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David Millon

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DAVID MILLON*

CRIMINALIZATION OF CORPORATE LAW
The Impact on Shareholders and Other Constituents

THE TITLE FOR THIS PART OF THE PROGRAM IS "The Impact on Shareholders and Other Constituents," which I take as an opportunity to talk about a subject that has been of interest to me for a long time. This is the notion that corporate governance law ought to empower managers to take into account interests of non-shareholders as well as shareholders. Under this multi-fiduciary model, management owes duties of a more or less fiduciary nature not just to the shareholders, but to other corporate constituencies as well.

Having decided to talk about the multi-fiduciary idea, the next challenge is to think about how corporate criminal law might have some bearing on that topic. Having never given much thought to corporate criminal law, I am going to say the answer is not immediately apparent. Today's discussion, though, does suggest that if corporate criminal liability can penalize shareholders for the sins of corporate executives, the same point might also be made about non-shareholder constituencies. Harsh sanctions imposed upon the entity can cripple or even destroy a business. That will put people out of work, disrupt customer and supplier relations, and harm local communities reliant on a corporation's presence. This suggests to me that penalizing the corporate entity is even more problematic than those focused on shareholder interests realize.

But is there any way that criminalizing corporate law can strengthen the case for a multi-fiduciary conception of corporate governance? I know that the multi-fiduciary idea has been a hard sell for a long time, and it has actually been a much harder sell recently than it was when I was doing a lot of writing about it. Since Enron and the other high-profile corporate scandals,[1] there has been a heightened emphasis placed on the interests of shareholders, specifically the need to protect shareholders and the need to empower shareholders to protect themselves within the corporate governance structure. Examples include law reform efforts like

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* J. B. Stomback Professor of Law, Washington and Lee University School of Law.

1. *See, e.g.*, *In re* WorldCom, Inc. Sec. Litig., 456 F. Supp. 2d 508 (S.D.N.Y. 2006).

Sarbanes-Oxley's various provisions,[2] listing requirements by the New York Stock Exchange[3] and the NASDAQ,[4] the SEC's proposed rule allowing shareholders to nominate directors,[5] and academic discussion like Lucian Bebchuk's arguments about empowering shareholders to play a more direct role in structuring corporate governance and even intervening in particular business decisions.[6] In this world, it becomes even harder to think about the multi-fiduciary model because that approach assumes that shareholder interests may, on occasion, have to be sacrificed for the sake of non-shareholder considerations.

I want to make only a couple of modest suggestions. I think that a regime of robust criminal sanctions—and here I am talking about sanctioning individuals, not corporations, because, as I've suggested already, I do have a hard time thinking about how criminal liability for the corporate entity makes sense—might address a couple of the most pertinent objections that have been raised to the multi-fiduciary model.

The first objection is the notion that if management is going to owe duties not just to shareholders but also to non-shareholder constituencies, you compound the agency cost problem. The notion is that you cannot serve two masters effectively or, as Steve Bainbridge put it recently, directors who are accountable "to everyone are accountable to no one."[7] The added space that this expanded discretion creates can become a cover for efforts by management to extract private benefits through its use of control.

Criminal penalties, I think, can be helpful here. In theory, criminal penalties for individual wrongdoing ought to do a good job of punishing and therefore deterring efforts to extract private benefits. Cases like Koslowski's $600 million theft[8] or Fastow's $45 million accounting fraud,[9] designed to boost share prices in order to enhance the value of stock options, should be less likely to occur once there has been heavy punishment. That would address, at least in part, the concern that serving multiple masters degrades accountability and facilitates self-dealing.

A second critique of the multi-fiduciary model has to do with management entrenchment. For example, in a hostile takeover setting, if the target's management is empowered to regard not just shareholders but also non-shareholders, that discre-

2. *See generally* Company Accounting Reform and Investor Protection (Sarbanes-Oxley) Act, Pub. L. No. 107-204, 116 Stat. 745 (Jul. 30, 2002) (codified as amended at 11, 15 and 18 U.S.C. and other Titles (2006)).

3. *See generally* N.Y.S.E. Listing Standards, U.S. Standards, *available at* http://www.nyse.com/regulation/listed/1147474807344.html (last visited February 19, 2007).

4. *See generally* Listing on NASDAQ, *available at* http://www.nasdaq.com/about/listing_information.stm (last visited February 19, 2007).

5. Security Holder Director Nominations, 17 C.F.R. §§ 240, 249, 274 (2003).

6. Lucian Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 835 (2005).

7. Corporate Social Responsibility, http://www.professorbainbridge.com/2005/10/cowen_on_csr_pa.html (Oct, 25, 2005).

8. Levin v. Kozlowski, No. 602113/02, 2006 WL 3317048, at *2-3 (N.Y. Sup. Ct. Nov. 14, 2006).

9. Dana Calvo & Nancy Rivera Brooks, *Fastows Plead Guilty to Enron Charges*, L.A. TIMES, Jan. 15, 2004, at C1.

tion can provide management seeking to preserve its own position with a pretext for resisting a takeover that would be attractive to shareholders. The most potent anti-takeover defense of all, of course, is high share prices, and criminal penalties for accounting fraud should reduce artificially inflated values. To that extent it should be harder for management to prevent under-performing companies from attracting the attention of hostile bidders. A multi-fiduciary conception of the target board's role may still facilitate resistance, but under-performing managers will be required to make a case for the firm's continued independence. It will therefore be that much harder for corrupt, incompetent, or lazy managers to avoid determined efforts to replace them.

So does criminal law provide a full set of reasons or justifications for a multi-fiduciary approach to corporate governance? No, not at all. I am saying only that it can address a couple of important criticisms that have been raised against that model.