normative agenda as "consistent with the general thrust of New Deal legislative efforts: government intervention to ameliorate perceived market failures").

54. BERLE & MEANS, *supra* note 52, at 275 (suggesting that "corporation law becomes in substance a branch of the law of trusts").

55. *See id.* at 47 ("Dispersion in the ownership of separate enterprises appears to be inherent in the corporate

the other hand, their analysis largely failed to distinguish between the roles of directors and officers, for the most part alluding to both categories under the single rubric of "management."[56] This should not be entirely surprising, since directors and officers were mostly the same people in the insider-dominated boards prevalent at the time.[57] It is, however, clear that such overlap offered little hope that the board would operate as an effective monitor of management. In fact, throughout Berle and Means's work, unchecked managerial power lay with corporate directors, not with an all-powerful Chief Executive Officer (CEO), as came to be the case in later diagnoses.[58]

Berle and Means's work played a part in the enactment of the Securities and Exchange Acts of the early 1930s,[59] which primarily relied on mandatory disclosure to inform entry and exit[60] decisions by investors—not a prototypical governance solution.[61] Similarly, other contemporaneous pieces of legislation, such as the Glass Steagall Act of 1933 and the Investment Company Act of 1940, also sought to constrain corporate conduct from without, in fact disabling the role of institutional investors as a meaningful check on corporate management.[62] In any case, Berle and Means's contribution failed to trigger a lasting interest in corporate law. By 1962, Bayless Manning declared that "corporation law,

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system. It has already proceeded far, it is rapidly increasing, and appears to be an inevitable development."); *id.* at 89 ("For the most part the stockholder is able to play only the part of the rubber stamp."); *see also* Harwell Wells, *A Long View of Shareholder Power: From the Antebellum Corporation to the Twenty-First Century*, 67 FLA. L. REV. 1033, 1072 (2015) (noting that Berle and Means "depicted shareholder powerlessness as inevitable, and left little hope that shareholders could realistically wield any power in the modern corporation").

56. BERLE & MEANS, *supra* note 52, at 196 (elaborating on the legal position of management).

57. Gordon, *supra* note 15, at 1474 (showing that the proportion of independent directors on U.S. public company boards doubled from 35% to 70% between 1950 and 2005).

58. BERLE & MEANS, *supra* note 52, at 244 (alluding to a scenario "[w]here 'control' is in the hands of the Board of Directors because stock is widely dispersed").

59. *Id.* at xix (Preface to the Revised Edition).

60. A modest exception that proves the rule is Section 14(a) of the Exchange Act, which authorized the SEC to issue rules and regulations with respect to proxy solicitations. Whether these provisions allowed the SEC to encroach on the internal balance of power of corporations remains a controversial question. *See* Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1174 (1993) (claiming that while the drafters of the Exchange Act sought to reform the management of business corporations through greater shareholder participation, "[it] is unclear . . . whether the legislation adopted by Congress retained that objective"); *see also* Bus. Roundtable v. SEC, 905 F.2d 406, 410–11 (D.C. Cir. 1990) (finding that the Commission lacked the authority to regulate the "distribution of voting power," as "proxy regulation bears almost exclusively on disclosure"). In any event, despite the SEC's exaltation of a "democratic view of the voting process," its regulations effectively "increased the costs of shareholder communication and coordinated action among shareholders," especially since the 1950s. John Pound, *Proxy Voting and the SEC: Investor Protection Versus Market Efficiency*, 29 J. FIN. ECON. 241, 262 (1991); *see id.* at 245–68 (describing the historical evolution of the SEC proxy rules).

61. The purpose of securities regulation in the United States also underwent a transformation over time, in developments that parallel the turn to corporate governance. Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 372–73 (2013) (arguing that securities regulation has become increasingly about "social, political, and economic interests, in addition to capital formation" since the late 1970s).

62. Mark Roe's influential account attributes the predominance of dispersed ownership structures in the United States to various legal constraints imposed over time as a result of populist politics based on anti-Wall Street sentiment. MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 28–30 (1996). *But see generally* John Morley, *Collective Branding and the Origins of Investment Fund Regulation*, 6 VA. L. & BUS. REV. 341 (2012) (arguing that mutual funds lacked an interest in activism prior to the advent of such regulations).

as a field of intellectual effort, is dead in the United States."[63] As Roberta Romano subsequently put it, until the late 1970s corporate law had become "an uninspiring field of research even to some of its most astute students."[64]

If corporate law scholarship was dormant, the stage of economic theory during this period also militated against a focus on internal corporate governance. The business firm was famously treated as a "black box" by neoclassical economics,[65] whereas organizational economics was still in its infancy. In 1937, Ronald Coase broke new ground by exploring the economic rationale for the existence of firms, but his findings were not taken up for decades.[66] It was not until the 1970s that interest in what goes on inside the firm was reignited by the work of Oliver Williamson, Michael Jensen, William Meckling, and others.[67]

Finally, the tardy emergence of the corporate governance movement is also a function of the favorable economic conditions prevailing in the mid-twentieth century.[68] The United States enjoyed special economic prosperity and stability in the post-War period. Reformist in nature, the corporate governance agenda thrives in periods of crises. It is no coincidence that the movement emerged in the 1970s, when corporate failures, corruption scandals, and unfavorable macroeconomic conditions disrupted the previous economic equilibrium and created demand for institutional change.

III. THE PHASES OF THE CORPORATE GOVERNANCE OBSESSION

A. Problem #1: Unbridled Corporate Power and Economic Failure

The very expression corporate governance first gained ground in the 1970s. Although the New York Times featured the phrase as early as 1972, it was not until 1976 that the concept acquired theoretical backing.[69] That year marked both the publication of

63. Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n.37 (1962).

64. Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 923 (1984); *see also* Oliver Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1197 (1984) ("After a long hiatus, the study of corporate governance has recently enjoyed a revival . . . .").

65. Ronald H. Coase, Nobel Prize Lecture: The Institutional Structure of Production (Dec. 9, 1991), http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1991/coase-lecture.html.

66. Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937); *see* Ronald H. Coase, *The Nature of the Firm: Influence*, 4 J.L. ECON. & ORG. 33, 33 (1988) (remarking that "'The Nature of the Firm' had little or no influence for thirty or forty years after it was published").

67. *See generally, e.g.*, OLIVER E. WILLIAMSON, MARKET AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (1975) (discussing how microeconomics plays a role in the organization of firms); Jensen & Meckling, *supra* note 52 (discussing the problems afflicting widely-held corporations).

68. Eugene V. Rostow, *To Whom and for What Ends is Corporate Management Responsible?*, *in* THE CORPORATION IN MODERN SOCIETY 59 (Edward S. Mason ed., 1964) (1959) (writing in a period in which "[t]here seems to be no general conviction that reform is needed," as "business seems energetic"). This is not to say, of course, that the key tenets of the corporate governance movement were unprecedented. For examples of predecessors who anticipated key tenets of the corporate governance movement, see *supra* notes 52 and 59 and accompanying text.

69. *See supra* note 47 and accompanying text (defining corporate governance). The coinage of the term corporate governance is widely attributed to Richard Eells, a manager of public policy research at General Electric. *See generally, e.g.*, RICHARD EELLS, THE GOVERNMENT OF CORPORATIONS (1962) (arguing that corporations are similar to governments and thus need a constitution to prevent abuse); Bernard Mees, *Corporate Governance as a Reform Movement*, 21 J. MGMT. HIST. 194 (2015) (discussing the origins of the expression and

Ralph Nader's *Taming the Modern Corporation*, as well as the initial appearance of the term in the Federal Register.[70]

The first problem which corporate governance purported to address was the perception of unbridled "corporate power" and the ensuing need for corporate accountability.[71] Two central events in the 1970s contributed to this diagnosis. The first was the unexpected debacle of the Penn Central Railroad, a company then regarded as "the bluest of blue chips."[72] The second was the illegal campaign contributions and foreign corruption incidents associated with the Watergate scandal.[73]

To be sure, suspicion of corporate power runs deep in U.S. history, not least due to the early association between the corporate form and monopoly power.[74] From a historical perspective, the initial policy reaction was to restrict, and then later to liberalize, access to corporate charters in an era in which incorporations required prior governmental approval. Curiously, some of the early responses to corporate (market) power took the form of governance arrangements, such as voting caps and corporate purpose restrictions.[75] Nevertheless, as time went by, corporate law became increasingly narrow and specialized in the rights of shareholders, managers, and creditors.[76] Concerns about corporate and market power became the object of distinct areas of law, such as antitrust and industry regulation.[77]

By the mid-1970s, however, the emerging view once again was that limitations on corporate power should come from *within* the corporation. Rather than receiving further constraints by the government, the corporation could and should look more like government itself[78]—and hence cure its apparent failings through internal checks on misconduct. From the left, reforming the corporation from within seemed to be the only feasible solution given the government's frailty in the face of ever increasing corporate power and the accompanying degree of political influence, which rendered other forms of

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the related movement).

70. *See supra* note 47 and accompanying text.

71. For an excellent synthesis and critique of this view in the context of contemporary proposals for independent directors, see generally Victor Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597 (1982).

72. Gordon, *supra* note 15, at 1515.

73. *Id.* at 1514–15.

74. Citizens United v. FEC, 558 U.S. 310, 387 (2010) (Scalia, J., concurring) ("Most of the Founders' resentment towards corporations was directed at the state-granted monopoly privileges that individually chartered corporations enjoyed.").

75. *See* HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW, 1836–1937 63 (1991) (describing the powerful antitrust features of early corporate charters); *see generally* Henry Hansmann & Mariana Pargendler, *The Evolution of Shareholder Voting Rights: Separation of Ownership and Consumption*, 123 YALE L.J. 948 (2014) (arguing that a number of early nineteenth-century U.S. corporations were, in essence, consumer cooperatives, and that voting caps and purpose descriptions specified in their charters served to protect the interests of shareholders *qua* consumers).

76. Hansmann & Pargendler, *supra* note 75, at 993.

77. *Id.*

78. Cary Coglianese, *Legitimacy and Corporate Governance*, 32 DEL. J. CORP. L. 159, 161 (2007) (arguing that "[p]erhaps more than ever before, corporate governance reforms bear a much closer resemblance to institutional mechanisms typically found in government"). While Coglianese's account refers to the early 2000s, this phenomenon was conspicuous at least since the 1970s, as we shall see.

regulation futile.[79] From the right, internal governance reform appeared as a reasonable concession to deflect the specter of government intervention.[80]

Indeed, resort to the metaphor of the corporation *qua* government—and the related defense of mechanisms typical of government control—was pervasive across the political spectrum. At one extreme, in their progressive opus *Taming the Giant Corporation*, Ralph Nader, Mark Green, and Joel Seligman claimed that "[t]he modern corporation is akin to a political state in which all powers are held by a single clique."[81] They suggested, after quoting James Madison in the Federalist No. 47, that "[t]hese are precisely the circumstances that, in a democratic political state, require a separation of powers into different branches of authority."[82]

The same analogy between the corporation and government also permeated the discourse of conservative business associations. The Statement of the Business Roundtable of 1977 likewise relied on the Federalist papers and the "tripartite organization of the Federal Government" to address the "corporate governance triad of shareowners/directors/operating management."[83] The document expressly conceded that "the public and its elected representatives should be concerned that private business organizations like government itself be subject to checks and balances, to constraints on excessive power."[84]

One essential element of the corporate governance obsession—then as now—resides in the transposition to the corporate context of two time-honored mechanisms for constraining and legitimizing state power: checks and balances through separation of powers and democracy. In the corporate arena, the main actors in the tripartite separation of powers are shareholders, boards of directors, and managers. Yet managerial power, the perception went, had gone unchecked. An adequate system of checks and balances was thought to require strengthening the role of the board of directors and affording a meaningful role to shareholders—a recipe that would prove to be remarkably resilient in reappearing as a response to various economic problems for decades to come.

1. *Strengthening the Board: Independent Directors and the Monitoring Function*

Revitalizing the role of the board of directors was from the outset the most popular and least controversial of the two goals. There was growing recognition that actual boardroom practice had failed to live up to the central role conferred on the board of directors by corporate law. Although the "law on the books" assigned to the board the job of "managing the business affairs of the business corporations," real-world directors fell far short of this ideal.[85] Therefore, it was argued, directors ought to transition from their

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79. *See, e.g.*, RALPH NADER ET AL., TAMING THE GIANT CORPORATION 21 (1976) (drawing attention to the specter of government capture and the "unhealthy dependence by government on business"). Daniel Fischel, who was openly hostile to the corporate governance movement, ascribed the left's embrace of corporate governance reform to its failure in the political arena. Fischel, *supra* note 41, at 1271 ("It appears that it is only because the proponents of reform have largely failed in implementing their objectives through the political processes that they have turned to attempting to achieve these same objectives by altering the governance of corporations.").

80. Statement of the Business Roundtable, *infra* note 83, at 2089.

81. NADER ET AL., *supra* note 79, at 118.

82. *Id.* at 118–19.

83. Statement of the Business Roundtable, *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation*, 33 BUS. LAW. 2083, 2089 (1978).

84. *Id.* at 2090.

85. *See* MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION 3 (1976) (arguing that the received

historical roles as mere "pawns" of management to become effective monitors of corporate officers. In the terminology coined by Melvin Eisenberg, the imperative makeover was one from an advisory board to a "monitoring" board.[86]

It was evident that such a transformation in the actual functioning of the board required a corresponding change in board composition. Specifically, effective monitoring necessitated a certain level of distance and differentiation from management. The key, it seemed, was to replace corporate insiders with outside—and later, more forcefully, also independent—directors.[87]

Another companion policy to the rise of independent directors did not take long to surface: namely, the implementation of independent board leadership through a split in the positions of board chair and CEO.[88] The intuitive idea was that it did not make sense for the monitoring board in charge of overseeing the company's management to be led (and have its agenda controlled) by the person who was the main target of the monitoring efforts. These proposals shared a common spirit: as the state retreated, the promise of independent directors—as arbiters of adequate corporate performance *of* the private sector, *by* the private sector, and *for* the private sector—progressively gained ground.

The call for greater board independence gathered broad support, in part because of its political ambiguity. Social activists viewed independent directors as a suitable—if not ideal—mechanism to render corporate management more sensitive to the public interest.[89] Other commentators, by contrast, regarded the rise of independent directors as perfectly consistent with the goal of maximizing shareholder wealth.[90]

In 1977, urged by the Securities and Exchange Commission (SEC), the New York Stock Exchange adopted a listing rule requiring audit committees to be composed of a majority of outside directors.[91] The new rule came in the aftermath of the corruption scandals of the Nixon administration. The link between the corruption scandals and the policy response is revealing. Instead of relying solely (or primarily) on public law and government action,[92] the promise of independent directors ran in the opposite direction. It

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legal model about the role of the board was inadequate from both a descriptive and a normative perspective); *see generally* MYLES MACE, DIRECTORS: MYTH AND REALITY (1971) (documenting the limited advisory role played by the board of directors).

86. EISENBERG, *supra* note 85, at 165.

87. Gordon, *supra* note 15, at 1474.

88. For a description of the history of this policy proposal, see MILLSTEIN CTR. FOR CORP. GOVERNANCE & PERFORMANCE, CHAIRING THE BOARD: THE CASE FOR INDEPENDENT LEADERSHIP IN CORPORATE NORTH AMERICA 13 (2009).

89. *See* Brudney, *supra* note 71, at 597 ("Numerous observers have argued that the addition of independent directors to corporate boards would solve the problem of corporate social responsibility without incurring the costs of external regulation.").

90. Fischel, *supra* note 41, at 1282 ("Unlike the arguments for shareholder democracy, a plausible case can be made that boards dominated by independent directors will increase shareholders' welfare."). More recently, see Gordon, *supra* note 15, at 1469.

91. In a letter addressed to the New York Exchange, the SEC Chairman urged the Exchange to "take the lead in this area by appropriately revising its listing policies, thus providing a practical means of effecting these important objectives without increasing direct government regulation." Letter from Roderick M. Hills to William Batten (May 11, 1976), *in* STAFF OF S. COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 94TH CONG., REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES (1976).

92. To be sure, these scandals also triggered more interventionist regulatory responses, such as the enactment of the Foreign Corrupt Practices Act of 1977.

was premised on the assumption that private sector checks and balances are the best cure for private sector ills.

Interestingly, even corporate managers—the constituency whose power independent directors were designed to curb—came to support the measure as a sensible private sector reform that crowded out more intrusive forms of government intervention. In the same statement in which the Business Roundtable warned that "both human liberty and economic efficiency depend heavily on limiting the power of the state,"[93] it supported the "tendency of U.S. corporations to move to a board structure based on a majority of outside directors" [94] to further the board's role in carrying out "the effective performance of the economic functions of an enterprise and for meeting other responsibilities."[95]

The rise of outside directors likely looked so palatable to business interests in view of the far more radical character of the alternative policy prescriptions floating around at that juncture.[96] Proposals for federal chartering of corporations proliferated rapidly, as did calls for revamping the board's role through the inclusion of constituency directors, with representatives of workers, consumers, or general representatives of the public interest.[97] In this environment, the voluntary embrace of independent directors—whose precise practical import was, and continues to be, dubious[98]—was an attractive compromise.

As the political climate cooled in subsequent years, the Business Roundtable abandoned its prior moderate position and vigorously opposed the attempt by the American Law Institute (ALI) to endorse a majority of independent directors in corporate boards. The Business Roundtable's change of heart followed the different political environment of the Reagan era, which eliminated existing threats of federal regulation and, therefore, the need to make corporate governance concessions.[99] In 1982, the Chairman of the Business

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93. Statement of the Business Roundtable, *supra* note 83, at 2089.

94. *Id.* at 2093.

95. *Id.* at 2085. To be sure, the Roundtable's position that "[i]n most instances. . . it is desirable that the board be composed of a majority of non-management directors" was qualified by the usual caveat that "there will be exceptions [to a majority of outside directors] based on the particular situation of an enterprise." *Id.* at 2108. *But see* Myles L. Mace, *Directors: Myth and Reality—Ten Years Later*, 32 RUTGERS L. REV. 293, 297 (1979) ("The Business Roundtable statement on directors, for example, is a disappointment."). Yet the use of the argument that "one size does not fit all" to tone down proposed reforms has been a hallmark of the conservative approach to corporate governance debate ever since.

96. *See* Lawrence E. Mitchell, *The Trouble with Boards*, *in* PERSPECTIVES ON CORPORATE GOVERNANCE 44 (F. Scott Kieff & Troy A. Paredes eds., 2010) (noting that the Business Roundtable opened its 1977 Statement endorsing outside directors "in fear").

97. *See generally* NADER et al., *supra* note 79 (arguing for federal chartering of corporations and describing contemporary claims for constituency directors).

98. For reviews of the empirical literature challenging the effectiveness of independent directors, see generally Sanjai Bhagat & Bernard Black, *The Uncertain Relationship between Board Composition and Firm Performance*, 54 BUS. L. 921 (1999) (surveying "the trend towards greater board independence"); Roberta Romano, *Corporate Law and Corporate Governance*, 5 INDUS. & CORP. CHANGE 277 (1996); Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231 (2002); Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447 (2008); Romano, *supra* note 18. For a recent work arguing that the push for increased board independence is meant to deflect pressure for more meaningful regulatory reform, see Urska Velikonja, *The Political Economy of Board Independence*, 92 N.C. L. REV. 855 (2014).

99. *See* Joel Seligman, *A Sheep in Wolf's Clothing: The American Law Institute Principles of Corporate Governance Project*, 55 GEO. WASH. L. REV. 325, 345 (1987) ("After Ronald Reagan's election in 1980 . . . [b]usiness community opponents of corporate law reform shifted their posture from favoring the most moderate

Roundtable Task Force on Corporate Responsibility urged the Roundtable's members to oppose the ALI project by underscoring "its roots in the '70s as part of the effort to meet federal incorporation and similar proposals."[100] He pointed out that "[i]f the effort to adopt that kind of legislation was unsuccessful in the halcyon days of the activists, it is difficult to regard that concern as having much validity now or, for that matter, in the foreseeable future."[101]

Nevertheless, the obsession with independent directors was there to stay and was in an important sense also aided by courts. In controversies ranging from derivative suits to takeover battles, Delaware jurisprudence increasingly blessed decisions made by independent directors (or special committees thereof) in situations that would otherwise entail a conflict of interest.[102] This is yet another instance of devolution of decision-making power from the public to the private sector, with independent directors serving as the relevant arbiters of fairness.[103] In the continuing trend to substitute judicial control of substantive conduct for procedural guarantees, shareholder voice—to which I now turn—has played a major part as well.[104]

2. *The Promise of Shareholder Democracy*

Checks and balances through a monitoring board composed of independent directors was not the only politically inspired remedy to the perceived corporate crisis. Though far less agreeable to business interests,[105] the application of democracy to the corporate form—especially by increasing shareholder voice and power—was a popular concept among reformists. The corporate governance movement envisioned "a new role" for shareholders in monitoring and disciplining the board.[106]

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changes to opposing *any* reform.").

100. *See* Victor Brudney, *The Role of the Board of Directors: The ALI and Its Critics*, 37 U. MIAMI L. REV. 223, 228 (1983) (citing Letter from Chairman of the Business Roundtable's Corporate Responsibility Task Force to the Business Roundtable, Director's Monthly, Dec. 1982).

101. *Id.*

102. Gordon, *supra* note 15, at 1481, 1523; *see, e.g.*, Zapata Corp. v. Maldonado, 430 A.2d 779, 786 (Del. 1981); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 949 (Del. 1985).

103. In the words of Leo Strine, then Vice-Chancellor of the Delaware Court of Chancery and now Chief Justice of the Delaware Supreme Court, "we do not wish to maximize judicial rulings finding board actions unreasonable; we wish to provide an incentive for boards to use good processes that can be trusted to reduce the role of self-interest and promote a focus on what is in the best interests of the stockholders." Leo E. Strine Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 677 (2005).

104. *See, e.g.*, Kahn v. M & F Worldwide Corp., 88 A.3d 635, 644–45 (Del. 2014) (making clear that the exacting "entire fairness" standard would be replaced by the deferential business judgment rule in going-private mergers with controlling shareholders, so long as the transaction is properly approved by both an independent special committee and a majority of minority shareholders).

105. At the same time as it supported the shift towards greater board independence, the Business Roundtable was critical of shareholder empowerment. Statement of the Business Roundtable, *supra* note 83, at 2094–95 ("We think it appropriate that most of the discussion in the last few years on improvements in the system of corporate governance has focused on the functioning of the board of directors. This focus is undoubtedly based on a widespread appreciation of the practical obstacles to enlarging the role of share owners in the conduct of corporate affairs.").

106. *See, e.g.*, NADER ET AL., *supra* note 79, at 128–29. The idea of a shareholder democracy had already made an appearance in the proxy reforms of the 1950s, although the ensuing regulatory action arguably backfired. Pound, *supra* note 60; *see generally* Wells, *supra* note 55 (reporting various isolated calls for greater shareholder power in the earlier part of the twentieth century, which nevertheless failed to change corporate practice).

By the 1980s, the SEC Staff Report on Corporate Accountability acknowledged that "the emerging consensus concerning the proper role of corporate boards of directors, while extremely important, is only one part of the larger effort to enhance corporate accountability in America," drawing specific attention to the role of shareholders in corporate governance.[107] This was so even though the link between the problems of the time—illegal payments and corporate failures—and the proposed solution of greater shareholder involvement in corporate affairs was tenuous at best. As underlined by the contemporary critique of Daniel Fischel, illegal payments to foreign officials were in fact consistent with the pursuit of shareholders' financial interests. Likewise, attributing financial collapses to a "'breakdown' in corporate accountability" was, in his view, a "colossal *nonsequitur*."[108]

Yet the view that the lack of shareholder monitoring was at the root of economic underperformance in the United States would only gain force through the growing interest in comparative corporate governance in the 1980s.[109] Besides the United Kingdom, a sister jurisdiction, the focus of comparative investigations were Germany and Japan, the great exemplars of economic success at the time.[110] It turned out that Germany and Japan had systems of corporate governance that were markedly different from that of the United States, in that monitoring by large institutional investors (especially financial institutions) played a key role. The comparative experience showed that the U.S. system of shareholder apathy was not inevitable,[111] and might not necessarily be desirable, especially in view of the rise of institutional ownership in the United States.

Finally, another key development in the 1980s was the wave of hostile takeovers, which served as a major force behind the restructuring of U.S. industry and further prompted the corporate governance movement. The endorsement of "poison pills" by Delaware courts early in the decade progressively hampered the operation of the market for corporate control as a check on agency costs—thereby putting additional pressure on internal governance arrangements (through shareholder voice and independent board decision-making) as a substitute for exit.[112] In fact, the development of Delaware takeover jurisprudence illustrates how corporate governance considerations can displace market solutions. While hostile takeovers previously relied on shareholders' ability to sell their

107. SEC, STAFF REPORT ON CORPORATE ACCOUNTABILITY: A RE-EXAMINATION OF RULES RELATING TO SHAREHOLDER COMMUNICATIONS, SHAREHOLDER PARTICIPATION IN THE CORPORATE ELECTORAL PROCESS AND CORPORATE GOVERNANCE GENERALLY 10 (1980).

108. Fischel, *supra* note 41, at 1267.

109. This was not the first time in which works on comparative corporate governance made an appearance. In the 1960s, scholars began to suggest that Germany's system of two-tier boards (and codetermination) could serve as an attractive model for the United States. Edward B. Rock, *America's Shifting Fascination with Comparative Corporate Governance*, 74 WASH. U. L.Q. 367, 373 (1996).

110. Gilson, *supra* note 53, at 328 (describing the prevailing perception that "differences in economic performance between the countries might be explained by institutional differences in their governance systems").

111. Louis Lowenstein & Ira M. Millstein, *The American Corporation and the Institutional Investor: Are There Lessons from Abroad?*, 1988 COLUM. BUS. L. REV. 739, 745 ("[I]n no other major industrial nation is there so deep a chasm between owners and managers."); see generally ROE, *supra* note 62 (attributing the particular makeup of corporate ownership and governance in the United States to legal constraints enacted as a result of populist politics).

112. *See* Brian R. Cheffins, *Delaware and the Transformation of Corporate Governance*, 40 DEL. J. CORP. L. 1,1 (2015) ("Delaware court rulings helped to bring to an end the hectic takeover activity of the 1980s, which in turn likely prompted a shift in emphasis away from the market for corporate control in favor of 'internal' corporate governance mechanisms.").

shares (a quintessential market mechanism), the operation of the market for corporate control subsequently became enmeshed with multiple considerations about the proper balance of power between shareholders and boards.[113]

B. Problem #2: Promoting Financial and Economic Development

The corporate governance movement expanded in the 1980s as the product of the particular economic and political conditions then prevailing in the United States. But it was in the 1990s—described, perhaps prematurely, as the "decade of corporate governance"[114]—that the movement went global. In blending a reformist project with a private sector focus, corporate governance would provide an attractive agenda both for international development agencies in charge of promoting economic growth in developing and transitional countries and for think tanks seeking to revitalize the economies of the wealthy West.

A number of factors help explain the increasingly global grip of the corporate governance agenda. First and foremost—and consistent with its U.S. origin—corporate governance reform arose as a substitute for government action in the international context as well. In the 1990s, governments worldwide were in retreat as the fall of the Berlin Wall and the neoliberal ideological sway of the Washington consensus impelled a wave of privatizations and deregulation. In this context, a new system of corporate governance was needed to replace the old one based on state ownership of enterprise. As the early experience with privatizations made painfully clear, the shift to private ownership alone was unlikely to bolster economic performance in the absence of accompanying institutions.[115]

The idea that governance was a substitute for government was explicit in the global embrace of the movement. The influential Principles of Corporate Governance of the Organisation for Economic Co-operation and Development (OECD), first published in 1999, bring home the point.[116] Their preface is structured around three pillars: (1) it highlights the economic transformation leading to greater reliance on the private sector and market forces in the previous decade;[117] (2) it attributes the rising prominence of corporate governance to the growing "awareness of the importance of private corporations;"[118] and (3) it implies that corporate governance—defined as the "internal means by which corporations are operated and controlled"[119]—is not only a product of greater emphasis in the private sector, but also a contributing force to continued private sector dominance. That is, at the same time as the document acknowledges that "governments play a central role in shaping the legal, institutional and regulatory climate within which individual corporate governance systems are developed," it stresses that "the main responsibility lies with the private sector."[120]

113. *Id.*

114. Cheffins, *supra* note 16, at 59 (quoting a Financial Times column).

115. OECD PRINCIPLES, *supra* note 6, at 5.

116. *Id.* ("Over the past decade, the world has witnessed a significant transformation in the role of the private sector in economic development and job creation.").

117. *Id.*

118. *Id.*

119. *Id.*

120. OECD PRINCIPLES, *supra* note 6, at 5.

Second, and relatedly, the reformist ambitions of the corporate governance movement meant that it would gain traction in periods of economic failure or crisis. While the initial establishment in 1991 of a United Kingdom Committee on the Financial Aspects of Corporate Governance, chaired by Sir Adrian Cadbury, drew only limited attention, the "harsh economic climate" and subsequent corporate scandals afflicting British companies Maxwell and BCII soon brought the Committee's efforts into the spotlight.[121] The work products of the Committee, embodied in the celebrated Cadbury Report and its influential Code of Best Practices, benefited from the attention and sense of urgency spurred by a corporate crisis—a "climate of opinion which accepts that changes are needed," in the words of Sir Adrian Cadbury himself.[122]

But even if the corporate scandals in question were reasonably confined, the ambitions of the corporate governance movement as it expanded in the United Kingdom were far more grandiose. As was the case in the United States, reform proponents underscored the fundamental role played by corporate governance practices in the economy. The Cadbury Report opens by stating that "[t]he country's economy depends on the drive and efficiency of its companies."[123] It then immediately posits a strong causal relation between the board of directors and the general economic performance of the country ("[t]hus the effectiveness with which their boards discharge their responsibilities determines Britain's competitive position").[124]

Even though it was a relative latecomer, Britain's approach to corporate governance,[125] which relied on the promotion of a "Code of Best Practices," would become a particularly successful export in years to come.[126] To that effect, it benefited from the progressive reversal of economic fortunes in the 1990s, which prompted a reassessment of the lessons drawn from comparative corporate governance in the prior decade. As the U.S. and U.K. economies took off during this period, the prevailing conceptions about the efficiency of different systems of corporate governance changed accordingly. While in the 1980s the systems of Germany and Japan served as a source of inspiration, in the 1990s the conventional wisdom came to regard the U.S. and U.K. systems as the ultimate models of good corporate governance for both European and developing countries.[127]

A new wave of academic research would soon reinforce this trend. Inaugurated in the 1990s, the booming economic literature on "law and finance" contributed to the increasing prominence of corporate governance reform as an integral part of the recipe for

121. Adrian Cadbury, *Preface to* REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE (1992) [hereinafter Cadbury Report].

122. *Id.*

123. Cadbury Report, *supra* note 121, § 1.1.

124. *Id.*

125. Even though Britain was second only to the United States in embracing the corporate governance movement, it still lagged the United States by more than a decade. *See* Brian R. Cheffins, *The Rise of Corporate Governance in the U.K.: When and Why* 9 (ECGI-Law, Working Paper No. 293/2015, 2015), http://ssrn.com/abstract=2598179 (attributing the delay, among other things, to a "perception that market forces were doing an adequate job of fostering managerial accountability" during the 1980s).

126. *See generally* Brian R. Cheffins, *Corporate Governance Reform: Britain as an Exporter*, *in* 8 HUME PAPERS ON PUBLIC POLICY: CORPORATE GOVERNANCE AND THE REFORM OF THE COMPANY LAW 1 (2000), http://ssrn.com/abstract=215950 (describing the international diffusion of the U.K. approach to corporate governance). *But see* Cally Jordan, *The Conundrum of Corporate Governance*, 30 BROOK. J. INT'L L. 983, 984–85 (2005) (casting doubt on the effectiveness of transplanting Britain's voluntary approach to other contexts).

127. Rock, *supra* note 109, at 380–81 ("[T]he tone of comparative scholarship has changed over the last few years as the U.S. economy has bounced back and Germany and Japan have lagged. . . .").

economic development. A growing number of works pointed to the existence of a causal relationship between financial development and economic development.[128] A related, though more controversial, literature came to suggest that the level of legal investor protection in a given jurisdiction—as determined by its legal origin (whether common law, or French, German, or Scandinavian civil law)—influenced both the degree of ownership dispersion and the observed levels of capital market development.[129]

Taken at face value, one could be tempted to conclude that a logical policy corollary of the law-and-finance literature would be the prescription of sweeping regulatory reforms and a greater role for state intervention. Dispelling such doubts, however, subsequent work suggested that disclosure mandates and private enforcement were superior to public enforcement.[130] Although development agencies formally embraced legislative reform, a combination of free market ideology and political resistance to legal change by incumbents[131] redirected the reform efforts to voluntary programs through the private sector.

International development agencies not only supported the creation of stock exchange listing segments requiring greater investor protection—as in Brazil's successful experiment with the Novo Mercado[132]—but also backed a number of firm-level corporate governance initiatives.[133] The World Bank has sponsored a number of country-specific Corporate Governance Reports on the Observance of Standards and Codes (ROSCs), so as to not only "strengthen regulators," but also to "develop CG codes, and create institutes of directors."[134] International development agencies have thus been instrumental in

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128. *See, e.g.*, Robert G. King & Ross Levine, *Finance and Growth*: *Schumpeter Might Be Right*, 108 Q.J. ECON. 717 (1993) (presenting data from 80 countries supporting the view that the financial system can promote economic growth); Ross Levine & Sara Zervos, *Stock Markets, Banks, and Economic Growth*, 88 AM. ECON. REV. 537 (1998) (showing that stock market liquidity and banking development both positively predict growth); Raghuram G. Rajan & Luigi Zingales, *Financial Dependence and Growth*, 88 AM. ECON. REV. 559 (1998) (finding that industrial sectors in need of external finance develop faster in countries with more developed financial markets).

129. For a review of this extensive literature by its principal proponents, see generally Rafael La Porta et al., *The Economic Consequences of Legal Origins*, 46 J. ECON. LITERATURE 285 (2008).

130. *See generally* Rafael La Porta et al., *What Works in Securities Laws?*, 61 J. FIN. 1 (2006) (finding that laws facilitating private enforcement through liability rules are superior to public enforcement).

131. For an account of the opposition by existing elites to corporate governance change in Brazil, see Ronald J. Gilson et al., *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States, and the European Union*, 63 STAN. L. REV. 475, 482–94 (2011).

132. *See id.* (explaining how the voluntary character of the Novo Mercado's standards served to appease political resistance to legal reforms); *see generally* MARIA H. SANTANA et al., NOVO MERCADO AND ITS FOLLOWERS (2008) (describing the process leading to the creation of the Novo Mercado).

133. *See Corp. Governance: The Latin Am. Co. Circle,* INT'L FIN. CORP. http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/corporate+governance/overview/lac_companies_circle (last visited Nov. 7, 2016) (illustrating this approach via the IFC-sponsored Latin American Companies Circle, an initiative which "brings together a group of leading Latin American companies who have adopted good corporate governance practices in order to provide private sector input into the work of corporate governance regional development and to share their experiences with each other and other companies in the region and beyond").

134. THE WORLD BANK & INT'L FIN. CORP., *Improving Corporate Governance in Emerging Markets* 2, http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/Corporate_Governance_Introduction.pdf (last visited Nov. 7, 2016).

propagating the view that good corporate governance—as primarily implemented by the private sector—plays a fundamental role in economic development.[135]

Finally, the use of corporate governance to deflect more intrusive modes of state regulation carried forward to the international arena as well. The Cadbury Report was unequivocal in this regard, taking pride in "striking the right balance between meeting the standards of corporate governance now expected of them and retaining the essential spirit of enterprise."[136] It explicitly warned that "if companies do not back our recommendations, it is probable that legislation and external regulation will be sought to deal with some of the underlying problems which the report identifies."[137]

All in all, the internationalization of corporate governance served as a substitute for government action in two mutually reinforcing ways. While the retreat of the state propelled the decision-making processes of private corporations further into the spotlight,[138] corporate governance served to deflect other modes of state intervention.

C. Problem #3: Corporate Fraud

As the "corporate governance decade" drew to a close with the successful export of the Anglo-Saxon blueprint, the emergence of high-profile corporate scandals in the early 2000s in the United States reignited the debate. The unveiling of massive financial fraud at U.S. giant energy firm Enron was followed by similar problems at WorldCom, Tyco, and Adelphia. These failures were striking for at least three reasons.

First, these scandals took place in the United States, which at the time enjoyed the status of international paragon of good corporate governance.[139] Second, Enron itself had formally exemplary corporate governance practices: its highly independent board was composed of directors with stellar credentials, boasted a sophisticated committee structure, and met frequently.[140] Third, prior progress in the corporate governance movement in encouraging managers to maximize share prices might have, inadvertently, created the very incentives for doing so at any cost—even if by fraudulent means.[141]

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135. For an articulation of the channels contributing to this link, see Stijn Claessens, *Corporate Governance and Development*, 1 FOCUS 1, 13–14 (2003); Claessens & Yurtoglu, *supra* 2.

136. Cadbury Report, *supra* note 121, § 1.5.

137. *Id.* § 1.10.

138. *See, e.g.*, Claessens & Yurtoglu, *supra* note 2, at 1 ("The private, market-based investment process is now much more important for most economies than it used to be; that process needs to be underpinned by better corporate governance.").

139. *See* Gilson, *supra* note 14, at 143 ("By the close of the 1990s, the United States corporate governance system . . . was treated as the end point in the burgeoning convergence literature and was the template for the reform efforts of major NGOs, like the World Bank, the OECD and the International Monetary Fund."); Jonathan R. Macey, *Efficient Capital Markets, Corporate Disclosure, and Enron*, 89 CORNELL L. REV. 394, 395 (2004) (describing how the Enron scandal challenged the prevailing belief that "the U.S. corporate governance system is the best in the world").

140. Troy A. Paredes, *Enron: The Board, Corporate Governance, and Some Thoughts on the Role of Congress*, *in* ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS 495, 504–05 (Nancy Rapoport & Bala Dharan eds., 2004) (noting that "by all appearances the Enron board looked great," as its directors "reflected a wide range of business, finance, accounting, and government experience," the board exhibited "all the committees one would hope to see," and its audit committee "had a model charter and was chaired by a former accounting professor who had served as the Dean of the Stanford Graduate School of Business"); MACEY, *supra* note 7, at 80 (observing that the "Enron board was widely lauded as a shining example of good corporate governance," with all members of compensation, nomination and audit committees being unaffiliated with management").

141. *See generally* John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the*

The sheer magnitude of the Enron debacle—which, among other things, wiped out $60 billion in market capitalization and $2 billion in pension plans[142]—triggered public calls for reform. This was so even though the fraudulent conduct in question was already considered criminal under existing law. Indeed, Enron's executives endured extraordinarily long jail sentences as a result of their actions. Enron CEO Jeffrey Skilling was sentenced for 24 years (subsequently reduced to 14), CFO Andrew Fastow received a 6 year sentence after cooperating with the prosecution, and former board chair and CEO Kenneth Lay faced dozens of years in prison when he died prior to his sentence in 2006.[143]

The legislative response to the Enron scandal came in the form of the Sarbanes–Oxley Act of 2002 (SOX), described by then President George W. Bush as "the most far reaching reforms of American business practices since the time of Franklin Delano Roosevelt."[144] In SOX, the compromise character of corporate governance prescriptions offered an attractive blueprint for policymakers. If SOX apparently innovated in imposing federal corporate governance mandates for the first time in U.S. history,[145] it followed the new tradition of treating internal checks and balances within the corporation (and other private sector gatekeepers as well) as a universal remedy.

Although SOX contained its fair share of traditional regulatory mandates (ranging from new financial disclosures to insider trading prohibitions and criminal sanctions), it also reflected and reinforced the growing emphasis on corporate governance. Instead of solely compelling or proscribing specific conducts or increasing existing sanctions, it also placed greater weight on the ability of private sector actors to act as monitors and arbiters. Two of the most salient statutory additions—the requirement of wholly independent audit committees and the mandate of executive certification of financial statements—fall squarely within the concept of a corporate governance solution.[146] In the same spirit, a number of other rules relied on other types of private gatekeepers, such as auditors, attorneys, analysts, and whistleblowers.[147]

The apparent contradiction in imposing further corporate governance prescriptions in response to Enron did not escape observers, but did little to derail the

1990s, 89 CORNELL L. REV. 269 (2004) (attributing the scandals, *inter alia*, to the rise of equity-based compensation schemes, such as stock options, in the United States, which in turn was prompted by the greater role of institutional investors).

142. *10 YEARS LATER: What Happened To The Former Employees Of Enron?*, BUS. INSIDER (Dec. 1, 2011, 5:38 AM), www.businessinsider.com/10-years-later-what-happened-to-the-former-employees-of-enron-2011-12.

143. Richard Partington, *The Enron Cast: Where Are They Now?*, FIN. NEWS (Dec. 1, 2011), www.efinancialnews.com/story/2011-12-01/enron-ten-years-on-where-they-are-now.

144. President George W. Bush, Statement on Signing the Sarbanes–Oxley Act of 2002 (July 30, 2002) (transcript available at the The American Presidency Project), http://www.presidency.ucsb.edu/ws/?pid=64514.

145. Romano, *supra* note 18, at 1523. *But see* John C. Coffee, Jr., *The Political Economy of Dodd–Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019, 1025 (2012) (citing the Public Utility Holding Company Act of 1934 and the Investment Company Act of 1940 as prior precedents for the use of securities regulation to shape substantive corporate structure and governance). Indeed, the Investment Company Act pioneered in requiring a minimum proportion of independent directors, though such mandate was limited to investment companies.

146. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, §§ 301, 302, 906, 116 Stat. 776 (codified as amended in scattered sections of 15 U.S.C.).

147. *See, e.g.*, Sarbanes–Oxley Act, § 201 (prohibited activities for auditors); *id.* § 307 (outlining rules for attorney professional responsibility); *id.* § 501 (dictating the procedure used by security analysts); *id.* § 806 (protecting whistleblowers when they report fraud).

initiative. Particularly striking was the disjunction between the causes of the collapse and the new statutory requirements. As noted by Jonathan Macey, it is ironic that "Enron itself already met or exceeded the higher standards ostensibly promulgated to prevent future 'Enrons.'"[148]

Roberta Romano advanced an influential critique of the substantive mandates embraced by SOX.[149] She described the reform as a set of "recycled ideas advocated for quite some time by corporate governance entrepreneurs" whose effectiveness was either unconfirmed or positively denied by the existing empirical evidence.[150] Romano attributes what she regarded as the flawed legislative outcomes in SOX to the "frantic political environment."[151]

Even if puzzling at first sight, the lack of empirical support to the efficacy of the practices mandated by SOX is consistent with the compromise character of corporate governance responses. For one, empirical ambiguity may facilitate bipartisan support. Moreover, even reforms that are ultimately ineffectual can be useful in fending off more intrusive modes of government intervention.[152] This is a plausible reason why SOX was initially able to garner support even from conservative associations, such as the Business Roundtable,[153] which later reversed its stance on the statute once the threat of regulation was gone.[154]

Moreover, to the extent that SOX also encompassed new regulatory requirements, it would soon come under attack based on the argument that the associated compliance costs decreased the competitiveness of U.S. capital markets.[155] Interestingly, the reaction against regulation once again took the form of a corporate governance proposal—this time through an emphasis on shareholder empowerment. The influential report of the Committee on Capital Markets Regulation advocated for stronger shareholder rights which, in its view, "go hand in hand with reduced regulation or litigation."[156]

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148. MACEY, *supra* note 7, at 81 (Enron "would not need to change its corporate governance structure at all to conform to the requirements of the Sarbanes–Oxley Act"); Romano, *supra* note 18, at 1526 (arguing that the "ostensible remedies for future 'Enrons' reforms that had minimal or absolutely no relation to the source of that firm's demise").

149. Romano, *supra* note 18, at 1603 (arguing "that Congress committed a public policy blunder in enacting SOX's corporate governance mandate . . . .").

150. *Id.* at 1523.

151. *Id.* at 1602.

152. For a similar argument in the context of mutual fund governance, see John Morley & Quinn Curtis, *Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds*, 120 YALE L.J. 84, 140–42 (2010) (arguing that voting, boards, and fee liability exist because "[t]heir failure benefits various constituencies").

153. Romano, *supra* note 18, at 1564–65 (describing how the business community split over the bill, with the Business Roundtable supporting and the Chamber of Commerce opposing its enactment). Romano interprets the Business Roundtable's support to the bill as being motivated by large firms' desires to dissociate themselves from Enron. *Id.* at 1565.

154. *See* Hillary A. Sale, *The New "Public" Corporation*, 74 LAW & CONTEMP. PROBS. 137, 148 (2011) (examining motivations behind Business Roundtable's pressure for rollback of provisions in the Sarbanes–Oxley Act).

155. COMMITTEE ON CAP. MKTS. REG., INTERIM REPORT OF THE COMMITTEE ON CAP. MKTS. REG. 131 (2006), http://capmktsreg.org/wp-content/uploads/2014/08/Committees-November-2006-Interim-Report.pdf (suggesting reforms to reduce the costs of complying with Section 404 of the Sarbanes–Oxley Act).

156. *Id.* at 16.

D. Problem #4: Financial Crisis of 2008

A few years after Enron, the financial crisis of 2008 and its devastating economic consequences raised another serious problem in search of a solution. The emerging analyses of the crisis's root causes—whether a market failure or a government failure—split along predictable lines. On the one hand, a growing number of scholars (including conservative converts) attributed the financial crisis to the wave of financial deregulation in the previous decades, which eliminated existing constraints to the operation of banks and the trading of derivatives.[157] On the other hand, a number of commentators ascribed the financial collapse to misguided government policies, which, among other things, fueled the subprime mortgage market through implicit subsidies and guarantees.[158]

Yet for both ends of the ideological spectrum corporate governance would play a major role—both as the identified culprit for the crisis and as a recipe for reform. The financial crisis was linked to corporate governance failures in numerous—and at times conflicting—ways. For some, the financial crisis was, in an important sense, a variation of the incentives problem that first became apparent in the Enron affair. In the words of then Treasury Secretary Tim Geithner, "[t]his financial crisis had many significant causes, but executive compensation practices were a contributing factor."[159] The argument was that, once again, performance-based executive compensation had induced executives to misbehave—if not by engaging in outright fraud, at least by undertaking excessive risk to increase short-term gains to the detriment of the firm's long-term performance.[160]

A related concern was that stock options—in the past hailed as the ultimate instrument for linking executive pay to performance—could generate perverse incentives if markets were less than perfectly efficient. Stock options create incentives for risk-taking because they only benefit managers if share prices increase within the exercise period. Yet, such an asymmetric scheme (which rewards the upside but fails to punish any downside) fails to align managerial incentives with those of shareholders, whose wealth is affected by both upward and downward stock price movements.[161]

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157. As examples of studies in this large literature, see generally RICHARD POSNER, A FAILURE OF CAPITALISM (2011); Patricia A. McCoy et al., *Systemic Risk Through Securitization: The Result of Deregulation and Regulatory Failure*, 41 CONN. L. REV. 1327, 1329 (2009) (arguing that "deregulation and feeble enforcement" spurred bad investments leading to the financial crisis); Lynn A. Stout, *Derivatives and the Legal Origin of the 2008 Credit Crisis*, 1 HARV. BUS. L. REV. 1, 1 (2011) (arguing that the financial crisis was caused by "whole sale removal of centuries-old legal constraints").

158. *See, e.g.*, RAGHURAM G. RAJAN, FAULT LINES (2010) (interpreting the government's promotion of credit and consumption as an attempt to counterbalance growing inequality); Peter J. Wallison, *Cause and Effect: Government Policies and the Financial Crisis*, AEI (June 1, 2009), https://www.aei.org/publication/cause-and-effect/ (arguing that the financial crisis was caused by "well-intentioned government intervention in the private economy"); John A. Allison, *The Financial Crisis and the Bank Deregulation Myth*, FORBES, Dec. 10, 2012 (arguing that "the banking industry was misregulated, not deregulated").

159. Press Release, U.S. Department of the Treasury, Statement by Treasury Secretary Tim Geithner on Compensation (June 10, 2009), http://www.treasury.gov/Press-center/Press-releases/Pages/tg163.aspx (adding that "[i]ncentives for short-term gains overwhelmed the checks and balances meant to mitigate against the risk of excess leverage").

160. Lucian A. Bebchuk et al., *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000–2008*, 27 YALE J. REG. 257, 261 (2010) (concluding that "given the structure of executives' payoffs, the possibility that risk-taking decisions were influenced by incentives should not be dismissed, but rather, should be taken seriously").

161. *See, e.g.*, WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 337 (4th ed. 2012) (describing the view that, given the predominance of stock-option pay, "the

A competing account offered a different diagnosis, suggesting that the existing corporate governance structures in fact made the governance of financial institutions more aligned with the interests of shareholders than would otherwise be optimal.[162] The reason behind this view is the recognition that—in light of systemic risk and the negative externalities generated by the failure of a large financial institution—the pursuit of shareholder wealth maximization fails to promote social welfare. The argument was forcefully illustrated by the billions of dollars of public money spent on rescuing the financial sector and by the deleterious economic consequences of the financial crisis in terms of growth and employment.

Beyond the realm of executive compensation, the financial crisis was linked to corporate governance failures of different stripes. First and foremost, boards of directors received the blame. Specifically, the lack of effective oversight of risk management by corporate boards was a recurrent object of criticism.[163] Corporate governance reports pointed out that failing financial institutions fell short of corporate governance best practices, such as the split in the positions of board chair and CEO.[164] Other accounts called into question the role of institutional investors (or lack thereof) in monitoring firm risk and performance.[165]

Similarly to what transpired in the enactment of SOX in response to the Enron collapse in the early 2000s, corporate governance again played a conspicuous role in the legislative response to the financial crisis embodied in the Dodd–Frank Act of 2010. Dodd–Frank contains a fair share of command-and-control regulation, and also provides for the creation of new regulatory agencies in charge of promoting financial stability and protecting consumers—though the extent to which the new regulatory framework overreached or did not go far enough remains a contested question. Nevertheless, corporate governance changes were once again visible in a variety of new rules that arguably bore little direct relationship to the causes of the financial debacle.

The main additions to the corporate governance soup followed the traditional recipe of enhancing board independence and increasing shareholder power. With respect to the former, the focus this time around was on members of the compensation committee, which are now required to meet independence standards similar (but not identical) to those imposed on audit committee members by SOX. The new independence requirements also extend to any advisors engaged by the compensation committee, such as legal counsel and compensation consultants.[166] Furthermore, although companies retained flexibility in choosing their board leadership structure, Dodd–Frank requires them to explain the reasons why they chose to combine or to split the roles of board chair and CEO.[167]

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highly leveraged investments that seemed excessively risky in hindsight were the inevitable consequences of sophisticated managers responding rationally to their compensation system").

162. *See, e.g.*, Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247, 247 (2010) (arguing that "banks' compensation structures have produced incentives for excessive risk-raking").

163. *See, e.g.*, OECD, CORPORATE GOVERNANCE AND THE FINANCIAL CRISIS: KEY FINDINGS AND MAIN MESSAGES 8 (2009), http://www.oecd.org/corporate/ca/corporategovernanceprinciples/43056196.pdf ("Most important of all, boards were in a number of cases ignorant of the risk facing the company.").

164. MILLSTEIN CTR. FOR CORP. GOVERNANCE & PERFORMANCE, *supra* note 88, at 18.

165. *See, e.g.*, CORPORATE GOVERNANCE FAILURES: THE ROLE OF INSTITUTIONAL INVESTORS IN THE GLOBAL FINANCIAL CRISIS 1–3 (James P. Hawley et al. eds., 2011) (noting that the failure of institutional investors to monitor risks contributed to the financial crisis).

166. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 952, 124 Stat. 1376, 1900 (2010).

167. *Id.* § 972.

The recurring focus on board structure again reflected the attempt to replace outside constraints with internal checks. As expressed at the time by Harvard fellow and former GE executive Ben Heineman, "the board of directors stands between government regulation and corporate freedom. . . . When boards don't succeed but fail . . . the terms of debate shift from how companies can best govern themselves to how regulators should govern them."[168]

In addition to enhancing board independence, Dodd–Frank includes a number of provisions devised to enhance shareholder participation in corporate governance. The main novelty in that respect was the introduction of a "say on pay" mandate—the requirement that companies periodically give shareholders the opportunity to cast an advisory (i.e., nonbinding) vote on executive compensation.[169] This mechanism, which had been in force in the United Kingdom since 2002, was a favorite among U.S. institutional investors.[170] The Senate Committee justified the rule based on the revelations following the financial crisis of exorbitant pay packages in the face of poor company performance.[171]

Dodd–Frank also strengthened the role of shareholders in various ways.[172] The statute prohibited broker discretionary voting in director elections and other significant matters.[173] Because broker votes were famously cast in favor of management, the measure effectively increased the clout of institutional investors. In the same spirit, Dodd–Frank explicitly authorized (but did not require) the SEC to issue regulations granting proxy access to shareholders for director nominations.[174]

Already visible in SOX, the ever-increasing emphasis on governance in lieu of regulation was conspicuous in Dodd–Frank as well. The area of executive compensation illustrates the shift from regulatory to governance solutions. In the 1990s, the political reaction to high CEO pay came in the form of a clear rule: specifically, the addition of section 162(m) to the Internal Revenue Code, which limits the deductibility of executive compensation to one million dollars unless it was substantially based on performance.[175] This followed a long tradition of regulation seeking to influence the level and structure of

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168. Ben W. Heineman Jr., *Boards Fail – Again*, BLOOMBERG (Sept. 26, 2008, 4:01 AM), http://www.bloomberg.com/news/articles/2008-09-26/boards-fail-againbusinessweek-business-news-stock-market-and-financial-advice.

169. Dodd–Frank Wall Street Reform and Consumer Protection Act, § 951.

170. For an analysis of the origins and the international expansion of "say on pay" legislation, see Randall S. Thomas & Christoph Van der Elst, *The International Scope of Say on Pay* (ECGI Law Working Paper No. 227, 2013), http://ssrn.com/abstract=2307510 (discussing the origin of "say on pay" in the U.K. in response to pressure by investors).

171. S. REP. No. 111-176, at 133 (2010).

172. *But see* George S. Georgiev, *Shareholder vs. Investor Primacy in Federal Corporate Governance*, 62 UCLA L. REV. DISCOURSE 71, 72 (2014) (arguing that Dodd–Frank, by itself, has not accorded any unique and meaningful governance rights to shareholders as a group).

173. Dodd–Frank Wall Street Reform and Consumer Protection Act, § 957

174. The import of such a provision was largely symbolic, however, since it was widely believed that the SEC already had such authority under existing legislation. Stephen M. Bainbridge, *Dodd–Frank: Quack Federal Corporate Governance Round II*, 95 MINN L. REV. 1779, 1802 (2011). In any event, the D.C. Circuit invalidated the proxy access rules promulgated by the SEC in 2010 as an arbitrary and capricious exercise of agency power, criticizing the cost-benefit analysis conducted by the agency. Bus. Roundtable v. SEC, 647 F.3d 1144, 1149–56 (D.C. Cir. 2011).

175. I.R.C. § 162(m) (2014). Even this rule, however, had a clear governance component, since the deductibility of performance-based compensation was conditioned on the determination of performance goals by a committee composed exclusively of outside directors.

executive pay through tax rules and substantive mandates.[176] By the 2000s, however, this strategy had been largely discredited—not least because it arguably had the unintended consequence of significantly increasing the overall pay levels without a commensurate sensitivity to performance.[177] Dodd–Frank did contain an important provision requiring the appropriate federal regulators to issue rules constraining the use of incentive-based compensation that encourages inappropriate risk-taking by covered financial institutions, but changes have yet to be implemented.[178] In sum, instead of solely imposing public constraints on private action, SOX and Dodd–Frank insisted on tweaking the internal balance of power and incentive structure within the corporation to encourage private actors to police themselves.[179]

In an op-ed in the Wall Street Journal entitled *Crazy Compensation and the Crisis*, Princeton economist and prior member of the Clinton administration Alan Blinder articulates this view:

> It is tempting to conclude that the U.S. (and other) governments should regulate compensation practices to eliminate, or at least greatly reduce, go-for-broke incentives. But the prospects for success in this domain are slim. (I was in the Clinton administration in 1993 when we tried—and failed miserably.) The executives, lawyers and accountants who design compensation systems are imaginative, skilled and definitely not disinterested. Congress and government bureaucrats won't beat them at this game. Rather, fixing compensation should be the responsibility of corporate boards of directors and, in particular, of their compensation committees.[180]

E. Problem #5: Inequality and Other Social Issues

Finally, as a return of sorts to its roots, corporate governance has recently been enlisted as a solution to the great social issues of our time, such as income inequality,

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176. *See generally* Kevin J. Murphy, *Executive Compensation: Where We Are, and How We Got There*, *in* HANDBOOK OF THE ECONOMICS OF FINANCE (George Constantinides et al. eds., 2013) (describing numerous instances of regulation of executive pay in the U.S. over time, including pay caps for executives of bailed-out railroads in the early 1930s and the punitive tax treatment of golden parachutes enacted in the 1980s).

177. *See* Gregg D. Polsky, *Controlling Executive Compensation through the Tax Code*, 64 WASH. & LEE L. REV. 877, 881 (2007) (reviewing the empirical literature). *But see* Nancy L. Rose & Catherine Wolfram, *Regulating Executive Pay: Using the Tax Code to Influence Chief Executive Officer Compensation,* 20 J. LAB. ECON. 138, 166 (2002) (finding that executive pay decisions were not much influenced by the new tax regime). As a vestige of the regulatory approach, the special legislation applicable to firms receiving governmental assistance following the financial crisis imposed temporary restrictions on the structure and level of pay. Murphy, *supra* note 176, at 304.

178. For a discussion, see Coffee, *supra* note 145, at 1067.

179. Building on the trend that began with SOX, Dodd–Frank strengthened the requirement of clawbacks of executive compensation that turns out to have been based on materially inaccurate financial information. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 954, 124 Stat. 1376, 1900 (2010). To be sure, clawbacks are not a pure governance solution, insofar as the state has imposed substantive constraints on corporate policy. Still, the clawback mandate has an important governance component. Rather than specifying the nuts and bolts of the clawback mechanics, it requires companies to do so themselves in their own clawback policies. In doing so, it devolves policymaking authority to the private sector and relies on the operation of the firms' internal checks and balances (such as shareholder votes and proxy advisors) to make sure that the regime ultimately adopted is a sensible one.

180. Alan S. Blinder, *Crazy Compensation and the Crisis*, WALL ST. J. (May 28, 2009, 12:01 AM), http://www.wsj.com/articles/SB124346974150760597.

gender imbalance, human rights, and environmental protection. Once again, the emphasis lies on the notion that duly informed shareholders and properly structured boards of directors can play a crucial role in promoting the public good. Moreover, in this new context, the corporation and its governance not only emerge as an alternative to state action, but also become the focal point in which a number of social problems are exposed and supposedly addressed.

1. Rising Inequality

The concern about growing inequality—described by President Obama as the "defining challenge of our time"[181]—epitomizes this trend. First, one of the most cited figures to demonstrate the degree of rising inequality in the United States concerns the growing gap between the wage of the average worker and that of public company CEOs. The ratio between the pay of U.S. CEOs and that of the average production worker increased from 20 times in 1965 to 231 times in 2011 after peaking at 383.4 times in 2000.[182] The fact that other occupations—from lawyers and athletes to private equity and hedge fund managers—experienced similar gains to those of CEOs during the same period has received far less attention in the public debate.[183]

Yet, corporate governance emerged not only as the focal point of the debate about rising inequality, but also as a likely contributor to the problem. Although scholars have identified a number of factors to explain the soaring levels of income inequality, corporate governance failure appears as a recurrent culprit. For Nobel Laureate Paul Krugman, the "monumental executive incomes" are a product not of the "invisible hand of the market," but of the "invisible handshake in the boardroom."[184] Joseph Stiglitz, another Nobel Laureate in economics, declared that "weak corporate governance and eroding social cohesion have led to increasing gaps between the pay of chief executives and that of ordinary workers."[185]

Corporate governance has also made it to Thomas Piketty's celebrated opus *Capital in the Twenty-First Century*, where he argues that "extremely high executive pay" offers "the most convincing proof of the failure of corporate governance."[186] Yet Piketty, who has shown little concern for offering politically viable responses to growing inequality, is skeptical about the promise of corporate governance change to remedy the problem.[187]

181. President Barack Obama, Remarks by the President on Economic Mobility (Dec. 4, 2013, 11:31 AM), http://www.whitehouse.gov/the-press-office/2013/12/04/remarks-president-economic-mobility.

182. Lawrence Mishel & Natalie Sabadish, *CEO Pay and the Top 1%: How Executive Compensation and Financial-Sector Pay Have Fueled Income Inequality*, ECON. POL'Y INST. (May 2, 2012), http://www.epi.org/publication/ib331-ceo-pay-top-1-percent/; *see* Paul Krugman, *For Richer*, N.Y. TIMES (Oct. 20, 2002), http://www.nytimes.com/2002/10/20/magazine/for-richer.html?pagewanted=all (noting that while the annual compensation of the top 100 CEOs was on average 39 times greater than that of the average worker in 1970, the difference had soared to 1000 times more by 1999).

183. For a description of comparable increases in the levels of compensation in other occupations, see Steven N. Kaplan, *Executive Compensation and Corporate Governance in the U.S.: Perceptions, Facts and Challenges*, 25 J. APPLIED CORP. FIN. 8, 8 (2013).

184. Krugman, *supra* note 182.

185. Joseph E. Stiglitz, Opinion, *Inequality Is a Choice*, N.Y. TIMES (Oct. 13, 2013), http://opinionator.blogs.nytimes.com/2013/10/13/inequality-is-a-choice/.

186. THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 334–34 (2014).

187. *Id.* at 512 ("[T]he idea that skyrocketing executive pay is due to lack of competition, and that more

Nonetheless, the mainstream position is that corporate governance reform can help tackle inequality too. In his book devoted to the negative implications of growing inequality, Joseph Stiglitz not only identified corporate governance failure as a cause of the problem, but also embraced corporate governance as an effective solution by advocating for "improving corporate governance"—by curbing executive power, giving shareholders a "say on pay," and enhancing disclosure.[188]

In this light, the new requirements with respect to compensation committee independence and the adoption of say on pay by Dodd–Frank can also be interpreted as an all-purpose remedy that tackles inequality as well—a problem that is broader, and distinct from, shareholder value and systemic risk. The concern with pay equity and growing inequality is particularly clear with respect to say on pay. House Report 110-88, issued in connection with the earlier bill on say on pay, noted that "in 1991, the average large-company CEO received approximately 140 times the pay of an average worker; in 2003, the ratio was about 500 to 1."[189]

The desire to address inequality through corporate governance is also evident in the novel—and highly controversial—disclosure requirement, also introduced by Dodd–Frank, about the gap between the compensation of the company's CEO and the median pay of all company employees.[190] Although some commentators have argued that such disclosure is addressed to society more generally, there is presumably also hope that shareholders may provide a check for companies whose pay ratios they disapprove from a financial or moral perspective. When the SEC finally regulated the pay-ratio mandate in mid-2015, dissenting Republican commissioners dubbed the initiative "applesauce," denouncing the effort to address perceived income inequality through the securities laws.[191]

Yet the United States is not alone in this trend. The proposed amendments to the EU Shareholders Rights Directive follow a similar, if more ambitious, path: the changes would require companies to submit their compensation policies (including the maximum level of executive pay) to a shareholder vote, as well as to explain the ratio between the pay of executives and that of average employees.[192] Likewise, the United Kingdom has recently proposed the enactment of binding say on pay on an annual basis, as well as disclosure between the ratio between the pay of the CEO and of the average worker.[193]

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competitive markets and better corporate governance and control would put an end to it, seems unrealistic.").

188. JOSEPH STIGLITZ, THE PRICE OF INEQUALITY 271 (2012) ("Improving corporate governance—especially to limit the power of the CEOs to divert so much of corporate resources for their own benefit. Too much power, too much deference to their supposed wisdom, is given to corporate executives. We have seen how they use that power to divert too much of the corporation's resources to their own benefit. Laws that give shareholders a say on pay would make a difference. So would accounting rules that let shareholders know clearly how much they're giving away to their executives.").

189. H.R. REP. NO. 110-88, at 3 (2007); Bainbridge, *supra* note 174, at 1808.

190. An alternative interpretation is that the pay-ratio rule serves union interests in obtaining leverage for purposes of collective bargaining. The rule was introduced by Democrat Senator John Menendez, who has strong ties to unions, in exchange for his vote in support of the bill. Roberta Romano, *Further Assessment of the Iron Law of Financial Regulation: A Postscript to Regulating in the Dark* 8–9 (Eur. Corp Governance Inst., Working Paper No. 273/2014; Yale L. & Econ. Res., Working Paper No. 515, 2014), http://ssrn.com/abstract=2517853.

191. Daniel M. Gallagher, Commissioner, SEC, Dissenting Statement at an Open Meeting to Adopt the "Pay Ratio" Rule (Aug. 5, 2015), http://www.sec.gov/news/statement/dissenting-statement-at-open-meeting-to-adopt-the-pay-ratio-rule.html.

192. European Commission, *supra* note 36.

193. Theresa May, Speech Launching her National Campaign to Become Leader of the Conservative Party

2. Gender Inequity

Another related area in which corporate governance became the focal point of social debate is that of gender inequality. Interestingly, the proportion of women in boardrooms has assumed special salience in that debate. A widely cited statistic is that, even though women comprise a majority of college graduates, they occupy a small fraction of the board seats in publicly traded companies.[194] As of 2013, women accounted for only 16.9% of directors of Fortune 500 boards and 11.9% of board seats in Russell 300 companies.[195]

Consistent with the pattern observed in other areas, corporate governance change appeared as a solution to gender inequality as well. While some countries sought to address gender imbalances by creating quotas for political representation,[196] many others have done so also or exclusively at the boardroom level. Beginning with the introduction of the pioneering 40% quota for female directors in Norway in 2006, gender quotas in the boardroom have since spread to several other countries, such as Belgium, France, Germany, Italy, and the Netherlands.[197]

The United States has so far refrained from mandating a quota system, which at first glance may appear incompatible with its legal culture and ideology.[198] Even so, corporate governance has still been called to address the issue of gender balance. The California Senate, for instance, has urged California public companies to have one to three female directors by the end of 2016.[199] More generally, the SEC amended its proxy rules in 2009 so as to require disclosure of the company's policy with respect to diversity in the director nomination process.[200]

3. Other Social Issues

Finally, corporate governance has also been harnessed to address other social issues, such as human rights and environmental protection. In this spirit, a number of recent initiatives stand out. Among its various provisions, the Dodd–Frank Act requires companies to disclose the use of conflict minerals from the Democratic Republic of the Congo, in response to the humanitarian crisis in the region.[201] In 2014, the European Parliament enacted a new directive requiring the disclosure of non-financial information in

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and Prime Minister of the United Kingdom, 5 (July 11, 2016), http://www.wlrk.com/docs/TheresaMayJuly11Speech.pdf.

194. *The Economist explains: The spread of gender quotas for company boards*, ECONOMIST (Mar. 25, 2014, 11:50 PM), http://www.economist.com/blogs/economist-explains/2014/03/economist-explains-14.

195. Deborah L. Rhode & Amanda K. Packel, *Diversity on Corporate Boards: How Much Difference Does Difference Make?*, 39 DEL. J. CORP. L. 377, 379 (2014).

196. For a list of such countries, see GLOBAL GENDER GAP REPORT, WORLD ECONOMIC FORUM (2013), http://www.weforum.org/reports/global-gender-gap-report-2013.

197. For a discussion of this trend, see Anne L. Alstott, *Gender Quotas for Corporate Boards: Options for Legal Design in the United States*, 26 PACE INT'L L. REV. 38, 39 (2014).

198. *Id.* at 40.

199. S. Con. Res. 62, 2013 Leg. Reg. Session (Cal. 2013).

200. *See generally* Tamara S. Smallman, Note, *The Glass Boardroom: The SEC's Role in Cracking the Door Open So Women May Enter*, 2013 COLUM. BUS. L. REV. 801 (analyzing the proxy statements of Fortune 50 firms and finding significant levels of noncompliance with the new mandates).

201. The D.C. Circuit has held the statute and the rule to be partly unconstitutional, finding that the requirement to report that a company's products have "not been found to be 'DRC conflict free'" violates the First Amendment. Nat'l Ass'n of Mfrs. v. SEC, 748 F.3d 359, 364 (D.C. Cir. 2014).

management reports, such as "policies, main risks and outcomes relating to at least environmental matters, social and employee aspects, respect for human rights, anticorruption and bribery issues, and diversity in their board of directors."[202]

These initiatives also reflect the turn to corporate governance. The notion that corporations should strive to respect human rights and protect the environment in ways that go beyond the legal requirements presupposes the economic significance of corporations and the comparative powerlessness of government.[203] The perceived advantage of also addressing the issue through corporate (rather than government) action also appears to be due to the inherent fallibility of regulation in implementing optimal legal sanctions,[204] to the greater expediency of private sector action in promoting change,[205] and to the public governance void in the international context.[206]

Moreover, the strategy relies on applying to the corporate form the traditional methods of government control, such as democracy and transparency. Shareholders have played an active role in striving to shape corporate policy through the growing use of shareholder proposals—and a central corporate governance debate has revolved around the shareholders' authority to include such proposals (especially when in precatory form) in the firm's proxy statements.[207] By 2010, social and environmental issues accounted for the lion's share of all shareholder proposals.[208] The rationale for investor involvement is clearly one of substitution for government failure. As law firm Fried Frank put it in a memorandum commissioned by Special U.N. Representative on Business and Human Rights, John Ruggie, "[i]n the United States, there are two principal mechanisms for

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202. *Non-Financial Reporting*, EUR. COMM'N., http://ec.europa.eu/internal_market/accounting/non-financial_reporting/index_en.htm (last updated Jan. 7, 2016).

203. For the influential report by the Special Representative of the U.N. Secretary-General, see, e.g., U.N. Human Rights, Office of the High Commissioner, *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework* 13, U.N. Docs. HR/PUB/11/04 (June 16, 2011), http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf (specifically alluding to the responsibility of corporations to respect human rights "independently of States' abilities and/or willingness to fulfil[l] their own human rights obligations" and not to "undermine States' abilities to meet their own human rights obligations").

204. Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 740 (2005) (arguing that efficiency requires legal mandates to be complemented by social and moral sanctions).

205. Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES MAG. (Sept. 13, 1970), http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html (articulating and rebutting the view that "the problems are too urgent to wait on the slow course of political processes, that the exercise of social responsibility by businessmen is a quicker and surer way to solve pressing current problems").

206. John Ruggie, *Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises* 3, U.N. Docs. A/HRC/8/5 (Apr. 7, 2008), http://www.ohchr.org/EN/Issues/Business/Pages/SRSGTransCorpIndex.aspx [hereinafter Ruggie Report] ("The root cause of the business and human rights predicament today lies in the governance gaps created by globalization—between the scope and impact of economic forces and actors, and the capacity of societies to manage their adverse consequences.").

207. For a discussion, see FRIED, FRANK, HARRIS, SHRIVER & JACOBSON, LLP, *Trends in the Use of Corporate Law and Shareholder Activism to Increase Corporate Responsibility and Accountability for Human Rights* 1–2 (Dec. 2007), http://www.business-humanrights.org/Links/Repository/846297 [hereinafter Fried Frank Memo].

208. *Shareholders Press Boards on Social and Environmental Risks*, ERNST & YOUNG (2011), http://www.ey.com/us/en/services/specialty-services/climate-change-and-sustainability-services/shareholders-press-boards-on-social-and-environmental-risks---is-your-company-prepared-.

compelling corporate conduct: governmental action (through legislation and judicial enforcement) and shareholder action."[209]

The notion that shareholder action, as well as board oversight, should substitute for regulatory voids has also gained particular traction in the aftermath of the 2010 decision in *Citizens United v. Federal Election Commission*,[210] when the U.S. Supreme Court held that the existing statutory restrictions on corporate political spending were an unconstitutional violation of the right to free speech. In lieu of a governmental ban on political spending by corporations, the majority opinion by Justice Kennedy specifically alludes to shareholder objections raised "through the procedures of corporate democracy" as an adequate control mechanism.[211] The reaction to this new regulatory retreat was, once again, familiar: renewed calls for greater shareholder power, board oversight, and transparency.[212]

Enhanced transparency is indeed another way in which a classic recipe for government accountability has been transposed to the corporate form—and one that, like the other incarnations of the corporate governance agenda, is also particularly agreeable from a political perspective.[213] Unlike traditional disclosure mandates in securities regulation, the goal of these new requirements is not only to assist investors in making informed buy, sell, and pricing decisions, but also to affect shareholder voting decisions and substantive corporate behavior.[214] The hope is that—once the information is available—market forces can complement government regulations in compelling socially responsible behavior. A European Union statement expressly articulates the expectation that "[c]onsumers and investors are in a position to enhance market reward for socially responsible companies through the consumption and investment decisions they take."[215]

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209. Fried Frank Memo, *supra* note 207, at 1.

210. Citizens United v. FEC, 558 U.S. 310 (2010).

211. *Id.* at 362.

212. *See, e.g.*, *Corporate Governance After Citizens United: Hearing Before the Subcomm. on Capital Mkts., Ins., & Gov't Sponsored Enters. of the U.S. H.R. Comm. on Fin. Servs.*, 111th Cong. 2 (2010) (testimony of Ann Yerger, Executive Director, Council of Institutional Investors), financialservices.house.gov/media/file/hearings/111/printed%20hearings/111-109.pdf (urging Congress to pursue a legislative response that increases transparency and "empowers investors with meaningful tools to hold boards accountable if they fail to properly monitor and assess these contributions"); Lucian A. Bebchuk & Robert J. Jackson Jr., *Corporate Political Speech: Who Decides?*, 124 HARV. L. REV. 83, 117 (2010) (proposing greater shareholder voice, independent director oversight, and transparency with respect to corporate political contributions in response to *Citizens United*); Leo E. Strine Jr. & Nicholas Walter, *Conservative Collision Course?: The Tension between Conservative Corporate Law Theory and* Citizens United, 100 CORNELL L. REV. 335, 378 (2015) ("By creating a need to protect stockholders from having their entrusted capital used for political purposes they did not authorize, *Citizens United* creates an incentive for corporate governance workarounds that divert resources—including managerial time—from focusing on making the corporation more profitable by developing more attractive products and services.").

213. *See, e.g.*, Steven M. Davidoff & Claire A. Hill, *Limits of Disclosure*, 36 SEATTLE U. L. REV. 599, 604 (2013) ("Solutions are hard to come by and as hard, if not harder, to agree upon. A solution emphasizing disclosure can give the appearance of 'doing something' when nobody can agree on anything else.").

214. Bainbridge, *supra* note 174, at 1797 (describing such "therapeutic disclosures" as designed not to "inform investors," but rather to "affect substantive corporate behavior"); *see* Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417, 464 (2003) ("The strategy of shaming is premised on actively using disclosure to influence corporate conduct.").

215. *A Renewed EU Strategy 2011–14 for Corporate Social Responsibility*, EUR. COMM'N 7 (Oct. 25, 2011), http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0681:FIN:en:PDF.

Nevertheless, the extent to which real-world shareholders (and consumers)[216] can fulfill such a function remains an open question. As Edward Rock put it, policymakers may be looking for "a very different sort of shareholder, a shareholder more like a rich uncle who, while demanding, is ultimately focused on doing what is best for the family as a whole, one who 'can be encouraged to take an interest in sustainable returns and longer term performance' even at the cost of lower returns."[217] It is therefore critical to assess whether corporate governance is able to deliver on such growing expectations.

IV. EVALUATING THE TURN TO CORPORATE GOVERNANCE

While the normative properties of individual corporate governance practices are the object of an immense literature, the merits of this emphasis on corporate governance solutions as a whole have received little scrutiny. The recent work by Marcel Kahan and Edward Rock, which undertakes to examine the gap between rhetoric and reality in corporate politics, is a notable exception. After analyzing a number of high-profile corporate governance controversies, the authors find that the actual stakes involved are trivial and "hardly seem to justify the intensity of the contest."[218] The explanation for these empty controversies, they conclude, lies in their symbolic or folkloristic character.[219]

Given the prominence of the corporate governance agenda in the academic and public spheres—and its resilience despite variations in the specific issues of the day—further appraisals of its normative implications are badly needed. There are two competing normative justifications for the obsession with corporate governance: whereas the first view is based on the relationship between corporate governance and shareholder value, the second conception assumes a direct effect of corporate governance practices on non-shareholder constituencies and social welfare more generally.[220] While there is no easy way to assess the net benefits of this fixation with corporate governance, several important considerations should surely be weighed in the balance. To the extent that corporate governance crowds out other policy approaches, its benefits need to be weighed not only against its costs, but also against its alternatives.

216. Encouragingly, both survey results and recent experimental evidence suggests that at least some consumers might be willing to pay more for socially-responsible products. *See, e.g.*, Jens Hainmueller & Michael J. Hiscox, *The Socially Conscious Consumer? Field Experimental Tests of Consumer Support for Fair Labor Standards*, (MIT Political Sci. Dep't Research, Paper No. 2012-15, 2015) http://ssrn.com/abstract=2062435 (finding that labels with information about fair labor standards increased sales of more expensive women's items by 14%, but had no impact on the sales of lower-priced items); Jens Hainmueller & Michael J. Hiscox, *Buying Green? Field Experimental Tests of Consumer Support for Environmentalism* (last updated Dec. 6, 2015), http://ssrn.com/abstract=2062429 (finding that environmental labels increased sales to women in retails stores by eight percent, but had no effect on male shoppers in outlet stores).

217. Edward Rock, *Institutional Investors in Corporate Governance*, *in* OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey N. Gordon & Wolf-Georg Ringe eds., forthcoming 2017) (reacting to the 2011 EU Green Paper on institutional investors).

218. Kahan & Rock, *supra* note 19, at 1998 (discussing corporate governance policies, shareholder activism, and the symbolism relating to governance).

219. *Id.*

220. We could label these competing paradigms the "Bebchuk view" and the "Nader view," respectively, in reference to prominent advocates of both prongs of the corporate governance movement.

A. The Shareholder Value Channel

The most popular normative defense of corporate governance practices relates to the shareholder value channel. This view derives from the satisfaction of three premises: (1) the adoption of "best" corporate governance practices promote the financial interests of shareholders (as measured by the market price of their shares); (2) corporate practices that promote the financial interests of shareholders maximize general social welfare; and (3) corporate governance practices promote the financial interests of shareholders at lower cost than other alternatives (such as regulation or the market for corporate control). However, as we will see below, it turns out that each of these premises is highly contested.

1. The Link Between Corporate Governance and Shareholder Value

First, as is the case with other social phenomena, assessing the actual consequences of corporate governance practices on shareholder wealth is difficult, but not intractable. Share prices at least provide a readily observable and reasonable proxy for shareholder welfare, though endogeneity poses an obstacle to causal inferences in corporate governance.[221] Still, as previously mentioned, the finance literature on the effects of specific corporate governance practices is so voluminous that not even specific review articles can cover much ground.[222]

For our purposes, suffice it to say that there are important empirical studies suggesting that at least some corporate governance practices appear to have a positive effect on firm performance.[223] Nevertheless, the empirical evidence that the key prescriptions of the corporate governance movement—enhanced board independence and greater shareholder empowerment—increase shareholder value remains inconclusive.[224]

2. The Link Between Shareholder Value and Social Welfare

Leaving aside the empirical ambiguities surrounding the effect of corporate governance practices on share value, it remains critical to examine the underpinnings of the widely held view that equates shareholder value maximization with social welfare maximization. In other words, as put by William Bratton and Michael Wachter, what

221. *See generally* M. Babajide Wintoki et al., *Endogeneity and the Dynamics of Internal Corporate Governance*, 105 J. FIN. ECON. 581 (2012).

222. Diane K. Denis, *Twenty-Five Years of Corporate Governance Research . . . and Counting*, 10 REV. FIN. ECON. 191, 191 (2001) ("The sheer volume of papers that have been written on the subject makes the prospect of surveying corporate governance a daunting task.").

223. *See, e.g.*, Lucian Bebchuk et al., *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783, 785 (2009) (finding that certain entrenching provisions are correlated with lower Tobin's *Q* and shareholder returns in the 1990s); Sanjai Bhagat & Brian Bolton, *Corporate Governance and Firm Performance*, 14 J. CORP. FIN. 257, 271 (2008) (finding that certain corporate governance practices are correlated with better operating performance).

224. *See, e.g.*, Romano, *supra* note 18; Klausner, *supra* note 21; K.J. Martijn Cremers & Simone M. Sepe, *The Shareholder Value of Empowered Boards*, 68 STAN. L. REV. 67, 70–71 (2016) (contradicting earlier findings in showing a positive association between staggered boards and firm value); *see also supra* note 98 and accompanying text.

makes shareholder wealth maximization "a key that unlocks the door to making the world a better place"?[225] There are at least two possible answers to this question.[226]

The first and foremost answer in the academic literature is based on the conception of the firm as a "nexus of contracts"[227] and the related lessons of transaction cost economics. In this view, the corporation is simply an engine of efficiency. Shareholders—like workers, consumers, creditors, and suppliers—have a contractual relationship with the firm. However, while these other groups have fixed claims against the firm, shareholders have no more than a residual claim—that is, shareholders only receive whatever is left after all other claimants have been satisfied. Moreover, unlike investors in other types of business entities, shareholders' investment is "locked" in the corporation, as they lack the ability to exit by forcing the liquidation of the firm's assets.[228]

It is the unique nature of their interest in the firm that makes it particularly costly for shareholders to protect their interests through contract alone. Consequently, efficiency requires corporate law and policy to favor the interests of shareholders—not because these interests are intrinsically superior to those of other constituencies, but rather because workers, consumers, creditors, and suppliers are able to protect their interests through contract terms at lower cost.[229] As is the case with respect to individuals, the externalities imposed by the firm on outsiders should be addressed by government regulations.

The foregoing view, although dominant, has always had its critics in legal academia, including among law and economics scholars.[230] But it was the financial crisis of 2008—and its immense costs to taxpayers and deleterious implications for macroeconomic performance—that has disseminated growing skepticism of the shareholder primacy norm. At least with respect to financial institutions, the pursuit of

225. William W. Bratton & Michael L. Wachter, *Shareholders and Social Welfare*, 36 SEATTLE U. L. REV. 489, 489 (2013).

226. For a detailed account (and critique) of the different rationales for shareholder primacy, see Ronald Chen & Jon Hanson, *The Illusion of Law: The Legitimating Schemas of Modern Policy and Corporate Law*, 103 MICH. L. REV. 1 (2004). Still another possible argument in favor of shareholder primacy has to do with dynamic efficiency—that is, through its effect on capital allocation and financial development and, consequently, on financial development. *See, e.g.*, Claessens & Yurtoglu, *supra* note 2 (suggesting the existence of such a connection).

227. Jensen & Meckling, *supra* note at 52, at 311.

228. Lynn A. Stout, *On the Nature of the Corporation*s, 2005 U. ILL. L. REV. 253, 253 (depicting the ability to lock in shareholders' initial capital contributions as the defining characteristic of the corporate form); Hansmann et al., *supra* note 44, at 1336–37 (describing the properties of what they call "entity shielding").

229. *See, e.g.*, Armour et al., *supra* note 50, at 28; Williamson, *supra* note 64, at 1228 ("By its very nature, the contractual relationship between the shareholders and firm is difficult to safeguard . . . . For this reason, the board of directors should be regarded principally as a governance instrument of the shareholders.").

230. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) (arguing that the main problem the corporate form seeks to address is one of "team production," which, in turn, requires directors to maximize the joint welfare of all corporate stakeholders). The debate about the interests that corporate management should serve dates back to the celebrated Berle–Dodd debates of the early 1930s. For the first and more influential installments of this debate, see Adolph A. Berle Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931) (arguing that directors should act in the interests of shareholders alone); E. Merrick Dodd Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932) (viewing the "business corporation as an economic institution which has a social service as well as a profit-making function"). For more recent work recasting the debate in terms of the corporatist ideology prevailing at the time, see William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and The Modern Corporation*, 34 J. CORP. L. 99 (2008).

shareholder value maximization no longer appears conducive to the promotion of social welfare even to advocates of shareholder primacy.[231]

A second and more politically popular version of the defense of investor interests posits that in a "society of shareholders"[232] where a major portion of the population is invested in stock markets, shareholder wealth provides a reasonable approximation of social welfare. This view has gained traction in the last decades. Prompted by a shift from defined benefit to defined distribution pension plans,[233] a large portion of the middle class came to rely on stock markets for retirement savings. The fraction of U.S. households that owned corporate equities soared from one-fifth in 1983 to one-half in 2005.[234] Accordingly, politicians seized on the opportunity to equate stock market performance to the interests of the American public.[235]

Yet for all of the political appeal associated with the image of an ownership society, closer scrutiny of the distribution of shareholdings across the general population provides a markedly different picture. As noted by Bratton and Wachter, data from the Federal Reserve Board's Survey of Consumer Finances and the Internal Revenue Service show that "even as shareholding has diffused downward to lower income individuals, the shareholders' overall socioeconomic status has remained largely unchanged," with the modal shareholder being old, white, and in the top 1% of the income distribution.[236] The concentration of equity ownership remains astoundingly high: the top 10% owns 81% of the stock, while the bottom 80% accounts for only 9% of shares.[237] Accordingly, there is little immediate overlap between the interests of shareholders and those of society as a whole.

B. Other Channels

Whereas the confidence in the link between shareholder value and social welfare has dwindled in recent years, the view that corporate governance can contribute to social welfare in other ways has correspondingly gained ground. Nonetheless, in contrast to the large number of works investigating the relationship between corporate governance and performance, the literature on the impact of corporate governance on other metrics of social

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231. *See supra* note 162 and accompanying text. This view derives from the same theoretical perspective that defends shareholder value maximization for non-banks, but acknowledges that deposit insurance and "too-big-to-fail" policies make taxpayers, rather than shareholders, residual claimants in failing financial institutions. For a broader reappraisal of shareholder primacy prompted by the global financial crisis, see Simon Deakin, *Corporate Governance and Financial Crisis in the Long Run* (Ctr. for Bus. Research, University of Cambridge Working Paper No. 417, 2010), http://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp417.pdf.

232. It is revealing that President Clinton justified his plea to Congress to renew his "fast-track-trade-negotiation authority" by claiming that "I think it will have a very positive impact on the stock market here and around the world." Jacob Weisberg, *Whatever Happened to Politics?; United Shareholders Of America*, N.Y. TIMES MAG. (Jan. 25, 1998), http://www.nytimes.com/1998/01/25/magazine/whatever-happened-to-politics-united-shareholders-of-america.html.

233. Gelter, *supra* note 17.

234. Bratton & Wachter, *supra* note 225, at 510.

235. *Id.* at 512.

236. *Id.* at 491.

237. *Id.* at 518. For the original analysis, see Edward N. Wolff, *Recent Trends in Household Wealth in the United States: Rising Debt and the Middle Class Squeeze—An Update to 2007* (Levy Econ. Inst., Working Paper No. 589, 2010), http://www.levyinstitute.org/pubs/wp_589.pdf.

well-being is scant.[238] This scarcity is in part due to the fact that the spike in interest in the topic has been quite recent and in part due to the inherent difficulty in measuring the impact of corporate governance on other social metrics.

If the empirical evidence is sparse, there are good theoretical reasons to give us pause about the recent uses of corporate governance to tackle broad societal concerns. If evaluating the effect of different corporate policies on aggregate welfare is exceedingly challenging for researchers, the difficulty is only compounded for corporate directors, who will likely lack the information, expertise, and time to engage in such calculations. It is precisely for this reason that scholars have long warned against the imposition on the board of directors of wide-ranging duties to multiple constituencies.[239] Because of the inherent difficulty in measuring performance against multiple objectives, a likely unintended consequence would be to increase directors' ability to pursue their own interests.

Nor is the prospect of direct shareholder involvement in corporate governance sufficient to overcome this problem. The rise of institutional investor ownership has created an extra layer of agency costs—which Ronald Gilson and Jeffrey Gordon have dubbed the "agency costs of agency capitalism."[240] The pursuit of multiple bottom lines makes it at least as difficult to monitor the performance of institutional investors as it does with respect to corporate directors.

Yet even if institutional investors were perfect agents of the beneficial owners of the shares, there would still be a fundamental problem in the use of corporate governance to further social interests. The intractable difficulty is the ultimate misalignment between the interests of shareholders and those of society as a whole. Because the distribution of share ownership in the general population is highly concentrated,[241] shareholders have few incentives—and questionable legitimacy—to act as stewards for the public good.[242] Hence, the external constraints provided by market forces and regulation are likely to remain necessary.

238. For examples of this line of work, see generally Ola Sjöberg, *Corporate Governance and Earnings Inequality in the OECD Countries 1979–2000*, 25 EUR. SOC. REV. 519 (2009) (linking corporate governance institutions to stratification processes); Judith L. Walls et al., *Corporate Governance and Environmental Performance: Is There Really a Link?*, 33 STRATEGIC MGMT. J. 885 (2012) (finding that companies with powerful CEOs who also served as board chair had more environmental strengths); Renee B. Adams & Vanitha Ragunathan, *Lehman Sisters* (Aug. 1, 2015) (Working paper), http://ssrn.com/abstract=2380036 (finding no relationship between the greater presence of female directors prior to the crisis and firm risk).

239. Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 31 (1991); *see also* Luca Enriques et al., *The Basic Governance Structure: Minority Shareholders and Non-Shareholders Constituencies*, *in in* THE ANATOMY OF CORPORATE LAW, *supra* note 50, at 103 ("[E]ven fair-minded directors are unlikely to know how best to distribute surplus among multiple corporate constituencies.").

240. Gilson & Gordon, *supra* note 16, at 868.

241. *See supra notes* 236–237 and accompanying text (discussing how the share ownership in the general population is highly concentrated).

242. Bratton & Wachter, *supra* note 225, at 525. For a critique along these lines of board involvement in distributional issues, see Ronald J. Gilson & Reinier Kraakman, *Clark's Treatise on Corporate Law: Filling Manning's Empty Towers*, 31 J. CORP. L. 599, 604 n.21 (2006) (raising "the ugly problem of political legitimacy"—"do we want to encourage an institution that is disproportionately white, male and conservative to make social policy?"); *see generally* also Velikonja, *supra* note 98 (arguing that institutional investors support enhanced board independence precisely to fend off more meaningful reforms).

C. Corporate Governance and Its Alternatives

In any serious analysis of this turn to corporate governance, it is not enough to assess the effects of prescribed practices on shareholder value or social welfare; it is also critical to examine how corporate governance fares compared to alternative mechanisms to further the same objectives, such as strengthening government regulation and unleashing market forces. For instance, one might conclude that corporate governance mandates are not nearly as effective in promoting shareholder value as the unobstructed operation of the market for corporate control,[243] that strict prudential regulation is more likely to prevent future financial crises than relying on "say on pay," independent compensation committees,[244] or that the tax and transfer system is a more effective way to fight soaring inequality than meddling with executive compensation. Yet any adequate analysis of these different alternatives will inevitably be context specific. This stands in sharp contrast to the corporate governance solution, an off-the-rack response that is not well matched to the specific problems at stake.

The importance of evaluating corporate governance in view of its alternatives has been generally overlooked. Instead, advocates have over time defended corporate governance practices based on a "'chicken soup' type of argument – ('it can't hurt, but might help')."[245] Nevertheless, even if the adoption of such practices does not harm companies or society, the obsession with corporate governance may still be harmful to the extent that it crowds out more meaningful modes of reform. Just like chicken soup, the relentless emphasis on corporate governance might hurt if it ends up discouraging the patient from seeking a more powerful remedy for a real problem.

It turns out, however, that a distinctive feature of corporate governance, and a major source of its appeal, is its role as a substitute for free markets and government action. The corporate governance agenda is repeatedly used to replace market and regulatory solutions—and purposefully so. The fact that corporate governance might crowd out the intellectual agenda and discourse may be problematic insofar as corporate governance proves to be less effective than alternative interventions.

As a result, the advantages of corporate governance in political palatability need to be traded off against this crowd-out effect. The corporate governance agenda might well withstand this test and prove to be superior to its alternatives in a number of contexts. However, this should not be a foregone conclusion.

V. CONCLUSION: THE FUTURE OF CORPORATE GOVERNANCE

Interest in corporate governance soared as the government retreated in the last decades. Ralph Nader, previously self-described as an "adversary of capitalism" has joined

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243. *See generally, e.g.*, MACEY, *supra* note 7 (discussing how corporate governance mandates are not as effective in promoting shareholder value as unobstructed operative of the market for corporate control).

244. *See generally, e.g.*, Bebchuk & Spamann, *supra* note 162 (discussing that strict prudential regulation is more likely to prevent financial crises than the "say or pay" or independent compensation committees).

245. *See* MILLSTEIN CTR. FOR CORP. GOVERNANCE & PERFORMANCE, *supra* note 88, at 19 (advancing this argument to support the separation of roles of board chair and CEO); Constance E. Bagley & Richard H. Koppes, *Leader of the Pack: A Proposal for Disclosure of Board Leadership Structure*, 34 SAN DIEGO L. REV. 149, 166 (1997). For an early development of this argument in the context of "just say no" campaigns by stockholders, see Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 868 (1993) (laying out an early development of the "chicken soup" argument in the context of the "just say no" campaign by shareholders).

the ranks of activist investors—a role he regards as a "natural extension of his work" in a world in which "deregulation is rampant."[246] Whether the present salience of corporate governance will endure in the future remains an open question. There are at least two key challenges to the agenda's continued vitality, one stemming from its success and another one from its limitations.

A first threat to the corporate governance obsession comes from its wide acceptance, as evidenced by the rising levels of adoption of "best practices" that made up the traditional repertoire of advocates and policy entrepreneurs.[247] As described in a 2013 memorandum by the celebrated law firm of Wachtell, Lipton, Rosen & Katz, a vocal corporate governance critic, "[i]n many respects, the relentless drive to adopt corporate governance mandates seems to have reached a plateau," for "[t]he activists' 'best practices' of yesterday have become the standard practices of today."[248]

To a significant extent, the dreams of yesterday's corporate governance advocates have come true. Boards have never been so independent, at least on paper. We are currently in the golden age of shareholder activism. Nevertheless, the implementation of past prescriptions does not, by itself, entail the demise of the corporate governance movement.

Although the central issues of board independence and shareholder democracy have been fairly stable since the 1970s, the corporate governance movement has also shown a remarkable tendency to reinvent itself at the margins. As previous frontiers are overcome, new ones emerge. For instance, as boards become increasingly independent, the requirements for independence become more exacting—as is the case with respect to the new debates around board refreshment and tenure limits to board service.[249] But even if the corporate governance industry is able to foster new frontiers, it is plausible that, in the process of delving into further technicalities,[250] the agenda may lose part of its political and symbolic appeal.

A more credible threat to the corporate governance approach comes from the loss of faith in its theoretical underpinnings: skepticism of government action and the related belief that the private sector is best positioned to govern itself.[251] Since the financial crisis, even the most ardent corporate governance proponents have come to acknowledge the shortcomings of this approach and argue for regulatory responses.[252] Yet much of the

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246. Steven Davidoff Solomon, *Nader, an Adversary of Capitalism, Now Fights as an Investor*, N.Y. TIMES: DEALBOOK (Jan. 14, 2014, 3:43 PM), http://dealbook.nytimes.com/2014/01/14/nader-an-adversary-of-capitalism-now-fights-as-an-investor/.

247. On this point, see Cheffins, *supra* note 16, at 59 (quoting a corporate responsibility consultant who argued in 2010 that corporate governance was "dead. Gone. Pfffft").

248. Martin Lipton et al., *Some Thoughts for Boards of Directors in 2014*, WACHTELL, LIPTON, ROSEN & KATZ, (New York, N.Y.) Nov. 27, 2013, at 1, http://www.wlrk.com/docs/ThoughtsforBoardsofDirectorsin2014.pdf (citing the advent of "say on pay," the majority voting, and the dismantling of takeover defenses).

249. *Id.* at 2.

250. Kahan & Rock, *supra* note 19, at 1998 (arguing that "there is a corporate governance reform 'industry' that demands activity to keep itself going").

251. In the words of Robert Monks, one of the founders of the corporate governance movement, "[m]uch hard activist work has gone into furthering the ideals of corporate governance by so many who believed corporations could responsibly regulate themselves, []" but "'self-restraint' proved largely to be no restraint." Robert Monks, *Governance at a Crossroads: A Personal Perspective*, 8 INT. J. DISCLOSURE & GOVERNANCE 62, 62–63 (2011).

252. For a paradigmatic example of this shift, see Bebchuk & Spamann, *supra* note 162 (defending the inefficacy of corporate governance reforms and arguing for the regulation of bankers' pay). *See also* John Armour

zeitgeist propelling the turn to corporate governance remains alive and well. As Larry Summers recently put it, "[a]t the same time as there is widespread unhappiness with market outcomes, confidence in government has reached a low ebb," with the result that "the idea of achieving reform through altered business behaviour, rather than government programmes, is appealing."[253] It is illustrative that corporate governance reform featured prominently in Theresa May's pitch to become the U.K. Prime Minister in 2016, reflecting the attempt to combine conservative principle with the "public's appetite for change."[254] The general appeal of corporate governance may well subsist, which may or may not be a good thing.

Nothing here should be read as suggesting that corporate governance does not matter—it most likely does. Rather, the goal is to underscore the growing appeal of corporate governance, and to offer a new perspective on this phenomenon. In doing so, this Article raises the possibility that the promise of corporate governance may have been overrated, but it does not—indeed, cannot—pass definitive judgment on this issue.

Whatever the future holds for the corporate governance obsession, its lasting grip on public discourse makes the theme ripe for further scrutiny. Understanding its roots and premises is but a first step. Future research into the merits of different corporate governance mandates should not only examine the costs and benefits of these practices in isolation, but also account for the extent to which the metaphor of the self-governing corporation may crowd out potentially more effective responses to the problems at hand.

& Jeffrey Gordon, *Systemic Harms and Shareholder Value*, 6 J. LEGAL ANALYSIS 35 (2014) (arguing for the imposition of stricter liability rules for directors and officers at financial firms).

253. Lawrence Summers, *Corporate long-termism is no panacea—but it is a start*, FIN. TIMES (Aug. 9, 2015), http://www.ft.com/cms/s/2/97f3db5e-3d11-11e5-bbd1-b37bc06f590c.html#axzz4L0iwHPxN.

254. Her proposals include an annual binding shareholder vote on executive compensation and the disclosure of ratio between the CEO's pay and the average worker's pay, as well as the more radical push for worker and consumer representation on company boards. May, *supra* note 193.