

Corporate Governance

Corporate Governance

Cases and Materials

THIRD EDITION

J. Robert Brown, Jr.

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*To the Brown and Lee children,
Tessa, Beth, Ryan, Josh and Zoey,
all unique and astounding in their own right.
JRB*

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Preface

A textbook on corporate governance is a particularly daunting thing to write. Like all textbooks, it must provide an overview of an area of law in a manner that is sufficiently accessible to the faculty member teaching the class and to the students who are trying to understand the area. Corporate governance, however, is a particularly challenging topic to develop in a casebook for several reasons.

First, the area involves a complicated regulatory construct, a byproduct not of reason but path dependency. Governance practices may emanate from the federal government, particularly the Securities and Exchange Commission, state government, with Delaware the predominate player, and the stock exchanges, self-regulatory organizations that are for profit companies with regulatory responsibilities. Each regulator has a different philosophical approach and works to promote its own policy objectives. Moreover, enforcement mechanisms vary. For example, private enforcement is a significant enforcement tool under the federal securities laws but not under the rules of the stock exchanges.

At the same time, the regulatory construct has been in a state of considerable flux. Historically, matters were mostly divided between the SEC and the states. Created in 1934, the SEC was assigned the task of regulating corporate disclosure, particularly financial disclosure, while states regulated the substantive standards of corporate governance. But in response to various corporate scandals and crises — most significantly, after the collapse of Enron and WorldCom in 2001 and 2002 — the post-Depression division of authority has shifted.

In passing the Sarbanes-Oxley Act in 2002, Congress gave the SEC more extensive authority over the substance of corporate governance, particularly with respect to board structure. Congress continued this trend toward federalization by enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010. Dodd-Frank, among other things, clarified the SEC's authority to allow shareholders to include their nominees for the board in the company's proxy statement and to provide advisory votes on executive compensation.

Second, corporate governance has proved extraordinarily dynamic. At one time, perhaps, the area could have been described as somewhat sleepy. Public companies

were run by their executive officers with occasional input from the boards of directors. Boards consisted mostly of company employees, family members, and persons financially connected to the company. Shareholders were mostly passive. To the extent unhappy with management, their only real option was to exercise the Wall Street Walk, selling shares and exiting the company.

Much, however, has changed. Institutions now own about 80% of the shares of the companies in the S&P 500. With the increased domination of these shareholders and the increased concentration of ownership in public companies, activism has increased. Activism can take any number of forms, whether through engagement with management, support for activist investors, or voting for shareholder proposals. Management has, however, pushed back. Advance notice bylaws have become widespread; dual class stock structures that reduce the voting power of public shareholders have reappeared. Regardless of the outcomes of these battles, shareholders' fight for greater voice in corporate governance no doubt will continue.

Corporate boards have also undergone significant structural changes. Director independence has emerged as the accepted method of reducing agency costs by management. As a result, insiders (with the exception of the CEO) have been all but eliminated from public company boards. The role of outside directors as monitors of management has been strengthened. For example, listing standards of the stock exchanges require that independent directors on the audit committee of public companies, rather than the CEO, have the authority to hire and fire the independent accounting firm. Yet concerns with the degree of board oversight of executive officers remain.

Finally, governance has become a topic of extensive public debate, particularly with respect to the role of public companies in matters of significant social concern. Corporations have been at the center of debates over climate change and political contributions. The SEC was subjected to extraordinary pressure to require corporate disclosure relating to climate change. These debates have reignited discussions over the purpose of corporations and whether boards have responsibilities to stakeholders other than shareholders.

This textbook attempts to illuminate and accommodate both the complicated regulatory framework and the dynamic nature of corporate governance law. Chapters typically cover all three areas of regulation — federal, state, and self regulatory organizations. The text examines corporate governance as positive law but also includes normative and even empirical perspectives. Discussions have been incorporated on new developments and evolving practices, often in the comments and questions following each section.

Because the text has been written as a teaching tool, cases and other materials have been heavily edited to aid in the text's readability. Citations and footnotes usually have been omitted, mostly without indication. The text includes excerpts of the key statutes and regulations, and, of course, complete copies of the relevant laws and rules are readily accessible on the internet.

In the meantime, comments and suggestions are welcome. You never know; there may yet be a Fourth Edition.

J. ROBERT BROWN, JR.

May 2024

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