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Foreword, Corporate Governance Five Years After Sarbanes-Oxley: Is There Real Change

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FAITH STEVELMAN

Foreword

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I. Introduction

The articles in this issue are the product of the first academic symposium hosted by New York Law School's Center on Business Law & Policy. Founded in 2005, the center's activities highlight the current dynamism in the field of corporate governance and the vital, changing relationship between business, government, and the economy. Titled, *Corporate Governance Five Years after Sarbanes-Oxley: Is There Real Change?*, the symposium provided a lively forum for debating the effects of recent law reforms affecting public companies' governance structures, reporting obligations, systems of internal controls, and accountability for misconduct.

Scholars on the first panel examined the influence of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or "the Act") from a socio-economic perspective. As Professor James Fanto's article describes, Sarbanes-Oxley exemplifies the aspirational mode in federal securities law—the spirit that motivated Congress to enact laws that would promote "honest" markets, "full and fair disclosure," and "high standards of business ethics in the securities industry."¹ And yet the Act remains highly controversial—a lightning rod for disagreement—because in Sarbanes-Oxley, Congress chose to codify what had previously been mostly looser, nonbinding standards and incorporated these objective, more rigorous standards into mandatory *federal* laws and rules. Furthermore, Congress exercised its jurisdictional authority quite broadly in the Act; its new standards speak to public company auditors, accounting firms, corporate counsel,² audit committees, senior executives, and corporate whistleblowers. As Professor Fanto's article states, current popular sentiment evidences profound skepticism toward the motivations of politicians and government, hence the law's ability to influence institutions, especially economically-oriented institutions, for the better. As our panelists' discussion demonstrated, Professor Fanto's article illuminates, and I have argued

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1. See, e.g., SEC v. Zandford, 535 U.S. 813, 819 (2002) ("Among Congress' objectives in passing the Act was to insure honest securities markets and thereby promote investor confidence after the market crash of 1929 Congress sought to substitute philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the industry.") (internal quotations omitted); Basic Inc. v. Levinson, 485 U.S. 224, 230, 234 (1987) ("There cannot be honest markets without honest publicity We have recognized time and time again, a fundamental purpose of the various securities acts, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.") (internal quotations omitted); SEC v. Capital Gains Research Bureau, 375 U.S. 180, 186 (1963) ("A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.").
 2. For a discussion of the significance of the new Sarbanes-Oxley-inspired rules and standards governing corporate counsels' appropriate responses to signs of illegality, see Peter Kostant, *From Lapdog to Watchdog: Sarbanes-Oxley Section 307 and a New Role for Corporate Lawyers*, 52 N.Y.L. SCH. L. REV. 535 (2008).

elsewhere,³ there is a deep meta-politics underlying the legal and economic criticisms of Sarbanes-Oxley.⁴

In terms of substance, the first panel focused especially on provisions of the Act pertaining to public companies' boards. Reflecting this discussion, Professor Lawrence Lederman's article discusses the Walt Disney Company ("Disney") litigation involving Michael Eisner's hiring and firing of Michael Ovitz, and the Disney board's approval of the stunning compensation package awarded to Ovitz. As Professor Lederman describes, neither the litigants nor the court paid much attention to the chief executive officer ("CEO") succession issues that underlay the compensation dispute.⁵ This was true despite the fact that CEO succession planning is accepted as a signal responsibility of corporate directors.⁶ Although the Delaware Supreme Court exonerated the Disney board from liability for breach of fiduciary duty, Professor Lederman astutely proposes that the litigation might have taken a different turn if the plaintiffs had emphasized the board's abdication of its responsibilities for overseeing CEO succession—its failure to wrest control over succession planning from the company's obviously self-interested, current chief executive.

The second panel focused on the legal regulation of executive compensation—in particular, the extraordinarily large executive pay packages that continue to be announced even by firms that are in financial difficulty.⁷ Because

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3. Faith Stevelman Kahn, *Bombing Markets, Subverting the Rule of Law: Enron, Financial Fraud, and September 11, 2001*, 76 TUL. L. REV. 1579 (2002) (describing how the Act reflects the pressure being brought to bear on the legitimacy of secular, market institutions, and democratic values).
 4. James Fanto, *A Social Defense of Sarbanes-Oxley*, 52 N.Y.L. SCH. L. REV. 517, 522–25 (2008).
 5. Lawrence Lederman, *Disney Examined: A Case Study in Corporate Governance and CEO Succession*, 52 N.Y.L. SCH. L. REV. 557, 569–81 (2008).
 6. See A.B.A., CORPORATE DIRECTOR'S GUIDEBOOK § 2 (3d ed. 2001) [hereinafter CORPORATE DIRECTOR'S GUIDEBOOK]; see also William Ocasio, *Institutionalized Action and Corporate Governance: The Reliance on Rules of CEO Succession*, 384 ADMIN. SCI. Q. 44 (1999).
 7. See *Mozilo to Slice his Own Pay, Fees; Countrywide's Chief Executive is Expected to Forfeit \$37.5 Million*, L.A. TIMES, Jan. 28, 2008, at A12; James R. Hagerty & Joann S. Lublin, *Countrywide Directors' Dilemma*, WALL ST. J., Nov. 3–4, 2007, at B1; Rachel Sams, *Norris Retires as W.R. Grace CEO with \$9 Million Payout*, BALTIMORE BUS. J., Mar. 17, 2006, available at <http://baltimore.bizjournals.com/baltimore/stories/2006/03/20/story6.html>; Liam Plevin & Susanne Craig, *Deal Fees Under Fire Amid Mortgage Crisis - - - Guaranteed Rewards of Bankers, Middlemen are in the Spotlight*, WALL ST. J., Jan. 17, 2008, at A1 ("Merrill Lynch & Co.'s former chief executive, Stan O'Neal, left in October after the firm's \$8.4 billion write-down. He didn't get a bonus or severance, but he retained \$161.5 million in previously earned benefits and compensation because he met the age and service requirement for collecting those benefits. Charles Prince, Citigroup Inc.'s former CEO, lost his job, too. He left Citigroup in November with stock and other compensation valued at the time at \$29.5 million, as well as a bonus. He didn't get severance. Tuesday, Citigroup reported a fourth-quarter loss of \$9.83 billion."); see also Louis Uchitelle, *Revising a Boardroom Legacy*, N.Y. TIMES, Sept. 28, 2007, at C1; Eduardo Porter, *More Than Ever, It Pays to Be the Top Executive*, N.Y. TIMES, May 25, 2007, at A1; MAJORITY STAFF OF COMM. ON OVERSIGHT AND GOV'T REFORM, 110TH CONG., EXECUTIVE PAY: CONFLICTS OF INTEREST AMONG COMPENSATION CONSULTANTS (2007) (prepared for Chairman Henry A. Waxman), available at <http://oversight.house.gov/documents/20071205100928.pdf>.

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the Act addresses excessive executive compensation only tangentially, it has left the door open for further law reform. But choosing among law reforms in the area of executive compensation involves selecting among policy goals, as Professor Brett H. McDonnell's article explores. The corporate legal academy has been indecisive about corporate law's appropriate role in addressing growing income inequality.⁸ Federal securities laws and corporate laws, respectively, allow disclosure and internal approval mechanisms to suffice as checks on excessive executive compensation. Yet Professor McDonnell concludes that corporate legal scholars "do not have a good basis" for dismissing the fact that income inequality has been exacerbated by sky-high executive pay.⁹

Also included in this issue are the insightful remarks of our keynote speaker, Delaware Supreme Court Chief Justice Myron T. Steele. The chief justice expresses concern about the increasingly porous boundary between state and federal laws affecting companies' governance structures and reporting duties.¹⁰ As he notes, since Sarbanes-Oxley, federal securities law has increasingly influenced state corporate laws' traditional domain of internal corporate affairs.¹¹ And Delaware corporate law has become more "activist" in employing fiduciary law to setting standards for companies' disclosures.¹² As is evident in his remarks, Chief Justice Steele is concerned that the increased overlap between federal and state standards is creating legal uncertainty that will decrease shareholder wealth.¹³

The third panel focused on developments in accounting, auditing, and corporate disclosure—subjects at the heart of Sarbanes-Oxley. In this area, the cumulative effects of the Act's provisions are only just becoming apparent. Indeed, shortly after our symposium, the Public Company Accounting Oversight Board ("PCAOB") brought its first enforcement action—an action in which it censured Deloitte & Touche, LLP for its failed audit of Ligand Pharmaceuticals Incorporated.¹⁴

8. Brett H. McDonnell, *Two Goals for Executive Compensation Reform*, 52 N.Y.L. SCH. L. REV. 585 (2008).

9. *Id.* at 586.

10. Chief Justice Myron T. Steele, *Sarbanes-Oxley: The Delaware Perspective*, 52 N.Y.L. SCH. L. REV. 503 (2008).

11. *Id.* at 506–07.

12. For a recent Delaware Chancery Court decision mandating firms' disclosure of analysis underlying fairness opinions, see *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171 (Del. Ch. 2007). See also *In re Checkfree S'holder Corp. Litig.*, No. 3193-CC, 2007 Del. Ch. LEXIS 148, (Del. Ch. Oct. 18, 2007) (emphasizing the materiality of the information and analysis).

13. Steele, *supra* note 10 at 507.

14. In its disciplinary proceedings against Deloitte & Touche, LLP, the PCAOB obtained a civil monetary penalty against the firm in the amount of \$1 million and required it to commit to certain undertakings to improve auditing quality and oversight. *In re Deloitte & Touche, LLP*, PCAOB Release No. 105-2007-005 (Dec. 10, 2007).

The fourth and final panel discussed recent trends in Securities and Exchange Commission (“SEC” or “Commission”) enforcement actions and Department of Justice prosecutions of corporate frauds.¹⁵ Of special concern to the speakers was the pressure being brought to bear on the attorney-client privilege in internal corporate investigations spurred by criminal inquiries.¹⁶ In addition, as highlighted in the article by Barry Rashkover and Laurin Blumenthal Kleiman, there has been continuing concern about the potential for fraud by hedge funds and their managers, and its potential to destabilize the markets.¹⁷

Decrying the costs imposed by recent regulations affecting public companies and Wall Street firms, in early spring 2007, New York City Mayor Michael Bloomberg and Senator Charles Schumer issued a report cautioning that these new laws and regulations could undermine New York City’s financial prosperity.¹⁸ But the symposium, held on April 13, 2007, coincided with an exciting, upbeat moment in New York Law School’s history—in pauses between speakers, we watched giant cranes hoisting into place the foundations of our new building.

II. Recent Developments in Corporate Governance and the Capital Markets

The magnitude and pace of corporate and securities law reform has accelerated appreciably since Sarbanes-Oxley’s enactment. The Act was passed in the aftermath of the burst technology stock bubble, after years of concern over earnings management,¹⁹ and just months after the frauds at Enron and WorldCom culminated in the largest bankruptcy filings in U.S. history.²⁰ Nevertheless, when President George W. Bush signed Sarbanes-Oxley into law on July 30, 2002,²¹ controversy over the wisdom of the legislation and the costs it would

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15. See, e.g., Preet Bharara, *Corporations Cry Uncle and Their Employees Cry Foul: Rethinking Prosecutorial Pressure on Corporate Defendants*, 44 AM. CRIM. L. REV. 53 (2007).
 16. See, e.g., Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U. L. REV. 311, 319-21 (2007) (discussing factors for assessing corporate cooperation and hence the likelihood and severity of criminal sanctions against corporate defendants).
 17. Barry Rashkover & Laurin B. Kleiman, *SEC Enforcement and Examinations Concerning Hedge Funds*, 52 N.Y.L. SCH. L. REV. 599 (2008); see also *Hedge Funds: In Need of International Regulation?*, Int’l Rev. (N.Y. L. Sch. Ctr. for Int’l Law, New York, N.Y.), Fall 2007, at 3.
 18. SUSTAINING NEW YORK’S AND THE U.S.’ GLOBAL FINANCIAL SERVICES LEADERSHIP (2007) [hereinafter SUSTAINING FINANCIAL SERVICES LEADERSHIP] (commissioned by New York City Mayor Michael R. Bloomberg and Senator Charles E. Schumer), available at http://www.senate.gov/~schumer/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf.
 19. For a famous statement expressing such concern, see Arthur Levitt, The “Numbers Game,” Remarks at the New York University Center for Law and Business (Sept. 28, 1998), available at www.sec.gov/news/speech/speecharchive/1998/spch220.txt.
 20. *In re Enron Corp.*, No. 01-16034, 2001 Bankr. LEXIS 1563 (Bankr. S.D.N.Y. Dec. 3, 2001); *In re WorldCom, Inc.*, No. 02-13533, 2003 Bankr. LEXIS 2192 (Bankr. S.D.N.Y. May 16, 2003).
 21. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28 and 29 U.S.C.); see also George W. Bush, U.S. President, *President Bush Signs Corporate Corruption Bill* (July 30, 2002), available at <http://www.whitehouse.gov/news/releases/2002/07/20020>

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impose on public companies and their advisers erupted almost immediately. And this controversy has continued to the present.²²

The past five years have been exciting but also confusing for corporate legal scholars and those who follow the regulation of public companies and the capital markets.²³ Since Sarbanes-Oxley's enactment, there has been a steady outpouring of new anti-corruption, "increased accountability" laws, SEC regulations, and listing standards—consistent with Congress's mandate.²⁴ Notwithstanding the massive financial fraud currently enveloping Refco Inc.,²⁵ fewer large scale corporate accounting frauds have been reported in the past few years. However, the scope and variety of other kinds of financial frauds and schemes remains shocking. As of December 2007, the *Wall Street Journal* had declared that the economic ill effects of investor losses on mortgage-backed securities would equal those arising from the savings and loan crisis of the 1980s,²⁶ and SEC probes and other investigations are ongoing.²⁷ Ironically, a significant portion of these losses, like those from the Enron era, relate to erroneous financial valuations,

730.html ("[T]oday I sign the most far-reaching reforms of American business practices [Sarbanes-Oxley] since the time of Franklin Delano Roosevelt.").

22. Corporate legal scholars are often harshly critical of corporate and securities legislation, noting the relative rigidity and slow pace of statutory reform, the potentially questionable incentives of politicians and legislators, and the difficulty of demonstrating the "efficiency" of legislative reforms based on compelling empirical evidence. For a scathing review of Sarbanes-Oxley along these lines, see Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. J. 1521, 1526-28 (2005); Larry E. Ribstein, *Sarbanes-Oxley After Three Years*, 3 N.Z. L. REV. 365 (2005). For a more favorable account of Sarbanes-Oxley, including consideration of the empirical evidence, see Robert A. Prentice & David B. Spence, *Sarbanes-Oxley as Quack Corporate Governance: How Wise is the Received Wisdom?*, 95 GEO. L. J. 1843 (2007); John C. Coates IV, *The Goals and Promise of the Sarbanes-Oxley Act*, 21 J. ECON. PERSP. 91 (2007).
23. For a discussion of the disparate popular opinions regarding Sarbanes-Oxley's effects and the hurdles that limit the reliability of empirical proofs of its effects, see *Sarbanes-Oxley, Five Years Under the Thumb*, ECONOMIST, July 26, 2007, available at http://www.economist.com/displaystory.cfm?story_id=9545905.
24. See, e.g., Robert Charles Clark, *Corporate Governance Changes in the Wake of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too*, 22 GA. ST. U. L. REV. 251 (2005) (presenting a synthetic overview of Sarbanes-Oxley-inspired reforms and recent empirical analyses of their costs and impacts); Jeffrey N. Gordon, *Governance Failures of the Enron Board and the New Information Order of Sarbanes-Oxley*, 35 CONN. L. REV. 1125, 1127 (2003) ("The sum total may portend the most far-reaching changes in American corporate governance since the original 1930s securities acts.").
25. For reference to the criminal indictment of the company's senior executives, including its general counsel, see, for example, *Refco Ex-Finance Chief Pleads Guilty*, WALL ST. J., Feb. 21, 2008, at C3.
26. Greg Ip, Mark Whitehouse & Aaron Lucchetti, *U.S. Mortgage Crisis Rivals S&L Meltdown — Toll of Economic Shocks May Linger for Years; A Global Credit Crunch*, WALL ST. J., Dec. 10, 2007, at A1.
27. See, e.g., Susan Pulliam & Kara Scannell, *Pricing Probes on Wall Street Gather Steam*, WALL ST. J., Dec. 21, 2007, at C1 ("Regulatory investigations into mortgage-securities pricing are examining whether financial firms should have told the public earlier about the declining value of such securities and how they priced them on their books, people close to the matter say.").

faulty record keeping, and inflated credit ratings.²⁸ Easy and cheap credit tied to the promise of ever rising real estate values appears to have done to the later-2000s what speculation in technology stocks did for the 1990s. In both periods the mechanisms of market efficiency overloaded, despite what seemed to be robust legal controls.

Putting aside the large-scale financial accounting and corporate looting scandals from Enron to Refco²⁹ in order to survey the financial landscape more broadly, the years after Sarbanes-Oxley's enactment have brought to light ongoing cheating by New York Stock Exchange ("NYSE") floor specialists,³⁰ illicit investor trading in mutual funds,³¹ systematic bias in equity analysts' reports,³²

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28. See, e.g., Susan Pulliam, *Merrill's Deals With Hedge Funds May Have Delayed Day of Reckoning*, WALL ST. J., Nov. 2, 2007, at A1 ("The SEC is looking into how the Wall Street firm [Merrill] has been valuing, or 'marking' its mortgage securities and how it has disclosed its positions to investors, a person familiar with the probe said."); see also Michael Siconolfi, *Did Authorities Miss a Chance To Ease Crunch? — SEC, Spitzer Probed Bear CDO Pricing in '05, Before Backing Away*, WALL ST. J., Dec. 10, 2007, at C1 ("Financial firms have disclosed write-downs totaling more than \$40 billion this year involving mortgage-related assets, partly stemming from mark-downs following cuts in the credit ratings of complex securities known as collateralized debt obligations. The SEC in recent months opened broad, new investigations into whether a number of financial firms are properly valuing such investments.").
29. In the past several years, major financial accounting or looting/self-dealing scandals have occurred at, for example, Adelphia Communications, Inc., AOL-Time Warner, Bristol Myers Squib, Computer Associates, Dynegy, Enron, Fannie Mae, Freddie Mac, Global Crossing, Halliburton, HealthSouth, ImClone, Kmart, Lucent, Parmalat, Qwest, Refco, Rite Aid, Tyco, WorldCom, and Xerox. For a factual discussion, see Press Release, Dep't of Justice, Fact Sheet: President's Corporate Fraud Task Force Marks Five Years of Ensuring Corporate Integrity (July 17, 2007), available at http://www.usdoj.gov/opa/pr/2007/July/07_odag_507.html. See also Penelope Patsuris, *The Corporate Scandal Sheet*, FORBES, Aug. 26, 2002, available at <http://www.forbes.com/2002/07/25/accountingtracker.html>. For socio-legal commentary, see John C. Coffee, *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269, 271 (2004) ("[T]he explosion of financial irregularity in 2001 and 2002 was the natural and logical consequence of trends and forces that had been developing for some time. Ironically, the blunt truth is that recent accounting scandals and the broader phenomenon of earnings management are by-products of a system of corporate governance that has indeed made corporate managers more accountable to the market. Yet sensitivity to the market can be a mixed blessing, particularly when the market becomes euphoric and uncritical.").
30. For a discussion of the specialist scandal and its effects on the NYSE, see William G. Christie & Robert B. Thompson, *Wall Street Scandals: The Curative Effects of Law and Finance*, 84 WASH. U. L. REV. 1567, 1577 (2006) ("In our view, markets failed to adequately police themselves due to the self-interests of the market participants and their owner/regulators. The responsibility for resolving this anti-competitive scenario, then, fell to the legal system rather than the markets. When entrenched interests are so deeply grounded in their routines, and when market participants have little or no option to bypass these interests, regulation and/or litigation can produce a value-enhancing outcome.").
31. For an explanation of the causes and effects of late trading in mutual funds, see Christie & Thompson, *supra* note 30, at 1586 ("The losses created by late trading are dispersed among each of the fund's shareholders, so that the loss of all but the largest of trades may be hidden in the background noise created by other factors affecting value The real control rests with the fund manager who has a contract with the board to manage the fund. These managers' incentives to address these issues may be overridden by relationships with others in the industry who benefit from late trading or stale prices."). See also *Conference—Mutual Fund & Investor Welfare*, 1 J. BUS. & TECH. L. (INAUGURAL ISSUE) 1 (2006).

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and widespread stock options backdating.³³ Credit rating agencies, which had come under fire after Enron's collapse,³⁴ are once again under scrutiny from Congress and the SEC.³⁵ Headlines decrying Enron's massive losses on off-balance sheet liabilities tied to special purpose entities³⁶ have given way to headlines decrying even more massive investor losses on mortgage-backed security investments involving structured investment vehicles.³⁷ These losses suggest that

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32. For extensive information regarding the Global Research Analyst Settlement, see SEC, SPOTLIGHT ON THE GLOBAL RESEARCH ANALYST SETTLEMENT, *available at* <http://www.sec.gov/spotlight/globalsettlement.htm> (last visited Feb. 22, 2008). *See also* Press Release, Office of N.Y. State Attorney Gen. Eliot Spitzer, SEC, NY Attorney General, NASD, NASAA, NYSE and State Regulators Announce Historic Agreement to Reform Investment Practices (Dec. 20, 2002); Robert B. Ahdieh, *Dialectical Regulation*, 38 CONN. L. REV. 863, 885–86 (2006) (discussing the Global Research Analyst Settlement as an instance of dialectical regulation); Jill E. Fisch, *Regulatory Responses to Investor Irrationality: The Case of the Research Analyst*, 10 LEWIS & CLARK L. REV. 57 (2006).
 33. *See, e.g.*, Christopher Cox, Chairman, SEC, Address to the 2007 Corporate Counsel Institute (Mar. 8, 2007), *available at* <http://www.sec.gov/news/speech/2007/speech030807cc.htm> (citing roughly one hundred sixty backdating investigations as being ongoing and observing the essential role of inside counsel in bringing wrongdoing to the Commission's attention); *Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs*, 109th Cong. (2006) (statements of Erik Lie, Associate Professor of Finance, Henry B. Tippie College of Business, University of Iowa) (setting forth empirical data evidencing backdating), *available at* <http://www.biz.uiowa.edu/faculty/erie/TestimonyErikLie.pdf>. On September 6, 2006, the Senate Finance Committee held hearings on the backdating of stock options and other controversial features of executive compensation. *See* David I. Walker, *Some Observations on the Stock Option Backdating Scandal of 2006* (Boston Univ. Sch. of Law Working Paper No. 06-31, 2006) *available at* <http://ssrn.com/abstract=929702>; Justin Scheck & Steve Stecklow, *Brocade Ex-CEO Gets 21 Months in Prison*, WALL ST. J., Jan. 17, 2008, at A3 ("To date, 17 executives at eight companies have been charged with criminal offenses relating to backdating.").
 34. Arthur R. Pinto, *Control and Responsibility of Credit Rating Agencies in the United States*, 54 AM. J. COMP. L. 341, 349–51 (2006) (describing SEC's regulatory responses to credit rating agencies' failures to respond to Enron's genuine risk profile).
 35. Aaron Lucchetti & Serena Ng, *How Rating Agencies' Firms' Calls Fueled Subprime Mess*, WALL ST. J., Aug. 15, 2007, at A1 ("S&P, Moody's Investors Service and Fitch Ratings gave top ratings to many securities built on the questionable loans, making the securities seem as safe as a Treasury bond."); Kara Scannell & Deborah Solomon, *Unraveling the Subprime Mess; Congress, Treasury Set to Review Meltdown; Targeting Credit Raters*, WALL ST. J., Sept. 4, 2007, at A6; Stephen Labaton, *Debt-Rating Agencies are Under Scrutiny by S.E.C.*, WALL ST. J., Sept. 27, 2007, at C4 ("At a hearing before the Senate Banking Committee, the chairman, Christopher Cox, said the commission was examining whether the credit agencies had 'compromised their impartiality' when they simultaneously rated various mortgage-backed securities and provided advice to Wall Street investment firms about how to package them so as to gain higher credit ratings. The credit agencies also receive fees from the investment firms.").
 36. For a superb discussion of Enron's use of special purposes entities, see Steven L. Schwarcz, *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, 70 U. CIN. L. REV. 1309, 1315 (2002) (noting that many of Enron's special purpose entities, which supplied the company with needed cash, were capitalized with Enron stock). *See also* William W. Bratton, *Enron and the Dark Side of Shareholder*, 76 TUL. L. REV. 1275 (2002) (describing Enron's extensive use of off-balance sheet financing and transgression of appropriate accounting standards). Congress provided for specific reporting requirements for off-balance sheet transactions in Section 401(a) of Sarbanes-Oxley. *See* 15 U.S.C. § 78m (Supp. IV 2004).
 37. *See, e.g.*, Carrick Mollenkamp et al., *How London Created A Snarl in Global Markets; SIVs Fueled Debt Boom, But Now Banks Scramble to Prop up the Funds*, WALL ST. J., Oct. 18, 2007, at A1

structured finance continues to pose a fundamental challenge to the basic promise of corporate financial transparency³⁸—that is, the bedrock assumption that U.S. investors will be able to make informed choices when they invest in the capital markets.³⁹

In sum, if Sarbanes-Oxley was intended to restore investor confidence in the reliability of financial reporting systems in public companies listed in the United States and the integrity of corporate and Wall Street executives, subsequent events have vexed this promise and aspiration. Despite Sarbanes-Oxley-inspired upgrades to the mandatory reporting system prescribed by the federal securities laws,⁴⁰ the *Wall Street Journal* recently made the worrisome,

“Fears are rife that dozens of huge, structured investment vehicles, or SIVs, many of them affiliated with banks, will be forced to unload billions of dollars of mortgage-backed securities and other assets. Such a fire sale could cripple debt markets that play a crucial role in the global economy by providing financing for everything from company payrolls to mortgage loans.”)

38. For official acknowledgment of the problem, see Press Release, SEC, SEC Chairman Cox Announces Members of Advisory Committee on Improvements to Financial Reporting, (July 31, 2007), *available at* <http://www.sec.gov/news/press/2007/2007-154.htm>.

As financial reporting has become more complex, many investors have expressed concerns that it is often difficult to understand the financial reports of companies in which they invest. Likewise, companies have expressed concerns that it is difficult to ensure compliance with U.S. GAAP and SEC reporting rules when preparing financial reports. In fact, during 2006, almost 10 percent of U.S. public companies had to restate prior financial reports due to the discovery of errors in those reports. Restatements are costly to companies, and undermine the confidence of investors in the financial reporting system.

Id. For academic commentary noting this fundamental dilemma, see Steven L. Schwarcz, *Rethinking the Disclosure Paradigm in a World of Complexity*, 2004 U. ILL. L. REV. 1, 5–6 (using Enron as exemplar to question whether concept of genuine financial transparency is illusory given financial complexity in global corporate enterprises).

39. See, e.g., Eleanor Laise, *Funds Struggle with Pricing Pitfalls*, WALL ST. J., Sept. 17, 2007, at C1 (“Many funds are still struggling to find the best way to value their holdings. In a Deloitte & Touche USA LLP survey released last month, 65% of fund firms said they had made changes in their valuation policies in the past year. . . . Valuation policies can vary substantially from fund to fund.”); Henry Kaufman, *Our Risky New Financial Markets*, WALL ST. J., Aug. 15, 2007, at A13 (“These two developments — securitization and the seamless interconnectivity of markets — have brought intricate quantitative risk modeling to the forefront of financial practices. . . . Few recognize, however, that such modeling assumes constancy in market fundamentals. This is because modeling does not adequately account for underlying structural changes when attempting to calculate future risks and prices.”). For a discussion of asset securitization and its advantages for firms seeking to raise financing, see Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J. L. BUS. & FIN. 133, 137 (1994).
40. Extensive commentary on the SEC’s ongoing program of enhancing mandatory reporting system for public companies is available on the SEC’s website at <http://www.sec.gov/spotlight/sarbanes-oxley.htm>. For an example of an upgrade to the reporting system, see Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, Securities Act Release No. 8400, Exchange Act Release No. 49424, 2004 SEC LEXIS 639, *6–7 (Mar. 16, 2004) (“Under the previous Form 8-K regime, companies were required to report very few significant corporate events. . . . The revisions that we adopt today will benefit markets by increasing the number of unquestionably or presumptively material events that must be disclosed currently. They will also provide investors with better and more timely disclosure of important corporate events.”). For commentary, see Frank B. Cross & Robert A. Prentice, *The Economic Value of Securities Regulation*, 28 CARDOZO L. REV. 333 (2006) (describing SEC’s mandatory reporting system and concluding that its effects are beneficial to investors); Troy A. Paredes, *After the Sarbanes-Oxley Act:*

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remarkably far-reaching assertion that investors face “an age of murky pricing.”⁴¹ And this murkier pricing persists despite the fact that public company auditors, now under the watchful eye of the PCAOB,⁴² are credited with conducting more independent, vigilant audits than they had in the 1990s.⁴³ That many of Wall Street’s largest, most prestigious financial firms are suffering multi-billion dollar investment losses imports a special irony and heightened anxiety into the recent turmoil. That is, if these powerful, sophisticated investment houses cannot protect themselves from financial devastation, this does not bode well for retail investors and the broader health of the U.S. capital markets.⁴⁴

Also disturbing is the fact that in many instances, the senior executives of these firms appear to have walked away from the devastation with handsome compensation/severance packages.⁴⁵ Hence, as was previously the case, their pay packages continue only loosely to correlate with their firms’ financial performance or genuine increases in shareholder value.⁴⁶ Even the current, notoriously busi-

The Future of the Mandatory Disclosure System, Forward, 81 WASH. U. L. Q. 229 (2003) (analyzing the post-Sarbanes-Oxley disclosure regime and describing the contemporary scholarly debate over required disclosure). For a comprehensive historical review of SEC-mandated public company disclosure “upgrades,” see Jeffrey N. Gordon, *Independent Directors in the United States, 1950s-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1541-63 (2007) (arguing that SEC rule changes and other factors have dramatically improved stock price informativeness since the 1950s). For an empirical study supporting the view that Sarbanes-Oxley successfully improved the quality of corporate information disclosure to the market, see Pankaj K. Jain et al., *Trends and Determinants of Market Liquidity in the Pre- and Post-Sarbanes-Oxley Act Periods* (2006) available at <http://ssrn.com/abstract=488142>.

41. Susan Pulliam, Randall Smith & Michael Siconolfi, *U.S. Investors Face an Age of Murky Pricing: Values of Securities Tougher to Pin Down*, WALL ST. J., Oct. 12, 2007, at A1.
42. Title I of Sarbanes-Oxley establishes the PCAOB, outlines its organization, requires registration with the Board by public accounting firms, and grants the Board authority to establish rules regarding auditing. See Sarbanes-Oxley Act of 2002 § 101(a), 15 U.S.C. § 7211(a) (Supp. IV 2004) (“There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. The Board shall be a body corporate, operate as a nonprofit corporation, and have succession until dissolved by an Act of Congress.”); see also Sarbanes-Oxley Act of 2002 § 101(c), 15 U.S.C. § 7211(c) (Supp. IV 2004).
43. David Reilly, *In Current Crunch, Auditors Stand Firm on Accounting Practices*, WALL ST. J. Oct. 17, 2007, at C1 (quoting Lynn Turner, a former chief accountant at the SEC, who concurred that public company auditors are doing a better job than they had before the scandals of 2001 to 2002 and also before the savings and loan crisis).
44. See Tom Lauricella et al., *More Zeroes for Investors*, WALL ST. J., Jan. 18, 2008, at C1.
45. For a discussion and accounts of recent pay packages in Wall Street firms that are suffering massive losses, see Liam Plevin & Susanne Craig, *Financiers Reap Riches Even as Deals Wobble*, WALL ST. J., Jan. 17, 2008, at D1; Landon Thomas Jr., *What’s \$34 Billion on Wall St.? A Subprime Strategy Implodes. But Some of Its Captains Are Just Fine*, WALL ST. J., Jan. 27, 2008, at Sunday Business 1.
46. For academic commentary and prescriptions for reform, see LUCIAN BEBCHUK & JESSE FREID, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* 189 (2004) (“Thus, the problems of executive compensation can be fully addressed only by adopting reforms that would confront boards with a different set of incentives and constraints.”). For a critical review of the latter, see

ness-friendly U.S. president recently warned that such outsized compensation awards are undermining Americans' faith in the fairness of the economic system.⁴⁷

Confidence that activist investors will rouse themselves to oppose excesses in executive pay has been compromised by the SEC's seemingly never-ending reforms to compensation disclosure. These disclosure reforms seem consistently to deliver far less clarity than promised.⁴⁸ Furthermore, at least through 2007, the Commission (which had been criticized for laxity in hearings shortly after Enron's demise)⁴⁹ was under intense political and business pressure to back off from further regulation and even to loosen Sarbanes-Oxley's dictates pertaining to internal controls certification.⁵⁰ In addition, the U.S. Supreme Court has contin-

John E. Core et al., *Is U.S. CEO Compensation Inefficient Pay Without Performance?*, 103 MICH. L. REV. 1142, 1181 (2005) (reviewing LUCIAN BEBCHUK & JESSE FREID, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* (2004)) ("[Bebchuk and Fried] ignore executives' stock and option portfolios, which are the primary source of their incentives."). For a recent discussion of the problematically high levels of compensation affecting both chief executives and directors, see James R. Hagerty & Joann S. Lublin, *Countrywide Directors' Dilemma*, WALL ST. J., Nov. 3, 2007, at B1 ("Critics have long questioned the outsize pay packages and lucrative share sales of Countrywide Financial Corp.'s chairman and chief executive, Angelo Mozilo. But outside members of the company's board also have above average compensation, and three of them have sold more than \$2 million of Countrywide shares apiece since mid-2006."); Plevin & Craig, *supra* note 7 (reporting that former CEOs of Citigroup and Merrill Lynch, who lost their positions on account of their firms' multi-billion dollar losses, left with compensation packages, including stock, valued at \$29.5 million and \$161.5 million respectively). The same article reported that the House Committee on Oversight and Government Reform has scheduled hearings in which these and other executives were called to account for their pay packages. *Id.*

47. John D. McKinnon & Greg Hitt, *Bush Vows Push for Trade, Chides Boards on Pay*, WALL ST. J., Oct. 12, 2007, at A1.
48. The SEC's most recent revisions to executive compensation disclosure were in excess of four hundred pages. See Executive Compensation and Release Person Disclosure, Securities Act Release No. 8732A, Exchange Act Release No. 54302A, Investment Company Act Release No. 27444A, 2006 SEC LEXIS 2016 (Aug. 29, 2006). For a helpful summary of the revised compensation disclosure requirements, see MORRISON & FOERSTER, SEC RELEASES FINAL RULES ON EXECUTIVE COMPENSATION DISCLOSURE (2006), <http://www.mofo.com/news/updates/bulletins/bulletin02189.html>. See also *Annual Review of Federal Securities Regulation*, 62 BUS. LAW. 1065, 1067-88 (2007). For a critique of the intersection between SEC efforts on compensation and state corporate law standards, see Jennifer S. Martin, *The House of Mouse and Beyond: Assessing the SEC's Efforts to Regulate Executive Compensation*, 32 DEL. J. CORP. L. 481 (2007). See also Eric Dash, *S.E.C. Finds Fault on Pay Disclosures*, N.Y. TIMES, Oct. 10, 2007, at C3.
49. For a comprehensive index and links to Congressional hearings on Enron, see LAW LIBRARY OF CONG., ENRON HEARINGS, <http://www.loc.gov/law/help/guide/federal/enronhrgs.html> (last visited Feb. 11, 2008).
50. See Jonathan D. Glater, *Here It Comes: The Sarbanes-Oxley Backlash*, N.Y. TIMES, Apr. 17, 2005, at 3 ("Last week, business representatives gathered in Washington at an all-day roundtable discussion held by federal regulators and complained about the cost of complying with a provision of the Sarbanes-Oxley corporate reform law."). The greatest outcry has surrounded the complaint that Section 404 of Sarbanes-Oxley has occasioned excessive costs and has, especially, imposed hardships on midcap or smaller capitalized firms. On the latter, see Robert Prentice, *Sarbanes-Oxley: The Evidence Regarding the Impact of SOX 404*, 29 CARDOZO L. REV. 703 (2007).

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ued to chip away at public investors' ability to employ SEC Rule 10b-5 to bring class actions for corporate fraud, as exemplified most recently by its decision in *Stoneridge Investment Partners v. Scientific-Atlanta*.⁵¹

In conclusion, the first decade of the twenty-first century is shaping up to be an extraordinarily tumultuous period in respect to public companies' corporate governance and securities market activities. For these reasons, though enormously significant, Sarbanes-Oxley, the SEC's implementing regulations, and the stock exchanges' new listing standards may seem like a few stones in a river that has not calmed.

III. Assessing Sarbanes-Oxley's Effects

It is exceedingly difficult to assess the progress resulting from the corporate and securities law reforms inspired by Sarbanes-Oxley. Although a full account of the empirical and legal explanations for this opacity is beyond the scope of this foreword, certain basic challenges to greater clarity can be identified.

A. Bolstering Corporate Legitimacy and Rule of Law Values

First, if Sarbanes-Oxley's enactment constitutes a watershed in corporate law reform—and I believe it does—it is not because the Act effectuated sweeping, transformative changes in corporate and securities law. To the contrary, most of the law reforms effectuated by the Act and the ensuing SEC regulations had circulated for years as “best practices.”⁵² The “watershed” aspect of Sarbanes-Oxley, as stated previously, stems from the fact that the Act *objectified* what had previously been looser norms or quasi-authoritative, professional standards and then codified them in the canon of binding *federal* laws and regulations. In so doing, Sarbanes-Oxley altered the pre-existing equilibrium between governance and regulation, as well as the pre-existing equilibrium between federal law's and state law's oversight of corporate governance.⁵³ Both of these changes are highly

51. 128 S. Ct. 761 (2008).

52. See, e.g., Lawrence Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 CONN. L. REV. 915 (2003). For a recitation of the best practices that circulated to business leaders, sometimes through their lawyers' commentary, see generally ORG. FOR ECON. COOPERATION AND DEV., OECD PRINCIPLES OF CORPORATE GOVERNANCE (1999); NAT'L ASS'N OF CORPORATE DIRS., REPORT OF THE NACD BEST PRACTICES COUNCIL: COPING WITH FRAUD AND OTHER ILLEGAL ACTIVITY (1998); CORPORATE DIRECTOR'S GUIDEBOOK, *supra* note 6. See also Helen S. Scott, *The SEC, the Audit Committee Rules, and the Marketplaces: Corporate Governance and the Future*, 79 WASH. U. L. Q. 549 (2001); Melvin Aron Eisenberg, *The Architecture of American Corporate Law: Facilitation and Regulation*, 2 BERKELEY BUS. L. J. 167 (2005) (describing the agglomerative nature of American corporate governance as a mosaic of inputs from authoritative legislative bodies, industry proposals, judicial pronouncements, and market forces); Melvin A. Eisenberg, *Corporate Governance: The Board of Directors and Internal Control*, 19 CARDOZO L. REV. 237 (1997).

53. See Steele, *supra* note 10; William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 WAKE FOREST L. REV. 619 (2006); Lisa M. Fairfax, *Sarbanes-Oxley, Corporate Federalism, and the Declining Significance of Federal Reforms on State Director Independence Standards*, 31 OHIO N.U. L. REV. 381 (2005).

significant, notwithstanding that their near-term practical effects are impossible to quantify.

In this valorization of the role of law, Sarbanes-Oxley reflects an appreciation of the fragility of organizations that suffer a loss of value legitimacy (e.g., a widely perceived shortfall in honesty, transparency, and accountability for transgressions). The Act's provisions are an attempt to shore up these value commitments in regard to public companies, accounting firms, and other professional institutions substantially affecting the marketplace. In this regard, the Act's broader purposes are illuminated by reading it in the context of its political and social moment.⁵⁴ Enron's and WorldCom's "crack-ups" coincided with the suffering, demoralization, and economic hardship ensuing from Al Qaeda's attacks on the World Trade Center and the Pentagon.⁵⁵ In addition, in the scrutiny ensuing after Enron's collapse, members of Congress were widely "tagged" with having received generous campaign contributions from that company—at the same time that its role in precipitating California's energy crisis was coming to light. By enacting Sarbanes-Oxley, Congress was simultaneously seeking to shore up its legitimacy and exhorting and mandating that public companies and their advisers do the same. Once this important, value-driven dimension of Sarbanes-Oxley comes into view, the "mathematics" of calculating its effects is altered, since its purpose is broader than increasing economic efficiency and investor wealth in the near term.⁵⁶

B. Sarbanes-Oxley and Corporate Boards of Directors, An Unfinished Project

To return to business-oriented particulars, Sarbanes-Oxley's efficacy has been blunted by the fact that its substantive provisions are not nearly as comprehensive as its controversial reception might suggest.⁵⁷ Many fundamental

54. Kahn, *supra* note 3 (describing the complex socio-economic forces at play in the months prior to Sarbanes-Oxley's enactment, including the background of Enron's extensive political contributions and Kenneth Lay's connections to the Bush family—hence politicians' incentives to distance themselves from perceived corporate corruption). For further consideration of Sarbanes-Oxley from a socio-economics perspective, see Fanto, *supra* note 4; Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817 (2007).

55. See Kahn, *supra* note 3.

56. There is considerable irony in reading Sarbanes-Oxley from this perspective, unfortunately, because the Bush administration has a poor record in terms of its respect for the rule of law and its adherence to the values associated with it. The Bush administration's nonconformity with constitutional limits on executive power was recently discussed in a debate between Harvard constitutional law professor Charles Fried and Fritz Schwarz of New York University School of Law's Brennan Center on the Bill Moyers Journal on October 26, 2007. Their debate can be viewed at <http://www.pbs.org/moyers/journal/10262007/watch.html>. For a longer exposition of the argument that the Bush administration has trampled on domestic and international rights since 9/11, see FREDERICK A.O. SCHWARZ JR. & AZIZ Z. HUQ, UNCHECKED AND UNBALANCED (2007); CHARLIE SAVAGE, TAKEOVER: THE RETURN OF THE IMPERIAL PRESIDENCY AND THE SUBVERSION OF AMERICAN DEMOCRACY (2007).

57. See *supra* note 22.

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problems in corporate governance and financial market oversight are not addressed at all or are addressed only obliquely or indirectly in the Act. For example, the Act addresses executive compensation only in its somewhat curious prohibition on corporate loans to insiders.⁵⁸ Sarbanes-Oxley does nothing to shore up the systems of corporate governance that immediately influence executive compensation decisions—most obviously, compensation committees.

In light of commentary like the *Powers Report* (which assessed the dysfunction of Enron's board), the recent corporate governance scandals precipitated much agitation about reforming public companies' boards of directors, including, perhaps, the process of shareholder elections of directors.⁵⁹ Yet the Act is quite conservative in its board-related reforms. It merely mandates that public companies' audit committees be composed exclusively of independent directors,⁶⁰ and it charges the SEC with overseeing upgrades to corporate governance related listing standards. And while the exchanges and the self regulatory organizations have responded to this exhortation by clarifying and upgrading their standards for board independence (in regard to overall board composition and the composition of key functional committees),⁶¹ there is ample room to doubt whether these stan-

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58. See Sarbanes-Oxley Act of 2002 § 402, 15 U.S.C. § 78m(k) (Supp IV 2004). Sarbanes-Oxley requires a CEO and chief financial officer ("CFO") to disgorge bonus or options compensation tied to periods for which there has been an earnings' restatement on account of corporate wrongdoing. Sarbanes-Oxley Act of 2002 § 304, 15 U.S.C. § 7243 (Supp IV 2004). The Act prohibits managers from being able to trade during pension blackout periods. Sarbanes-Oxley Act of 2002 § 306, 15 U.S.C. § 7244 (Supp IV 2004). It also requires timelier reporting of trades by insiders and major stockholders relevant to short swing profit liability. Sarbanes-Oxley Act of 2002 § 403(a), 15 U.S.C. § 78(p)(a) (Supp IV 2004).
59. See, e.g., Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233 (2002) (noting the conflicts affecting purportedly independent directors at Enron and Enron's potential to destabilize the monitoring model of the corporate board); William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002); Leo E. Strine Jr., *Derivative Impact? Some Early Reflections on the Corporation Law Implications of the Enron Debacle*, 57 BUS. LAW 1371, 1373 ("I believe that Enron will ignite a fiery debate centered upon the so-called 'independent director.'"). Several commentators noted that purportedly independent directors on Enron's board may have been influenced by large scale "charitable contributions" to their home institutions. For early commentary on this problem, see Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 609-21. For further consideration of the problem as relevant to litigation disputing the independence of Oracle's special litigation committee, see *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 920 (Del. Ch. 2003). For commentary on the standards of independence applied by the Delaware court therein, see Elizabeth Cosenza, *The Holy Grail of Corporate Governance Reform: Independence or Democracy?*, 2007 B.Y.U. L. REV. 1 (2007). Recent amendments to stock exchange listing standards acknowledge the potential for such contributions to abridge outside directors' independence; in defining standards for independent directors they prohibit these and other forms of indirect as well as more direct financial ties that might compromise directors' independence. See *infra* note 61.
60. Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C. § 78j-1(m) (Supp. IV 2004).
61. Under the rules of the New York Stock Exchange, a majority of the directors on a public company's board must be independent. See NYSE LISTED COMPANY MANUAL § 303A.00 (2006) available at http://www.nyse.com/Frameset.html?nyseref=http%3A/www.nyse.com/regulation/listed/1182508124422.html&displayPage=/lcm/lcm_section.html.

dards go far enough in fostering impartiality and the absence of “beholden-ness” assumed in the bedrock constructs of state corporate law.

Even more dramatically, neither Sarbanes-Oxley nor any subsequent SEC reforms have improved the still formalistic process of shareholder election of directors. The present amalgamation of federal securities and state corporate laws still perpetuate largely passive, demographically homogenous boards rife with soft conflicts and propensities to cronyism. As corporate legal scholars have increasingly noted, because such boards are highly susceptible to “groupthink,”⁶² they are poorly equipped to take on the expansive set of responsibilities assigned to them in the contemporary corporate governance model; for example, vetting corporate strategy, monitoring conflicts of interest and self-dealing transactions, overseeing the quality of internal control systems and legal compliance, overseeing CEO-selection, replacement, and incentive/compensation arrangements, accommodating the demands of equity investors with the claims of non-shareholder constituencies, and managing external relations including global geo-political risk. Although corporate law increasingly relies on the acts and approvals of independent directors, the existing legal frameworks have not facilitated the development of processes and institutions, which would furnish public companies with outside directors properly situated and freed up to take on the responsibilities that law and practice assign them.⁶³

A few years ago, I authored a research paper advocating the need for legal and social/institutional changes, which would foster the growth of a corps of “professional independent directors.” The motivating force for my research agenda

62. For a discussion of the problems associated with board homogeneity and attendant “groupthink,” see Lynne L. Dallas, *A Preliminary Inquiry into the Responsibility of Corporation and their Officers and Directors for Corporate Climate: The Psychology of Enron's Demise*, 35 RUTGERS L.J. 1 (2003); Lynne L. Dallas, *The New Managerialism and Diversity on Corporate Boards of Directors*, 76 TUL. L. REV. 1363 (2002); Marleen A. O'Connor, *The Enron Board: The Perils of GroupThink*, 71 U. CIN. L. REV. 1233 (2004); Joan MacLeod Heminway, *Sex, Trust, and Corporate Boards*, 18 HASTINGS WOMEN'S L.J. 173 (2007). For seminal articles on board function focusing on the role and limits of independent directors, see generally Lynne L. Dallas, *Proposals for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudsperson*, 54 WASH. & LEE L. REV. 91 (1997) (prescribing fundamental structural reform of corporate boards); Jill E. Fisch, *Taking Boards Seriously*, 19 CARDOZO L. REV. 265 (1997) (rejecting one-size-fits-all approach to board regulations); Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797 (2001) (describing certain negative implications of predominance of independent directors for public company boards). See also James D. Cox, *Managing and Monitoring Conflicts of Interest: Empowering the Outside Directors with Independent Counsel*, 48 VILL. L. REV. 1077 (2003).

63. The Delaware Chancery Court has proposed doing away with the entire fairness standard in freeze-out transactions by controlling shareholders principally on the rationale that independent directors' approvals of such transactions (especially in combination with a majority of the minority votes) provide adequate protection against overreaching by controlling shareholders. See *In re Cox Commc'ns. Inc., S'holders Litig.*, 879 A.2d 604 (Del. Ch. 2005). For a critique of the adequacy of director approvals in this context, see Faith Stevelman, *Going Private at the Intersection of the Market and the Law*, 62 BUS. LAW. 775 (2007).

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was that corporate law is increasingly limiting the scope for private litigation and liability to operate as disciplining forces and, instead, relying on outside directors' approvals as a primary mode of corporate governance and accountability to investors. Nor are takeovers a neat or necessarily efficient disciplining force outside of egregious instances of management ineptitude. The problem with relying principally on "outside" (presumably "independent") directors is that they are—by definition—principally engaged in another professional situation. Indeed, public company outside directors are not uncommonly sitting executives elsewhere. This situation leaves many of these individuals with too little time and professional attention to devote to the increasingly critical job of public company board service.

None of the Sarbanes-Oxley-inspired changes address this practical/institutional problem. For these reasons, I proposed that a new institution akin to the PCAOB be created. Such a new director oversight body might be able to devise an alternative compensation system, which would help liberate outside directors from having to have a separate, full time job while they served as a public company independent director. In the same way that public companies contribute funds (on a sliding scale) to support the PCAOB, they could pool funds to support this cadre of new director candidates to fill some of the slots for independent directors. The PCAOB-like director oversight board could also support ongoing professional education and voluntary certification systems for public company director candidates, and thereby, encourage their nomination to public companies' boards. It was clear to me, also, that these social and professional changes would allow women to capitalize on these new opportunities—which would be mutually beneficial to the women themselves and the companies where they served as directors. There is ample evidence that highly motivated, well-trained, accomplished women are increasingly leaving Wall Street law firms, investment banks, and prestigious consulting firms in search of greater professional freedom and flexibility. These goals would be compatible with service on public companies' boards.

Unfortunately, my reform agenda provoked extraordinarily harsh criticism. Some commentators objected that we do not really need corporate boards of directors. Many comments reflected the existence of widespread confusion and disagreement about the scope and substance of public company directors' legal and professional roles and duties. Some commentators suggested that such a professional oversight body would serve primarily to effectuate a professional monopoly. One commentator objected that since standards of professional responsibility for lawyers had (in his opinion) proved meaningless, standards of professional responsibility for public company directors could not be expected to be more persuasive and effective. Some commentators proposed that no one with the necessary talents would accept a position (or up to three, I proposed) that paid less than \$150,000 or so a piece—a comment I found particularly disturbing. In any

event, like my research agenda in this area, the project of fully addressing the practical problems that inhibit the efficacy of outside, independent directors remains a work in progress.

Furthermore, in an era when the leading contenders for the Democratic nomination for the presidency are an African-American man and a woman, the minimal demographic diversity of corporate boards remains a salient problem for corporate America, especially as companies are increasingly compelled to operate internationally in order to remain competitive. Again, greater demographic diversity would likely be a byproduct of meaningful structural reform to the director election process, but such reforms have repeatedly failed.

On several occasions, the SEC has proposed new rules, which would have allowed large shareholders to use the corporate proxy statement to nominate a separate slate of directors (in narrowly defined circumstances). In each instance, however, the SEC has retracted its proposal in the face of a wall of resistance to change.⁶⁴ Notwithstanding the more stringent independence standards adopted by the exchanges, broader reform to the board election process—structural reform extending far beyond that inspired by Sarbanes-Oxley—will be required if corporate boards are to fulfill their full oversight responsibilities, including those that pertain to monitoring the quality of their firms' systems of information gathering and reporting.⁶⁵ In sum, corporate law scholars' early intuition that the rash of major frauds and oversight failures that came to light throughout 2001 and 2002 would instigate a fundamental restructuring of the institution of the corporate board has not panned out.⁶⁶ Sarbanes-Oxley has inspired much worth-

64. In July 2007, the SEC proposed amendments to the shareholder proposal process that would allow certain shareholders to include their own director nominees in the management's proxy statement in certain limited circumstances. See Shareholder Proposals, Exchange Act Release No. 56160, Investment Company Act Release No. 27913, 2007 SEC LEXIS 1651 (July 27, 2007). In December 2007, the SEC then reverted back to the original rule that shareholders cannot use the proxy to insert their own nominees for consideration. See Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56914, Investment Company Act Release No. 28075, 2007 SEC LEXIS 2845, *9-10 (Dec. 6, 2007) ("[T]he staff has determined that shareholder proposals that may result in a contested election — including those which establish a procedure to list shareholder-nominated director candidates in the company's proxy materials — fall within the election exclusion. We agree with this position and believe it is consistent with the explanation that the Commission gave in 1976."); Press Release, SEC, SEC Votes to Codify Long Standing Policy on Shareholder Proposals on Election Procedures (Nov. 28, 2007). For citation and commentary on proposed SEC Rule 14a-11, see George Dent, *The Case for Real Shareholder Democracy*, 55 CASE W. RES. L. REV. 581 (2005) (commenting on proposed SEC Rule 14a-11). See also Kara Scannell, *SEC Chairman's Proxy Pitch Loses Steam*, WALL ST. J., Nov. 15, 2007, at C1.

65. See, e.g., Hillary A. Sale, *Independent Directors as Securities Monitors*, 61 BUS. LAW. 1375 (2006) (analyzing the existing regulations and focusing on the SEC's efforts to heighten requirements for independent directors oversight of corporate filings). For a discussion of boards' duty to oversee their firms' public disclosures under corporate fiduciary law, see Faith Stevelman Kahn, *Transparency and Accountability: Rethinking Corporate Fiduciary Law's Relevance to Corporate Disclosure*, 34 GA. L. REV. 505 (2000).

66. See Leo E. Strine, Jr., *Derivative Impact? Some Early Reflections on the Corporation Law Implications of the Enron Debacle*, 57 BUS. LAW. 1371 (2002); Jeffrey N. Gordon, *What Enron Means for*

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while academic discussion about corporate boards, but achieving real world change in this cornerstone institution of corporate governance has proven exquisitely difficult.

C. More Reports, Not Necessarily More Action

The Act also sought to foster reform by identifying “hot” areas for further study. In particular, in Sarbanes-Oxley Congress called on the SEC to oversee the production of reports on: (1) the “consolidation” of public accounting firms so that relatively few remained, and its implications for the quality of auditing;⁶⁷ (2) the roles, conflicts of interest, and barriers to entry affecting credit rating agencies;⁶⁸ (3) the amount and kinds of enforcement actions brought by the SEC in the five years preceding the Act;⁶⁹ (4) the occurrence of securities violations (including aiding and abetting) by lawyers, investment bankers, broker-dealers, and public accountants;⁷⁰ and (5) investment bankers’ and investment advisers’ potential complicity in earnings management and financial statement fraud.⁷¹ However, these calls for further study have infrequently produced meaningful action and, thus, have not had much positive influence on the areas of concern or the problems they flagged.

D. What Gets Lost in the “Origami” of Securities Laws and Regulations

Analyzing Sarbanes-Oxley’s efficaciousness is also complicated by the fact that in many instances, the Act directly effectuates “merely” a broad mandate for further SEC action.⁷² Not infrequently, the Act’s precise impact was left by

the Management and Control of Modern Business Corporation: Some Initial Reflections 69 U. CHI. L. REV. 1233 (2002). There were several prominent reports that described gross failures of oversight by independent directors in preventing false corporate reporting and ruinous insider self-dealing transactions. See WILLIAM C. POWERS, JR. ET AL., REPORT OF INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE BOARD OF DIRECTORS OF ENRON CORP. (2002), available at <http://fl1.findlaw.com/news.findlaw.com/wp/docs/enron/specinv020102rpt1.pdf>; see also RICHARD C. BREEDEN, RESTORING TRUST: REPORT TO THE HON. JED S. RAKOFF: THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK ON CORPORATE GOVERNANCE FOR THE FUTURE OF MCI, INC. 13 (2003), available at <http://www.thedirectorscollege.com/images/downloads/Breeden%20Report%20Restoring%20Trust.pdf>; *In re WorldCom Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 663 (S.D.N.Y. 2004) (holding independent directors responsible for conducting a reasonable investigation of the portions of the registration statement that are not made on the authority of an expert).

67. Sarbanes-Oxley Act of 2002 § 701, 15 U.S.C. § 7201 (Supp. IV 2004).

68. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §702, 116 Stat. 745, 797-98.

69. *Id.* § 704, 116. Stat. at 799.

70. *Id.* § 703, 116. Stat. at 798-99.

71. *Id.* § 705, 116. Stat. at 799-800.

72. For an analysis of the legal and democratic problems associated with congressional delegation and administrative regulation, see DAVID SCHOENBROD, POWER WITHOUT RESPONSIBILITY: HOW CONGRESS ABUSES THE PEOPLE THROUGH DELEGATION (1993). Compare *id.* with Edward L. Rubin, *Getting Past Democracy*, 149 U. PA. L. REV. 711, 716 (2001).

Congress to subsequent SEC action, as well as responses by the stock exchanges, self regulatory organizations, and the federal courts. This process of “churning” through successive layers of legislation, regulation, quasi-authoritative standard setting, and adjudication opens the door for Congress to make bold statements that may be decoupled, potentially, from subsequent bold legal action. The controversies and compromises affecting the SEC’s final rules relating to the appropriate standards of conduct for corporate lawyers observing signs of corporate illegality are evidence of this dynamic.⁷³

Furthermore, as is always the case in regard to the SEC’s regulations, its rules implementing Sarbanes-Oxley’s mandates are both highly complex and detailed—and they have rolled out, in changing iterations, against the backdrop of a dynamic economy. Even if the complexity in the SEC’s regulations is necessary and warranted in light of the intricacy of what is being regulated, this complexity means that their merits and shortcomings of these regulations will not be readily apparent on their face.⁷⁴ Each of these factors complicates the project of assessing Sarbanes-Oxley’s impact.

E. The Act’s Criminal Provisions and the Modalities of Legal Persuasion

Sarbanes-Oxley’s provisions speak to the conduct of many different actors in the corporate governance system: CEOs and chief financial officers (“CFOs”), boards and audit committees, general counsel, auditing firms, whistleblowers, and prosecutors pursuing white collar indictments and penalties. These different actors are likely to be pleased and persuaded, or displeased and disgruntled, in different measures by the changes wrought by the Act.⁷⁵ Restated from a broader perspective, corporate law (like other areas of law) becomes efficacious—persuasive in influencing the conduct of individuals and institutions—by operating through many different modalities, both formal and informal. This facet of the law-in-action has been illuminated by the research of “law and society”-oriented scholars, although their work has uncommonly focused on the influence of corporate or securities law.⁷⁶

73. Sarbanes-Oxley Act of 2002 § 307, 15 U.S.C. § 7245 (Supp. IV 2004).

74. For an analysis of the normative power of what is left unstated in the federal securities laws and regulations, see Faith Stevelman Kahn, *Legislatures, Courts and the SEC: Reflections on Silence and Power in Corporate and Securities Law*, 41 N.Y.L. SCH. L. REV. 1107, 1109 (1997) (“[L]ike the normative, political dimensions of the modern corporate philanthropy laws, the normative, political dimensions of the SEC’s disclosure policies are not express in the securities regulations themselves, and hence are not readily apparent.”).

75. For a discussion of Sarbanes-Oxley’s differentiated reception among corporate executives, institutional investors, the securities industry, accountants, auditors, lawyers, regulators, and the media, see Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817, 1834–45 (2007).

76. See, e.g., TOM TYLER, *WHY PEOPLE OBEY THE LAW* 3–4 (1990) (arguing that people obey the law when they internalize respect for it); Dan M. Kahan, *Social Influence, Social Meaning, and Deter-*

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Sarbanes-Oxley's criminal provisions, set forth in Titles VIII, IX, and XI thereof, are especially interesting from this perspective.⁷⁷ Although Sarbanes-Oxley redresses minor gaps in the framework of criminal liability for fraud, the Act's criminal provisions are most notable for increasing the maximum fines and jail terms for these offenses.⁷⁸ These higher penalties and jail terms should be interpreted most fundamentally as added socio-legal admonishment against corporate fraud, because prosecutors rarely, if ever, were genuinely hindered by the previous statutory ceilings on fines and jail terms.⁷⁹ Moreover, despite certain high publicity cases, it isn't clear that the average criminal penalties for corporate fraud have increased substantially or lastingly since the Act's passage. Notwithstanding the outcry arising from the post-Enron financial scandals, the government has commonly encountered substantial hurdles to white collar convictions and vigorous prosecutions. For example, white collar prosecutions commonly inspire fervent condemnations of governmental abuse of power.⁸⁰ Despite Sarbanes-Oxley and the corporate abuses of power that precipitated it, as a nation, we remain deeply ambivalent about white collar prosecutions.⁸¹

Similarly, the Act's whistleblower provisions⁸² have not altered the fact that "squealing" on your fraudster colleagues is a virtual guarantee of a failed career

rence, 83 VA. L. REV. 349, 351 (1997); LYNNE DALLAS, LAW AND PUBLIC POLICY: A SOCIO-ECONOMIC APPROACH (2005).

77. See Sarbanes-Oxley Act of 2002 tit. 9, 107 Pub. L. No. 204, §§ 901–906, 116 Stat. 745, 804–06 (codified in scattered sections of 18, 28 and 29 U.S.C.); Sarbanes-Oxley Act of 2002 tit. 11, 107 Pub. L. No. 204, §§ 1101–1107, 116 Stat. 745, 807–10 (codified in scattered sections of 15, 18 and 28 U.S.C.).
78. See, e.g., Sarbanes-Oxley Act of 2002 § 1107, 18 U.S.C. § 1513(e) (Supp. IV 2004) (making knowing retaliation against a corporate whistleblower a criminal offense).
79. For a discussion of the government's reluctance to prosecute corporate fraud in the most vigorous manner possible, and its mixed success in achieving criminal convictions in white collar cases, see, for example, Lisa H. Nicholson, *The Culture of Under-Enforcement: Buried Treasure, Sarbanes-Oxley and the Corporate Pirate*, 5 DEPAUL BUS. & COM. L.J. 321 (2007); J. Kelly Strader, *White Collar Crime and Punishment: Reflections on Michael, Martha, and Milberg Weiss*, 15 GEO. MASON L. REV. 45 (2007).
80. See, e.g., Bruce H. Kobayashi & Larry E. Ribstein, *The Hypocrisy of the Milberg Indictment*, 2 BUS & TECH. L. 369, 371 (2007) ("Even more fundamentally, this article shows that the prosecution of Milberg shares attributes with the 'abusive' class action lawsuits targeted by the Milberg prosecution.").
81. See Kathleen F. Brickey, *In Enron's Wake: Corporate Executives on Trial*, 96 J. CRIM. L. & CRIMINOLOGY 397 (2006); Strader, *supra* note 79; Nicholson, *supra* note 79. See generally CORPORATE FRAUD TASK FORCE, SECOND YEAR REPORT TO THE PRESIDENT (2004); FED. BUREAU OF INVESTIGATION, FINANCIAL CRIMES REPORT TO THE PUBLIC (2005). For examples of recent cases involving corporate fraud, see Tim Arango, *Black Given Prison Term Over Fraud*, N.Y. TIMES, Dec. 11, 2007, at C1; Michael J. de la Merced, *Former Outside Counsel is Charged in Refco Fraud*, N.Y. TIMES, Dec. 19, 2007, at C3.
82. See Sarbanes-Oxley Act of 2002 § 806(a), 18 U.S.C. § 1514A (Supp IV 2004); see also 18 U.S.C. § 1513(e).

and crushing legal fees.⁸³ Congress did not go far enough in creating a meaningfully protective scheme for corporate whistleblowers in Sarbanes-Oxley.

F. Expanded Corporate Regulation but Limited Liability

In assessing Sarbanes-Oxley's efficacy, it is notable that most of the Act's prescriptions and prohibitions are not matched by attendant civil liability provisions. With the exception of the Act's slight lengthening of the statute of limitations for private suits alleging fraud,⁸⁴ Sarbanes-Oxley's corporate governance, auditing, and reporting provisions did nothing to expand or even to bolster shareholders' increasingly limited ability to bring private lawsuits against companies and their executives.⁸⁵ The Act does not provide that shareholders may sue a public company's general counsel for failing to act upon discovering signs of fraud.⁸⁶ Nor does Sarbanes-Oxley provide for private enforcement of the provisions mandating disgorgement of bonuses and other performance-based compensation by corporate CFOs and CEOs when their firms have restated their earnings on account of corporate malfeasance.⁸⁷ In this respect, Congress did almost nothing to alter the tide sweeping against private liability for corporate wrongdoing, or to empower private plaintiffs to "pick up the slack" created by shortfalls in agency and criminal enforcement.

This pushback against private lawsuits alleging fraud was validated by Congress in the Private Securities Litigation Reform Act of 1995, which imposed substantial procedural hurdles on private class actions and enhanced defendants' ability to win motions to dismiss.⁸⁸ Congress further pursued this objective in enacting the Securities Litigation Uniform Standards Act of 1998, which has preempted most state common law class actions for fraud against publicly listed companies.⁸⁹ Such limitations on private recoveries in lawsuits alleging corporate fraud have also been reinforced by the Supreme Court's interpretation of

83. This phenomenon has been widely noted and remains true. See, e.g., I.J. Alexander Dyck et al., *Who Blows the Whistle on Corporate Fraud?* (European Corporate Governance Inst., Finance Working Paper No. 156 2007), available at http://ssrn.com/abstract_id=959410.

84. See Sarbanes-Oxley Act of 2002 § 804, 28 U.S.C. § 1658 (Supp. IV 2004).

85. For example, Sarbanes-Oxley does not allow shareholders to sue a company that includes insider/management directors on the audit committee, as is prohibited by the Act. See Sarbanes-Oxley Act of 2002 § 201, 15 U.S.C. § 78j-1(m) (Supp. IV 2004).

86. See Sarbanes-Oxley Act of 2002 § 307, 15 U.S.C. § 7245 (Supp. IV 2004).

87. See Sarbanes-Oxley Act of 2002 § 304, 15 U.S.C. § 7243 (Supp. IV 2004).

88. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended at scattered sections in 15 U.S.C.).

89. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended at scattered sections in 15 U.S.C.).

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plaintiffs' burden in demonstrating loss causation.⁹⁰ Also relevant is the Supreme Court's proscription of aiding and abetting liability in private suits under Rule 10b-5—which was accentuated by the recent decision in *Stoneridge Partners v. Scientific-Atlanta*.⁹¹ In addition, federal circuit courts are applying increasingly stringent standards in ruling on whether to certify shareholder class actions.⁹² These pressures and law “reforms” are all limiting the viability of private lawsuits alleging corporate fraud.

This anti-liability/anti-litigation trend is broadly established in federal law and unlikely to change in the foreseeable future. Most graphically, three years after Sarbanes-Oxley's passage, Congress enacted the Class Action Fairness Act of 2005.⁹³ This legislation, in its practical impact if not in its declared purpose, will further limit private actors' ability to pursue claims of corporate wrongdoing.⁹⁴ In their totality, these several acts of Congress validate the view that most private class actions are detrimental to companies, investors, consumers, and, therefore, the American economy overall. Sarbanes-Oxley's push toward increased oversight, transparency, and accountability for public companies foundered on this cross-current of anti-litigation/anti-liability sentiment, which has limited Sarbanes-Oxley's influence.

G. *Rising Stock Prices Stem Enthusiasm for Law Reform*

The persistently positive performance of U.S. stock market prices since the enactment of Sarbanes-Oxley has negatively influenced the reception given this legislation. At the time of writing this foreword, the American stock markets and the U.S. economy are suffering serious setbacks,⁹⁵ but even through October 2007, stock market prices were setting new records.⁹⁶ Instead of crediting Sarbanes-Oxley with shoring up investor confidence in the last several years when stocks performed well, many commentators claimed that the new laws and regulations were unwarranted and inefficient. Such resistance from business and Wall Street is predictable, of course; even the SEC's prohibition on selective dis-

90. See generally *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336 (2005). For insightful commentary on *Dura's* effect on a plaintiff's burden of proving loss causation, see Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud* (Nov. 2006) (unpublished manuscript on file with author).

91. 128 S. Ct. 761 (2008).

92. See *Regents of the Univ. of Cal. v. Credit Suisse First Boston, Inc.*, 482 F.3d 372 (5th Cir. 2007).

93. Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4 (codified as amended in scattered sections of 28 U.S.C.).

94. See Edward A. Purcell, Jr., *The Class Action Fairness Act in Perspective: The Old and the New in Federal Jurisdiction Reform*, 156 U. PA. L. REV. (forthcoming 2008).

95. See, e.g., Greg Ip, *Fears of Stagflation Return as Price Increases Gain Pace*, WALL ST. J., Feb. 21, 2008, at A1.

96. See, e.g., Nicolas Brulliard, *Oil Sector Holds Fast, Even as Crude Gains - - Lack of Inside Sales Suggests Optimism; CEO Lifts Holdings*, WALL ST. J., Oct. 10, 2007, at C3 (“[T]he stock prices of oil producers and oil-services companies have also risen to new highs.”).

closure was met with a virtual tidal wave of opposition, including claims that it would kill-off the analyst industry and impair efficient levels of corporate disclosure (which it clearly has not done).⁹⁷ Prior to Sarbanes-Oxley's enactment, Warren Buffett's and Arthur Levitt's warnings about earnings management were largely ignored.⁹⁸ Through the 1990s and the 2000s, many or even most outspoken corporate legal academics remained skeptical or unsupportive of robust legal oversight of market actors and public company governance. Although there was widespread popular support for Sarbanes-Oxley as of the late spring of 2002 (especially after the revelations of the fraud at WorldCom⁹⁹), the market's buoyancy in the years subsequent to Sarbanes-Oxley's passage made it too easy to criticize the new laws and regulations as excessive and anti-competitive.¹⁰⁰ For example, in the spring of 2007, three highly influential reports emerged from serious, high level "working groups" calling for loosening Sarbanes-Oxley-inspired legal reforms.¹⁰¹ These reports were enthusiastically received by Wall Street firms, vocal politicians, conservatively-oriented law reformers, and many financial reporters. By the winter of 2007 through 2008, however, enthusiasm for quashing these law reforms was swamped by the subprime mortgage fiasco and its widening negative effects. It seems that during good times, legal oversight of business and Wall Street's conduct is adjudged unwarranted; in hard times (outside of moments of extraordinary popular outrage), it is described as too costly.

H. Information Technology and Sarbanes-Oxley

Improvements in information technology are also part of the Sarbanes-Oxley story. Technology stocks fueled the stock market bubble of the 1990s¹⁰² and, hence, the euphoria that clouded investors' and regulators' better judgment. Improvements in information technology in this period also allowed for faster and cheaper trading of equity securities, which further spurred stock market spec-

97. See Regulation FD, 17 C.F.R. §§243.100–103 (2007).

98. See Levitt, *supra* note 19; see also Lawrence A. Cunningham, ed., *Conversations from the Warren Buffett Symposium*, 19 CARDOZO L. REV. 719, 799 (1997) (noting Warren Buffet's caution about the effects of earnings management).

99. For citation to academic criticisms of Sarbanes-Oxley, see *supra* note 22.

100. See, e.g., Greg Ip, Kara Scannell & Deborah Solomon, *Trade Winds: In Call to Deregulate Business, A Global Twist*, WALL ST. J., Jan. 25, 2007, at A1.

101. See SUSTAINING FINANCIAL SERVICES LEADERSHIP, *supra* note 18; see also COMM. ON CAPITAL MARKET'S REGULATION, INTERIM REPORT (2006), available at http://www.crapo.senate.gov/documents/committee_capmarkets_reg.pdf; COMM'N ON THE REGULATION OF U.S. CAPITAL MKTS. IN THE 21ST CENTURY, REPORT AND RECOMMENDATIONS (2007) available at http://www.capitalmarketscommission.com/NR/rdonlyres/eozwwssfrqzdm3hd5siogqhp6h2ngxwdpr77qw2bogptzvi5weu6mmi4plfq6xic7kjonfpg4q2bpks6ryog5wwh5sc/0703capmarkets_full.pdf.

102. See generally E.S. Browning, *Buying Long: Why Market Optimists Say this Bull Has Legs - - - They See Decard of Gain Fed by Global Growth*, WALL ST. J., May 23, 2007, at A1 (discussing the bull market of the 1990s).

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ulation. In a more positive vein, by 1996 the duty of care (as described by the Delaware Court of Chancery) had evolved to recognize directors' ongoing responsibilities to monitor the quality of their firms' systems of information gathering and reporting¹⁰³—systems that have been further refined and bolstered by Sarbanes-Oxley's provisions. The Act's call for increasingly timely corporate reporting also builds on developments in information technology.¹⁰⁴ Faster, cheaper computing power and increasingly sophisticated information technology is enhancing firms' ability to compete on a global scale.¹⁰⁵ However, this same technology presents heightened potential for abuse, since it can be used to obscure rather than accurately represent a firm's operations and financial conditions.¹⁰⁶ Accordingly, in response to Sarbanes-Oxley's new certification requirements, executives have worried aloud about their ability to attest to the adequacy of their firms' internal controls.¹⁰⁷ One is prompted to ask, however, if they cannot confidently make such attestation, what does this mean for their ability to manage their assets and finances efficiently?

Improvements in information technology are also assisting our study of the effects of laws and regulations on companies and markets. Empirical analysis is at the vanguard of the legal academy—especially as corporate legal scholars increasingly collaborate with economists and other scholars in quantitatively-oriented fields.¹⁰⁸ The expanded data sets becoming available are assisting further

103. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 969–70 (Del. Ch. 1996). For the Delaware Supreme Court's general affirmation of the directors' ongoing oversight obligations as described by the Court of Chancery in *Caremark*, see *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).

104. See generally Sarbanes-Oxley Act of 2002, tit. 4, 107 P.L. 204, §§ 401–409, 116 Stat. 745, 785–91 (codified in scattered sections of 15 U.S.C.). See also Sarbanes-Oxley Act of 2002 § 403, 15 U.S.C. § 78p (Supp. IV 2004) (enhancing disclosures in periodic reports); Sarbanes-Oxley Act of 2002 § 402, 15 U.S.C. § 7262 (Supp. IV 2004) (enhancing disclosures of conflict of interest transactions involving insiders and principal stockholders and requiring disclosure of management's assessment of the adequacy of internal controls); Sarbanes-Oxley Act of 2002 § 406, 15 U.S.C. § 7264 (Supp. IV 2004) (requiring disclosure of presence or absence of corporate code of ethics); Sarbanes-Oxley Act of 2002 § 407, 15 U.S.C. § 7265 (Supp. IV 2004) (requiring disclosure of presence or absence of financial expert on audit committee); Sarbanes-Oxley Act of 2002 § 409, 15 U.S.C. § 78m (Supp. IV 2004) (requiring 'real time' disclosure by reporting companies).

105. For an account of Enron as a global trading firm, see FRANK PARTNOY, *INFECTIOUS GREED: HOW DECEIT AND RISK CORRUPTED THE FINANCIAL MARKETS* (2003).

106. See, e.g., *id.*

107. For a thoughtful account of the controversy, see Prentice, *supra* note 50.

108. For discussion of how improved information technology and information gathering have influenced economic analysis, see DIANE COYLE, *THE SOULFUL SCIENCE: WHAT ECONOMISTS REALLY DO AND WHY IT MATTERS* 4 (2007).

Economics is enjoying a spectacularly fruitful period, in particular where it overlaps with other disciplines such as psychology, history or anthropology. . . . The combination of cheap computing power, the development of new data sets, and innovations in econometrics and in analytical and computational techniques has had a very profound influence on economics, as on other sciences.

Id.

study of the relationship between corporate and securities law reforms, corporate performance, and stock market prices.¹⁰⁹ Nevertheless, these studies' implications for law reform are complicated by the same factors that lend them prestige. The full scope of the variables analyzed, the reliability of the data sets, the reasonableness of the underlying assumptions, and the importance of questions *not* posed all suggest caution.

I. *Global Competition's Anti-Regulatory Force*

Lastly, the global flow of capital is exerting an inhibiting influence on U.S. lawmakers' willingness to regulate American firms and markets. Global competition across capital, product, and labor markets is pressuring firms, where possible, to conduct business under legal regimes, which promise the lowest level of scrutiny and regulatory requirements. Against the backdrop of such permissible regulatory arbitrage, Sarbanes-Oxley appears onerous. The triad of reports calling for repealing or limiting its reforms is evidence of this.¹¹⁰

Ironically, as U.S. stock prices and Wall Street firms are being beset by the fallout of the subprime mortgage fiasco, foreign governments (whose citizens are invested and suffering alongside U.S. investors) are calling for more stringent governance and reporting requirements for U.S. firms and markets.¹¹¹ Recent financial events underscore that the financial prosperity arising from high stock market prices is linked to the presence and enforcement of adequate supervisory controls on corporate governance and financial reporting, and limits on self-dealing. Reputation and self-governance are loose safeguards in a world where anonymous, instantaneous global financial transactions are the norm.¹¹²

109. For a recent example analyzing the influence of activist hedge funds on corporate performance, see Frank Partnoy & Randall S. Thomas, *Gap Filling, Hedge Funds, and Financial Innovation*, BROOKINGS-NOMURA PAPERS ON FINANCIAL SERVICES, (Yasuki Fuchita & Robert E. Litan, eds., Brookings Inst. Press 2007), available at <http://ssrn.com/abstract=931254>.

110. See *supra* note 101.

111. Heather Timmons & Katrin Bennhold, *Calls Grow for Foreigners to Have a Say on U.S. Market Rules*, WALL ST. J., Aug. 29, 2007, at C1 ("Politicians, regulators and financial specialists outside the United States are seeking a role in the oversight of American markets, banks and rating agencies after recent problems relating to subprime mortgages. Their argument is simple: the United States is exporting financial products, but losses to investors in other countries suggest that American regulators are not properly monitoring the products or alerting investors to the risks.")

112. See Renee M. Jones, *Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance*, 92 IOWA L. REV. 105 (2006); John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301 (2004); Frank Partnoy, *Strict Liability for Gatekeepers: A Reply to Professor Coffee*, 84 B.U. L. REV. 365 (2004). For a more optimistic view of the power of reputation as an effective safeguard against corporate misconduct, see John Armour, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition* (European Corporate Governance Inst. L. Working Paper No. 54, 2005), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=860444.

III. Concluding Insights

The academic fields of corporate and securities law bear some interesting resemblances to the study of medicine. The cumulative level of complexity and detail identified in the scholarship on corporate governance and securities law approximates the complexity in the medical science literature. In addition, although both academic medicine and the study of corporate and securities law demonstrate a remarkable level of sophistication, conclusions reached by scholars in these areas are constantly subject to revision based on new information. In medicine and in corporate and securities law, empiricism is laudable, even essential, but its limits should also be recognized. Good medical researchers acknowledge that what they find is influenced by what they look for. And they recognize that all living organisms (like firms and markets in this analogy) are changing in the course of their study. Commentators in the area of corporate governance and securities law should heed these lessons. Event studies and econometric analysis may yield important insights and policy prescriptions for corporate and securities law. But judges and legislators should proceed with caution before “junking” legal protections intended to benefit shareholders and other investors.

Some legal scholars take the limits of empirical proofs as a rationale for reducing the role of law in corporate governance and the capital markets. Others counsel greater regulatory competition—that is, variation and choice among legal regimes. Other corporate legal scholars, myself included, believe that firms and markets must, by definition, exist in a collaborative relationship with the law if there is to be meaningful social and economic progress. As was evident in our symposium, these disagreements are profound; as in debates over medicine and science, the experts believe that something precious is at stake.

Finally, it bears noting that the increasing specialization of corporate and securities law (like the advance of medical science) has generated an academic elite. This is an inevitable byproduct of the maturation of any field of study. Yet there is always a danger that academic elites will stanch dissent and, thus, the progress of genuine understanding in their field. In this regard, a worthwhile academic symposium should invite constructive debate, kind skepticism, and robust discussion of alternative viewpoints. And by this measure, the first corporate governance symposium hosted by New York Law School’s Center on Business Law & Policy was an unqualified success.

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