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Book Review

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CORPORATE INTERNAL AFFAIRS. By *Marc I. Steinberg.* Westport, Connecticut: Quorum Books, 1983. Pp. vii, 294.

Marc I. Steinberg, former Special Projects Counsel of the United States Securities and Exchange Commission (SEC) and present Associate Professor of Law at the University of Maryland School of Law, has repolished several of his previously published articles on an odd lot of issues of corporate management and responsibility and titled the compilation *Corporate Internal Affairs.*[1] The book addresses seven topics: the SEC's influence on corporate internal affairs; disclosure of information bearing on management integrity; the use of special litigation committees to terminate derivative suits; disclosure of corporate mismanagement; the duties of directors and management in tender offer contests; the business judgment rule from a "corporate accountability" perspective; and the role of inside counsel. This compendium is not useful as either an academic tool nor as a timely guide to the practitioner on these rapidly changing topics.[2] In fact, the aggregation of the articles is without merit at all save to display in a concentrated fashion a hodge podge of issues on how corporations are and should be managed. The thought is that corporations and their managers must be made more "accountable."

Corporations are legal entities, designed in a trust format, with managers (directors and officers) as trustees, using the shareholders' invested capital for the sole purpose of making a profit in business. For well-endowed corporations, the advantages of limited liability have decreased over time due to the corporations' sheer size, and the legal and societal efforts to avoid the collapse of large entities employing large numbers or rendering an important service.[3] Corporations serve as the primary legal entity for large enterprises

1. MARC I. STEINBERG, CORPORATE INTERNAL AFFAIRS (1983).

2. If information is sought on these topics, the reader is recommended to relevant law review articles.

3. This has occurred, for example, though the bankruptcy laws, reorganizations and government bail-outs.

because the corporation's legal attributes permit it to organize vast amounts of capital, to describe and evidence simply an investor's interest, and to allow transfer of that interest in an easy and effective manner.

When the stockholder invests through purchase of shares, the traditional philosophy is that he has invested with the notion that the objective of the corporation is profit and that the managers are legally (and, in a less rigorous sense, morally) constrained to operate its business and to manage the assets with that sole objective. In addition, the stockholder might assume, unless the purpose clauses of the articles of incorporation suggested otherwise, that the objective and perception of the other stockholders are similar. However, the increasingly accepted idea of "corporate accountability" erodes the investors' ability to make those traditional assumptions. Under the accountability doctrine the corporation is required to be responsive, in some way not governed by the profit motive tradition, to (shockingly) non-shareholders and to permit some sects of shareholders, through methods other than obtaining legal control of the corporation, to influence the corporation's managers to act with some not-for-profit mores. This movement for accountability may not be simply characterized as a change sought by corporate law academics but, it is argued, the movement is stockholder influenced, as well. Steinberg states:

> Although a number of shareholders wish solely to maximize their investments, others have a strong concern that companies in which they have an equity interest comply with certain minimal ethical or legal standards. Labeling such shareholders 'unreasonable' or such information 'unimportant' discounts a corporation's accountability to its shareholders and to society in general.[4]

Without legal question, the legislature can regulate the internal affairs of corporations of all sizes in order to modify the traditional rubric of profit motive and provide explicitly for broad accountability. Steinberg and many other thinkers view corporations as powerful and impersonal agglomerations of capital, whose concentration of wealth enables the manager to exercise unchecked influence in the community in which the corporation operates. He concludes that such corporations must be operated with some lodestone other than profit, i.e., some broader social accountability.

But, note carefully that Steinberg does not speak of criminal matters as a guide to corporate accountability, although these

4. *See* STEINBERG, *supra* note 1, at 111.

cases are simpler. Rather, he speaks about ethical responses. While I hesitate to call his philosophy fallacious, I recommend care in its adoption. As Harold M. Williams stated in his thoughtful foreword to Steinberg's book:

> Periodic intervention of governmental, administrative and legislative bodies is a predictable reaction to occurrences in the corporate sector that are not acceptable to the public at large and to the body politic. . . [G]overnmental intervention, as it occurs, threatens increasingly over time to so fetter American business as to result, largely unintentionally, in the diminution of the potential growth and viability of American business.[5]

The goal of the program of "corporate accountability" must be to make America better (by, at least, some vague standard) and to make American business better, i.e., more efficient and more profitable. Tying this goal should be the demonstration that the quest for increased accountability is not borne of misapprehensions of the character of management, which would surely lead to the fettering of enterprise. My concern is that attempting to raise the level of ethical behavior of corporations and their officers through legal obligations is an unwise approach. Success in legislating one ethical perspective does not necessarily make America better.

For example, Steinberg believes that, under the appropriate triggering mechanisms of security laws, management should be required to disclose information bearing on its integrity which, by definition, has no material economic effect.[6] The purpose of the rule is to discourage such behavior, assuming that sinners will commit fewer sins if they know their sins will be exposed to the approbation of society. If Steinberg's rule is imposed and breached, what is the remedy? Perhaps the invalidation of a stockholders' vote on a corporate issue or the removal of a director, who may otherwise be well disposed to the profit of the enterprise, on the motion of an aggrieved minority of non-profit seeking shareholders. Consider the choice of the remaining shareholders who, after the breach of ethics has been disclosed, conclude that this issue of integrity has no pitch and movement toward profit, which is their prime and only motive for investment. Their faith in their ability to invest in the corporation and to have their property managed traditionally, for profit, is shaken and the enterprise is not better off save in the vaguest of ethical terms.

Consider, for example, the issue of whether special litigation

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5. *Id.* at viii.
6. *Id.* at 73-133.

committees of boards of directors should be permitted to foreclose actions commenced on behalf of the corporation by shareholders. The issue arises from the ancient fiction of corporate law that certain actions belong to the corporation rather than the individual shareholders because the corporation has been damaged as a whole by the iniquity. The corporation should first decide whether the action is appropriate, i.e., profitable to pursue. The irate shareholder, before he can sue, will be required to demand that the directors consider the action. Of course, the shareholder argues that such demand is futile because of collusion among the managers. To avoid spurious litigation, special committees are formed, with varying degrees of disinterestedness and with the support of independent professional counselors (independent of the usual crowd employed by the interested manager). These committees review the evidence, determine that the matter is not worth the corporation's trouble and may successfully apply to the court to dismiss the action in order to avoid the charge of collusion. Steinberg presents a lawyer-like review of this process and the creation of an effective committee whose decision a court will not peek behind. He applauds, however, the instruction of the Delaware Supreme Court in the leading case of *Zapata Corp.* v. *Maldonado,*[7] to review decisions by these committees with "special consideration to matters of law and public policy."[8] Steinberg takes this instruction as a license to review the reasonableness of the committee's decision by standards "transcend[ing] the sometimes narrow economic interests of the corporation and encompass[ing] principles of shareholder welfare, public policy and, in essence, corporation accountability."[9]

Will the increase in derivative suits permitted by a more liberal view of the derivative action enhance the effectiveness of the corporation and society? The managers subject to such suits, if they prevail may in some instances be indemnified or insured. In other instances, if the damages are sufficient, the directors will not have the wherewithal to recompense the corporation, thus rendering the remedy hollow. Threat of such suits may increase the difficulty in finding individuals to act as managers. But again, will judicial review of corporate activity which might have significant community effects,[10] and which are tested by some standard other than

7. 430 A.2d 779 (1981). *See* STEINBERG, *supra* note 1, at 147, 149-51.
8. 430 A.2d at 789. *See* STEINBERG, *supra* note 1, at 150.
9. *See* STEINBERG, *supra* note 1, at 154.
10. Community effects would include such occurrences as plant closings, layoffs, dives-

whether such a move is profitable for the corporation and its shareholders only, improve the quality of the service the corporation provides to society?

I do not mean to infer that the reforms suggested under the banner of corporate accountability are without merit. I only recommend that analysis of such reforms goes beyond an assessment that the ethical climate will be improved and that proponents demonstrate some concrete improvement in the function of the business enterprise which might be effected by such changes. The vast majority of investors invest for their own profit. If a corporation begins to operate as an unprofitable facility because of community standards or community consideration or even by the will of a minority of shareholders promoting such conduct, then investors will simply invest less or change the format of their investment.

One of the reasons this frontier area of the law is fraught with vagueness is because of the moral rather than legal aspects of the issue.[11] In framing the legal solutions, assumptions must be made about the character of the managers of these enterprises. Steinberg paints an ethical portrait of the manager which is not pretty—his inclination to the immoral is directly related to his ability to conceal the immorality; he is inclined, when tested, to place preservation of his job and the perquisites of his friends above the corporate interests; he belongs to a close-knit structure of managers who are inbred, tied by religious, political and moral concepts, and who look out for their own. In fairness, Steinberg does not condemn them all but he does design solutions to problems which might arise because of these perceived ethical failings. These solutions are largely designed to force accountability through disclosure and retribution.[12] A true raising of moral standards is not the objective but rather a system which reins in the predilections of the managers to be unethical.

I am uncomfortable in accusing anyone that his morals are not as good as mine. Nor do I believe that the law, as a matter of course, should assume that man is a sinner. But, clearly, if Steinberg's perceptions concerning the character of these people is ac-

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titures, relocations or acquisitions.

11. According to one commentator, "[t]he debate concerning . . . 'corporate accountability' is a good example of this tendency to look for legal solutions to what have traditionally been perceived as ethical questions." Williams, *Corporate Accountability and the Lawyer's Role*, 34 BUS. LAW. 7, 9 (1978).

12. *See* STEINBERG, *supra* note 1, at 248-49.

cepted, the law will impose such guarantees of corporate accountability. But, if that portrait is incorrect, which, I believe it is, then the legal solutions proposed will not be effective and will have unintended results. As Williams wisely states "the best antidote . . . is for corporations to take steps to assure the public that they are capable of self-discipline which is consistent with both the realities of the market place and the noneconomic aspects of the public interest."[13]

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13. *See* Williams, *supra* note 11, at 9.