

# **Corporate Governance**



# Corporate Governance

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## Law, Theory and Policy

SECOND EDITION

Edited By

**Thomas W. Joo**

UNIVERSITY OF CALIFORNIA, DAVIS  
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# Preface to the Second Edition

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The first edition of this book was prepared in 2003, as the nation was sorting through the wreckage of Enron, WorldCom, and the other corporate disasters that accompanied the turn of the millennium. In that post-Enron moment, the Sarbanes-Oxley Act of 2002 seemed to mark an end to the deregulatory philosophy of the 1980s and 1990s. But a backlash of anti-regulatory sentiment soon followed, accompanied by a booming economy. I believe it was Professor Larry Ribstein who first dubbed that backlash the “post-post-Enron era.” I had imagined this second edition would focus on that shift, but then came the financial meltdown of 2008 and the subsequent recession, which was the dominant economic narrative while this edition was being prepared. A re-regulatory post-post-post Enron era may be dawning as I write this Preface—but it may well have faded by the time it is published. Stay tuned for the third edition.

The obvious question today is why an epidemic of corporate failures recurred so soon after Enron and Sarbanes-Oxley. Perhaps there was insufficient regulatory reform; perhaps too much. Or perhaps the vagaries of the business cycle, and of human cognitive limitations and behavior, are simply beyond our control.

I thank Nina Bell, Xong Vang, and Glenda McGlashan for their help in preparing the manuscript and obtaining reprint permissions and to Adam Lunceford for providing research assistance. I would also like to thank Dean Kevin Johnson, the University of California, Davis, and the UC Davis School of Law for supporting my work on this edition. Finally, I thank Irene, Jason and Alicia Joo for their love and patience.



# Preface to the First Edition

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At the turn of the millennium, the collapse of the “dot.com” stock market and the rash of scandals involving Enron and other major corporations attracted renewed attention to corporate governance. Shareholders, employees, and society at large felt betrayed by the managers of America’s large corporations. The challenges to corporate governance today involve many new economic and business factors, but are rooted in perennial issues of governing the publicly traded corporation.

In their classic 1932 book, *The Modern Corporation and Private Property*, Adolf Berle and Gardiner Means identified the separation between the ownership by shareholders and control by professional managers as a crucial characteristic of the public corporation. They argued that this separation makes public corporations fundamentally different from conventional forms of private property and justifies special legal treatment of the corporate form. Also in 1932, Berle and E. Merrick Dodd engaged in a famous scholarly debate over the question, “For Whom Are Corporate Managers Trustees?” In contrast to the Berle and Means focus on shareholder ownership rights, Dodd argued that other elements of society have an interest in the conduct of large corporations.

Despite their differences, these pioneering scholars agreed that despite its legal form, a corporation is not a monolithic entity, but a complex intersection of various interests seeking control over shared “corporate” resources. As this book shows, subsequent commentary continues to wrestle with the implications of this fundamental insight. Decades after Berle and Means, the separation of ownership and control remains a central concern of corporate governance. In addition, newer theoretical approaches consider the place of additional parties—employees, creditors, corporate acquirers, and others—in the competition and negotiation for control of corporate resources. Regulators—states, the federal government, and stock exchanges—also compete with corporate constituents and even with one another. Social interest groups also vie for control, using both politics and internal corporate governance mechanisms.

Underneath this ongoing competition is a debate over which parties have a legitimate claim to controlling the fate of the corporation. And underlying that debate are the fundamental normative questions about what criteria should determine social priorities, and what role the law should play in all of this.

This volume anthologizes previously published recent scholarship on the law of corporate governance in publicly traded corporations. The selections have been chosen to address current policy issues, as well as to present a wide range of both established and developing approaches to legal analysis, such as law and economics, corporate finance, public choice theory, expressive law, organizational behavior, and sociology.

This book’s focus on recent works is not meant to slight the classic literature in the field, but to put the perennial legal and theoretical issues in a contemporary policy context. In addition to exposing the reader to a broad range of theoretical approaches, I hope to familiarize the reader with current policy debates and provide useful descriptive detail

about fundamental legal and economic institutions such as the proxy process, takeover defenses, the stock exchanges, shareholder litigation, institutional investors, and the roles of auditors and corporate lawyers.

The discussion questions at the end of each chapter invite readers to compare and contrast the readings and to form their own opinions about the issues raised. Admittedly these questions tend toward the critical. Some issues raised in the questions are addressed by the author in other work or even in excised parts of the articles presented. The questions are intended to encourage critical reading and inspire further thought; they are not meant to pass judgment on any of the works presented.

For the sake of brevity and focus, I have had to excise a great deal of fascinating material from each article. (I have also taken the liberty of altering and renumbering footnotes and section headings in order to increase readability.) Moreover, there are of course many more important works of scholarship excluded from this volume than I could include in it. I encourage readers interested in learning more to seek out the original sources in their entirety, as well as to consult the other sources referred to in the notes and questions.

I would like to thank the authors and publishers of the original articles for their permission to include the edited versions in this book. I also thank Glenda McGlashan, Courtney Hennigan, and Linda Cooper for their invaluable help in preparing the manuscript and obtaining reprint permissions, Charles Yu for his tireless research assistance, my colleagues Bob Hillman and Dick Wydick for their insights, and Dean Rex Perschbacher, Associate Dean Kevin Johnson, and the UC Davis Martin Luther King, Jr. Hall School of Law for financial and moral support. I would also like to thank the King Hall students who have taken my Law of Corporate Governance seminar for helping to shape these materials. Finally, I could not have completed this project without the support and patience of Irene and Jason Joo.