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CORPORATE GOVERNANCE: SARBANES-OXLEY ACT, RELATED LEGAL ISSUES, AND GLOBAL COMPARISONS

JOHN M. HOLCOMB

"I don't sense an enthusiastic pursuit of the fundamental principles of corporate governance even today. I see a reluctant minimalist approach, staying one step ahead of the regulators more than anything else. I am trying to find my own way in getting a stronger board and stronger shareholder involvement on the issues. If you re not utterly insensitive to matters, you have to agree that shareholders are getting more active and restless. They want more say."[1]

When even a leading corporate CEO such as Andrew Grove is skeptical of the system of corporate governance in place today at most corporations, there is a real problem. Many of the corporate scandals of the past two years come back to the deficiencies in corporate governance. At Enron and other companies, the focus was on the failure of the audit committee of the board of directors. At Tyco and WorldCom, the focus was on the willingness of the board to approve lavish loans and compensation for the CEO and other top officers. At other companies, the focus has been on both the structure and composition of the board, and particularly on its lack of independence. We should remember, however, that in terms of independence, some consider the Enron board to have been a model board of directors.

HISTORICAL EVOLUTION

Reform of corporate governance is not a new issue. It is now simply a more compelling and urgent issue, perhaps because adequate responses were not forthcoming earlier. Ever since the 1970s, there has been a concern about the

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1. Patrick McGeehan, *Can Annual Meetings Restore Trust?* N.Y TIMES, May 11, 2003, at 3.1 (quoting Andrew S. Grove, Chairman of Intel).

independence of the board. Irving Shapiro, then CEO of DuPont, was one of the leading spokespersons for greater board independence and for an infusion of independent outside directors. Diversity on the board became an issue as well in the 1970s, partially in response to the civil rights era and to issues of minority and women's rights. These were modest suggestions at the time, in contrast to Ralph Nader's more aggressive call for federal chartering of corporations. In the 1976 book *Taming the Giant Corporation,* he and Joel Seligman criticized the lenient governance standards imposed on corporations through the state chartering mechanism, especially for those major companies chartered in the state of Delaware.[2] They proposed instead that corporations be chartered by the federal government and that every corporation with over $700 million in assets have a board of nine members, representing various corporate constituents, including workers, consumers, suppliers, environmental advocates, and community members.[3]

That proposal strikes at the heart of the ongoing debate over corporate governance – to whom should corporations be ultimately accountable, shareholders or stakeholders? The classical corporate model or ownership model would answer "shareholders."[4] The more modern theory would answer "stakeholders."[5] Some claim that is more consistent with the managerial model of most large corporations, though others claim the managerial model has degenerated into a form that elevates managerial self-interest and executive ego over the interests of any stakeholders.[6] The separation of ownership and management characteristic of the large modern enterprise analyzed by Adolph Berle and Gardiner Means in the classic work *The American Corporation* and a large body of literature on the issue, has spawned a governance trap.[7] With no real consensus on the accountability

2. *See* RALPH NADER ET AL., TAMING THE GIANT CORPORATION (1976).

3. *Id.*, *See also* Donald E. Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L.J. 574 (1984) (containing a sympathetic discussion of this proposal).

4. Milton Friedman, *The Social Responsibility of Business is to Increase its Profits, in* ETHICAL THEORY AND BUSINESS (Tom L. Beauchamp & Norman E. Bowie eds., 6th ed. 2001).

5. R. Edward Freeman, *A Stakeholder Theory of the Modern Corporation, in* ETHICAL THEORY AND BUSINESS (Tom L. Beauchamp & Norman E. Bowie eds., 6th ed. 2001) (leading work on stakeholder theory or the stakeholder approach); *see also* MARGARET M. BLAIR, OWNERSHIP AND CONTROL. RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY (1995) (setting forth an approach that blends accountability to stakeholders with the fiduciary duty to shareholders); *See also* J.A. CONGER, ET AL, CORPORATE BOARDS: NEW STRATEGIES FOR ADDING VALUE AT THE TOP CH. 9 (2001); STEVEN WALKER & JEFFERY MARR. STAKEHOLDER POWER: A WINNING PLAN FOR BUILDING STAKEHOLDER COMMITMENT AND DRIVING CORPORATE GROWTH 2001 (an example of modern executives have also largely embraced the stakeholder approach).

6. *See generally* KEVIN PHILLIPS, WEALTH AND DEMOCRACY 317-46 (2002) (detailing a historical and political perspective on executive abuses). *See also* Jack Bogle, What Went Wrong in Corporate America, Community Forum Distinguished Speaker Series (February 25, 2003), transcript available at http:www.vanguard.com/bogle_site/sp20030224.html (last visited Feb. 14, 2004) (Jack Bogle, founder of the Vanguard Group, and Peter Peterson, former Secretary of Commerce and co-chair of the Commission on Public Trust of the Conference Board, have spoken widely before many pubic forums and in congressional testimony about executive greed and abuses.). For historical and political perspective on executive abuses, see KEVIN PHILLIPS, WEALTH AND DEMOCRACY· A POLITICAL HISTORY OF THE AMERICAN RICH, CH. 8 2002.

7 ADOLPH A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE

model of the corporation, there is much confusion and disagreement over just how it should be governed.

The need for a committee structure on the board became a prominent issue in the 1970s as well.[8] With the scandal over inappropriate payments to foreign government officials in the early 1970s and the subsequent passage of the Foreign Corrupt Practices Act in 1977 the requirement that corporate boards have an audit committee became a legal requirement.[9] Corporate public policy or public responsibility committees became more common among Fortune 500 companies at the time as well.[10] In response to a shareholder resolution that Ralph Nader filed against General Motors as part of his Campaign GM, requesting that the company form such committee, the company did so.[11] A few years thereafter, a survey by the Conference Board found that over a hundred companies had formed such board committees.[12]

Beyond audit and public policy committees, the gradual formation of nominating and compensation committees also followed over time. Nominating committees were a response to the need to both diversify boards and to identify outside directors not beholden to CEOs.[13] Compensation committees were a response to the need for a check and independent voice on decisions over executive compensation, and they have assumed an even larger significance with the rising controversy over CEO compensation.[14] The latter issue is examined in another section of this article, but it is inextricably tied to the issue of corporate governance. In fact, some see it as the major unresolved issue of corporate accountability and credibility, even with the Sarbanes-Oxley law and other recent reforms.[15] In terms of public perception and corporate image, it leaves a more indelible impression on the public than any other issue. It also goes beyond corporate accountability and is symbolic of the issue of social justice that heavily

PROPERTY 4 (1932).

8. Michael L. Lovdal, *Making the Audit Committee Work*, HARV. BUS. REV., Mar.-Apr. 1977, at 108, 108-9. (There has been growing recognition of the importance of board committees for large corporations over time.). *See also* The Business Roundtable, *Principles of Corporate Governance*, May 2002, at 14, *available at* http://www.businessroundtable.org/pdf/704.pdf (last visited Feb. 24, 2004) (The Business Roundtable has stated that it believes that the functions generally performed by the audit, compensation and corporate governance committees are central to effective corporate governance.").

9. RICHARD SCHAFFER ET AL., INTERNATIONAL BUSINESS LAW AND ITS ENVIRONMENT 503 (2002).

10. Michael L. Lovdal et al., *Public Responsibility Committees of the Board*, HARV BUS. REV May-June 1977, at 40, 40-41.

11. JOHN H. JACKSON, BUSINESS AND SOCIETY· MANAGING SOCIAL ISSUES 370 (1997).

12. PHYLLIS MCGRATH, CORPORATE DIRECTORSHIP PRACTICES: THE PUBLIC POLICY COMMITTEE. RESEARCH REPORT NO. 775 (1980).

13. Jeffrey A. Sonnenfeld, *What Makes Great Boards Great*, HARV. BUS. REV., Sept. 2002, at 106, 113.

14. *Id.* at 109 (citing a 2001 study from the National Association of Corporate Directors and Institutional Shareholder Services of 5,000 public company boards showing that 99 percent have audit committees and 91 percent have compensation committees).

15. *Treasury Snow Says Corporate Reform Includes Executives Pay*, Oct. 16, 2003, at ¶ 2, *at* http://usinfo.state.gov/ei/Archive/2004/Jan/06-631299.html (last visited Mar. 10, 2004).

resonates with a large portion of the public.

Duties of Directors

Beyond the structure and composition of the board, the legal duties of the directors have also become more stringent over time. Historically good-faith errors in judgment by board members enjoyed the defense of the business judgment rule, a rather permissive rule that prompted a court to defer to business judgment rather than substitute its own. The Delaware Chancery Court issued many decisions providing for a wide expanse of managerial prerogative.[16] Over time, however, even the Delaware courts have begun to demand more in the way of due care and diligence, informed decision-making, and independent judgment by corporate directors, through such decisions as *Smith v. Van Gorkum*.[17] Regarding board member independence, there is one major point of legal vulnerability for many current board members and that is potential conflicts of interest they might have as insiders or quasi-insiders.

Board-Management Relations

In the midst of rising concerns over CEO compensation and with the greater role now being played by outside directors, evidence exists that boards are being tougher in holding CEOs accountable.[18] In their annual survey of CEO turnover, Booz Allen Hamilton experts have found that performance-related turnover reached a record high in 2002.[19] It constituted 39 percent of all CEO successions, including those who voluntarily retired and merger-related turnovers.[20] The highest rates of performance-related turnover were in the information technology telecommunications services, and consumer discretionary industries.[21] The most impressive finding is that the "return gap" – the difference in the total shareholder return between a company's return and the total market return for voluntarily retired and fired CEOs – declined to 6.2 in 2002 from 13.5 in 2000 and 11.9 in 2001.[22] This demonstrates that boards are now judging CEOs more harshly and that forced dismissals took place for underperformance that earlier would have been tolerated.

Despite the renewed assertiveness of some boards, the examples of recent board failures are many Most often, those failures have been due to inattention

16. This phenomenon is what many critics have labeled the "race to the bottom" in terms of attracting corporations and generating chartering fees by conditions friendly to management; a race that Delaware seems to have won.

17 Smith v. Van Gorkum, 488 A.2d 858, 872-73, 893 (1985).

18. Patrick McGeehan, *Study Finds Number of Chiefs Forced to Leave Jobs Is Up*, N.Y TIMES, May 12, 2003, at C2.

19 Chuck Lucier, et al., *CEO Succession 2002: Deliver or Depart*, STRATEGY + BUSINESS, Summer 2003, at 1-2, *available at* http://www.strategy-business.com/press/article/21700?pg=0 (last visited Feb. 28, 2004).

20. *Id.* at 4.

21. *Id.* at 8-11.

22. *Id.* at 8.

rather than lack of independence, although there is sometimes a mixture of the two. The Freddie Mac case is an instructive one.[23] A series of interviews related to the Freddie Mac accounting issues "shows a board whose members struggled, and sometimes hesitated, to take tough action against top executives they had known and respected for years."[24] The board's audit committee finally hired former SEC General Counsel James Doty to conduct an investigation, later broadening that investigation and requesting a report to the full board.[25] The firm's auditor, PricewaterhouseCoopers (PwC), refused to accept representations from Freddie Mac's president and chief operating officer, and Doty found pages deleted from the COO's diary that may have shown his direct involvement in the accounting problems related to over one trillion dollars of derivatives and an effort to hide fluctuating earnings and create an impression of smooth earnings growth over time.[26] The board, initially wanting the COO to resign, only then decided it must fire him, and forced out the CEO and chief financial officer as well.[27] While Doty's report "largely absolves the board, saying that management withheld key information from the board, other finance experts believe the report is too soft on the board, that the board "should have been more aggressive, asked more questions and relied less on what officials were telling them."[28] *The Economist* found the following as key features of the Freddie Mac crisis: "missing documents; lavish executive pay· uncooperative directors; and indications that Freddie Mac's reported figures are wrong, and its internal controls are in chaos."[29]

Subsequent to forcing out the three top officers, the board then promoted the chief investment officer to be president and CEO.[30] However, the Doty report directly implicates him as well in circumventing new derivatives accounting rules and even in dividing the derivatives transactions so they would not have to be disclosed to the board. One business reporter therefore concludes, "Restoring Freddie's credibility ought to mean getting rid of everybody involved – up to and including the board of directors."[31] The Doty report found that the tone of the organization and goal of attaining smooth reporting earnings for "steady Freddie" was set at the top.[32] Another report concludes:

> The convoluted strategies Freddie Mac employed ultimately failed, contributing to as much as $4.5 billion in accounting errors [and] provide some of the most vivid illustrations since the collapse of Enron Corporation of the lengths to which corporations have gone to circumvent accounting rules and manipulate the

23. Kathleen Day, *A Reluctant Coming to Grips at Freddie Mac*, WASH. POST, July 10, 2003, at E1.

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*, Kathleen Day, *Freddie Mac Told to Remove CEO*, WASH. POST, Aug. 22, 2003, at E1.

28. Kathleen Day, *Report Faults Freddie Mac Officials*, WASH. POST, July 24, 2003, at E1.

29. *Trouble at Home*, ECONOMIST, June 14, 2003, at 70.

30. Day, *supra* note 28.

31. Jerry Knight, *At Freddie Mac, It's Hard to Lay Claim to Innocence*, WASH. POST, July 28, 2003, at E1.

32. *See* Day, *supra* note 28.

numbers they disclose to the investing public.[33]

Outside or Independent Directors

The debate over corporate governance has emphasized, and some would argue has overemphasized, the importance of companies having outside or independent directors on the board. That was emphasized by early reformers and is a key component of the Sarbanes-Oxley provisions and the NYSE standards, requiring that key board committees be composed entirely of outsiders.[34] Outsiders, and especially genuinely independent directors, are ostensibly less prone to defer to the CEO and may bring broader perspectives to board deliberations. Anecdotal evidence suggests that outside directors are also becoming more actively engaged in corporate decision-making.[35] One study found that when such outsiders serve on a network of multiple boards, they may diffuse positive standards of CEO compensation and of useful strategic lessons among several firms.[36]

Beyond the legal duties of directors, the powers of the board include those of both monitoring the behavior of management and more actively contributing to strategic policy-making. Both require a certain detachment from management and independence from management influence.[37] Hence, a great debate has ensued over the need to have more outside or independent directors on the board. If a director has business or personal ties to corporate management, he or she might too easily be influenced into rubber-stamping management decisions. The control exerted by management over directors and the "cozy" relationship between the two is the most common criticism of corporate governance. The criteria for determining a genuinely "independent" director is of course subject to debate, and to be independent does not guarantee a board member will be actively engaged in his or her board responsibilities.

Both the regulators and the academic literature favor independent rather than inside directors. The academic literature does so because it is based on agency theory, which sees the key role of boards as being the control or monitoring function.[38] It is reasonable that independent directors, less related and beholden to the CEO, would be more effective monitors. However, a competing theory, that of

33. David S. Hilzenrath, *Strategy Aimed to Circumvent New Rule*, WASH. POST, July 28, 2003, at E1.

34. Lovdal, *supra* note 8, at 108-9.

35. Carrie Johnson, *Corporate Audit Panels to Gain Power*, WASH. POST, Apr. 2, 2003, at E2 (citing Charles M. Elson, director of the Center for Corporate Governance at the University of Delaware, who has noticed audit committees are meeting more often and seeking more outside advice since the collapse of Enron).

36. James D. Westphal, et al., *Second-order Imitation: Uncovering Latent Effects of Board Network Ties*, ADMIN. SCI. Q., Dec. 2001, at 717

37. *See* CONGER, *supra* note 5, ch. 2; Sonnenfeld, *supra* note 13, at 111 (stressing that a culture of open dissent within the board is even more important than dominance by outside directors).

38. Amy J. Hillman & Thomas Dalziel, *Boards of Directors and Firm Performance: Integrating Agency and Resource Dependence Perspectives*, 28 ACAD. MGMT. REV. 383, 383-84 (2003).

resource dependency, suggests that the board provides much more than a control function and that it also provides a wide range of resources or capital to the corporation beneficial to business and strategic decisions.[39] Based on this theory dependent directors from the firm's customers, suppliers, consultants, or bankers might actually have a greater incentive to supply "board capital" since they would stand to gain more from the contribution than would completely detached outsiders.[40] Based on this analysis, the firm would gain more from a board composed of both dependent and independent directors, rather than one dominated by independent directors. However, the dependent directors need not be corporate insiders in the strictest sense of that term, i.e., employees of the firm. It is not necessary that they actually be on the board for the directors to gain from their insights and input. Outside directors should be able to question key insiders at anytime for relevant information and some companies are even structuring such interaction to ensure that directors are informed of new developments within the firm.[41]

This may also explain why a meta-analysis of all studies on the link between board composition and financial performance[42] found there is no positive correlation between firm financial performance and a large proportion of outsiders on a corporate board.[43] Further, both Enron and Tyco had boards with a heavy presence of outside directors and might be considered model boards, yet they failed in dramatic fashion.[44] Hence, the culture of firm and the board, along with other best board practices, may be more important than the presence of outsiders on the board, as required or promoted by Sarbanes-Oxley and the standards of the stock exchanges.[45]

The life cycle and tenure of the CEO, and even of the firm, may further complicate the value of dependent and independent directors at any given point in time. One study argues that early in a CEO's tenure, especially one hired from outside the firm, the board must play a greater role in leadership development than in monitoring opportunistic behavior.[46] Cultivating leadership might call for a combination of backgrounds and skills from both independent and dependent directors.

Separation of Chairman and CEO

The separation of the positions of chairman and CEO is seen by some experts

39. *Id.* at 385-388.

40. *Id.* at 391.

41. Saul Gellerman, *Why Corporations Can't Control Chicanery*, 46 BUS. HORIZONS 3, 17-24 (2003).

42. Dan R. Dalton, et al., *Meta-Analytic Reviews of Board Composition, Leadership Structure, and Financial Performance*, 19 STRATEGIC MGMT. J. 269, 269-70 (1998).

43. *Id.* at 280.

44. Sonnenfeld, *supra* note 13, at 108.

45. *Id.* at 109-113.

46. Wei Shen, *The Dynamics of the CEO-Board Relationship: An Evolutionary Perspective*, 28 ACAD. MGMT. REV 466, 466-67 (2003).

as even more important than dominance by independent directors on the board, but it is an area where little progress has been made by U.S. corporations. According to a study by The Corporate Library, only fifteen of S&P 500 corporations have an independent director as chairman.[47] More common has been a compromise measure of selecting a lead outside director to preside over board meetings even when the CEO is chairman.[48]

Best Board Practices

Along with new actors and new aspects of shareholder activism, there is also an evolving discussion and study of "best practices" in corporate governance. That list has expanded from the traditional list of director independence and committee structures.[49] Various advocates are now emphasizing such new board practices as:

> Separation of Chairman and CEO Positions;
> Lead Director Position;
> Totality of Independent Directors (as at American Standard, Baxter Healthcare, and Fortune Brands);
> Limits on Number of Multiple Directors (numbers of board seats held);
> Downsizing of Boards (Crandall, former CEO of AMR recommends six to eight members and no committees);
> Board Meetings without Management
> More Frequent Meetings and Staff Support;
> Frequent and Complete Disclosure of Information to the Board;
> Stock Ownership by Board Members, but no options;
> Evaluations of Corporate Governance Process;
> Board Committee on Corporate Governance; and,
> Limit CEOs and Directors on Each Other's Boards[50]

Whatever measures are taken voluntarily or mandated by the SEC, some advocates contend that they all fall short. Jeffrey Sonnenfeld, Associate Dean of the Yale School of Organization and Management, claims it all comes down to corporate culture.[51] There must be a culture of independence on the board, in substance and not just in form. Independent directors must be inquisitive and challenging, and dissent must be respected and encouraged by senior management for genuine checks and balances to exist. Independent directors of stature,

47 Ben White, *Save the Chair for the Chief?* WASH. POST., Feb. 7, 2003, at E1; *see also* The Corporate Library, *Exclusive Special Report on CEO/Chairman Splits in the S&P 500: How Many and How Independent?* Feb. 2003, *at* http://www.thecorporatelibrary.com/study/spotlight.asp (last visited Feb. 29, 2004) (containing multiple corporate studies).

48. Paul Kocourek, et. al., *Corporate Governance: Hard Facts About Soft Behaviors*, STRATEGY + BUSINESS, Spring 2003, at 1, *available at* http://www.strategy-business.com/press/article/8322?pg=0 (last visited Jan. 30, 2004); Mary Williams Walsh & David Leonhardt, *To Rein in Abuses, Executives Get Watchdogs*, N.Y TIMES, July 5, 2002, at C1.

49. *See* Sonnenfeld, *supra* note 13, at 106-109 (detailing traditional board structures); Nell Minnow, *Stockholders Would Benefit From More Board Flexibility*, USA TODAY, Sept. 16, 2002, at 13A (detailing emerging board best practices).

50. Sonnenfeld, *supra* note 13, at 112-13; Minnow, *supra* note 49.

51. Sonnenfeld, *supra* note 13, at 109.

expertise, and standing must be appointed.[52]

In keeping with Sonnenfeld's views, others have also suggested that qualitative reforms going well beyond the requirements of Sarbanes-Oxley may do much more to improve corporate governance.[53] Kocourek, Burger, and Birchard emphasize the following key ingredients: (1) Select the right directors: one study by Korn/Ferry found that current directors rate "willingness to challenge management" as the number one criteria for a good director;[54] (2) Training of directors: a major failing of most corporations, but Pfizer is an example of a company that does an excellent job; (3) Inform and empower directors: they need a constant flow of information, ready access to key managers, and both financial and nonfinancial measures of company progress; (4) Counterbalance the CEO: separating the positions of chairman and CEO is necessary and far better than just having a lead director, and the board nominating committee must have more power than the CEO in selecting future directors; (5) Nurture a culture of collegial questioning: while being a partner with the CEO, strong-willed directors must also challenge and disagree; (6) Devote an adequate amount of time: directors must devote 100-200 hours a year to a board, and perhaps 300 hours for audit committee members;[55] (7) Measure board performance: studies show a small percentage of boards face up to this need, but surveyed directors recognize its value.[56]

Continuing with the emphasis on director diligence, as opposed to independence, another author suggests ways of increasing the time invested by directors and expanding their control. One argues in favor of full-time directors, who view that job as their primary responsibility and serve on only one corporate board.[57] Such directors would also be given "the authority of a military inspector-general, with the right to question anyone within the company and impose sanctions on them.[58]

Finally, for corporate governance to really work, cooperation must exist between the corporate community and business policy organizations on the one hand and self-regulatory bodies and government regulators on the other. Each must respect the professionalism of the other. The adversary spirit long dominant between business and regulators will impede progress on the road to reform. All must march together in the same direction.

Shareholder Rights

In the 1970s, much of the incipient changes in corporate governance related to the structure and composition of the corporate board.[59] However, there also was

52. *Id.* at 113
53. Kocourek, *supra* note 48, at 12.
54. *Id.* at 5.
55. *Id.* at 11.
56. *Id.* at 4-5.
57 Gellerman, *supra* note 41.
58. *Id.*
59. Lovdal, *supra* note 8, at 108-10; JACKSON, *supra* note 11, at 367-370.

movement in the area of shareholder rights and powers as well. Shareholders have historically enjoyed and used the following legal powers:

> Voting – to vote for or against directors, usually a management slate of directors, as well as to vote on proxy resolutions. There has also been a modest campaign for the system of cumulative voting, which would give dissident directors more concentrated power in electing some representatives to the board.
> Inspecting the Books – beyond having access to the 10-K report and other corporate disclosures, shareholders sometimes legally demand and receive access to more detailed financial information, under special circumstances and when it is in their material interests.
> Lawsuits – shareholders can bring individual, class action, or derivate suits against management when they have been injured by management mistakes.
> Wall Street Rule – the final power by shareholders has been that of exiting or selling their shares when they disagree with the direction of the company and decisions of management.
> Shareholder Resolutions – they can file a resolution on a corporate policy with which they disagree, to be voted upon by all shareholders, when they own $2,000 worth of stock.[60]

It is the final power of introducing shareholder resolutions that has become ever more prominent since the 1970s. The SEC has periodically ruled on the criteria that such resolutions should meet, which can be disqualified by management, and the votes required for resubmission of such resolutions.[61] Organized shareholders, though, have been the driving force behind what has really become a movement of shareholder resolutions. The radical organizer Saul Alinsky used resolutions as an organizing strategy in the 1950s;[62] Nader later used them for a time in the late 1960s;[63] and the National Council of Churches really promoted their widespread use since that time.[64] Its Interfaith Center on Corporate Responsibility annually sponsors hundreds of shareholder resolutions.[65] Other religious and labor organizations now sponsor resolutions as well.[66]

As an indication of their growing impact, the Investor Responsibility Research Center (IRRC) formed in 1973 to monitor shareholder resolutions and to advise institutional investors on how to vote their shares.[67] Most of the resolutions

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60. ARTHUR LEVITT, TAKE ON THE STREET 211-212 (2002).

61. Security Exchange Act of 1934, § 14(a)(8), 17 CFR 1.

62. SANDOR D. HORWITT, LET THEM CALL ME REBEL. SAUL ALINSKY, HIS LIFE AND LEGACY (1989).

63. JACKSON, *supra* note 11, at 370.

64. *Id.*

65. Interfaith Center on Corporate Responsibility, Companies, Resolutions and Status: 2002-2003 Season, *at* http://www.iccr.org/shareholder/proxy_book03/03statuschart.php (last visited Feb. 14, 2004) (listing continual update on these resolutions); The Corporate Library, News Briefs, *at* http://www.thecorporatelibrary.com/news/default.asp (last visited Feb. 14, 2004) (featuring articles on shareholder activism).

66. The Corporate Library, News Briefs, *supra* note 65.

67 The Investor Responsibility Research Center Library, *at*

of the 1970s and 1980s related to the social impact of corporate policies, such as disclosure of EEO data, investment in South Africa, development of nuclear power, or animal testing.[68] Reflecting current times, shareholder resolutions more commonly focus today on mainstream corporate governance issues, such as the separation of the office of CEO and chairman of the board, the demand for more independent directors, or reform of CEO compensation.[69]

NEW ELEMENTS IN CORPORATE GOVERNANCE

In terms of what is new in shareholder activism, the upsurge in activism by mainstream shareholders on mainstream issues tells the tale. No longer are liberal church groups and other cause organizations the only ones sponsoring resolutions on largely social issues. Even before the wave of corporate scandals, corporate governance had become a growing concern among institutional investors. Beyond the formation of the IRRC in 1973, other organizations formed to assist institutional investors in the 1980s, including Institutional Shareholder Services, Inc.[70] James E. Heard, an organizer of IRRC, is now a principal in this firm.[71] In fact, boards and senior management might have seen the earlier activism on corporate governance as an early-warning signal to its importance as an issue. Regulators might likewise have paid closer attention.

Now, in the wake of the scandals over management and board misconduct, other organized interests have entered the arena. The Council of Institutional Investors, along with state pension funds, is playing a greater role in pressuring management and boards on corporate governance and executive pay issues.[72] The rating agencies, such as Standard & Poor's and Moody's, are now involved in evaluating the governance mechanisms and systems of the companies they

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http://www.irrc.org/resources/library.htm (last visited Feb. 20, 2004) (providing some of IRRC's research which is known as fair and objective).

68. *See* DAVID VOGEL, LOBBYING THE CORPORATION: CITIZEN CHALLENGES TO BUSINESS AUTHORITY 69-125 (1978); *see also* PATRICIA O'TOOLE, MONEY & MORALS IN AMERICA 300-27 (1998).

69. Robert D. Hershey, *Investor Angst Prompts Funds to Speak Up*, N.Y TIMES, July 7 2002, at 3.5; *see also* The Corporate Library, Shareholder Proposals, *at* http://www.thecorporatelibrary.com/ shareholder-action/shareprops/default.asp (last visited Feb. 14, 2004) (containing submitted shareholder proposals); CalPERS, Shareholder Action, *at* http://www.calpers-governance.org/alert/default.asp (last visited Feb. 14, 2004) (detailing CalPERS' policies on exercising its voting rights); TIAA-CREF TIAA-CREF Publications, *at* https://www5.tiaa-cref.org/bookstore/list.do?cat=6 (last visited Feb. 14, 2004) (containing TIAA-CREF's investment philosophies); AFL-CIO, Executive PayWatch, *at* http://www.aflcio.org/paywatch (last visited Feb. 14, 2004) (covering executive compensation trends, issues, and resolutions).

70. Institutional Shareholder Services, Company Profile (2004), *at* http://www.issproxy.com/about/index.asp (last visited Jan. 27, 2004) (Institutional Shareholder Services (ISS), Inc. is a for-profit proxy monitoring service.). For a critique of ISS's potential conflicts of interest, see Adam Lishinsky, *ISS Wants Business Both Ways*, FORTUNE, June 16, 2003, at 24.

71. Institutional Shareholder Services, Company Profile, *supra* note 70 (information about staff and operations).

72. *See* Council of Institutional Investors, What We Do, *at* http://www.cii.org/dcwascii/web.nsf/ doc/what_index.cm (last visited Feb. 29, 2004) (information on its corporate governance activities).

evaluate.[73] Finally, there are new companies that have been recently formed to sell services on corporate governance evaluation, such as Governance Metrics International.[74] Investors are beginning to focus much more on governance evaluation, partially because studies increasingly show a positive relationship between "good governance" and financial performance.[75] That field of study will likely grow even more as the corporate governance issue remains high on the agenda.

Organized political interests have also taken positions on corporate governance. The Business Roundtable has promoted the need for more independent boards, even while it takes a cautious stance on the expensing of stock options.[76] The Conference Board formed a Commission on Public Trust and Private Enterprise, co-chaired by former Commerce Secretary Peter Peterson and John Biggs of TIAA-CREF [77] and it has stressed the need for more scrutiny and independence on corporate boards, as well as the expensing of stock options.[78]

John Bogle, a member of the Commission and founder of the Vanguard Group, has emerged as a leading activist in favor of corporate governance reform.[79] He has been a critic of both the gatekeepers and monitors, such as corporate boards, regulators, and legislators, as well as of investors themselves. He believes the mutual funds must step to the plate in monitoring the governance of companies in which they invest. As he puts it:

> Even after the bear market that devastated the value of our clients' equity holdings, the only response we've heard from the mutual fund industry is the sound of silence. We need to return to behaving as *owners* rather than *traders*, to return to principles of prudence and trusteeship rather than of speculation and salesmanship, and to return to acting as good stewards of the assets entrusted to our care.[80]

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73. *See* Standard & Poor's, Governance Services, *at* http://www.standardandpoors.com (last visited Jan. 26, 2004).

74. *See* Governance Metrics International, About Us: Overview, *at* http://www.gmiratings.com (last visited Feb. 29, 2004).

75. *See* Jeanne Patterson, The Patterson Report: Corporate Governance and Corporate Performance Research (2003), *available at* http://www.thecorporatelibrary.com/Governance-Research/patterson-report/patterson.asp (last visited Mar. 11, 2004). *See also* The Corporate Library, Governance Research (2004) (containing multiple studies), *at* http://www.thecorporatelibrary.com/Governance-Research/default.html (last visited Mar. 11, 2004).

76. The Business Roundtable, *Principles of Corporate Governance*, (May, 2002) *at* http://www.businessroundtable.org/pdf/704.pdf (last visited Feb. 29, 2004).

77 The Commission on Public Trust and Enterprise, (2004), *at* http://www.conferenceboard.org/knowledge/governCommission.cfm (last visited Mar. 2, 2004) (Co-chair Biggs was an erstwhile candidate to head the Public Company Accounting Oversight Board, established by the Sarbanes-Oxley Act, while Harvey Pitt was still Chairman of the SEC, but his candidacy met with substantial business opposition.).

78. The Commission Board, *Commission on Public Trust & Private Enterprise: Findings & Recommendations*, Jan. 9. 2003, at 38-39, *at* http://www.conference-board.org/pdf_free/758.pdf (last visited Mar. 2, 2004).

79. *See* Bogle, *supra* note 6.

80. *Id.*

One other major issue is of renewed concern for shareholders, that of transparency. Disclosures of all sorts of corporate practices related to the governance system, to accounting, and to the means of evaluating executive performance and compensation are being promoted by shareholders. The SEC has unanimously proposed a rule requiring greater disclosure on how corporate directors are selected, including policies on how directors are nominated, the minimum qualifications to serve on the board and how candidates came to the attention of the board.[81]

Shareholder Nomination of Directors

Historically, shareholders have had limited powers in nominating directors due to management's control of the proxy machinery. Shareholders' ability to nominate directors and participate in board elections has been undermined by the huge financial barriers of financing a campaign for their own nominees. Corporations enjoy the power to finance campaigns and proxy materials for only those candidates nominated by the corporate board. Shareholders therefore face a slate of choices selected by the company. Outside candidates must present shareholders with an alternative ballot at their own expense. As one business writers concludes, "Most significant [even after Sarbanes-Oxley], the very heart of corporate governance, the election of directors, is still a sham. The shareholder ballots you receive with your proxy materials are just like those Stalin used to distribute. For every position there is exactly one candidate. Please mark your choice."[82]

However, the SEC is now considering a rule which would allow significant and long-time shareholders, those with more than 3 to 5 percent of corporate ownership, to nominate their own directors.[83] Shareholder activist Evelyn Y. Davis and corporate governance expert Charles Elson are concerned that such a high threshold might set a precedent for elevating the share holding requirement to sponsor shareholder resolutions from the current level of one percent or $2,000 of shares, but the SEC has defeated such moves in the past.[84] The rule may allow shareholder nominations when certain triggering events occur, such as a company's failure to implement the terms of shareholder resolutions enjoying wide support that call for changes in corporate governance, or when shareholders have expressed widespread dissatisfaction in the current board.[85] Some experts fear that if support for shareholder resolutions becomes a triggering event, then corporations will fight earlier and harder to heavily defeat such resolutions.[86]

Another rule proposed by the SEC would require disclosure of nominating or governance committee actions on shareholder candidates. The board would have

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81. Carrie Johnson, *SEC Votes to Propose Director Rules*, WASH. POST, Aug. 7, 2003, at E3.

82. Geoffrey Colvin, *Shareholders are No Fools Anymore*, FORTUNE, July 7, 2003, at 42.

83. Charles Duhigg, *SEC May Aid Rebels Seeking Board Seats*, WASH. POST, Aug. 6, 2003, at E1.

84. *Id.*

85. *Id.*

86. *Id.*

to explain why it found unacceptable a board candidate nominated by shareholders who owned more than 3 percent ownership stake for the past year.[87]

Some corporate governance reformers, such as Nell Minow and the AFL CIO, see shareholder empowerment as bringing more fundamental change in corporate governance than does the Sarbanes Oxley Act, through the presence of more "outside directors" chosen by the board itself.[88] Opponents, such as Henry Manne, notable expert in the law and economics movement, believe that empowering shareholders in director elections will create mischief by creating too much corporate democracy and paralyzing corporate decision-making with the presence on the board of activist shareholder representatives.[89] Even moderate critics reject the "romantic notion that corporations should be laboratories of democracy, and conclude that "running a corporation requires more stability and internal harmony than the democratic model allows."[90] For these reasons, leading business lobbies like the Business Roundtable have opposed the new rule, saying it would "turn every director election into a divisive proxy contest."[91] The American Society of Corporate Secretaries and the New York City Bar Association also oppose the rule, contending it would produce divided and unqualified boards.[92] However, to this fear of a balkanized board, other governance experts reply that, "the ideal board candidate is someone with forceful opinions who isn't afraid to share them and that the best boards aren't necessarily those that agree, but those that argue."[93] Some companies, like Apria Healthcare Group and Hanover Compressor, have already allowed shareholder access to the proxy machinery to make director nominations.[94]

Shareholder Litigation

Beyond the promotion of these new concerns through shareholder resolutions, there is also a renewed emphasis on shareholder litigation. Many of the scandal-ridden corporations have been the targets of such litigation by pensioners and institutional investors, such as the lawsuit brought against Enron and its creditors by the University of California system.[95] Beyond the suits brought by the leading plaintiff lawyers, such as William Lerach, many established law firms are moving into this line of business, joined by new firms that are carving it out as a niche business.[96] Hence, any corporations and management tinged with legal problems

87. Johnson, *supra* note 81.

88. Minow, *supra* note 49.

89. Henry Manne, *Citizen Donaldson*, WALL ST. J., Aug. 7, 2003, at 10.

90. Steven Pearlstein, *Corporate Reform Could Go Too Far* WASH. POST, July 18, 2003, at E1.

91. Louis Lavelle, *Shareholder Democracy Is No Demon*, BUS. WK. ONLINE, July 2, 2003, at 1, *at* http://businessweek.com/bwdaily/dnflash/jul2003/nf2003072_0829_db042.htm (last visited Mar. 3, 2004).

92. *Id.*

93. *Id.* at 2.

94. *Id.*

95. Jerry Hirsch, *UC Named Lead Plaintiff in Enron Class-Action Suit*, L.A. TIMES, Feb. 16, 2002.

96. *In Praise of Trial Lawyers*, ECONOMIST, July 12, 2003, at 60.

can expect to confront such litigation. Just the investment banks involved in the recent Wall Street settlement may face potential outside liability of up to $82 billion, prior to appeals and out-of-court settlements.[97] Hence, the individual fines and criminal actions, and the billions involved in the settlement, may be just the tip of the iceberg.[98]

Given the requirement of the 1995 Private Securities Litigation Reform Act,[99] that the control of such shareholder suits would rest with that largest investor, attorneys such as William Lerach are now forced to work more closely with institutional investors, which have the largest stakes in the litigation. In representing the University of California against such Enron creditors as Citigroup, J.P Morgan Chase, Bank of America, Goldman Sachs, and Merrill Lynch, Lerach's opening settlement proposal was for $15 billion.[100] He is also trying to persuade the banks to drop their indemnification agreements, which would increase his fees.[101] As the *Economist* comments, "These indemnification agreements throw liability for due-diligence failures back on the company issuing the shares or bonds, making a nonsense of an underwriter's gatekeeping role."[102]

The battle over final liability for the failures of directors and officers, and of investment analysts in other cases, will be fought between the banks and insurance companies. The banks will argue that D&O and E&O insurance policies should cover their liability and even some of the money owed in the $1.4 billion settlement orchestrated by New York Attorney General Eliot Spitzer,[103] while the insurance companies will resist paying, arguing that their policies do not cover fraud and deceit.[104] The contest relates to the larger argument over the appropriateness of D&O indemnification policies. Some like Warren Buffet argue that such policies create a moral hazard and encourage sloppy behavior by directors, so Berkshire Hathaway does not even carry such policies.[105] Xerox Corporation, on the basis of its D&O policy, paid for the disgorgement of $6.4 million of gains due to fraud committed by former CEO Paul Allaire.[106] This is but one example of what some consider the moral hazard created by such policies, in arguing that directors and officers should, at a minimum, purchase their own policies.[107]

Corporate Governance Ratings

Given the major failures and blowups in corporate governance, along with the

97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.*
103. *Whose Skunk Is It?* ECONOMIST, June 7, 2003, at 63-64.
104. *Id.*
105. *Id.*
106. Carrie Johnson, *Former Xerox Officials Settle Case*, WASH. POST, June 6, 2003, at E2.
107. *See Whose Skunk Is It? supra* note 103.

rising interest in the investment community over good governance practices, various organizations that serve business and institutional investors have launched corporate governance ratings services. The two major organizations that advise institutional investors on a wide array of issues – the Investor Responsibility Research Center (IRRC) and Institutional Shareholders Services (ISS) – have both done so.[108] The Corporate Library, a research organization and website directed by Nell Minow, has also developed its own rating system, as has Governance Metrics International, a firm developed specifically to rate corporate governance.[109] Finally Standard & Poor's, a major ratings company has expanded its evaluation of corporations and developed a Global Corporate Governance practice, headed by George Dallas in its London office.[110]

One of the firms, ISS, has already been criticized for possible conflicts of interest in its ratings practice.[111] It offers a service costing $15,000 to corporations that helps them improve their governance ratings, while it also provides the resulting metrics to its institutional investor clients.[112] ISS responds that it maintains a wall of separation between its corporate and client services, but other corporate watchdogs remain critical.[113]

While the major rating firms, such as Moody's and Standard & Poor's have developed corporate governance ratings services, they have also been criticized for failing to alert the investment public to the possibility of unfolding corporate scandals, especially in the case of Enron.[114] A report to the Senate Committee on Governmental Affairs, *Financial Oversight of Enron: The SEC and Private-Sector Watchdogs* criticized the rating companies for failing to probe deeply enough, for focusing on largely short-term issues, and for failing to hold themselves accountable for the accuracy of their reports.[115]

Corporate Governance and Financial Performance

Many studies have examined the link between different changes in corporate governance and financial performance, and the results have been mixed. Studies show that the impact of more independent boards on financial performance has been notably weak.[116] That was the key finding of a recent study based on a large sample of firms over an extended period of time.[117] Broadening the base from independence on corporate boards to other criteria of corporate governance,

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108. *See* Investor Responsibility Research Center Library, *supra* note 67· Institutional Shareholders Services, *supra* note 70.

109. *See* Governance Metrics International, *supra* note 74.

110. *See* Standard & Poor's, *supra* note 73.

111. Adam Lashinsky, *ISS Wants Business Both Ways*, FORTUNE, June 16, 2003, at 24.

112. *Id.*

113. *Id.*

114. Claire Hill, *Rating Agencies Behaving Badly*, 35 CONN. L. REV. 1145, 1145 (2003).

115. *Id.* at 1148.

116. Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 IOWA J. CORP L. 231, 232-233 (2002).

117. *Id.*

however, reveals more positive results, especially in comparing the firms with the best governance systems versus those with the worst. Corporate governance experts Ira Millstein and Paul MacAvoy found that those companies rated A in their governance by the California Public Employees Retirement System outperformed those rated "F" by over 25 percent.[118]

Business and Federalism Issues

In the regulatory arena, there has been a lively debate over states' rights in the courts, and especially in the U.S. Supreme Court under Chief Justice Rehnquist's leadership. The tensions within our federal system of government have been important ever since the nation's founding, have assumed even more significance since the expansion of federal authority during the late New Deal years.[119] In the past ten years, there has been a rollback in federal authority and a resurgence of states' rights under the Rehnquist Court, also vigorously promoted by Justice O'Connor. Decisions like *U.S. v. Lopez*, ruling unconstitutional the Gun-free School Zones Act,[120] and *U.S. v. Morrison*, ruling unconstitutional the Violence Against Women Act,[121] have marked a new watershed on federalism issues. While the rollback in federal authority may please business in certain respects, the resulting promotion of more state regulation and activism may not be so pleasing. In fact, uniform regulation at the federal level, accompanied with a more rational and professional approach to regulation might prove easier for business to accommodate.

The rise in initiatives by state attorneys general and their aggressive pursuit of investigations and litigation against certain industries became more prevalent during the 1990s. The litigation by the states against the tobacco industry and against Microsoft are but two examples.[122] Most prominent starting since the year 2002 has been the action by New York Attorney General Eliot Spitzer versus the financial industry, relying on state laws like the Martin Act to prosecute leading investment banking firms.[123] Some conservatives and business interests have complained that he has invaded the legitimate turf of the Justice Department and SEC,[124] while Spitzer and his defenders respond that he was driven to act by the passivity and failure of the SEC under Chairman Harvey Pitt to act in a timely

118. Ira Millstein, & Paul MacAvoy, *The Active Board of Directors and Improved Performance or the Large Publicly Traded Corporation.* 98 COLUM. L. REV 1283, 1300 (1998).

119. ROBERT NAGEL, IMPLOSION OF AMERICAN FEDERALISM 5 (2001).

120. *See generally* U.S. v. Lopez, 514 U.S. 549 (1995).

121. *See generally* U.S. v. Morrison, 529 U.S. 598 (2000).

122. *See* CARRICK MOLLENKAMP, ET AL., THE PEOPLE VS. BIG TOBACCO: HOW THE STATES TOOK ON THE CIGARETTE GIANTS (1998); JOEL BRINKLEY & STEVE LOHR, U.S. V MICROSOFT: THE INSIDE STORY OF THE LANDMARK CASE (2000); Carolyn Mayer, *Attorneys General Crusade Against Corporate Misdeeds*, WASH. POST, Feb. 19, 2003, at E1.

123. Amy Borrus & Mike McNamee, *States vs. the SEC. What' all the Shouting For?* BUS. WK., July 28, 2003, at 39; Gary Weiss, *Competing Watchdogs Are Good for the Street*, BUS. WK., Sept. 1, 2003, at 86.

124. Brooke A. Masters, *States Role in Doubt on Wall Street*, WASH. POST, July 23, 2003, at E1.

manner.[125]

Congress and the U.S. Supreme Court do have the ability to override state initiatives through the doctrine of federal preemption.[126] While the Court has not always been sympathetic to claims of federal preemption, as in leading tobacco cases and occupational safety cases, it will usually defer to explicit statutory provisions of federal preemption.[127] This may provide an incentive for business to lobby for more such provisions in the future. While it may seem strange for business to advocate the expansion of federal power over the states, it may advance efficiency concerns for business while also boosting its public reputation for seeking constructive solutions. It may also curry favor with certain citizen groups who would join a coalition promoting federal power and regulation against old-guard conservative groups.

One major caveat is that the willingness of non-business interests to embrace federal pre-emption really depends on the stringency of the uniform federal standard to be applied. Bills proposed for uniform federal product liability standards have floundered for the past two decades because consumer groups and trial lawyers have objected to the more lenient standards of liability for business embodied in these bills, whether the issue is caps on punitive damages or standards for strict liability [128]

In the summer of 2003, House capital markets subcommittee Chairman Richard H. Baker (R-LA), proposed legislation to curb the power of state securities regulators and attorneys general,[129] perhaps to clip the wings of NY state attorney general Eliot Spitzer and his counterparts in other states. Baker and his supporters believe that securities markets should have only one watchdog, the SEC, and that states should not have the power to fashion remedies that change industry practices, and certainly not enforce rules tougher than those of the SEC.[130] SEC Chairman William Donaldson and Fed Chairman Alan Greenspan also seem to support that view.[131] Spitzer and his allies, however, aggressively lobbied against the bill, and it died in committee.[132] Given that Spitzer and the states have acted more swiftly against industry misconduct than have the SEC and the federal government, Wall Street firms supported Baker's initiative.[133] The criminal charges brought by Oklahoma State Attorney General Edmondson against

125. E.J. Dionne, *Defending States Rights Except on Wall Street*, WASH. POST, July 22, 2003, at A17.

126. U.S. CONST. art. I, § 8 (the Commerce Clause).

127. *See generally* U.S. v. Morrison, 529 U.S. 598 (2000); Cipollone v. Liggett Group, Inc., 505 U.S. 504 (1992); Lorillard Tobacco v. Reilly, 533 U.S. 525 (2001).

128. Lorraine Woellert, *Tort Reform: A Little Here, A Little There*, BUS. WK., Jan. 20, 2003, at 60.

129. Masters, *supra* note 124.

130. *Id.*

131. Brooke Masters & Ben White, *Donaldson Backs SEC Supremacy Bill*, WASH. POST, July, 16, 2003, at E1.

132. Ben White & Brooke Masters, *Bill to Limit State Probes of Wall St. Delayed*, WASH. POST, July 25, 2003, at E1.

133. *See* Masters, *supra* note 124; Borrus & McNamee, *supra* note 123.

WorldCom and four executives in August, 2003,[134] when the U.S. Department of Justice had thus far failed to act, again demonstrates the aggressive role the states sometimes play in the face of federal delays. The tension between the states and the federal government will certainly continue in the area of corporate financial fraud, as in many other areas.

Given the popularity of Spitzer's actions, the rise of state activism, and the tradition of state regulation of corporate governance, the Sarbanes-Oxley Act breaks new ground by pre-empting state law on corporate governance and absent the crisis of corporate scandals, surely would have generated much more controversy and debate. Of course, the U.S. House of Representatives was more resistant to the broad sweep of the law than was the Senate,[135] but on the heels of the WorldCom scandal, even Republicans in the House joined the throng supporting Sarbanes-Oxley.[136] The rather rapid passage of the law, however, should not obscure its major departure from past regulatory approaches. As one expert comments:

> For over 200 years, corporate governance has been a matter for state law. Even the vast expansion begun by the New Deal securities regulation laws left the internal affairs and governance of corporations to the states. Taken individually, each of Sarbanes-Oxley's provisions constitutes a significant preemption of state corporate law. Taken together, they constitute the most dramatic expansion of federal regulatory power over corporate governance since the New Deal.[137]

The law not only injects the SEC and the national listing exchanges into the regulation of the structure, composition, and duties of the corporate board, but it also regulates several aspects of executive compensation. Traditional federalism analysts believe that the states, as "laboratories of democracy, might generate better solutions through interstate competition, and that the one-size-fits-all approach of Sarbanes-Oxley is particularly inappropriate when trying to design governance models to fit different corporate cultures in vastly different industries.[138] Since Congress has moved so far on federalizing corporate law, it is perhaps less strange that even leading Republican legislators would now try to roll back state securities regulations and the power of state attorneys general. Perhaps those moves appease the efficiency interests of their business supporters, but they also move counter to the trends of recent Republican administrations and to the line of federalism decisions by the Rehnquist Court.

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134. Christopher Stern, et al., *Oklahoma Plans to Charge Ebbers, WorldCom*, WASH. POST, Aug. 27, 2003, at E1; Christopher Stern & Brooke Masters, *WorldCom, Ex-Officers Charged in Oklahoma*, WASH. POST, Aug. 28, 2003, at E1; Barnaby Feder and Kurt Eichenwald, *A State Pursues WorldCom and May Hurt the U.S. Case*, N.Y TIMES, Aug, 28, 2003, at C1.

135. Jackie Spinner, *Sarbanes Circulates Auditing Reform Bill*, WASH. POST, May 9, 2003, at A10.

136. Dana Milbank, *Both Political Parties Say Enron Proves Their Point*, WASH. POST, May 8, 2002, at A5.

137 Stephen Bainbridge, *The Creeping Federalization of Corporate Law*, REGULATION, Spring 2003, at 26

138. *Id.* at 30-31.

SARBANES-OXLEY ACT PROVISIONS

This section will first briefly state some of the leading provisions of the act[139] and then will elaborate on some contentious issues left open for regulation. The act provides for:

1 Public Accounting Oversight Board – with powers over the public accounting profession and independent audit firms: only firms registered with the board will be allowed to audit public companies; accountants must disclose any civil or criminal proceedings against them; the larges firms will be evaluated annually and smaller firms once every three years; in case of deficiencies, audit firms can be fined up to $15 million or barred entirely from public accounting.[140]

2. Auditor Independence – prohibits the provision of specified non-audit services, requires that permitted services be pre-approved by the corporate board, and requires that the lead audit partner be rotated every five years.[141]

3. Board of Directors Audit Committee – must be comprised only of independent directors and is responsible for the appointment, oversight, and compensation of company auditors.[142]

4. Certification of Periodic Financial Reports – the CEO and CFO must certify that financial statements fairly represent the issuer's financial condition and results of operations.[143]

5. Corporate Governance and Responsibility/Reimbursement of CEO/CFO Compensation – in the event of misconduct and misstated financial results, the CEO and CFO must repay any bonus, incentive compensation, or profits resulting there from.[144]

6. Insider Trades During Blackout Periods – directors and officers may not trade during blackout periods, and any resulting profits must be disgorged.[145]

7 Loans to Officers and Directors – issuers may not make any new loans or modify prior loans to their officers and directors.[146]

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139. Rules of Professional Responsibility for Attorneys (Sarbanes-Oxley Act), 15 U.S.C.S. § 7201 (2003) [hereinafter Sarbanes-Oxley Act].

140. Charles A. Bowsher, Statement before the Senate Banking Committee (Mar. 19, 2002) (transcript *available at* http://www.publicoversightboard.org/news_03_19_02.htm (last visited Mar. 3, 2004) (Charles Bowsher, at the time of this statement, was the chairman of the Public Oversight Board.); Sarbanes-Oxley Act, *supra* note 139.

141. Robert Reilly, *Summary of the Sarbanes-Oxley Act for Bankruptcy Appraisers*, 2003 AM. BANKR. INST. J. 40, 1-8 (2003). *See also* Sarbanes-Oxley Act, *supra* note 139.

142. Reilly, *supra* note 141.

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.*

8. Enhanced Financial Statement Disclosures – financial statements must reflect all material correcting adjustments identified by the company's auditors, and the SEC shall issue rules on the disclosure of off-balance-sheet transactions and the disclosure of pro forma financial results.[147]

9. Issuer and Management Disclosure/Insider Transactions – insider sales and purchases of stock must be reported within two days of the transaction.[148]

10. Other Issuer and Management Disclosures – the SEC must issue rules on the disclosure of a company's internal controls and financial reporting procedures, whether the company has a code of ethics and any waivers it allows, and whether the audit committee includes a financial expert.[149]

11. Fraud and Criminal Penalties – increases or adds criminal penalties for a number of securities and corporate governance matters, increases the statute of limitations, provides that debts arising from securities fraud cannot be discharged in bankruptcy, and authorizes the SEC to freeze any payments to officers and directors during investigations. For "knowingly" signing off on inaccurate financial statements, the penalty is up to ten years in jail and a $1 million fine, while for "knowingly and willingly" signing off on such statements, the penalty is up to tweny years in jail and a $5 million fine.[150]

12. SEC Resources and Authority – requires the SEC to issue rules regarding the minimum standards of professional conduct for attorneys practicing before the SEC.[151]

13. Securities Analysts and Securities Research Reports – requires the SEC to issue rules that address conflicts of interest of securities analysts.[152]

14. Regulatory Studies and Reports – authorizes the SEC, Comptroller General, and GAO to issue reports on the need for further legislation.[153]

15. Fraud and Criminal Penalties/Whistleblower Protections – creates protection for whistleblowers and employees when they act lawfully to disclose information about fraudulent activities in their companies.[154]

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147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.*, Jeremy Kahn, *A Taste of Success: But the Real Test for Sarbanes-Oxley is still ahead.* Fortune, Sept. 1, 2003, at 21.

151. Reilly, *supra* note 141.

152. *Id.*

153. *Id.*

154. *Id.*

16. Corporate Fraud Accountability – authorizes the SEC to prohibit "unfit" individuals from serving as officers or directors.[155]

Auditor Conflicts of Interest

According to Sarbanes-Oxley provisions, auditors are discouraged from providing a range of non-audit services to clients.[156] Those that are prohibited include human resources and technology services.[157] Tax projects must be approved by the client corporation's board, and the SEC has released guidelines stipulating that the approval must be for each project proposed and cannot be on a blanket basis.[158] In order to avoid the paperwork and processing costs that each pre-approval would entail, some firms may spread the work among various audit firms instead.[159]

Regulation of Attorneys

Since the passage of Sarbanes-Oxley, the SEC now requires attorneys to report any client misconduct upward in the organization as far as the board of directors, if necessary This is the so-called "reporting-up" or "laddering-up" provision.[160] More controversial has been its consideration of a "noisy withdrawal" provision, requiring that a corporate attorney resign from representing the firm and that the firm report any misconduct to the SEC.[161] In order to blunt this possible regulation, the American Bar Association narrowly approved an exception to the rule of attorney-client confidentiality which allows but does not require an attorney to go to the public authorities when company officials are violating the law in a way that harms the company [162] Attorneys are normally required to report violations of a client only when those violations pose physical harm to persons. The voluntary reporting standard follows the lead of forty-two states that already allow it.[163] In arguing in favor of the ABA's approach over that of a more rigid SEC noisy-withdrawal requirement, Bart Schwartz, general counsel to the Mony Group states, "The 'permissive reporting-out' rule approved by the ABA leaves more discretion to corporate lawyers about when it is necessary to divulge client confidences, and should give corporate clients more comfort that their lawyers can continue to handle sensitive information without turning into SEC informants."[164]

155. *Id.*

156. Sarbanes-Oxley Act, *supra* note 139.

157. *Id.*

158. *Id.* at §§ h (regarding preapproval of non-audit services).

159. Carrie Johnson, *Tyco Auditor Barred from SEC Work*, WASH. POST, Aug. 14, 2003, at E1.

160. Sarbanes-Oxley Act, *supra* note 139.

161. *See* Brooke A. Masters, *ABA Eases Rule On Informing; Lawyers Can Now Report Suspected Fraud By Clients*, WASH. POST, Aug. 12, 2003, at E1 (The "noisy withdrawal" requirement is not contained in the statute itself but is subject to possible rule-making by the SEC.).

162. *Id.*

163. *Id.*

164. *Id.*

Prior to the ABA s action, the Washington state bar association was feuding with the SEC over the issue. It argued that complying with the SEC mandate would provide lawyers no protection from state bar sanctions for violating lawyer-client confidentiality [165] Citing Sarbanes-Oxley, the SEC argues to the contrary that federal rules should prevail over state rules.[166] The ABA's action, however, by making reporting outside the organization only voluntary, may have minimal impact in the face of such state bar codes. In California, for example, the state's Business and Professions Code provides for strict attorney-client confidentiality [167] On the other hand, if lawyers fail to exercise their option to report offenses to the SEC, they may be subject to shareholder lawsuits by injured investors.[168]

Expert assessments of the ABA's decision range from largely symbolic to "modest, as Columbia Professor Jack Coffee says,[169] to a "tectonic shift, as NYU Professor Stephen Gillers states.[170] Gillers states that the ABA "to its credit recognized that lawyers are in a public profession and have obligations to other people."[171] Coffee said the ABA amendments were "modest changes in the right direction, under the shadow of far more sweeping change that the SEC is considering this has real teeth, and the bar is scared to death about it."[172]

The ABA actually passed two amendments, one allowing lawyers to warn potential victims of fraud perpetrated by their clients, and the other allowing them to report the conduct.[173] In some states, codes of conduct already permit lawyers to report criminal conduct, and in most states, attorneys may warn victims of fraud if clients used the lawyers' legal work in conceiving the fraud.[174] The new ABA amendments and SOX oblige lawyers to report fraud to the board of directors and therefore go beyond the voluntary standard. The ABA standards go beyond Sarbanes-Oxley Act in one respect. They cover attorney obligations to private companies and nonprofit organizations such as unions, not just companies that report to the SEC.[175]

Part of the pressure being exercised on law firms to help expose white-collar crimes is also coming from the IRS. In its first action ever taken against a law firm, the IRS is taking action in federal court to force Jenkens & Gilchrist, a Dallas firm, to disclose details of a tax shelter plan the firm has allegedly marketed to a

165. Brooke A. Masters, *New Rules Leave Lawyers In Bind on Whistle-Blowing,* WASH. POST, Aug. 6, 2003, at E1.

166. *Id.*

167 California Business & Professions Code, *available at* http://www.leginfo.ca.gov/.html/ bpc_table_of_contents.html (last visited Mar. 11, 2004).

168. Myron Levin, *ABA Code Targets Corporate Crimes; The Lawyers Group Amends Ethic Standards to Encourage Attorneys to Report Wrongdoing,* L.A. TIMES, Aug. 13, 2003, at 1.

169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.*

173. *Id*

174. *Id.*

175. *Id.*

client.[176] Here again, the concern is violation of the attorney-client privilege.

Regarding the rights of investors to bring private lawsuits against law firms, the SEC has banned them from doing so unless they can show the firms are "primary actors" causing their losses.[177] Senator Christopher Dodd (D-CT) and others inserted that dubious provision as part of the Securities Litigation Reform Act of 1995.[178] Nonetheless, investors are trying to hold liable the firms of Kirkland & Ellis and Milbank, Tweed, attorneys for various Enron entities and investment bankers.

COMBINATION OF REGULATIONS AND SELF-REGULATION

There are several cases where agencies, both government and self-regulatory bodies, have concurrent jurisdiction over an industry, sector, or issue. This is no truer than in regulations of the financial sector. The Freddie Mac case is a good example where different agencies have jurisdiction and have taken action. In this case, the SEC, Department of Justice, and the Office of Housing Enterprise Oversight, the agency established to specifically regulate Fannie Mae and Freddie Mac, have all been involved.[179] Freddie Mac is being investigated for violating SFAS 133, a rule passed in January 2001 to require companies to value at current market prices its derivatives contracts.[180] Freddie Mac instead sought to actually understate current earnings, in contrast to all the other earnings restatement cases, in order to smooth out earnings projections over the long term and avoid the appearance of volatility [181]

In the aftermath of the WorldCom collapse, even more government agencies and authorities have assumed important roles. The SEC investigated the accounting fraud and came to a $500 million settlement with the company [182] The Justice Department is prosecuting several former WorldCom executives for criminal violations.[183] The Department of Justice and the Federal Communications Commission are both investigating charges, including illegal rerouting of calls, made by the firm's competitors.[184] The General Services Administration (GSA) has ordered that WorldCom should not be able to compete for government

176. Albert B. Crenshaw, *IRS Case Tests Attorney-Client Privilege*, WASH. POST, Aug. 15, 2003, at E3.

177 Steven Pearlstein, *Not So Firm With Lawyers*, WASH. POST, Aug. 13, 2003, at E1.

178. *Id.*

179. Kathleen Day & David S. Hilzenrath, *Stock Sales Followed 'Smoothing Freddie Mac Chief Cleared $17* Million, WASH. POST, Aug. 16, 2003, at A1.

180. *Id.*

181. *Id.*

182. Seth Schiesel, *WorldCom Seems Close to Deal to Settle SEC's Fraud Case*, N.Y TIMES, Nov. 5, 2002, at C1, *See also* Jerry Knight, *WorldCom Stockholders Owe SEC Thanks for Almost Nothing*, WASH. POST, May 26, 2003, at E1.

183. Christopher Stern, *New Charges Brought Against CFO at WorldCom*, WASH. POST, April 17, 2003, at E1.

184. Christopher Stern, *FCC Opens Probe Into WorldCom Access-Fee Allegations*, WASH. POST, July 31, 2003, at E2; *see also* Christopher Stern & Brooke A. Masters, *U.S. Probes WorldCom on Evading Access Fees*, WASH. POST, July 27, 2003, at A1.

contracts, but Congress can always make a different determination.[185] Politics could make a big difference here for WorldCom since the Federal Government is a major customer and depends heavily on the company WorldCom's major competitors, especially Verizon and AT&T however, also have political clout in Congress and have been generous campaign donors.[186] Finally, WorldCom is also accountable to a bankruptcy court, which will take into account two investigations of the firm's collapse, one report authorized by the board and the other by the court itself.[187] That investigation, supervised by former Attorney General Richard Thornburgh concluded, among other things, that "[i]t appears that the Company's officers and Directors went along with Mr. Ebbers and Mr. Sullivan, even under circumstances that suggested corporate actions were at best imprudent and at worst inappropriate."[188] WorldCom had concocted an $11 billion accounting fraud, involving the blatant violation of classifying operating expenses as capital costs,[189] which should have set off alarm bells for an engaged board and audit committee.

The National Association of Securities Dealers (NASD) will also sometimes join regulatory bodies in bringing suit or other action against alleged violators. In one celebrated case, the NASD has filed suit against Frank Quattrone, former research director and investment banker for Credit Suisse First Boston for failing to supervise stock analysts, for undermining their independence by tying their bonuses to banking fees generated, and for spinning IPOs to investment banking clients.[190] Subsequently, the Manhattan U.S. Attorney launched a criminal investigation for obstruction of justice by Quattrone, for ordering employees to purge emails after an investigation had been launched, and may prosecute following an initial mistrial. The SEC is also involved in the investigation.[191]

Multiple agencies and authorities have also been involved in the various investigations and charges brought against Enron and its executives. The SEC and federal prosecutors have brought various civil and criminal charges.[192] The

185. Yuri Noguchi, *WorldCom Appoints Roscitt as President: Former AT&T Executive Faces Tough Rebuilding Challenge*, WASH. POST, Aug. 13, 2003, at E1.

186. Christopher Stern, *SBC Accused WorldCom in '02; Regional Phone Company Said It Was Shortchanged*, WASH. POST, July 29, 2003, at E1; *See also* Christopher Stein, *Verizon Backs Ending U.S.-WorldCom Deals*, WASH. POST, July 28, 2003, at E1.

187 Griff Witte & Brooke A. Masters, *WorldCom Creditors Agree to Suspend Routing Probe*, WASH. POST, Sept. 5, 2003, at E1; Jonathan D. Glater, *WorldCom Hearing Starts, Then Stops for More Talks*, N.Y TIMES, Sept. 9, 2003, at C4; Kenneth N. Gilpin, *WorldCom and Dissident Creditors Settle on Payment Plan*, N.Y TIMES, Sept. 9, 2003, *available at* http://www.nytimes.com (last visited Feb. 16, 2004); *see also* Jonathan D. Glater, *WorldCom Agrees on Deal to Satisfy More Creditors*, N.Y TIMES, Sept. 10, 2003, at C1.

188. Christopher Stern, *Two Reports Fault Founder on WorldCom Operation: Atmosphere Allowed Deception, Probes Say*, WASH. POST, June 10, 2003, at A1.

189. Christopher Stern & Brooke A. Masters, *WorldCom, Ex-Officers Charged in Oklahoma: U.S. Prosecutors Say Move Could Hurt Federal Case*, WASH. POST, Aug. 28, 2003, at E1. *See also* Christopher Stern, *WorldCom Writes Off $80 Billion in Assets: Value of Acquisition, Network Has Declined*, WASH. POST, Mar. 14, 2003, at E1.

190. Gretchen Morgenson, *Suit Expected Against Star of First Boston*, WASH. POST, Feb. 1, 2003, at 1.

191. Brooke Masters, *Quattrone Charged in Probe of CSFB*, WASH. POST, Mar. 7, 2003, at E4.

192. Kurt Eichenwald, *Fraud Charges Filed Against 2 Employees of Enron Unit*, N.Y TIMES, Mar.

Federal Energy Regulatory Commission has investigated Enron's manipulation of the California energy market.[193] Further, the Commodity Futures Trading Commission has charged Enron and two executives with manipulating natural gas and agricultural commodity prices.[194]

Exchange Rules. Beyond the combination of government rules and regulations are the rules established by the NYSE and Nasdaq that must meet with SEC approval. According to major legal expert Jack Coffee, it is the history and effectiveness of the private self-regulatory organizations, not state intervention or supervision that has built confidence in the integrity of the financial markets.[195] The NYSE requires that all listed companies have a majority of outside directors and that the audit and compensation committees be composed entirely of independent directors.[196] The NYSE is also tightening its definition of "independent, excluding those with a "material relationship" to the firm, and is requiring non-management directors to meet in executive sessions.[197] The Nasdaq offered parallel rules in advance of Sarbanes Oxley and also requires that an audit committee of independent directors hire and fire the firm's auditor. While the NYSE has never delisted a company for governance reasons, of the 670 companies delisted by Nasdaq over 2001-02, 100 were delisted for reasons related to corporate governance.[198]

13, 2003, at C1; Peter Behr & Carrie Johnson, *More Enron Charges Expected Today: Fastow Wife, Executives in Broadband Unit Are Latest Targets*, WASH. POST, May 1, 2003, at E2; Nancy R. Brooks, *FBI Arrests Former Enron Energy Trader John Forney, Who Is Accused of Drafting Many of the Firm Schemes, Is Charged with Fraud, Conspiracy*, L. A. TIMES, June 4, 2003, at 1; Kurt Eichenwald, *Second Enron Energy Trader Pleads Guilty*, N.Y TIMES, Feb. 5, 2003, at C2; Peter Behr & Carrie Johnson, *Second Tier Key to Enron Case: Prosecutors Push Skilling Lieutenants*, WASH. POST, Nov. 30, 2002, at E1; Peter Behr & Carrie Johnson, *Executives Resist Enron Prosecutors: Government Falls to Get Testimony From Some High-Ranking Insiders*, WASH. POST, Dec. 28, 2002, at E1; Kurt Eichenwald, *Three British Bankers Are Accused of Fraud in Offshoot of Enron Case*, N.Y TIMES, June 28, 2002, at C1; Kurt Eichenwald, *U.S. Said to Warn Six Ex-Enron Executives Over Charges*, N.Y TIMES, April 28, 2003, at C2; Floyd Norris, *A Warning Shot to Banks on Role in Others Fraud*, N.Y TIMES, July 29, 2003, at C1; Kurt Eichenwald, *Two Banks Settle Accusations They Aided in Enron Fraud*, N.Y TIMES, July 29, 2003, at A1; Ben White & Peter Behr, *Citigroup, J.P Morgan Settle Over Enron Deals*, WASH. POST, July 29, 2003, at A1. *See also* James V Grimaldi, *Justice Rejected IRS Call for Enron Probe*, WASH. POST, July 29, 2003, at E1.

193. Alex Berenson, *Mystery of Enron and California Power Crisis*, N.Y TIMES, May 9, 2002, *available at* http://foi.missouri.edu/usenergypolicies/mystenron.html (last visited Feb. 16, 2004); Richard Simon, Ricardo Alonso-Zaldivar & Tim Reiterman, *Enron Memos Prompt Calls for a Wider Investigation; Electricity: Regulators Order All Energy Trading Companies to Preserve Documents on Tactics*, L.A. TIMES, May 8, 2002, at A1; Kenneth Bredemeier, *Memo Warned of Enron Calif. Strategy; West Coast Senators Complain About Market Manipulation During Power Crisis*, WASH. POST, May 16, 2002, at A4.

194. Richard A. Oppel, *Enron Many Strands: The Strategies: How Enron Got California to Buy Power It Didn't Need*, N.Y TIMES, May 8, 2002, at C1; *see also* Peter Behr, *U.S. Files New Enron Complaints: Former Officers Cited for Web, Trading Deals*, WASH. POST, Mar. 13, 2003, at E1.

195. John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1 (2001).

196. Ben White, *NYSE, Nasdaq Face Test Living Up to Tough Talk: New Rules Proposed, But Doubts Remain*, WASH. POST, Jan. 21, 2003, at E1.

197. *Id.*

198. *Id.*

The NYSE, along with the SEC, is also promoting the interests of disclosure to investors. In one area, it has backed off due to First Amendment concerns. The NYSE had considered prohibiting Wall Street analysts from speaking with media outlets that failed to disclose any potential conflicts of interest for analysts being interviewed. Though disclosure of such conflicts might be important information for investors, it did not justify the prior restraint on analyst speech.[199]

REMEDIES

The complex area of legal remedies involves a large range of issues and choices: litigation versus arbitration, government versus private action, civil versus criminal sanctions, and personal versus corporate liability The issue is also directly connected to that of legal jurisdiction, that of the specific agency or agencies involved, and whether a case can be brought by state or federal authorities, or both. The sanctions differ from one agency to another and from one level of government to another. Among the most significant issues, and perhaps the primary one, is whether the government ought to pursue individual violators or entire firms, whether they be corporations or audit firms.

Individual versus Corporate Liability: There is less dispute over the wisdom of criminally prosecuting individual wrongdoers than over prosecuting corporations. The controversy surrounding the prosecution and demise of Arthur Andersen is a leading example of that dispute. To convict an organization also still requires that an individual perpetrator be identified, and then a jury can hold the organization vicariously liable. Some of the legal controversy surrounding the guilty verdict of Andersen was the judge's ruling that different jurors could find different executives, rather than the same one, guilty in order to hold the firm liable.[200] The larger practical criticism is that entire firms, and many innocent parties, are punished for the sins of perhaps just a few when firms are held liable.[201] However, others argue that it is entirely appropriate to prosecute a firm when its culture is that of a repeat offender or chronic violator, even if the firm's

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199. Alex Berenson, *A U.S. Push on Accounting Fraud,* N.Y TIMES, April 9, 2003, *available at* http://securities.stanford.edu/news-archive/2003/20030409_Headline11_Berenson.htm (last visited Mar. 2, 2004); *N.Y.S.E Abandons Gag Plan,* N.Y. TIMES, April 4, 2003, *available at* http://securities.stanford.
edu/news-archive/2003/20030409_Headline11_Berenson.htm (last visited Mar. 2, 2004).

200. Stephen Gillers, *The Flaw in the Andersen Verdict,* N.Y TIMES, June 18, 2002, at A23; Carrie Johnson, *Andersen Jury Hints at Cause of Indecision: Note Asks About Individuals Roles,* WASH. POST, June 14, 2002, at E1; Kirstin D. Grimsley & Jackie Spinner, *Some Call Andersen Verdict Irrelevant: In Accounting Industry, Firm Viewed as Already 'Mortally Wounded'* WASH. POST, June 15, 2002, at E1; *Andersen Judge Rules Calamitous Court,* WASH. POST, June 6, 2003; Carrie Johnson, *Andersen May Ask Judge to Overturn Conviction,* WASH. POST, June 20, 2002, at E3.

201. J.M. Holcomb & S.P Sethi, *Corporate and Executive Criminal Liability: Appropriate Standards, Remedies, and Managerial Responses,* 4 BUS. & CONTEMP WORLD 81, 81-105 (1992). *See* Ann Davis, *Executives on Trial: Enron Heat Descends on Smaller Prayers; Others Enjoy Shade,* WALL ST. J., Dec. 1, 2003, at C1. *See also* Kristen Hays, *Enron Schemes Reflect Culture, Report' Author,* L.A. TIMES, Feb. 10, 2003, at 3.

existence is placed in jeopardy[202]

Though the tide may be turning more in favor of prosecuting organizations, the SEC has focused to date mainly on individual auditors and accountants, and the Andersen case was brought by the Department of Justice, not by the SEC.[203] Further, among its legal actions, the SEC has focused almost entirely on small accounting firms and brought charges in 2002 against only two auditors working for then Big 5 firms, while bringing actions against auditors from 15 auditors from smaller firms.[204] The disciplinary actions brought against smaller firms are more often for incompetence, while the actions brought against the large firms are for lapses of integrity[205] In total, it brought 598 enforcement actions in 2002, up 24 percent from the previous year.[206]

One example of the action taken by the SEC against individual auditors was a case involving PricewaterhouseCoopers (PwC), once the lead auditor for Microstrategy, a company whose "accounting mirage" and inflated earnings is credited for bursting the tech bubble,[207] even before subsequent scandals at Enron and WorldCom surfaced. In this case, the individual auditor was barred from auditing publicly traded companies for a two-year period and can then apply for reinstatement with the SEC. The SEC took a similar approach in penalizing an audit partner with PwC who was "reckless" in auditing Tyco and ignoring signs of trouble.[208] In neither case, though, did the SEC take any action against PwC as a firm. PwC also paid $50 million to settle a lawsuit with Microstrategy investors who charged the firm for defrauding them by approving the company's books.[209] The shareholders' report also charged that PwC and Microstrategy had discussed joint business deals, jeopardizing PwC's independence and creating a conflict of interest.[210]

In 2002, the SEC did bring administrative charges against Ernst & Young for violating independence rules by a joint marketing arrangement with client company PeopleSoft.[211] Words by Enforcement Director Stephen Cutler indicate

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202. *Id.*, *see generally* BARBARA L. TOFFLER & JENNIFER REINGOLD, FINAL ACCOUNTING: AMBITION, GREED AND THE FALL OF ARTHUR ANDERSEN (2003); BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM (2003); *see also* SHERRON WATKINS & MIMI SWARTZ, POWER FAILURE: THE INSIDE STORY OF THE COLLAPSE OF ENRON (2003).

203. *U.S. v. Arthur Anderson*, LLP Crim. CRH-02-121, (Tex. S. Dist. Ct., Mar. 7, 2002), *available at* http://news.findlaw.com/hdocs/enron/usand50202gopp2gjdoc.pdf (last visited Feb. 16, 2004).

204. David S. Hilzenrath, *Big Firms Avoiding SEC Ire; Enforcement Record Lopsided,* WASH. POST, Jan. 17, 2003, at E1; Paula Dwyer, *The Big Four· Too Few to Fail?* BUS. WEEK, Sept. 1, 2003, *available at* http:// www.businessweek.com/@@atkRB4UQxg*p9BQA/magazine/content/03_35/b3847033.htm (last visited Feb. 16, 2004). *See also* Carrie Johnson & Brooke A. Masters, *Prosecutors, Regulators Step Up Pace of Auditor Probes,* WASH. POST, Jan. 28, 2003, at E1.

205. Hilzenrath, *supra* note 204.

206. *Id.*

207 David S. Hilzenrath, *SEC Settles Case with Audit Firm,* WASH. POST, Aug. 18, 2003, at E1.

208. Carrie Johnson, *SEC Prods Boards on Work for Auditors,* WASH. POST, Aug. 14, 2003, at E2.

209. Hilzenrath, *supra* note 207.

210. *Id.*

211. *Id.*

that the SEC may bring more actions against the audit firms in the future. He has stated:

> In short, absent egregious conduct, in which senior firm managers participated or acquiesced, the commission typically has elected not to pursue a case against the firm itself. It is time to adopt a new enforcement model a new paradigm: one that holds an accounting firm responsible for the actions of its partners; one that reverses the current presumption against suing firms for an audit failure.[212]

In the wake of the criminal prosecution and subsequent demise of Arthur Andersen, however, there is one major factor that inhibits the government from bringing criminal charges against the organization. Should it do so and cause the downfall of yet another major accounting firm, the industry becomes even more concentrated. The "big five" that has dwindled to the "big four" risk becoming the "big three." Given its criminal jurisdiction, the Justice Department is thwarted more than the SEC by this factor. By shrinking the number of major firms, it also would make even more difficult the rotation of audit firms, discussed later in this article. Hence, the major accounting firms may be politically insulated from further criminal prosecution and, in a sense, may have become too big to fail. Businesses now audited by the big four accounting firms account for a huge 99 percent of all public company sales, about which SEC Chairman William Donaldson says, "It's a national problem. We're concerned about the long-term implications.[213] To combat such industry concentration, the government could award more contracts to non-big-four firms and to foreign accounting firms.

When the government seeks to hold firms and organizations liable, there are lessons that the Arthur Andersen case teaches, most importantly that such a firm must cooperate fully with the government. Firms will be rewarded for cooperation and punished dearly for resistance and confrontation. As one leading observer put it, "[t]ime and time again the firm made missteps that left prosecutors questioning its desire to resolve the case. Its efforts at internal change went nowhere, as the partnership spun into chaos. When its lawyers suggested that Andersen consider pleading guilty the firm's management replaced them."[214]

There have been stiffer organizational sanctions permitted under recent changes to the U.S. Sentencing Guidelines, giving the prosecution more leverage and making cooperation with the government more compelling.[215] This is further related to the new regulations of attorney obligations under Sarbanes-Oxley Not only are attorneys given a greater incentive to report management misconduct upward, but the firms themselves are given incentive to waive any privilege, under

212. *Id.*

213. Dwyer, *supra* note 204.

214. Kurt Eichenwald, *Miscues, Missteps, and the Fall of Andersen*, N.Y TIMES, May 8, 2002, at C1.

215. News Release, U.S. Sentencing Commission, Sentencing Commission Stiffens Penalties for White Collar Criminals (Jan. 8, 2003), *at* http://www.ussc.gov/PRESS/rel010803.htm (last visited Mar. 11, 2004).

Justice Department policies.[216] The law thus encourages cooperation in various ways, and individual employees must beware that their own personal interests that weigh in the balance may be sacrificed by the firm. When the firm is rewarded for cooperation, an employee can even be fired for asserting her legal freedom from self-incrimination under the Fifth Amendment. That has been one of the potential consequences even as firms have sought to mitigate their sentences since the organizational sentencing guidelines were passed in 1990.[217]

Civil versus Criminal Liability: While it has been less common for the government to seek criminal penalties against auditors, aside from the obstruction of justice prosecution of Arthur Andersen, it is becoming more common to seek such penalties against executives in the scandal-ridden firms. Three former Tyco executives, for example, have been charged with criminal offenses, and one of its board members has pleaded guilty to securities fraud.[218]

The enhanced criminal penalties under Sarbanes-Oxley are also proving to be an effective lever in building cases against violators at the top. The Justice Department and SEC combine forces to investigate corporate fraud, and as at companies like HealthSouth and Symbol Technologies, have pursued indictments of mid-level and senior managers to gather evidence against those at the top.[219] With the tougher penalties, lower level managers have a greater incentive to cooperate with the government to lighten their sentences. Still, some take a different view. Some defense lawyers believe that the penalties are too harsh and with more at stake, clients will actually be less willing to talk.[220] Whatever provided the incentive, nine HealthSouth executives, including three top finance officers, have pleaded guilty to criminal charges in the case involving $2.5 billion of overstated profits.[221]

In the complex Enron case, federal prosecutors have indicted Andrew Fastow on 78 counts and received a guilty plea from his deputy Michael Kopper.[222] The government has also brought criminal fraud charges against two other Enron executives for trying to hide the Braveheart internet video venture off the books while it failed to meet the rule of having a minimum of 3 percent of its capital from outside investors.[223] The essence of the fraud is that "Enron sold its interest in broadband to itself but pretended that there were outside investors with capital at risk to make the transaction appear to be a true sale."[224]

216. Lorraine Woellert, *How Much Can You Still Tell Your Lawyer?* BUS. WEEK, Sept. 1, 2003, at 52.

217 Holcomb & Sethi, *supra* note 201; *See also* J. Moore, J, *Corporate Culpability Under the Federal Sentencing Guidelines, in* TOM L. BEAUCHAMP & NORMAN E. BOWIE, ETHICAL THEORY AND BUSINESS 99-109 (2000).

218. Carrie Johnson, *Tyco Auditor Barred from SEC Work,* WASH. POST, Aug. 14, 2003, at E1.

219. Alex Berenson, *A U.S. Push on Accounting Fraud,* N.Y. TIMES, April 9, 2003, at C1.

220. *Id., See also* Christopher Stein, *SEC, WorldCom Say Settlement Is Just,* WASH. POST, June 12, 2003, at E5.

221. *The Ex-Bosses Fight Back,* ECONOMIST, April 12, 2003, at 56-57

222. Behr & Johnson, *More Enron Charges Expected Today, supra* note 192.

223. Eichenwald, *Fraud Charges Filed Against 2 Employees of Enron Unit, supra* note 192.

224. *Id.*

Civil fines and remedies can result from either court proceedings or administrative settlements. The SEC pursued administrative action against Deutsche Bank AG for failing to disclose a conflict of interest in voting its shares in favor of Hewlett Packard's (H-P) acquisition of Compaq Computer Corp.[225] The Bank had business deals with H-P with more to follow were the acquisition approved.[226] The forces supporting William Hewlett's opposition to the deal accused H-P of buying the bank's vote. For its failure to disclose, the bank agreed to pay $750,000, and the SEC also censured the firm and directed it to cease and desist from further securities violations.[227]

The largest settlement ever was negotiated by the SEC with WorldCom, on behalf of investors. WorldCom recently settled for $500 million with victimized stock and bond holders, and fraud victims will also receive $250 million worth of stock in the reorganized company, when it emerges from bankruptcy[228] Shareholders are normally last in line to be paid in bankruptcy proceedings, so critics of the settlement observe that bondholders who normally receive higher priority will be subsidizing shareholders through the settlement.[229] The Sarbanes-Oxley Act at least has made possible the ability to pay victims.[230] Prior to the law, settlement money would have been paid to the U.S. Treasury[231] The penalty is the largest ever paid by a non-Wall Street firm but is slight compared to the $180 billion in damage done to investors.[232] WorldCom has also taken some measures of internal reform, having replaced its entire board of directors and removed more than two dozen executives who were directly or indirectly involved in the company's accounting problems. More on the WorldCom internal reforms is discussed below. There is serious question whether WorldCom has been sufficiently punished by its settlement with the SEC, and some argue it should be liquidated rather than allowed to reorganize under bankruptcy[233] Given that WorldCom's collapse wiped out around $180 billion in shareholder value,[234] many competitors and critics argue the settlement is totally inadequate, even though it is

225. Ariana E. Cha, *Deutsche Bank Pays $750,000 in SEC Settlement*, WASH. POST, Aug. 20, 2003, at E1.

226. *Id.*

227. *Id.*

228. Jonathan D. Glater, *WorldCom Agrees on Deal to Satisfy More Creditors*, N.Y TIMES, Sept. 10, 2003, at C1. *See also* Gilpin, *supra* note 187

229. Glater, *supra* note 228. *See also* Jerry Knight, *WorldCom Stockholders Owe SEC Thanks for Almost Nothing*, WASH. POST, May 26, 2003, at E1.

230. Christopher Stern, *WorldCom Settlement Approved by Judge: Stock and Bond Holders to Get $750 Million in Civil Fraud Case*, WASH. POST, Aug. 7, 2003, at E1.

231. *Id.*

232. Christopher Stern, *WorldCom Settlement Passes Key Judicial Test*, WASH. POST, July 8, 2003, at A1. *See also* Johnathan Krim, *No Easy Road Ahead at WorldCom; Analysts Say that Troubles in Telecom may Prove Hard to Overcome*, WASH. POST, June 10, 2003, at E1; Christopher Stern, *WorldCom Picks New Directors; Firm Distancing Itself from Former Leaders*, WASH. POST, Aug. 30, 2003, at E1.

233. Jerry Knight, *WorldCom Stockholders Owe SEC Thanks for Almost Nothing*, WASH. POST, May 26, 2003, at E1.

234. *Id.*

the largest ever negotiated by the SEC.[235] Some suggest the government wanted WorldCom to emerge from bankruptcy and to survive as it now has under the MCI label, rather than face liquidation, for a number of reasons – to prevent any adverse impact on its 55,000 employees and the economy, to maintain its vital supplies of data equipment to the government and defense department, and to preserve competition in the telecommunications industry to serve antitrust values.[236]

The SEC has also settled its civil charges against J.P Morgan Chase and Citigroup for helping Enron "cook the books."[237] In announcing the $300 million settlement, enforcement director Stephen M. Cutler sent a message to all other financial institutions that might have facilitated fraud at other firms under investigation, such as Freddie Mac, WorldCom, and AOL Time Warner. Cutler stated, "If you know or have reason to know that you are helping a company mislead its investors, you are in violation of the federal securities laws."[238]

Corporate critics see the settlement as much too insignificant in contrast to the damage the banks facilitated at Enron. As William Greider states:

> The $300 million Enron 'settlement' government regulators worked out with the nation's two largest banks smells so bad that even *The Wall Street Journal* editorial writers gagged on the rank odor. What Citigroup and JP Morgan Chase did, remember, was to design the funny-money financial deals that directly pumped up Enron's profits and stock price. When Enron's fraudulent scheme unraveled and the stock collapsed, the nation's pension funds lost somewhere between $25 to $50 billion. And these two famous banks each profited mightily from their role as financial architects of the great swindle. The pay-up costs will not even require an asterisk on their balance sheets.[239]

Not just corporate critics like Greider weighed in against the settlement, but so did *Business Week* magazine. While acknowledging the difficulty of demonstrating willful fraud necessary to bring criminal charges, the amount of $300 million would be seen as merely a cost of doing business, since the fines represent "roughly a week's profit to the banks."[240] Especially since Sarbanes-Oxley allows some of the fines to be credited against liability under private securities litigation, authority Jack Coffee concludes, "I don't think there was

235. *Id.*

236. Stephanie N. Mehta, *Well Connected; Why is Washington So Determined to Save WorldCom*, FORTUNE, June 9, 2003, at 40; *see also* Christopher Stern, *WorldCom Wins New Federal Contract*, WASH. POST, July 19, 2003, at E2.

237 Ben White and Peter Behr, *Citigroup, J.P Morgan Settle over Enron Deals*, WASH. POST, July 29, 2003, at A1. *See also* Eichenwald, *Two Banks Settle Accusations They Aided in Enron Fraud, supra* note 162.

238. Jerry Knight, *Look Out, Aiders and Abettors*, WASH. POST, Aug. 4, 2003, at E1.

239. William Greider, *Crooks off the Hook*, TOMPAINE.COM, Aug. 7, 2003, *at* http://www.tompaine.
com/feature2.cfm/ID/8568 (last visited Feb. 16, 2004).

240. Emily Thornton and Mike France, *For Enron Bankers, a "Get Out of Jail Free Card*, BUS. WEEK, Aug. 11, 2003, at 29.

deterrence in these settlements."[241]

Fines versus Action Remedies: Even in civil cases, courts and especially regulatory agencies have the option of imposing financial penalties or action-forcing remedies, or both. The common complaint about fines or financial settlements is that they are usually passed on to shareholders, or sometimes to customers in the form of higher prices.[242] The pain may not be borne by the actual perpetrators, unless the penalties are so heavy that the firm or its board takes action against the offending officers or employees. Action remedies, however, may include pain directly inflicted on the individual offender. For instance, the SEC may bar auditors from auditing publicly-traded companies and may even bar executives from serving as officers or directors of a listed company[243] In the year 2000, the SEC barred thirty-eight executives from ever again serving as officers or directors of public companies, and in the first two thirds of 2003, that number had increased to 105, including two WorldCom financial executives.[244] The SEC has brought legal charges against two former executives from Merrill Lynch for aiding and abetting securities fraud at Enron for moving Nigerian ships off the books through a sham sale and for fraudulent energy trades.[245] In addition to fines and injunctions, the SEC is seeking a permanent ban to prevent the executives from serving as officers or directors of any listed company[246] The SEC has targeted for a similar fate executives with Qwest, HealthSouth, and Tyco.[247]

Not only can the SEC bar executives from future corporate positions, but so can the NASD. In the case against Frank Quattrone mentioned above, the NASD is seeking to bar Quattrone from the securities industry for failing to cooperate with the investigation.[248] The NASD also brought a different type of action-forcing remedy against the brokerage firm Hornblower & Weeks, suspending it from publishing research for six months, since it had published "misleading and exaggerated statements" about a stock.[249] Other government agencies besides the

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241. *Id.*

242. Holcomb and Sethi, *supra* note 171.

243. Amy Borrus & Mike NcNamee, *Go Ahead, Make the SEC' Day*, BUS. WEEK, June 2, 2003, at 27.

244. *Id.*

245. Carrie Johnson, *SEC Accuses Four Former Executives at Merrill of Aiding Enron Fraud*, WASH. POST, Mar.
18, 2003, at E1,

246. *Id.*

247. Carrie Johnson, *Tyco Auditor Barred from SEC Work: PricewaterhouseCoopers Partner said to have*
Ignored Signs, WASH. POST, Aug. 14, 2003 at E1. *See also* Christopher Stern, *U.S. Charges Eight in Qwest Fraud Probes*, WASH. POST, Feb. 26, 2003, at E1.

248. Walter Hamilton, *NASD Regulators Charge Quattrone; Investment Banker is Accused of 'Spinning*
Coveted IPO Shares and Improper Oversight of Stock Analysis, L.A. TIMES, Mar. 7, 2003, at B2; *see also* Brooke A. Masters, *Former Tech Banker Quattrone Indicted; Obstruction of Justice Alleged*, WASH. POST, May 13, 2003, at E4; Brooke A. Masters, *Quattrone Charged in Probe of CSFB; NASD Cites IPO Trades for Business*, WASH. POST, Mar. 7, 2003, at E4.

249. Patrick McGeehan, *For Financial Firms, Proposed New Rules on Analysts are the Least of Their Problems*, N.Y TIMES, May 8, 2002, at C2.

SEC can at least remove executives from their present positions, or urge their boards to do so. In the case of Freddie Mac, the OHEO agency ordered that two executives, the president and general counsel, be removed from the company,[250] after the board had already terminated the previous CEO and two other officers and restated earnings of $4.5 billion for the past three years.[251]

When fines are the remedy, the question arises what level of fine is appropriate and effective. Citigroup Global Markets, formerly Salomon Smith Barney, was fined only $1 million by the NYSE for failing to give suitable advice to WorldCom employees related to their pension holdings in company stock.[252] Salomon Smith Barney had advised the employees to borrow money to pay taxes resulting from the exercise of stock options, rather than cash in the options.[253] That level of fine is less than a slap on the wrist.

Private Lawsuits: Perhaps the most expensive remedy for any offending firm is that of private lawsuits brought by injured parties. In the many cases of corporate scandals, those injured parties are usually employees, retirees, or investors. The pension funds and institutional investors are often a greater threat than regulatory agencies, regarding the amount of damages they can extract from corporate offenders. The 1995 Securities Litigation Reform Act, meant to limit liability to shareholders, also gave institutional investors higher priority as lead plaintiffs in securities cases.[254] The University of California system, with its $145 million in losses following the Enron debacle, is the lead plaintiff in a class-action suit against Enron and all of its financial backers.[255] The pension funds of Ohio and California are suing AOL Time Warner for over $100 million in losses to their state pension funds.[256] Ohio and West Virginia pension funds are also suing Freddie Mac and three former executives for securities fraud, causing almost $30 million in stock losses to those states.[257] Ohio also has suits pending against Enron, WorldCom, and Global Crossing.[258] The California Public Employees' Retirement System (CALPERS) estimates it lost $565 million on its WorldCom investments, while the New York State Common Retirement Fund lost about $300 million.[259] Those pension funds are also bringing suits against the company The

250. Jonathan D. Glater, *Freddie Mac Board Forced to Remove Chief Executive*, N.Y TIMES, Aug. 23, 2003, at C1. *See also* Kathleen Day, *Freddie Mac Board Told to Remove CEO; Regulators Cite Parseghian Role in Improper Accounting; Directors Response is Unclear* WASH. POST, Aug. 22, 2003, at E01.

251. *See* Carrie Johnson and Kathleen Day, *Freddie Mac Ousts Three Top Executives; Shake-up at Mortgage Giant Roils Markets*, WASH. POST, June 10, 2003, at A1 (discussing the earlier action by the Freddie Mac board and the actions by top officer that lead to the board's actions).

252. Christopher Stern, *Citigroup Fined for WorldCom Advice: NYSE Says Workers Were not Warned*, WASH. POST, Aug. 23, 2003, at E1.

253. *Id.*

254. Jackie Spinner, *Pension Funds Sue Freddie Mac*, WASH. POST, Aug. 9, 2003, at E1.

255. *Id.*

256. *Id.*

257. *Id.*

258. *Id.*

259. Leslie Wayne, *Turmoil at WorldCom: Retirement Money; Irate Over all the Scandals and Big Losses, Pension Funds are Going to Court*, N.Y TIMES, June 28, 2002, at C1.

Wisconsin state pension fund lost $36.3 million through the WorldCom collapse, the Michigan state employee fund lost $116 million, and the Iowa state pension fund lost $33 million.[260] Michael L. Fitzgerald, state treasurer of Iowa, said:

> I'm outraged. We have invested in the American marketplace and we have lost confidence. There is now no confidence in people who are running these businesses. No trust in them at all. Institutional investors need to pick up the mantle of litigation. Who's watching those guys at the top? They are proving to be bald-faced liars.[261]

The lawsuits by all concerned private parties against Enron and Andersen will continue for sometime. Enron workers and investors are seeking $26 billion in a class-action suit that also names Enron and Andersen executives and board members.[262] Private suits brought by investors against outside directors of Enron for fraud and insider trading were dismissed in March 2003, for failure to show intent by the directors.[263] Suits for negligence, however, might still be possible.[264]

Given that most of these shareholder suits are settled for far lesser amounts though, the question remains what effect they really have on corporate misconduct. For firms like Enron and Andersen that no longer exist or exist in vastly diminished scale, the lack of connection is obvious. Even for any living entities, though, the effect is dubious. Former SEC Commissioner and Stanford Law Professor Joseph Grundfest concludes:

> I'm not suggesting that [the class-action system] has no deterrent effect. It's just weak compared with the criminal and the SEC enforcement mechanisms. The reason is that only 0.5 percent of the settlements in the fifteen largest settlements came out of the pockets of the wrongdoer. The vast amount of the money that is used to fund these settlements comes from the corporation, the defendant in the action. And who owns the corporation? The shareholders. The shareholders are also the plaintiffs who get the recovery. So there is no securities fairy paying the settlements. We're simply moving money from investors' right pocket to investors' left pocket – and paying lawyers a lot for moving the money around.[265]

Arbitration versus Litigation: The choice between arbitration and litigation is important for private plaintiffs bringing action against investment analysts and brokers, as well as against their firms. There is also a regulatory component provided by the $1.4 billion Wall Street settlement, as aggrieved investors who were victimized by fraudulent stock ratings might claim relief from the restitution

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260. *Id.*

261. *Id.*

262. *Five Ex-Andersen Execs Won't Face Enron Shareholder Suit: Judge Throws out Claims Against Group Including In-house Lawyer Claims Against Others Proceed*, L.A. TIMES, Jan. 29, 2003, at B7

263. Kurt Eichenwald, *Enron's Outside Directors Win Round in Court*, N.Y TIMES, Mar. 14, 2003, at C6.

264. *Id.*

265. Joseph Grundfest & Nicholas Varchaver, *Winona, Martha & the Securities Fairy*, FORTUNE, Aug. 11, 2003, at 50.

fund established by the settlement.[266] Those bringing individual court cases are having a difficult time recovering, however.

In the main, investors are left with the remedies provided by arbitration, since a 1987 Supreme Court case held that securities firms may force their clients into arbitration when provided by contract.[267] Plaintiffs complain that arbitration tends to favor the industry, and studies tend to bear that out.[268] In the case of California, however, the arbitration requirement may be eroded or bypassed due to a state ethics law that requires arbitrators to disclose their financial dealings and any conflicts of interest. The NASD, which hears 90 percent of all securities arbitrations, has asked any claimants to waive the application of the new law, and securities firms argue the law should be preempted by federal regulations.[269] A federal appellate court has just upheld the law in the face of those arguments.[270]

Some recovery may be easier in arbitration than in court, as arbitrators tend to be more concerned about a fair result than about technical procedures and burdens of proof. Nonetheless, even in arbitration, an investor or complainant must demonstrate "specific reliance" on the advice of a broker or analyst in causing his/her loss,[271] which is often difficult to show. Some state laws give investors broader relief if they can show that an adviser failed to disclose pertinent facts, such as an investment banking relationship with the covered company[272] Arbitration does not lend itself to a mass-tort class-action approach, but some lawyers are trying it anyway in the research analyst cases. One team of lawyers has signed up 9,000 potential plaintiffs through the website stockmarketfraud.com, and a Florida law firm represents 6,000 more.[273]

266. Anitha Reddy, *Investors Eligible for Restitution; Settlement will also Aid Class Actions*, WASH. POST, Apr. 30, 2003, at E1. *See also* Ben White and Kathleen Day, *SEC Approves Wall Street Settlement; Conflicts of Interest Targeted*, WASH. POST, Apr. 29, 2003, at A1, Ben White, *SEC Pushes for Approval of Wall St. Deal*, WASH. POST, June 17, 2003, at E1; Amy Baldwin, *Don't Count on Restitution Money; Fund Investors Unlikely to get Piece of Wall Street' $387.5 Million Pie*, WASH. POST, May 11, 2003, at F4.

267 Walter Hamilton, *Californians May Win Right to Sue Brokerages: Appellate Ruling Could Lead to Precedent Allowing Investors to Bypass Arbitration*, L.A. TIMES, Aug. 21, 2003, at B1.

268. Brooke A. Masters, *Few Gains for Investors Suing Over Research; Arbitration Panels Awarding Little if Anything in Cases Based on Stock Analysts Conflicts*, WASH. POST, Aug. 14, 2003, at E1. *See* also Walter Hamilton, *Aggrieved Investors Face the Big Fight; Contentious Brokerage Arbitration Renews Debate on how it Works and Whether it's Fair* L.A. TIMES, July 27, 2003, at B1.

269. *See* Hamilton, *supra* note 268.

270. *Id.*

271. Brooke A. Masters, *Laying Claim to Arbitration; Law Firm Aims to Dominate Investor Securities Cases*, WASH. POST, Aug. 20, 2003, at E1. *See also* Brooke A. Masters, *Investors v. Brokers; Meting out Quick Justice in Murky World of Arbitration*, WASH. POST, July 15, 2003, at E1.

272. *See* Masters, *supra* note 268.

273. *See* Brooke A. Masters and Ben White, *Wall St. Facing Legal Blitz: 'Global' Settlement Prompts Investor to File Claims*, WASH. POST, July 3, 2003, at E1 (for other figures on the expanding number of arbitration cases); *see also* Ben White and Brooke A. Masters, *Investor Suits Against Wall St. Firms Rejected; Federal Judges Dismiss Class Action Blaming Research Reports for Technology-Stock Losses*, WASH. POST, July 2, 2003, at E1 (for an account of an important victory for Merrill Lynch & Co. and the dismissal of class action suit by investors by Senior U.S. District Judge Milton Pollack).

The individual arbitrations conducted thus far have not been successful for injured investors. About a dozen cases, ranging all the way up to $30 million in claimed damages have been decided, and only two plaintiffs have received any awards.[274] Still the cases have really only begun. The NASD has received around 300 filed cases, with thousands more expected, and the NYSE has received almost 100.[275]

IMPACT OF REGULATION

With the passage of Sarbanes-Oxley, the debate now ensues over its impact. Will it deter fraud? Will the costs of compliance be excessive? Will it improve boards of directors or make it more difficult to attract top candidates? Will it make management too cautious and risk averse? Will it delay too many decisions and drive them to the top? Most important, will it restore investor confidence? The answers vary from one expert to another. It may also take a long time to assess the effectiveness of the act and new controls, since financial fraud is more typical at the end of long bull runs on Wall Street.

Cost of Controls: Beyond the debate over the definition of proper "internal controls, there is a deep concern over the cost of those controls. Some see Sarbanes-Oxley as ironically a windfall for the accounting industry One business journalist suggests it may raise audit fees by 30-100 percent.[276] Colleen A. Sayther, chief executive of Financial Executives International said, "With all due respect to the accounting firms, there is a financial incentive for them to increase their amount of testing."[277] Greg W Matz, director of internal audit at Agilent Technologies, said, "[c]ontrols are not free. [Companies may] overspend without a lot of benefit or safety for the investor."[278] Meanwhile, William J. McDonough, chairman of the Public Accounting Oversight Board, maintains, in my view, good internal controls are cost effective and once put in place more than justify the expense involved."[279]

Going Private: Considering these costs, some firms have decided to either remain private or move from public back to private, partially in order to avoid the demands of Sarbanes Oxley.[280] Hence, the law does nothing to improve their corporate governance. In 2002, ninety-seven firms filed requests with the SEC to

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274. *See* Masters, *supra* note 268.

275. *Id.*

276. Carrie Johnson, *Stiffer Accounting Standards Debated: Tougher Review Rules Planned,* WASH. POST, Aug. 9, 2003, at E1.

277. *Id.*

278. *Id., See also* Julie Hirschfield Davis, *For Sarbanes, the Grumbling was Expected,* BALT. SUN, July 29, 2003, at 1D (for additional estimates of compliance costs. The article notes that the Business Roundtable finds its member firms spending between $1 million and $10 million annually due to the new Sarbanes-Oxley law. Further, business law and consulting firm Foley & Lardner found that the cost of being a publicly traded firm has increased 100 percent due to new compliance requirements.).

279. *Id.*

280. Murray Coleman, *More Companies Exit Public Markets; New Accounting Rules Get the Blame Burden for Small Companies,* INVESTOR'S BUS. DAILY Aug. 26, 2003, at A1.

go private, and by July 31, 2003, sixty-seven firms had applied to go private.[281] Not only are the costs of compliance high for firms with little capital, but premiums for director and officer insurance policies have increased 30-40 percent since Sarbanes Oxley passed.[282] Small firms thus have great difficulty attracting willing outside directors. Given the Wall Street settlement with investment banking firms, and their commensurate needs to downsize among their analyst corps, some thinly traded small companies no longer enjoy analyst coverage at all. Hence, the benefits of remaining public pale in contrast to the costs. As the CFO of Tumbleweed, a small restaurant chain, put it, "We didn't see much value in being public. It was costing us a lot of extra money. Then Sarbanes-Oxley came along and that was the last straw."[283] Tom Taulli, a finance professor at the University of Southern California concludes that, with the added costs and restrictions of Sarbanes-Oxley, the tradeoffs are looking much better to go private."[284]

Recruiting Board Members: Given the enhanced responsibilities of directors and the stronger criminal penalties, some believe that many qualified candidates will now find board positions far less attractive and that it will be difficult to build strong boards. As defense attorney Ira Lee Sorkin states, "Why would someone want to be a director and face all this potential exposure?"[285]

Executive Reactions: Not surprisingly, most senior executives have a dim view of Sarbanes-Oxley as they might of most other regulation. A survey of 192 senior executives in the July 28, 2003 *Financial Times* found that 60 percent believe that reform has gone too far.[286] Further, a poll of CFOs and managing directors found that only 30 percent have a good opinion of Sarbanes Oxley[287] When trying to gauge the effectiveness of new reforms, professional money managers are skeptical of their likely effect. In a recent survey, just 23 percent said recent antifraud measures had been effective, and 60 percent doubted even the recent Wall Street settlement would improve the quality of brokerage research.[288] Still, half of the respondents supported the efforts of local and state regulators. As the chief coordinator of the study reported, "The support of these fund managers for the state securities regulators suggests somewhat of a lack of confidence in the ability of the S.E.C. to do its job."[289]

Internal Investigations: Whatever actual change in corporate behavior is

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281. *Id.*

282. *Id.*

283. Murray Coleman, *More Companies Exit Public Markets: New Accounting Rules Get the Blame*, INVESTORS BUS. DAILY, *at* http://www.mergerforum.com/ibdarticle.cfm (last visited Mar. 3, 2004).

284. *Id.*

285. Alex Berenson, *A U.S. Push on Accounting Fraud*, N.Y TIMES, April 9, 2003, at C1.

286. Adrian Michaels, *Reforms Lose Support of Business Leaders Corporate Governance*, FIN. TIMES (London), July 28, 2003, at 24.

287 Wes Pedersen, *Move On, Corporate America!*, IMPACT, July-Aug., 2003, at 3-4.

288. Gretchen Morgenson, *Wall Street Reform Falls Short, Survey Says*, N.Y TIMES, Aug. 31, 2003, at 6.

289. *Id.*

produced by new regulations, the scandals certainly have invited close scrutiny and outside pressure brought by former top SEC officials and law enforcement officers. Investigators have been installed by courts and boards of directors to supervise internal investigations that have produced enlightening reports.[290] Former SEC general counsel William McLucas has supervised internal investigations at Enron, WorldCom (at the invitation of the board), and Qwest Communications.[291] Former Attorney General Richard Thornburgh supervised another investigation of WorldCom for the bankruptcy court, and former SEC official Gregory S. Bruch coordinated the internal investigation at Global Crossing.[292] Attorney David Boies, who litigated the monopoly case against Microsoft, supervised internal investigations of Tyco,[293] while former SEC counsel Richard Doty conducted an internal investigation of Freddie Mac.[294] The bankruptcy judge in the Enron case appointed R. Neal Batson, an Atlanta attorney, who concluded creditors might be entitled to recover $5 billion in assets improperly transferred to outside partnerships and to $74 million in loans received by Chairman Kenneth Lay [295] He also found that CFO Fastow received twice as much as reported, and that Enron manipulated the tax laws to create "phantom" tax losses.[296]

Corporate Monitors: The government has also installed former SEC Chairman Richard Breeden to monitor and approve of business decisions at WorldCom, as Gregory Bruch is now doing for U.S. Technologies.[297] Such officials provide a valuable service in discovering all the elements of corporate misconduct, in the case of investigations, and of setting the ship aright again, in the case of corporate monitors.[298]

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290. One example is the internal investigative report on Enron, known as the *Powers Report*. The investigation was chaired by William C. Powers, Jr., an outside director on the Enron board and Dean of the University of Texas Law School. *See* William C. Powers, Jr., Raymond S. Troubh, and Herbert S. Winokur, Jr., *Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp.*, Feb. 1. 2002, *available at* http://bodurtha.georgetown.edu/enron/Board_Special_Report.htm (last visited Feb. 16, 2004).

291. Brooke A. Masters, *Ex-SEC Lawyer to Mind U.S. Technologies*, WASH. POST, Mar. 18, 2003, at E4. *See also* Floyd Norris, *Ebbers and Passive Directors Blamed for WorldCom Woes*, N.Y TIMES, June 10, 2003, at C1.

292. Christopher Stern, *Two Reports Fault Founder on WorldCom Operation: Atmosphere Allowed Deception, Probe Says*, WASH. POST, June 10, 2003, at A1.

293. Ben White, *Tyco Replaces Chief Lawyer is Hit with Downgrade of Debt*, WASH. POST, June 11, 2002, at E1; *see also* Alex Berenson, *Now, Questions Turn to Why Tyco Lawyer Received Bonus*, N.Y TIMES, June 12, 2002, at C1.

294. Kathleen Day, *Report Faults Freddie Mac Officials; Board says Firm's Culture led to Transactions that Forced Restatements*, WASH. POST, July 24, 2003, at E1.

295. Peter Behr, *Recovering for Enron Creditors; $5 Billion in Assets were Improperly Treated, Report Says*, WASH. POST, Mar. 7, 2003, at E2.

296. *Id.*

297. *See* Masters, *supra* note 258.

298. *Id.*

UNFINISHED BUSINESS: PROPOSED LEGISLATION AND ALTERNATIVE REGULATIONS

Some see Sarbanes-Oxley as misdirected, that it really won't do much to cure most of the corporate abuses and real problems of corporate governance. Some say the real problem is not lack of director independence but directors simply not working hard enough.[299] Separating auditing from non-audit services won't do much, some say, because the auditor still has an interest in ingratiating the client in order to retain its audit business.[300] As one analyst puts it, " even if auditing firms have to get out of the consulting business, the temptation for auditors to please the people they are paid to police will still be there."[301] The better approach is one of a genuine check and balance between two audit firms, through a forensic audit or periodic rotation of audit firms.

Alternative Reforms: Before resigning as SEC Chairman and even before the debate over Sarbanes-Oxley Harvey Pitt suggested that companies be subject periodically to full-scale forensic audits by a different audit firm.[302] Regular auditors normally review just a sample of company records and take management's words at face value. Forensic audits probe more deeply and would more likely uncover any real problems.[303] Other experts have suggested regular rotation of the audit firm, not just of the auditors within a firm, going well beyond the requirements of Sarbanes-Oxley which only requires the two principal partners involved in the audit be rotated every five years.[304] Bypassing the normal biases and relationships built up over time between a firm and its client is the only path that some see to true independence. Requiring forensic audits might create a lot of new business for audit firms, so one might suspect they would lobby for such a rule. More frequent rotation, however, might create disruption and transaction costs and therefore stimulate political opposition by the auditors.

Only Auditing: If Sarbanes-Oxley has minimal impact, another option worth considering is what Paul Volcker suggested as his condition of leading Arthur Andersen – forego consulting altogether and stick to auditing.[305] Despite the financial and business sacrifices that would entail for the firm, perhaps a model built for modest success and integrity of the business system overall is a better alternative for the future. As Volcker said, "We've missed an opportunity of having an accounting firm of some weight doing auditing the way it seems to me it

299. *See* Sonnenfeld, *supra* note 13.

300. Gellerman, *supra* note 41, at 23 n.3.

301. *Id.*

302. David S. Hilzenrath, *Forensic Auditors Find What Some Companies Try to Hide*, WASH. POST, Nov. 23, 2002, at E1.

303. *Id.*

304. Max H. Bazerman, et al., *Why Good Accountants Do Bad Audits*, 80 HARV. BUS. REV. 96, 102 (2002).

305. Kurt Eichenwald, *Miscues, Missteps, and the Fall of Andersen*, N.Y TIMES, May 8, 2002, at C1.

should be done. Andersen is now a very lame horse, a lame horse that got shot in the head."[306] Further, as the U.S. editor and a correspondent for the *Economist* contend:

> Enron is certainly an opportunity to instigate some long overdue corporate reforms. It was always a recipe for disaster that accountants were allowed to do consulting. It was always a scandal that chief executives were allowed to design their own remuneration packages. Despite some screams from the business lobby, new laws to restrict such abuses make sense.[307]

Ban Tax Services: While Sarbanes-Oxley bans auditors from providing certain kinds of consulting services – human resources and technology systems, it has not banned tax services or consulting on tax shelters, leaving that up to corporate audit committees to approve or not.[308] In January 2003, the SEC voted to allow tax services and consulting to continue, subject to approval by corporate boards and under the supervision of audit committees.[309]

Abolish Banking/Brokerage Combination: As for the provision in the Wall Street settlement requiring that analysts not be compensated for any investment banking business brought to the firm nor go on "road shows" for clients with the bankers, some maintain that is misdirected and insufficient as well.[310] Even without direct contact with the bankers and incentive pay based on touting client stocks, everyone in the firm knows that its overall success is inextricably tied to that of its clients. Scott Cleland of the Precursor Group, an independent research firm, observes that the entire model, based on research, trading, and banking is inherently conflicted.[311] That diagnosis leads to the conclusion that investment banking and securities analysis/brokerage should not exist under the same roof. They should be entirely separated, based on the model of the Precursor Group. For investment banking firms to be required to supplement their own analysis with that of truly independent firms, as stipulated by the Wall Street Settlement, might insure some check and balance, but is a tacit admission that the investment banking/analysis model has flaws.

Mutual Fund Industry Regulation: With the passage of Sarbanes-Oxley, the attention is shifting from corporate fraud to abuses by the mutual fund industry More aggressive than the SEC on this score is Rep. Richard Baker (R-LA), who has proposed legislation requiring greater disclosure of fees paid by individual investors, disclosure of the compensation structure for fund managers, and regulation of "soft dollar" commissions, in which funds pay higher than normal

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306. *Id.*

307. John Micklethwait & Adrian Wooldridge, *A Corporate Crisis? No, Just Business As Usual*, WASH. POST, June 23, 2002, at B1.

308. Kathleen Day, *SEC Allows Auditors as Tax Consultants*, WASH. POST, Jan. 23, 2003, at A1; David S. Hilzenrath, *Audit Firms Battle Curbs on Services*, WASH. POST, Jan. 16, 2003, at E1.

309. *Id.*

310. Patrick McGeehan, *For Financial Firms, Proposed New Rules on Analysts are the Least of Their Problems*, N.Y TIMES, May 8, 2002, at C2.

311. *Id.*

commissions in return for research, with the costs passed on to fund investors.[312] The Baker bill also would increase the mandated percentage of independent directors on fund boards from 40 percent to 67 percent.[313]

That legislation, the Mutual Fund Integrity and Fee Transparency Act of 2003, managed to get through the House Financial Services Committee, but is likely to die on the House floor[314] Industry lobbyists succeeded in watering down the final reform bill, and reform advocate Jack Bogle concluded, "If a journey of a thousand miles begins with a single step, I'd say this legislation still leaves us many hundreds of miles to go."[315] Jack Bogle has roundly criticized the industry he helped create and has been a crusader for reform.[316] He charges most funds with charging excessive fees, with insufficient disclosure of portfolio holdings, with failing to provide an informed choice to investors, with failing to compensate fund managers according to their performance, with excessively turning over stock holdings, with failing to disclose its votes on shareholder resolutions, with insufficiently holding management in invested firms accountable, and when all is said and done, with underperforming the market.[317] Bogle and others believe the governance and practices of this industry are the next best targets and candidates for reform.[318]

Governance of the Stock Exchanges: One matter not addressed by Sarbanes-Oxley related to the integrity of the listing process itself concerns the governance of the major stock exchanges, especially the NYSE. The controversy surrounding Chairman Richard Grasso's $10 million salary in 2002, and his deferred compensation package of $139 million, has brought more scrutiny to the NYSE's integrity[319] That Grasso and the founder of Home Depot sat on each other's compensation committees also raised questions of NYSE's governance process.[320] While the self-regulatory organizations will require listed companies to have a majority of independent directors by October 2004, they could set a better example by themselves having more independence on their own boards.[321] Ten of the twenty-seven board members of the NYSE were from either listed companies or the securities industry prior to new NYSE Director John Reed downsizing the

312. Floyd Norris, *For Mutual Funds, Calls for Reform*, N.Y TIMES, June 15, 2003, at 3.7

313. *Id.*

314. Paul B. Farrell, *Fund Reform is Dead: Congress Passing Buck to Do-Nothing SEC*, CBS.MARKETWATCH.COM, Aug. 14, 2003, *available at* http://cbs.marketwatch.com (last visited Jan. 29, 2004).

315. *Id.*

316. Justin Fox, *Saint Jack on the Attack*, FORTUNE, Jan. 20, 2003, at 112

317. *Id.*

318. *Id.*

319. Floyd Norris & Landon Thomas, Jr., *Grasso Giving Up $48 Million in Benefits*, N.Y TIMES, Sept. 10, 2003, at C1; Walter Hamilton & Kathy M. Kristof, *SEC Chief Rips Huge Grasso Pay Package*, L.A. TIMES, Sept. 3, 2003, at C1; Landon Thomas, Jr., *A Pay Package that Fat Cats Call Excessive*, N.Y TIMES, Aug. 29, 2003, at C1.

320. Ben White, *NYSE Sets Tighter Rules for Its Officers*, WASH. POST, June 6, 2003, at E1; Gretchen Morgenson & Landon Thomas, Jr., *Chairman Quits Stock Exchange in Furor Over Pay*, N.Y TIMES, Sept. 18, 2003, at A1.

321. White, *supra* note 196.

board, and that is also true of six of the twenty-one NASDAQ board members.[322] New York Attorney General Eliot Spitzer contends that, "Fixing self-regulation is perhaps the most important policy issue facing the SEC."[323]

MARKET REFORMS

As noted, there are compliance costs and administrative costs from Sarbanes-Oxley that have met with criticism. Most of the costs are surely yet to be realized. Further, there are questions whether the provisions of Sarbanes-Oxley are misdirected and will markedly improve corporate governance. As *The Economist* concludes, "[n]ew federal laws, such as the Sarbanes-Oxley Act, have created a dense thicket of rules prescribing good behaviour in the boardroom. But the system's essential features – weak boards, muted shareholder participation and sweeping power for the boss – so far remain intact."[324] At the same time, the corporate scandals have generated a spirit of reform in the marketplace that has produced other results. Whether the reforms voluntarily adopted by corporations will turn out to be better than the widespread reforms forced by regulation remain to be seen, but scandal-ridden companies like WorldCom are actually leading the way toward the most ambitious reforms. MCI/WorldCom will be adopting many of the seventy-eight reforms urged in the Breeden Report, "Restoring Trust."[325] Most of the reforms go well beyond the requirements of Sarbanes-Oxley The major reforms in corporate governance recommended include:

> Outside director as chairman of board;
> Full independence for all directors;
> Ban CEO from serving on any other corporate boards;
> CEO salary capped at $15 million without shareholder approval;
> When board is divided on new candidates, contested elections must be held;
> Heavier director workload, salary increased to $150,000;
> Explicit dividend policy, paying 25 percent of net profits;
> Electronic "town hall" meetings on company website ideas with 20 percent support go to annual meeting; and,
> Governance rules become part of articles of incorporation, not corporate bylaws, and can be changed only with shareholder approval.[326]

In the case of WorldCom, of course, there are unique factors that may have propelled the company to take more drastic steps in reforming itself. Those factors include:

> The extent of damage created to shareholders by the collapse of WorldCom, to the tune of $180 billion in lost market capitalization;

322. Paula Dwyer, *Why the Market Can't Police Itself*, BUS. WK., June 2, 2003, at 84.

323. *Id.*

324. *WorldCom's Revenge*, ECONOMIST, Aug. 30, 2003, at 44-45.

325. Christopher Stern, *WorldCom to Put Curbs on CEO's Pay, Influence*, WASH. POST, Aug. 26, 2003, at E1.

326. *Id.*

- The fact that WorldCom's reorganization under the bankruptcy laws has been roundly criticized by those who believe the company should instead be liquidated;
- The blatant nature of the company's accounting fraud and the fact that four top executives have already pleaded guilty·
- The criticism of the company's $750 million settlement with the SEC as being totally insufficient;
- The assault brought against MCI/WorldCom by its competitors (Verizon, AT&T and SBC) and their political allies in Congress. AT&T has even brought a suit under RICO (Racketeer Influenced and Corrupt Organizations Act) against MCI/WorldCom for its illegal routing of phone calls;
- The sweeping and harsh criticisms of the company's board and senior management by the McLucas Report, requested by the company's board, and by the Thornburgh Report, requested by the bankruptcy judge;
- The company's favored position as a major government contractor, along with the decision by the Government Services Administration (GSA) that the company be suspended from bidding on any new government contracts; and,
- The criminal charges for securities fraud brought by the state attorney general of Oklahoma against the company and its senior executives, likely to be followed by similar charges by other states.[327]

Given all of these political and legal pressures, the company perhaps felt it had to take bold steps, in hopes of defusing some of those pressures. Other companies not facing such a barrage of forces are unlikely to adopt such ambitious internal reforms.

GLOBAL CORPORATE GOVERNANCE

Changes in corporate governance are taking place in other political-economic systems as well, though not always parallel to those changes in the U.S. There are other pressing legal issues surrounding global corporate governance as well, including the application of the Sarbanes-Oxley Act to overseas auditors, the scope and integrity of foreign regulatory bodies, and the evolution of global accounting standards.

Corporate Governance Standards in other Countries: The roles of corporate boards and shareholders are being debated in other countries, just as they are in the U.S., but with some marked differences, depending on the country or region.[328]

327 Christopher Stern, et al., *Oklahoma Plans to Charge Ebbers, WorldCom*, WASH. POST, Aug. 27, 2003, at E1; Christopher Stern & Brooke A. Masters, *WorldCom, Ex-Officers Charged in Oklahoma*, WASH. POST, Aug. 28, 2003, at E1; Joseph Menn, *WorldCom Puts Him in the Spotlight*, L.A. TIMES, Aug. 30, 2003, at C1; Barnaby J. Feder & Kurt Eichenwald, *A State Pursues WorldCom*, N.Y TIMES, Aug. 28, 2003 at C1.

328. Katharina Pistor, et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. PA. J. INT'L ECON. L. 791 (2002); Kerry S. Burke, *Regulating Corporate Governance Through the Market: Comparing the Approaches of the United States, Canada and the United Kingdom*, 27 J.CORP

Wisely or not, attention has focused on the independence of boards and directors in the U.S. That is somewhat true of other countries as well, but their requirements and laws often have a different emphasis. For instance, following the publication of the Cadbury Commission recommendations in 1992, corporations in the UK have gone much further than American companies in separating the roles of chairman and CEO.[329] While in 1990, 90 percent of both U.S. and U.K. companies combined the CEO and chairman positions, about 85 percent of FTSE 100 companies today separate those positions, while the situation is still the same in the U.S.[330] The emphasis on empowering independent (or non-executive) directors has occurred more recently in the U.K. and earlier in the U.S. The Higgs Report includes two recommendations that most corporate chairmen find objectionable – that a senior non-executive be designated on the board, opposed by 82 percent of all chairmen; and a nomination committee be chaired by an independent non-executive director, opposed by 87 percent of all chairmen.[331]

In France, independent directors are becoming somewhat more common. There are no regulatory standards on independence, as in the U.S., but high-level reports have recommended that the percentage of independent directors be increased, the first report recommending a level of one third, and the second report recommending one half. Genuine independence is more problematic, as most corporate board members represent the French elite and are graduates of two exclusive institutions of higher education.[332] Some companies, especially those with well publicized problems, have nonetheless moved in the direction of more independent boards. Vivendi Universal, with the controversy surrounding its accounting and CEO compensation, now has an audit committee completely filled with independent directors.[333] Moreover, the number of European boards having at least one independent member, no great progress by U.S. standards, has nonetheless risen from 53 percent in 2001 to 59 percent in 2002.[334]

In South Korea, with its history of poor corporate governance, family dynasties called chaebol rule over large conglomerates, with opaque subcompanies controlled through extensive networks of cross-shareholding.[335] While the boards of such companies formerly had no outside directors, the situation is slowly changing. At Samsung Electronics, half of its fourteen board members are now outsiders, and its audit committee is totally composed of outsiders.[336] KT Corporation, the largest phone and broadband company in Korea, just recently

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L. 341 (2002); Douglas M. Branson, *The Very Uncertain Prospect of "Global" Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321 (2001).

329. Paul F Kocourek, et al., *Corporate Governance: Hard Facts about Soft Behaviors*, 30 STRATEGY + BUSINESS 58 (2003), *available at* http://www.strategy-business.com/press/article/8322?pg=0 (last visited Jan. 30, 2004).

330. *Id.*

331. *British Corporate Governance: Hating Higgs*, ECONOMIST, Mar. 15, 2003, at 63.

332. *French Corporate Governance: Independent? Moi?* ECONOMIST, Mar. 15, 2003, at 63.

333. Kerry Capell, *Opening Up the Boardroom*, BUS. WK., May 19, 2003, at 50.

334. *Id.*

335. Moon Ihlwan, *Crackdown on Korea, Inc.*, BUS. WK., May 19, 2003, at 44.

336. *Id.*

privatized, is one of few companies in Asia with an independent director as chairman of the board.[337]

Beyond the issue of independent boards, not as big an issue in other countries as in the U.S., there has been a movement in many global regions toward the adoption of board committee structures. Companies in the U.K. and European countries most often have compensation or remuneration committees, along with audit committees.[338] Leading companies in Japan, like Sony and Hitachi, have also put such committees in place.[339] Corporate governance codes, while setting only voluntary standards, are becoming more common throughout Europe. During 2002, Spain and Germany introduced governance codes for public companies, while Italy and France updated their own codes.[340] The German Stock Corporation Act also requires companies to disclose how well they comply with the corporate governance code.[341] Over time, the European Commission also intends to harmonize the over 40 European corporate governance codes.[342]

Boards all across the globe are now holding CEOs more accountable for their failures to perform while in office. CEO turnover is up "192 percent in Europe and 140 percent in the Asia/Pacific region since 1995, and 45 percent of all CEO replacements in the Asia/Pacific region in 2002 were related to corporate performance.[343] The percentage of performance-related dismissals increased ten-fold between 2001 and 2002.[344] Japan also revised its commercial code in 2002 to encourage companies to have outside directors.[345]

Despite increased accountability inattentive boards that fail to exercise diligence are a common problem in other countries, just as they are in the U.S. Boards dominated by strong-willed CEOs are also just as common in other countries as in the U.S. For instance, Cees van der Hoeven, CEO of Ahold, was a growth- and acquisition-focused executive and in many ways Europe's counterpart to General Electric's Jack Welch.[346] After the scandal surfaced, the company's board rejected his offer to resign due to his personality and power of persuasion.[347] In other words, the board may have been too intimidated to even allow the CEO to fall on his own sword.

Shareholder Activism: Shareholder activism is much more prevalent in the U.S. than in other countries, but the gap is narrowing in two ways. First, U.S.

337. *Id.*

338. Capell, *supra* note 333.

339. Ken Belson, *At Meetings Abroad, Raucousness and Hoopla*, N.Y TIMES, May 11, 2003, at 3.10.

340. Capell, *supra* note 333.

341. *Id.*

342. *Id.*

343. Chuck Lucier, Rob Schuyt, & Eric Spiegel, *CEO Succession 2002: Deliver or Depart*, 31 STRATEGY + BUSINESS, 32 (2003), *available at* http://www.strategy-business.com/press/article/21700?pg=all&tid=230 (last visited Jan. 30, 2004).

344. *Id.*

345. *Id.*

346. Robert J. McCartney, *Food Baron Fall Shakes Dutch*, WASH. POST, Mar. 1, 2003, at A1.

347. *Id.*

shareholder groups, whether church organizations like the Interfaith Center for Corporate Responsibility or mainstream institutional shareholders, will occasionally challenge the practices of firms in which they own shares that are based in other countries. That trend moved forward in the 1990s. For instance, in Europe, U.S. pension funds like TIAA-CREF which has an aggressive corporate governance department, are joining forces with European funds to bring pressure on companies based in Europe.[348] More recently, shareholders in other countries have organized to pressure companies in their own homelands. As one scholar put it, After years of relative isolation as primarily U.S. and British phenomenon, shareholder activism has finally shown signs of going global."[349] For instance, related to the Ahold scandal, a Dutch shareholder watchdog group called the Foundation for Investigation of Business Information has applied pressure for the CEO to return a large portion of his compensation.[350] There is also a Dutch Association of Shareholders, a more traditional group.[351] In France, since Alcatel has sought investors in the U.S. capital market, it has faced pressure from U.S. shareholder interests, while it has also had to face increasing pressure from French shareholders.[352] France now faces the question whether it is moving more in the direction of the American "shareholder democracy" model and abandoning its previous "stakeholder" model.[353]

Having acknowledged the growing activism of shareholders in the U.S., there are still corporate governance experts who claim that shareholder powers pale in contrast to those of directors, since the American model is much more director-centric.[354] In the U.S. and under the Delaware code, Bainbridge argues, "Shareholder control rights are so weak that they scarcely qualify as part of corporate governance."[355] Even as to institutional investors, he states:

> There is relatively little evidence that institutional investor activism has mattered. Although about fifty percent of equity securities are owned by institutions, large blocks held by a single investor are rare, and few U.S. corporations have any institutional shareholders who own more than five-to-ten percent of their stock. Even the most active institutional investors spend only trifling amounts on corporate governance activism. Institutions devote little effort to monitoring management; to the contrary, they typically disclaim the ability or desire to decide company-specific policy questions. They rarely conduct proxy

348. Capell, *supra* note 333.

349. Perry E. Wallace, *The Globalization of Corporate Governance: Shareholder Protection, Hostile Takeovers and the Evolving Corporate Environment in France*, 18 CONN. J. INT'L L. 1 (2002).

350. McCartney, *supra* note 346.

351. *Id.* (While this organization caters more to mainstream shareholders, the Foundation for Investigation of Business Information is more akin to groups in the U.S. like the Interfaith Center for Corporate Responsibility and is more prone to be aggressive and activist in its demands.).

352. Wallace, *supra* note 349, at 14.

353. *Id.* at 3.

354. Stephen M. Bainbridge, *Director v. Shareholder Primacy in the Convergence Debate*, 16 TRANSNAT'L LAW 45, 46 (2002).

355. *Id.* at 48.

solicitations or put forward shareholder proposals.[356]

That view of course conflicts with others discussed above. Meanwhile, even though the U.K. shares a common law foundation with the U.S., as well as many features of its corporate model, there the emphasis is much more on shareholder rights and powers. Hence, while directors are held much more accountable for executive salaries in the U.S., the U.K. has recently given shareholders the power to approve of CEO pay packages.

Even though shareholder meetings of Japanese companies have been historically friendly and quiet, they have also contended with professional disrupters, known as sokaiya, who demand hush money from corporations involved in scandal.[357] Companies have largely succeeded in thwarting those elements, but now legitimate shareholders have begun challenging management in proxy votes.[358]

In South Korea, foreigners own more than a third of the shares of companies listed on the Seoul stock exchange, and they are the primary forces promoting corporate governance reform.[359] Indigenous political forces also have the issue on their agenda, especially since the stock manipulation scandal involving SK Corporation, the country's third largest conglomerate.[360] A group called People's Solidarity for Participatory Democracy is seeking tighter restrictions on cross-shareholding, more outside directors, the ability to bring class action suits, and greater separation between banks and manufacturing companies.[361]

Organized shareholder groups are also forming in other countries, counterparts to the shareholder activist groups in the U.S. Beyond the Dutch groups mentioned above, South Korea has another group called the Center for Good Corporate Governance, and in the region, there is an Asian Corporate Governance Association.[362] In France, the major shareholder group is the Association pour la Defense des Actionnaires Minoritaires (ADAM).[363]

Pension funds have long been activist in the U.S., but mutual funds much less so, and hence the encouragement of Jack Bogle, founder of the Vanguard Funds, for mutual funds to exert much more pressure on corporate managements.[364] In European countries, such as the United Kingdom, activism by both pension funds and mutual funds has been at a much lower decibel, as only about 50 percent of all shares are voted, whereas the figure is closer to 80 percent in the U.S.[365] However, the volume is growing. Germany's second largest mutual fund is moving in an

356. *Id.* at 50.
357. Belson, *supra* note 339.
358. *Id.*
359. Moon Ihlwan, *Crackdown on Korea, Inc.*, BUS. WK., May 19, 2003, at 44.
360. *Id.*
361. *Id.*
362. *Id.*
363. *French Corporate Governance: Independent? Moi? supra* note 332, at 63.
364. Justin Fox, *Saint Jack on the Attack*, FORTUNE, Jan. 20, 2003, at 112.
365. *Will the Owners Please Stand Up?* ECONOMIST, Nov. 2, 2002, at 72.

activist direction, and the U.K.'s Institutional Shareholders Committee, representing pension funds, insurers, and mutual funds has adopted an activist code. Reflecting trends in the U.S., the U.K might also force funds to disclose how they vote on proxy resolutions.[366]

Shareholder v. Stakeholder Models: Many countries are following the Western model of corporate law and governance, including the wide dispersion of ownership to shareholders, in order to be listed on one of the U.S. stock exchanges and get access to greater capital in the U.S. Nevertheless, some experts believe it is arrogant and imperialistic for the U.S. to believe this trend is inevitable and to believe that its model of corporate governance is necessarily better.[367] Other models favor block ownership of shares, sometimes held by banks or families or other constituents, and emphasize accountability to other stakeholders besides shareholders.[368] One example is the European system of co-determination that favors accountability to labor through two-tiered boards of directors. In the face of other models, global convergence along the lines of the U.S. corporate governance model will likely never occur. As one critic puts it:

> The self-anointed corporate governance experts, elite as they may be in the United States corporate law academy, are not cognizant of the real issues of the twenty first century. Their advocacy of 'global' convergence, and that long the lines of United States style corporate governance, is not based upon 'global' developments, is culturally chauvinistic, and is anachronistic.[369]

A rich body of literature exists on the variables that account for the differences between shareholder and stakeholder accountability models. Why does one country embrace the shareholder model while another country follows the stakeholder model? One leading theory contends it is the quality of corporate law (QCL) that accounts for the difference and that common law systems facilitate the dispersion of shares and minority rights of shareholders, while civil law systems more often promote concentrated ownership with accountability to stakeholders.[370] This theory has generated a fair amount of criticism and counter-theories. John Coffee argues that the existence of a common law or civil law system has very little to do with the dispersion of ownership and shareholder power.[371] Were that the case, European civil law countries would not be able to move to a more shareholder-centric system, as many are now doing, and transitional economies with civil law systems would forever be trapped into a system of concentrated ownership. The QCL theory also cannot explain the thriving securities market in the Netherlands, a civil law country Coffee instead argues that the absence of

366. *Id.*

367 Douglas M. Branson, *The Very Uncertain Prospect of 'Global Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321, 325 (2001).

368. *Id.* at 331.

369. *Id.* at 361.

370. Rafael LaPorta, et al., *Investor Protection And Corporate Governance*, 58 J. OF FIN. & ECON. 3, at 9.

371. John C. Coffee Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State In the Separation of Ownership and Control*, 111 YALE L. J. 1, 4-7 (2001).

state supervision is the critical factor leading to dispersion of ownership.[372] In such environments, as in the U.S., the U.K., and Canada, vibrant stock exchanges and self-regulatory systems emerge. They in turn give rise to accommodating common law systems, rather than the other way around. Coffee believes the QCL theorists have the causal chain backwards.[373] It is liquidity and stock exchanges that produce legal systems protective of shareholder rights.

To this debate, Mark Roe injects a political thesis. He argues that the type of corporate governance followed by a given system is determined by the politics underlying that system.[374] The legal system and type of state supervision are not the critical variables but the nature of the overall political system.[375] He maintains, through an analysis of wide-ranging comparative examples, that social democracies promote concentrated ownership and accountability to stakeholders, while capitalist democracies promote dispersed ownership and shareholder powers.[376] It is social democracies that strengthen the claims of non-shareholders such as labor. Peter Gourevitch offers a sympathetic critique of Roe's work, believing it is essentially accurate, but still questions some of its elements.[377] Roe and Gourevitch are both political scientists, so it is not strange that they would both stress the importance of the political system. Gourevitch argues that Roe focuses too much on the overall political system and ignores such variables within any given system as issues, interest groups, and institutions.[378] Any combination of those forces, even in a social democracy, could serve to empower shareholders and create dispersed ownership. Conversely, they might also lead to concentrated ownership and stakeholder empowerment in a capitalist democracy. Even in the U.S., there is an active debate within the academy and larger political society over the relative power of shareholders and other stakeholders, over the ownership structure of major corporations, and over the range of corporate accountability and obligations.

Global Accounting Standards: The corporate scandals in the U.S., along with the debate over conflicting standards of expensing stock options, have highlighted the differences between U.S. and other country standards. The U.S. is no longer viewed as the gold standard of either corporate governance or accounting standards. The International Accounting Standards Board (IASB) has led the way in the expensing of stock options, for example, with the Financial Accounting Standards Board (FASB) about to follow Some Europeans view its standards based on principles as more fair and less susceptible to abuse and corruption than the U.S. rules-based standards based on rules.[379] Ironically, the Roman law or code

372. *Id.* at 8.

373. *Id.* at 7.

374. *See* MARK ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE 11-13 (2003).

375. *Id.*

376. *Id.*

377 Peter A. Gourevitch, *The Politics of Corporate Governance Regulation*, 112 YALE L. J. 1829, 1878-1880.

378. *Id.* at 1878.

379. F Robert Buchanan, *International Accounting Harmonization: Developing Single World Standard*, 46 BUS. HORIZONS 3, at 61-70.

law countries of France and Germany have more general and flexible accounting standards than do the common law countries of the U.S. and U.K.[380]

There are other differences as well. The common-law countries of the U.S., U.K., Canada, and Australia are more "shareholder-focused" in their governance and accounting standards, while the code-law countries of Japan, Germany, and France represent bank-dominated economies and are more "stakeholder focused."[381] They also tend to demand less transparency than their common-law counterparts.[382] Belying the accusation that U.S. standards tend to encourage more reckless earnings management, one study found that:

> [A]ccounting earnings in common law countries are more conservative than reported earnings in code law countries, arising out of the arm's-length relationship between contracting parties (managers and shareholders). Reviewing the results of earnings suggests that bad news is incorporated more slowly and good news more quickly in code law than in common law countries.[383]

Indeed, when Daimler-Benz conformed its earnings statements to U.S. standards in 1993, prior to its merger with Chrysler, it converted a sizable gain to a sizeable loss.[384]

With the differences in U.S. and global accounting standards, and the criticisms of U.S. corporate scandals, there is a movement toward convergence of standards. European companies that have used GAAP standards to date will be moving toward international accounting standards. The goal of the FASB and IASB is to have uniform standards created by 2005.[385] Currently, the rules of the two bodies cover the U.S. and almost fifty other countries.[386] James Harrington of PricewaterhouseCoopers states, "[y]ou're looking at a whole paradigm of how the rules are made. It's a momentous change."[387]

Included among the advantages of convergence are lower compliance costs for transnational enterprises and the stimulation of more global capital flows.[388] On the debit side, even with uniform and flexible standards, the implementation of those standards will vary according to national and institutional cultures.[389] As to whether international convergence would prevent scandals like Enron in the future, one author writes:

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380. *Id.*

381. *Id.*

382. *Id.*

383. *Id.*, Grace Pownall & Katherine Schipper, *Implications of Accounting Research for the SEC' Consideration of International Accounting Standards for U.S. Securities Offerings*, 13 ACCT. HORIZONS 3, at 259-280 (1999).

384. Buchanan, *supra* note 379.

385. Jackie Spinner, *Rulemakers Move Closer to Global Accounting Standards*, WASH. POST, Sept. 19, 2002, at E4.

386. *Id.*

387. *Id.*

388. Buchanan, *supra* note 379.

389. *Id.*

> The Enron debacle, though having drawn great attention in the IFRS dialogue, is not an indicator of any fundamental accounting or regulatory system failure. Rather, it is a case of corrupt management that was seeking technicalities behind which to perpetrate investor fraud. It appears that its primary infraction, nondisclosure of off-balance sheet financing, might be more clearly prohibited under IFRS. That, however, would not necessarily have precluded them from fraudulent tactics under the international system, because the IFRS is generally less structured than U.S. GAAP and more interpretive latitude is available to corporate accountants.[390]

Supporting the view that international accounting standards might create even more chances for manipulation, an accounting expert stated, "[t]here's all this talk about how international accounting standards are better. When I hear that it just makes me sick to my stomach because I think it's so wrong. There's more flexibility in the international standards. It makes it where it's easier to do the kinds of things you want to do. .If they want to hide it, they're going to hide it."[391]

Global Securities and Governance Standards: Beyond the effort to harmonize accounting standards, international organizations are also attempting to harmonize securities and corporate governance standards. The International Organization of Securities Commissions (IOSCO), formed in 1974, is composed of 161 securities regulatory agencies from various parts of the world that agree: (1) to cooperate to promote high standards of regulation; (2) to exchange information to promote the development of securities markets; (3) to establish standards of effective surveillance of international securities transactions; and (4) to provide mutual assistance to promote effective enforcement and the integrity of markets.[392]

Meanwhile, the Organization for Economic Cooperation and Development (OECD) is attempting to promote and harmonize global corporate governance standards.[393] Examining its website one will see the areas of emphasis of its Ad Hoc Task Force on Corporate Governance.[394] The five sections of its governance principals cover the rights of shareholders, the equitable treatment of shareholders, the role of stakeholders, disclosure and transparency and the role of the board.[395]

Application of Sarbanes-Oxley Act to Foreign Firms: The Public Accounting Oversight Board has recommended that auditors of foreign companies whose shares are traded on U.S. exchanges must register with the SEC.[396] Such

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390. *Id.*

391. Carrie Johnson, *Deloitte Probe to Test Reach of U.S. Law*, WASH. POST, Feb. 28, 2003, at E1.

392. Felicia Kung, *The International Harmonization of Securities Laws: The Rationalization of Regulatory Internationalization*, 33 LAW & POL'Y INT'L BUS. 443, 465-66.

393. Colin Mayer, *Developing the Rules for Corporate Governance*, FIN. TIMES, Nov. 6, 2000, at 2; *see also* Christopher Adams, *Think Tank Rethinks Its Role*, FIN. TIMES, Sept. 24, 1999, at 4. *See also* Jane Martinson, *OECD Code to Safeguard Shareholders*, FIN. TIMES, April 10, 1999, at 5.

394. Organisation (sic) for Economic Cooperation and Development, *Principles of Corporate Governance*, April, 1998, *at* http://www,oecd.org/dataoecd/47/50/4347646.pdf (last visited Mar. 3, 2004).

395. *Id.* at 6.

396. Carrie Johnson, *Accounting Board Wants Foreign Firms to Register* WASH. POST, Mar. 5,

registration may also include annual inspections and the possibility of disciplinary action being taken. Left undecided are whether the inspections might extend overseas and whether overseas branches of Big Four American firms will be treated differently from audit companies based abroad. Some legislators such as Senators Christopher Dodd (D-Conn.) and Jon Corzine (D-N.J.) are concerned that if foreign auditors are exempted from the law that there will be an incentive for U.S. audit firms to move much of their operations abroad.[397]

In January 2003, the EU was initially pleased when the SEC announced limited exemptions from new rules for accounting and corporate governance. Included among the exemptions were (1) that foreign companies do not have to disclose that a financial expert on the audit committee is independent of management; (2) that non-management employees are allowed to serve on the audit committee, a common practice in Germany· and (3) that foreign lawyers are not required to report securities law violations within the firm, if they do not advise management on issues of U.S. law.[398] However, by April 2003, the EU was less pleased and was lobbying aggressively against any registration requirement.[399] Fritz Bolkenstein, the European commissioner in charge of market reform, wrote a threatening letter to SEC Chairman William Donaldson, on behalf of the 15 member finance ministers, warning that such a requirement would undermine confidence in financial markets and prompt reciprocal requirements for registration of U.S. audit firms in each EU member country[400] The EU and European governments are concerned that their audit firms not be subject to conflicting laws and regulations and maintain that meeting U.S. disclosure requirements would violate European data protection laws.[401] They object to the law's coverage as unfair, since European firms are already subject to a large number of U.S. regulations.[402] The timing of the accounting fraud and restatement of over $800 million of earnings by Dutch food company Royal Ahold, however, stiffened the resolve of the PAOB to cover the conduct of foreign auditors as well.[403]

Jurisdiction over Overseas Firms and Auditors: When auditors working abroad have evidence of accounting fraud, the question arises over U.S. access to that information. When the Senate was investigating the BCCI (Bank of Credit and Commerce International) scandal in 1991, Pricewaterhouse contended that documents in its London office could not be subpoenaed, since the U.S. headquarters had no control over its foreign branch offices.[404] The firm now says it nevertheless regularly cooperates in supplying foreign work papers to the U.S.

2003 at E3.

397. *Id.*

398. Robert J. McCartney, *Audit Exemptions Relieve Europeans*, WASH. POST, Jan. 25, 2003, at E2.

399. Paul Meller, *Europe Asks Compromise on Auditors*, N.Y TIMES, April 15, 2003, at 1.

400. *Id.*

401. *Id.*

402. *Id.*

403. Stephen Labaton, *S.E.C. Chief Has Plan to Pick Audit Board Head*, N.Y TIMES, Mar. 5, 2003, at 3.

404. Johnson, *supra* note 396.

government.[405] Foreign accounting firms must provide opinions and work papers, upon which a registered public accounting firm relies when issuing an audit report or anything that relates to its participation in an audit of a U.S. firm, though it does not have to provide other unrelated documents.[406] The U.S. Customs Office will also assist the SEC in tracking down documents by screening auditors when they cross the border and denying them passage unless they turn over the documents.[407] A KPMG auditor crossing the Mexican border turned over papers implicating Xerox Corporation in one such case, resulting in a $10 million settlement.[408]

The SEC and federal prosecutors also have jurisdiction over overseas companies based abroad that are listed on the New York Stock Exchange and may have engaged in fraud that harmed U.S. investors.[409] On that basis, the SEC has brought administrative proceedings against the Cronos Group, a Luxembourg company headquartered in England, and against its British accountants, for an alleged fraud in connection with an initial public offering in 1995.[410] The SEC has also asserted jurisdiction over the Ahold accounting investigation, since the company is listed in the U.S.[411]

Regulatory Bodies in Foreign Countries: In the U.S., the Justice Department and the SEC usually work together to examine accounting and securities fraud.[412] Most other countries lack the kind of serious regulatory framework and enforcement agencies that exist in the U.S. In the case of Royal Ahold's accounting fraud, it is being investigated by three entities in the Netherlands – the public prosecutor's office, the Netherlands Authority for Financial Markets, and Euronext Amsterdam NV the operator of the Dutch stock exchange.[413] However, no Dutch regulatory authority enjoys the sweeping powers of the SEC, and penalties for even such violations as insider trading are much milder than in the U.S.[414]

Having discussed both the voluntary changes in global corporate governance, as well as some of the comparative regulations of corporate governance, the following chart compares the ratings of corporate governance in leading European countries.

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405. *Id.*

406. David M. Stuart, & Charles F Wright, *The Sarbanes-Oxley Act: Advancing the SEC's Ability to Obtain Foreign Audit Documentation in Accounting Fraud Investigations*, 2002 COLUM. BUS. L. REV. 749, 776.

407 Johnson, *supra* note 396.

408. *Id.*

409. Brooke A. Masters, *Ahold Problems Go Beyond Foodservice*, WASH. POST, Mar. 1, 2003, at E1.

410. *Id.*

411. *Id.*

412. Robert J. McCartney, *Dutch Exchange is Investigating Giant Food' Parent*, Wash. Post, Feb. 27, 2003, at E1.

413. *Id.*, Brooke A. Masters & Robert J. McCartney, *Ahold Reported Scandal to Prosecutors*, WASH POST, Feb. 27, 2003, at E1

414. Gregory Crouch & Suzanne Kapner, *Royal Ahold Confirms U.S. Inquiries Into Its Accounting*, N.Y TIMES, Feb. 26, 2003, at C2.

How the Europeans Stack Up

Britain led the pack last year when consultant Deminor ranked West European countries on three broad measures of corporate governance*

COUNTRY	SHAREHOLDER RIGHTS	DISCLOSURE	BOARD STRUCTURE	TOTAL
BRITAIN	4	5	5	14
FRANCE	4	3	3	10
ITALY	3	4	3	10
GERMANY	4	3	2	9
NETHERLANDS	2	3	3	8
SPAIN	2	2	4	8
SWITZERLAND	2	2	2	6

*Based on analysis of FTSE Eurotop 300 companies.
1=worst and 5=best Data: Deminor

[415]

415. Capell, *supra* note 333.

CONCLUSION

While U.S. Corporations have been under pressure to adopt more independent boards since the 1970s, the corporate scandals and subsequent Sarbanes-Oxley Act have added substantially to that pressure. Independence may be one factor among several vital to reforming corporate governance, but it is certain that many corporate boards are changing, especially in their scrutiny of CEOs and top management. Business groups and leaders have criticized the Sarbanes-Oxley Act for going too far and adding needless expenses to conducting business, especially in the standards and documentation of internal controls, while making it more difficult to attract talented directors to govern the corporation. Meanwhile, business critics contend the law falls short even in the area of accounting reform, where it is most directed, and ignores other important areas of corporate governance. Still, most acknowledge it is the most important corporate reform legislation since the Securities and Exchange Act of 1933, and its impact is bolstered by shareholder activism and litigation, by state and federal regulatory authorities, by increased penalties and criminal prosecutions, and by more aggressive stock exchanges.

The rise in concern over corporate governance is also occurring on a global basis, taking on forms both similar to and different from those in the U.S. Some countries take a stronger stakeholder approach than does the U.S., but shareholder activism is becoming more common even in countries that do not share the American history of capitalistic democracy. Further, in the U.K., governance reform and shareholder empowerment has advanced in some ways even more than it has in the U.S. Hopefully, this global movement will deter management misconduct and elevate investor confidence in the future, thereby enhancing the prospects for global economic expansion.