BOOK REVIEW

LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY—AMERICA'S NEWEST EXPORT (Yale University Press, New Haven, Connecticut, 2001)

Reviewed by: Douglas M. Branson[*]

Why is corporate irresponsibility "America's newest export?" Of the world's 100 largest multinational corporations, forty-seven are headquartered within the European Union. Forty-six are headquartered in the United States.[1] Is Professor Mitchell telling us that the Anglo-Dutch Unilever is more responsible than, say, Procter & Gamble? Is Total-Fina, the French petroleum giant, more responsible than Chevron-Texaco or Exxon-Mobil? After all, it is Total, and not the U.S.-based Unocal, that is the operator of the Myanmar pipeline with which Mitchell opens his book, as an example of corporate irresponsibility.[2] International human rights organizations are suing on behalf of Myanmar citizens brutalized when Total and Unocal used the Burmese army as a subcontractor to provide security on the pipeline project.[3]

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1. *See* Forbes, *The International 500*, *available at* http://www.forbes.com/2003/07/07/internationaland.html (last visited Feb. 26, 2004) [hereinafter *International 500*] (compilation by nationality by the author).

A recent study of corporate home countries finds that 185 of the world's largest 500 multinationals are headquartered in the United States while 108 are headquartered in Japan and 147 are headquartered in the (pre May 2004) fifteen member states of the European Union. There are fifteen in Canada, twelve in China, eleven in South Korea, and seven in Australia. MEDARD GABEL & HENRY BRUNER, GLOBALIZATION INC: AN ATLAS OF THE MULTINATIONAL CORPORATION 5 (2003).

2. *See* LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY—AMERICA'S NEWEST EXPORT 22-25 (2001).

3. *See* Doe v. Unocal Corp., 248 F.3d 915, 916 (9th Cir. 2001) (affirming dismissal of Total for lack of personal jurisdiction in California). *See also* Doe v. Unocal Corp., 2002 WL 31063976, *1 (9th

The United States does not have a monopoly on corporate irresponsibility any more than Germany (11), the United Kingdom (9), France (8), the Netherlands (6), Switzerland (5) or other multinational domiciliary nation states do.[4] Mitchell's fallacy is one in which Americans frequently engage, namely, the assumption that American ideas, methods of governance, laws, and investment norms are universal, or should be.[5] Mitchell begins and ends his book on the note that, "the overwhelming power and influence of American capital are changing everything, creating nearly irresistible pressures on corporate systems throughout the world to replicate the U.S. model for the benefit of American investors."[6]

Unlike other American scholars,[7] however, Mitchell's complaint is that, while becoming universal, American methods are not superior. His paean is that U.S. corporations, and those that imitate them, are more irresponsible than others.

In fact, there is a considerable backlash in many developed and newly industrializing countries against the adoption of American methods and "corporate systems," to use Mitchell's words. We see it in the protests of the anti-globalization forces, who view globalization as a Trojan Horse for large multinationals to flatten all cultural and other barriers to multinationals doing business anywhere, anytime, and any way they like.[8] On a more sophisticated

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Cir. 2002) (upholding complaint), *reh'g granted en banc*, 2003 WL 359787, *1 (9th Cir. 2003).

4. Numbers in parentheses indicate number of top 100 multinationals headquartered in each nation. *See International 500*, *supra* note 1. On a relative basis, it is the United Kingdom, and not the United States, which has the highest number of publicly held corporations. *See* John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 644 (1999).

5. I have railed elsewhere against this chauvinistic assumption made by U.S. scholars. *See* Douglas M. Branson, *The Very Uncertain Prospect of "Global" Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321 (2001).

6. MITCHELL, *supra* note 2, at 275. *See also id.* at 7 ("American ideas about business and American styles of management appear to be taking over the world.").

7. *E.g.*, Lucian Ayre Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999); Coffee, *supra* note 4; Lawrence A. Cunningham, *Commonalities and Prescriptions in the Vertical Dimension of Corporate Governance*, 84 CORNELL L. REV. 1133 (1999); Jeffrey N. Gordon, *Pathways to Corporate Convergence? Two Steps on the Road to Shareholder Capitalism in Germany*, 5 COLUM. J. E. EUR. L. 219 (1999); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

8. *See*, *e.g.*, John Burgess, *Activists Aim to Halt Meeting of World Bank and IMF*, INT'L HERALD TRIB., Jan. 27, 2000, at 17; John Burgess, *At IMF Headquarters; Embattled Staffers Wonder 'Why Us?'*, WASH. POST., Apr. 13, 2000, at A1; Thomas Hayden et al., *The Battle in Seattle: What Was That All About*, WASH. POST, Dec. 5, 1999, at B1; Michael Kazin, *Saying No to WTO*, WASH. POST, Dec. 5, 1999, § 4 (Magazine), at 17. *See generally* JOHN GRAY, FALSE DAWN: THE DELUSIONS OF GLOBAL CAPITALISM (1998); JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS (2002).

plane, we see resistence to American methods in developing countries which resent what they perceive as International Monetary Fund and World Bank efforts to force adoption of U.S.-style economic laws, what author Thomas Friedman refers to as the "golden strait jacket."[9]

The other assertion Mitchell seems to make is that most of the world's investment capital is in the United States.[10] Ergo, the rest of the world must dance to the tune played by large U.S. investors and multinationals. In fact, there is money, and lots of it, in Sydney, Singapore, Hong Kong, Shanghai, Riyadh, Milan, Paris, Frankfurt, London, and elsewhere around the globe.

So I intend to review Professor Mitchell's book without the subtitle, "America's Newest Export." The question then becomes universal: is there something pandemic in the governance and operation of large multinational corporations which causes them to trample non-shareholder constituencies, such as labor, consumers, the environment, local economies, and so on?[11] The further question is what, as a legal and policy matter, can governments, "best practices" governance working groups, and other relevant actors do about it?[12]

MITCHELL'S CENTRAL THESIS

The evil is "stock price maximization" at all costs, by corporations' managers and investors.[13] Corporate managements pander to the share markets, and to share markets alone.[14] This leads to short-termism and to the trampling of non-shareholder interests.[15]

One unsupported assertion is that all managers engage in short-term stock price maximization to the exclusion of all else. I seem to find many companies in which I invest whose managers do not engage in stock price

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9. THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 99-108 (2000) (Chapter 6, "The Golden Straightjacket"). Based upon this author's experience, what the IMF and World Bank desire to see are modern laws, user friendly to direct foreign investment and international trade, not American style laws.

From 1999-2002, the author served as a USAID sponsored consultant to the Ministry of Justice in the Republic of Indonesia, advising on corporate law reform, corporate governance, capital markets law, and asset securitization, working with representatives of the World Bank and the IMF. He has also formulated or worked on similar projects in Afghanistan, Bulgaria, Macedonia and the Ukraine.

10. *See*, *e.g.*, *supra* text accompanying note 6.

11. I have chronicled those socially irresponsible tendencies elsewhere. *See* Douglas M. Branson, *The Social Responsibility of Large Multinational Corporations*, 16 TRANSNAT'L LAW. 121 (2002).

12. *See id.*

13. *See* MITCHELL, *supra* note 2, at 6.

14. *Id.*

15. *Id.* at 7-8.

maximization.[16] I think what Professor Mitchell refers to is the practice of high flying, high tech, telecommunications and other hot companies at the peak of the late 1990s bull market, or bubble. Managers of many of those companies did place stock price maximization in the ascendancy.

He also asserts that stock price maximization is a zero sum game. If managers attempt to maximize the share price, other constituencies are necessarily hurt. For example, with regard to workers, "[t]he premise . . . is that the mandate of stockholder profit maximization encourages managers to treat workers poorly . . . ."[17] Stock price maximization, to Mitchell, means a loss of professionalism, "professional ethic," and "professional purpose" among middle managers and other employees.[18]

That is a *non sequitur*. Take, for instance, the example of Silicon Valley high tech companies. In many of those companies, employee morale is high. Managers and employees feel they lead extremely productive lives. All the while, the managers at an Intel, an Oracle, or an eBay, have pursued stock price maximization.

I think where Mitchell goes awry is his assumption of the old "command and control" model of management in its relationship with rank-and-file employees. Indeed, he cites to Frederick Winslow Taylor, whose early twentieth century method of "scientific management" epitomized command and control.[19] Management theorists, and many managers, however, have long ago moved on to "collaborative" production methods and away from command and control. And, indeed, they have had to do so to insure product quality and to keep employees energized and productive over careers that span twenty or twenty-five years.[20]

In his description of the evil endemic to the U.S. corporate system, Professor Mitchell lapses into a lack of analytical precision. He slides into describing the evil to be avoided as "profit maximization" rather than just

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16. More seriously, for example, I have invested in regional and community banking organizations and local service telecommunications providers for whom the mantra is community service, high regard for customers and employees, and steady, sure growth for stockholders. Especially since the burst of the dot.com bubble, in April, 2000, these stocks have done quite well.

17. MITCHELL, *supra* note 2, at 211.

18. *Id.* at 236.

19. *Id.* at 219 n.f.

20. *See*, *e.g.*, DAVID PACKARD, THE HP WAY: HOW BILL HEWLETT AND I BUILT OUR COMPANY (David Kirby & Karen Lewis eds., 1995) (discussing collaborative design and production and management by "walking around" at Hewlett-Packard) (1995); RICHARD S. TEDLOW, GIANTS OF ENTERPRISE: BUSINESS INNOVATORS AND THE EMPIRES THEY BUILT 402-18 (2001) (founder Robert Noyce and collaborative production at Intel).

"stock price maximization" or, (what I think he really means), short-term "stock price maximization."[21] Microeconomics teaches us that in competitive markets firm managers must maximize profits. If they do not do so, the firm will wither.[22] Profit maximization, or at least non-ruthless profit maximization, is a desirable goal. Further, while it may be related, it is not the equivalent of stock price maximization.

The excesses of the 1990s demonstrate that stock price maximization often involves making up profits by managers who, in reality, have failed to maximize. Thus, they improperly recognize revenue, use slush funds and other devices to "smooth out" quarterly earnings, and bribe securities analysts to upgrade or at least maintain favorable recommendations on their stock.[23] Recent cases have involved permitting an analyst to sit as a de facto member of the board of directors (Worldcom) and the upgrade of a stock (AT&T) by an analyst in return for the favor of admission of his children to an exclusive New York kindergarten.[24] Those events are symptoms of the evil Professor Mitchell addresses: short-term and headlong stock price maximization. Standing alone, profit maximization is not evil.

PENULTIMATE CAUSES OF THE ULTIMATE CAUSE (STOCK PRICE MAXIMIZATION LEADING TO WIDESPREAD CORPORATE IRRESPONSIBILITY)

Professor Mitchell's book sets out several reasons why corporations engage in stock price maximization:

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21. MITCHELL, *supra* note 2, at 234 ("Workers . . . have no doubt as to what their purpose is. It is not to make the best product . . . . It is to maximize corporate profit."). Taylor's methods were dominant early in the early twentieth century. *See generally* DANIEL NELSON, FREDERICK W. TAYLOR AND THE RISE OF SCIENTIFIC MANAGEMENT (1980) (describing the dominance of Taylor's methods in the early twentieth century).

22. *See*, *e.g.*, RICHARD G. LIPSEY & PETER O. STEINER, ECONOMICS at 191-92, 267-77 (4th ed. 1975) (discussing profit maximization and equilibrium in competitive markets respectively).

23. Earnings management involving "'cookie jar' reserves" and "[p]remature revenue recognition, especially by high-tech companies" are two "hot button accounting issues" on the SEC's agenda. *See* Staff, *SEC Names Niemeier Its Chief Accountant At Enforcement Unit*, WALL ST. J., May 26, 2000. Lucent and Tyco are two large capitalization companies recently alleged to have engaged in "cookie jar" earnings management. *See* Laurie P. Cohen & Mark Maremont, *E-Mails Show Tyco's Lawyers Had Concerns*, WALL ST. J., Dec. 27, 2002, at C1; Jonathan Weil, *SEC Probe of Lucent is Broader*, WALL ST. J., Nov. 1, 2002, at C1.

24. *See, e.g.*, Erik Portanger, *Banned on Wall Street, but All Right Abroad? Analysts Still Pitch Deals In Some Non-U.S. Settings; Waxing Billish on Tussands*, WALL ST. J., June 6, 2003, at C1.

1. Laws, which bestow upon corporations all the rights of natural persons without adequately recognizing the lack of a moral compass which would inform exercise of those rights.[25]

2. Adoption of a legal model which requires that corporations maximize profits for the sole benefit of owners (shareholders).

3. Provision of limited liability to corporations and the resulting moral hazard: "[L]imited liability . . . separat[es] corporate decision making from the effects of those decisions and their consequences to others."[26]

4. The failure of large institutional and other "relational" investors to propound social proposals[27] and, rhetoric aside, their headlong pursuit of stock price maximization in their investment portfolios.

5. The prevalence of day traders (who accounted for seventeen percent of trading volume in the 1990s)[28] and other "casino stockholders" who are completely detached from corporations in which they invest.[29]

According to Professor Mitchell, these are the reasons corporations "go bad" and the reasons why very little, if any, solicitousness should be exhibited toward shareholders (as opposed to workers, consumers, etc.). I will discuss each in turn.

1. No Moral Compass

Addressing himself to a mythical reader, Professor Mitchell asserts:

> You have some belief or system of beliefs that directs you in your daily life . . . . [Y]ou have some limits to what you will do in pursuit of your self interest. You have a sense that sometimes, at least, the ends do not justify the means. . . . [T]he corporation is different. The corporation has one end, and that is to maximize its stock price. And the officers and directors that animate it do so with that end in mind.[30]

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25. *See* MITCHELL, *supra* note 2, at 45-47

> You have some belief or system of beliefs that directs you in your daily life . . . . [Y]ou have some limits to what you will do in pursuit of your self-interest. You have some sense that sometimes, at least, the ends do not justify the means. . . . [T]he corporation is different. The corporation has one end, and that is to maximize its stock price. And the officers and directors that animate it do so with that end in mind.

Id. at 46.

26. *Id.* at 61.

27. Which, in the United States, shareholders may do in management's annual proxy solicitation sent to shareholders at corporate expense. *See* SEC Rule, 17 C.F.R. § 240.14a-8 (2003).

28. MITCHELL, *supra* note 2, at 149.

29. *See id.* at 151.

30. *Id.* at 46.

I will make three points. The first is that many corporations begin, and continue to exist, merely as an efficient mechanism with which persons may organize the economic sector of their lives. Centralized management (the board of directors) and transferability of interests (by selling some or all shares) are features of the corporate form which make it useful for many enterprises, large or small. Corporations are not solely, or often even primarily, vehicles for headlong pursuit of stock price maximization, even after they become public companies, as I pointed out earlier.

Second, the corporation often comes into being, and continues to exist, as a means to undertake a project, business, or endeavor that no one person or family might undertake alone. Limited liability encourages investors to pool their capital. Secondary securities markets provide a means of exit (liquidity) that makes entrance in the first place more attractive. Profit is the motive, but ruthless stock price maximization often is not, even after companies have gone public and grown large.

Third, even though, to paraphrase the first Baron Thurlow, "the corporation has neither a soul to be damned nor a body to be kicked,"[31] Professor Mitchell never explains why, in many cases, corporate managers and the board of directors, cannot supply the moral compass the corporation lacks. Rather, he attempts to convince with conclusionary rhetoric: "Instead of animating the corporation, the corporation animates them [officers and directors]. It's like the soldiers of Troy who piled into the Trojan horse. . . . [O]nce inside the horse they collectively took on the horse's form and could go only in the direction the horse was designed to pursue."[32] But why is that so? And, experience tells us, that often is not the case. Time after time in the 1990s boards of directors removed not just underperforming, but misguided or wrongdoing CEOs.[33] Officers and directors live among us, share our values, and attempt to serve their employees, neighbors and families, as well as shareholders.[34]

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31. One version of the quotation by Edward, First Baron Thurlow and Lord Chancellor (1731-1806) is: "Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and no body to be kicked?" THE OXFORD DICTIONARY OF QUOTATIONS 550 (3d ed. 1979).

32. MITCHELL, *supra* note 2, at 44.

33. *See*, *e.g.*, ROBERT A.G. MONKS & NELL MINOW, CORPORATE GOVERNANCE 298-437 (2d ed. 2001) (reviewing of CEO removals at, *inter alia*, General Motors, American Express, Sears Roebuck, Polaroid, Carter Hawley Hale, Eastman Kodak, and Waste Management).

34. Harvard economist John Kenneth Galbraith posited the existence of shared values in the middle management layer he denominated the "technostructure," a group "no longer confined by profit maximization" and which would act as a force for corporate social responsibility:

> This . . . group is very large . . . . It embraces all who bring specialized knowledge, talent or

2. The Legal Model's Incorporation of Profit Maximization

There is no such thing. Yet, one footnote disclaimer aside,[35] Professor Mitchell repeatedly states that the law requires profit maximization. Thus, there exists "the legal constraint imposed upon the corporation itself . . . that mandates that the corporation maximize its profit."[36] Warming to his thesis, Mitchell states that "[t]he structure and laws governing the corporation create a situation in which the American citizenry learns to maximize profit, to make its decisions in reference to the maximization of profit, and to hone its skills primarily in the pursuit of maximizing profit."[37] Later still, rising not only to, but above, the occasion, Mitchell claims that corporate law requires managers and directors to maximize share prices.[38]

There are only two instances, that I know of at least, in which U.S. courts have come close to saying that directors' fiduciary duty is tantamount to a duty to shareholders. First, the Michigan Supreme Court in 1919, in *Dodge v. Ford Motor Co.*,[39] ordered Henry Ford to pay dividends to his shareholders out of the huge surplus Ford accumulated. "A business corporation is organized and carried on primarily for the profit of the stockholders," the court noted, and "[t]he powers of the directors are to be employed for that end."[40]

> experience to group decision making. This, not the management, is the guiding intelligence—the brain—of the enterprise. There is no name for all who participate in group decision making . . . . I propose to call this organization the Technostructure."

JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE 70-71 (2d ed. 1971). Later, he recanted, but without explanation. KENNETH GALBRAITH, ECONOMICS AND THE PUBLIC PURPOSE (1973). *See generally* Douglas M. Branson, *Corporate Governance "Reform" and the New Corporate Social Responsibility*, 62 U. PITT. L. REV. 605, 608-11 (2001).

Often it is true that corporate managers over-identify with the corporate purpose, leaving behind in whole or in part their moral compass and sense of social responsibility. But it is far from being the universal phenomenon Mitchell posits.

Professor Mitchell paints with an overly broad brush here and gives no satisfactory answer as to why, in some cases, managers and directors leave their values at the breakfast table.

35. *See* MITCHELL, *supra* note 2, at 67 n.b ("Note that I say 'maximize corporate profit.' The law has never demanded, except in one rare circumstance, that the corporation maximize *stock price*. (In fact it is questionable whether the law has actually ever demanded that the corporation *maximize* profit.)").

36. *Id.* at 67.

37. *Id.* at 94.

38. *See*, *e.g.*, *id.* at 112 ("[T]he structure of corporate law focuses directors on stock prices."); *id.* at 132 (stating that law incorporates a "stock price maximization rule").

39. Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

40. *Id.* at 684.

The other instance is a 1986 decision of the Supreme Court of Delaware, *Revlon, Inc. v. MacAndrews & Forbes Holdings*,[41] in which the court held that, in a takeover situation, once it became inevitable that the corporation would be broken up or sold, "[t]he directors' role change[s] from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[42]

No U.S. court has ever held directors liable for "failure to maximize profits." Whether by way of dictum or otherwise, no U.S. court has phrased directors' duty as one involving maximization of profits. Rather, U.S. courts have universally been coy, stating only that directors' duty is to "act in the best interests of the corporation." That may be largely, but not wholly, congruent with stockholders' interests, but courts do not so state. Courts create a tent large enough to protect many diverse stakeholder groups.[43]

Under U.S. or other nations' corporate laws, directors may oversee a corporation making only lackluster profits, but no court would hold the directors liable on that ground alone. With the two exceptions noted above, it is simply legal error to state that the U.S. (or any other) legal model of the corporation incorporates, or ever has incorporated, profit maximization in any way.

3. *The Moral Hazard of Limited Liability*

Limited liability is not, as Professor Mitchell intimates, the result of some diabolic plot to shift costs of doing business onto the shoulders of an innocent populace. Rather, limited liability flows from recognizing a collective of

41. Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 182 (Del. 1986).

42. *Id.* at 182.

43. And, at times, as in some of the corporate law insider trading cases, courts have pointedly held that directors' duties run to the corporation and not to any one group or individual within it, such as a selling shareholder. *See*, *e.g.*, Goodwin v. Agassiz, 186 N.E. 659, 660 (Mass. 1933) ("The contention that directors also occupy the position of trustee toward individual shareholders in the corporation is plainly contrary to the repeated decisions of this court . . . ."). *Percival v. Wright*, 2 Ch. 421, 423 (1902), is an early English holding to the same effect.

individuals as a separate juridical person.[44] As such, the new person, and not the individuals behind it, is responsible for its debts.[45]

Shifting some costs away from the incorporated enterprise is also only half of the story. The other half is that limited liability encourages capital formation which permits undertakings, great and small, that otherwise might not be undertaken.

Legal doctrines also exist that permit courts to disregard "corporateness" when the corporate form has been abused, resulting in loss of limited liability. Piercing the corporate veil in small corporations, or in subsidiary-parent relationships, and the doctrine of enterprise liability applicable to corporate groups,[46] are important footnotes to the limited liability story but absent from Professor Mitchell's presentation.

If corporate managers who left their moral compass at home could hide behind the veil of limited liability with impunity, why do many (most) corporations purchase insurance for all, or most, risks that are insurable?

Professor Mitchell is guilty of half truth here. He paints an incomplete picture. Limited liability is neither quite so limited nor quite so abused in the ways he posits.

4. Half Hearted or Duplicitous Institutional Investor Activism

I quite agree with Professor Mitchell that institutional investor activism was oversold in the first half of the 1990s, mostly by academics, but by some

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44. For this reason, in most jurisdictions, one searches in vain for a statutory provision that limits the liability of business corporations. Limited liability flows from recognition of a separate juridical personality ("entity" as opposed to "aggregate," as in partnerships or unincorporated associations, in U.S. law) if the statutory prerequisites for incorporation have been fulfilled. Also, limited liability, as opposed to centralized management and other organizational features, has not always been that central to corporate law. For example, until 1930, the California Constitution required unlimited (but proportionate) shareholder liability. CAL. CONST. art. IV, § 36 (1849) (repealed 1879); *id.* art. XII, § 3 (1879) (repealed 1930). The legislation limiting shareholder liability, which was necessary given the background in California, was enacted in 1931. *See generally* Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1052 & nn.84-86 (1991).

45. By contrast, a somewhat troubling trend in the United States has been legislative bestowal of limited liability "from the top down" rather than from the bottom up, with enactments such as limited liability company and limited liability partnership laws at the behest of lobbyists and bar associations. *See, e.g.*, Symposium, *Entity Rationalization: What Can or Should Be Done About the Proliferation of Business Organizations?*, 58 BUS. LAW. 1003 (2003).

46. *See, e.g.*, ARTHUR M. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW 35-64 (1999); Phillip I. Blumberg, *The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities*, 28 CONN. L. REV. 295 (1996).

managers of public employee and trade union pension plans as well.[47] First, the circle of potential players was actually quite small, limited only to a subset of public employee and union plans.[48] Second, as Professor Geoffrey Stapledon at the University of Melbourne demonstrated, in Australia and the United Kingdom (and probably in the U.S. as well), the marginal effort pension fund managers are willing to devote to activism is small. For instance, they may be willing to network with one or two other managers on an agenda item at a specific company's shareholders' meeting but they will not, generally speaking, attempt any broader based form of networking.[49]

But, that said, it does not take a small city, or even a whole village. A few high profile activist institutional investors may accomplish quite a bit. In the United States, the two poster children for institutional investor activism are TIAA-CREF, the annuity and pension fund for most of high education and much of the non-profit sector, and CalPERS, the California public employee pension fund. Both are very active but Mitchell faults them because TIAA-CREF has propounded only one social proposal at a portfolio company annual meeting and CalPERS has propounded none.[50]

What Mitchell does not disclose, let alone discuss, is that TIAA-CREF and CalPERS have made a conscious choice to emphasize governance and process issues rather than specific corporate social responsibility proposals.[51] Thus, these two relational investors push for supermajorities of independent directors, strong nominating committees, diversity of viewpoints and demographics on boards, confidential shareholder voting, bifurcation of the offices of CEO and Chairman, and so on. The byproduct of these governance improvements is that when social responsibility proposals are propounded,

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47. *See, e.g.*, MITCHELL, *supra* note 2, at 166 ("Legal scholars in the early to mid-1990s embraced the hegemony of the institutional stockholder with almost messianic fervor. Here, they argued, was the solution to the long-standing problem of the separation of ownership and control. . . . Some people believe this. But the bloom is off the rose.").

48. *See generally* Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445 (1991). *Cf.* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991).

49. G.P. STAPLEDON, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE (1997).

50. *See* MITCHELL, *supra* note 2, at 177 & 179.

51. Under SEC Rule 14a-8, 17 C.F.R. §240.14a-8 (2003), shareholders in SEC regulated public companies may propound resolutions to fellow shareholders, accompanied by a brief supporting statement, in the corporation's annual proxy statement. Such proposals, and the ins and outs of propounding them, are a favorite subject of authors of law school business organizations and corporation law casebooks. *See, e.g.*, JEFFREY D. BAUMAN ET AL., CORPORATIONS LAW AND POLICY 493-512 (5th ed. 2003); ROBERT HAMILTON & JONATHAN R. MACEY, CASES AND MATERIALS ON CORPORATIONS 777-95 (8th ed. 2003).

they may well find a neutral, or positive, reception at the board of directors level and be implemented. Alternatively, if social proposals go to a shareholders vote, confidential voting and other improvements increase their chances for success.

Institutional investment managers are not the pack of rapacious jackals Mitchell describes.[52] They are not focused solely on stock price maximization issues, such as disarming poison pill takeover defenses and other measures that will lead to an increase in the number of hostile takeover bids. My sense is that, while not a panacea, institutional investor activism has shown more than modest growth, contributing to more socially responsible corporate behavior. So, again, my conclusion is that Mitchell conveniently tells only half of the institutional investor story.

5. The Ubiquity of Day Traders and Other Investors to Whom No Allegiance Is or Should Be Owed

If, in Mitchell's view, institutional investment managers are rapacious jackals (my words, not his), individual investors are mongrels and curs, entitled to no allegiance or privilege whatsoever. To Mitchell, individual investors are the "living dead."[53] They are all principal villains in the headlong stock price maximization saga.

He points out that, in the United States, the number of individuals directly or indirectly owning shares of publicly traded companies has increased from 30.5 million in 1970 to 78.7 million in 1999.[54] That is roughly one-third of the U.S. population, and over one-half of the adult population. Regardless of how large the group may be, however, legal or regulatory protection of them is secondary, or even unimportant.

Professor Mitchell reaches that conclusion because he spreads two investor models based upon a very small, or even non-existent, subset of investors across the entire individual investor population. His models of the individual investor are "day traders" and adherents to the "cult of *Beta*."

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52. *See*, *e.g.*, MITCHELL, *supra* note 2, at 180: "Like the TIAA-CREF *Statement* [*on Corporate Governance*], the [CalPERS *Proxy Voting*] *Guidelines* spend most of their time setting out voting principles designed to keep portfolio corporations free and available for hostile takeovers and thus short-term stock price maximization.").

53. *Id.* at 135.

54. *Id.* at 139. *See also id.* at 147 (finding that U.S. share ownership has gone from 19% of households in 1983 to 48.2% of households in 1999).

Mitchell does not mince words: "[D]ay traders are the mercenaries of the corporate world, claiming allegiance to no corporation at all and moving in for the kill to take advantage of price movements with speed and stealth, grab their gains, and get back out . . . ."[55] Or, "[d]ay traders destabilize the market by their excessive in and out trading . . . they do nothing to move the [share] price in the right direction because they typically know nothing about the corporations in whose stock they trade . . . ."[56] Citing late 1990s data, Mitchell points out that day traders "make up some 17 to 18 percent of the daily trading volume on the New York Stock Exchange and the NASDAQ."[57]

As to the latter, I believe it safe to say that with the 2000-2002 market crash many of those day traders are gone. They have either lost their capital in the return to old economy stocks and investment values, or they have pulled out what capital was left to purchase real estate or take a long vacation.

I believe that a more representative individual investor model is a purchaser of mutual funds or an old fashioned "stock picker." The individual investors that I know still buy shares in a local or regional bank, dabble in a few more established high tech company shares, delve into some of the old economy stocks that show promise, and so on. I have only met one person who styled himself a "day trader," and he was a law student, presumably without much money (and maybe making it all up).[58]

Mitchell's other model is the investor who adjusts the *Beta* coefficient, a measure of volatility of an individual stock, when compared to a broad basket of stocks. This trader adjusts the *Beta* of the portfolio upward (say, 1.3 or 1.4, with 1.0 being the volatility of the market as a whole) if he believes the economy or the market, or both, are on an upward trend. By contrast, if he forecasts darker days ahead, he reduces the overall portfolio *Beta* (say, to .7 or .8), lowering the volatility.[59] He pays little attention to which individual stocks the portfolio contains.

Professor Mitchell is contemptuous of investors who join the cult of *Beta*, with whom

55. MITCHELL, *supra* note 2, at 149.

56. *Id.* at 151.

57. *Id.* at 149.

58. Moreover, many of the stock pickers I know apply one or more social screens to their stock picking. They do not invest in tobacco companies, or in multinationals engaged in less developed countries and "plantation production" practices, such as those of Nike, and so on.

59. *Beta* and the capital asset pricing model that is its corollary are described in detail in WILLIAM W. BRATTON, CORPORATE FINANCE 87-111 (5th ed. 2003).

> [y]ou have a logic . . . that denies the uniqueness of any single company, and instead argues for understanding such companies as nothing more than the risks and returns associated with their stock. . . . It is the logic of the day trader . . . who cares what the company does, what the company makes, what the company's long-term prospects are—or for that matter, how it behaves?[60]

Fair enough perhaps, but it is not a description or model that describes any great number of individual investors. Mitchell is taking a model that might describe a subset of professional money managers and ascribing the characteristics of those managers to individual investors.

Again, I believe that the dominant model of the individual investor who directly purchases shares is still that of the "stock picker," not the day trader and not the *Beta* practitioner. Of course, my only evidence is anecdotal—but so is Mitchell's.

Mitchell's shaky evidence is a thin reed upon which to base abandonment of allegiance to individual investors, who for decades have been encouraged to engage in "shirt sleeve" and "participatory" capitalism.[61] There are important socioeconomic reasons for policymakers to continue to encourage direct ownership of shares in public companies. Direct investment makes capitalism real. Direct investment creates another group of individuals who monitor and comment on corporate managers' behavior.[62]

PROFESSOR MITCHELL'S PRESCRIPTIONS TO CURB OR ELIMINATE THE EVIL OF STOCK PRICE MAXIMIZATION

1. Create a new "peerage" of lifetime directors (or, as a compromise, elected for five year terms) to eliminate the necessity of pandering to shareholders in order to be re-elected.[63]

2. Eliminate required quarterly, semi-annual or even annual reporting of financial results, to encourage long term management outlooks.[64]

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60. MITCHELL, *supra* note 2, at 144.

61. *See generally* Douglas M. Branson, *Securities Regulation After Entering the Competitive Era: The Securities Industry, SEC Policy, and the Individual Investor*, 75 NW. U. L. REV. 857, 860-61 (1980).

62. Professor Mitchell's disregard for shareholders is reminiscent of the American consumer advocate Ralph Nader's suggestion in the late 1970s that stockholders deserved little protection because they were "only gamblers in the stock market lottery." *See* RALPH NADER ET AL., TAMING THE GIANT CORPORATION 80-94 (1976). Nader seemed to have little regard for the important function trading markets have in society.

63. MITCHELL, *supra* note 2, at 129 ("[I]t is hard to imagine a serious disadvantage to freeing up boards [from the need to be re-elected periodically] and relatively easy to imagine an improvement in the current state of affairs."). *See generally id.* at 128-32.

64. *Id.* at 132-34, 157.

3. Place confiscatory taxes on day traders' and other short-term investors' profits.[65] Also, cap the income of professional money managers that can be based upon short-term share trading.[66]

4. Levy punitive taxes on short swing profits of corporate executives who sell shares shortly after receiving them via exercise of stock options.

5. Treat employee expense such as training and a portion of wages, along with research and development expenditures (R & D), as capital assets, to be amortized over a long period, rather than expensed as they occur.[67]

1. Life (or Five Year) Peers[68]

Perhaps, as the Blair government in the UK lessens the role of the House of Lords, Professor Mitchell's proposal will give many peers hopes for a new sinecure in the U.S. More seriously, the dominant model in the United States is the staggered, or classified board, in which directors serve three year terms or, in Nevada and New York, possibly four year terms.[69] New research demonstrating that board classification creates a powerful deterrent to hostile takeover bidders will accelerate the trend toward classified boards.[70] Three or four year terms as opposed to five year terms is not a large difference.

In his heart of hearts, rather than five years terms, Mitchell wants self-perpetuating boards, in order to eliminate most shareholder influence.[71] In the

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65. *Id.*

> [W]e might impose a sliding-scale tax on trading that occurs within an irrationally short period of time—say, a punitive tax of 75 percent of profits for trades that take place within a twenty-four hour period. . . . The amount of tax could go down by, say, several percentage points for each twenty-four or forty-eight hour additional holding period . . . .

Id. at 162.

66. *Id.* at 184 ("We might also want to think about ways of limiting the amount of money manager compensation that is tied to short term performance . . . .").

67. *Id.* at 245-50. *See, e.g.*, *id.* at 245-46 ("My principal proposal to make the worker central is to change the accounting rules to treat employees as assets instead of liabilities. . . . [C]hange the tax laws and the related accounting rules to require corporations to capitalize workers' salaries above a stipulated amount.").

68. Mitchell, who favors lifetime directorships, borrows the five year term idea from New York takeover lawyer Martin Lipton. *See* Martin Lipton & Steven Rosenblum, *A Proposal for a New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187 (1991), *discussed in* MITCHELL, *supra* note 2, at 129-32.

69. *See* DOUGLAS M. BRANSON, CORPORATE GOVERNANCE § 1.10, at 29 & n.143 (1993).

70. *See* Lucian A. Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887 (2002). *See also* Lucian A. Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy: Further Findings and a Reply to Symposium Participants*, 55 STAN. L. REV. 885 (2002).

71. *See*, *e.g.*, MITCHELL, *supra* note 2, at 132 ("I prefer the self-perpetuating board . . . .").

United States, one of the black holes of corporate regulation is the not-for-profit corporate sector, in which boards are, by and large, self-perpetuating. Besides producing a whopper of a scandal from time to time, such as the United Way debacle a few years ago,[72] self-perpetuating board schemes seem to result in a total lack of accountability, bordering on invisibility.

The self-perpetuating board idea also bucks the trend, which is to shorter overall board tenure. No longer do directors serve for twenty or twenty-five years. They serve two, or three terms (six or nine years) on a specific board of directors. Then they move on to other things.[73]

Professor Mitchell's idea for lengthened board tenures seems both unnecessary, in light of current trends, and not a particularly good idea, as it involves a paradigm shift to near complete lack of accountability (indeed, invisibility) for board members.[74]

2. Shift Away from Mandatory Quarterly Financial Reporting

Pick up any newspaper, whether it be the *New York Times,* the *Washington Post,* the *Chicago Tribune*, or the *Los Angeles Times*, the financial pages will be awash not merely in reports of quarterly performance, but with news stories about each and every reporting company. It is striking; it has become obsessive.

Pull up a financial website such as *Yahoo Finance*. As to each stock, the research page details quarter by quarter analysts' earning projections, matched with actual performance numbers. Falling just three percent, or five percent,

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72. *See*, *e.g.*, Dave Kansas, *United Way Delays Action to Settle with Ex-President*, WALL ST. J., Apr. 2, 1993; Pamela Sebastian, *Philanthropy: Unemployment and Unforgotten Scandal Work Against United Way Campaigns*, WALL ST. J., Oct. 21, 1992, at B1.

73. RALPH D. WARD, TWENTY FIRST CENTURY BOARD 45, 352-55 (1997) (finding board tenures of up to sixty years in times gone by as compared to newer boards with younger, more diverse directors with shorter tenure).

74. I would lay at the feet of largely self-perpetuating boards of directors, of the kind Professor Mitchell commends to us, most of the scandal currently rocking the U.S. mutual fund industry. The short-term rapid ("market timing") trading, late day ("stale price arbitrage") trading, payment of excessive management fees, and other abuses occur because self-perpetuating boards at mutual funds fail to exercise oversight and to monitor fund executives and employees who have permitted the abuses. *See*, *e.g.*, Len Boselovic, *Heard Off the Street A Mutual Fund Directors' Life—11 Meetings, $262K*, PITTSBURGH POST-GAZETTE, Mar. 1, 2004, at B1 (one group of self-perpetuating directors oversees management of 300 Fidelity mutual funds); Karen Damato, *Moving the Market: SEC to Seek Independent Chairmen on Fund Boards*, WALL ST. J., Jan. 14, 2004, at C3.

shy of analysts' composite projections, a matter of a few cents, can cause a stock to lose fifteen to twenty percent of its value overnight.[75]

Professor Mitchell's Imperative? "[Change] the securities laws to lengthen the periods between financial reports. We'd certainly want to eliminate quarterly reporting. And we might also get rid of annual reports. Maybe we'd require them every two years or every three years . . . ."[76] Really, what Professor Mitchell would do, is eliminate the "one size fits all" approach to financial reporting which allows no room for different circumstances in different industries and other variances:

> Nothing would stop companies from voluntarily reporting more frequently. In fact there may be entire industries, like those involved in high technology, for which more frequent reporting reflects business realities . . . . But in the new environment, frequent reporting would be a risky business: live by the short term, die by the short term.[77]

Other scholars are saying similar things, or at least recognizing the drawbacks of the historical "one size fits all" approach. In the securities law area, a considerable body of work now advocates permitting securities markets to compete against one another on the basis of differing listing standards, disclosure standards, governance rules, and financial reporting requirements.[78]

I like this proposal. I believe that it would aid significantly in curbing the obsessive fixation with short term results.

3. Tax Short-Term Traders and Cap Investment Managers' Compensation to the Extent It is Based Upon Short-Term Investment Success

I have two difficulties with these proposals. One, they represent an unwarranted intrusion on personal liberty and freedom of contract. Two, both in the United States and elsewhere around the globe, tax policy makers have steered tax policy away from utilizing taxes to achieve policy goals other than

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75. Even meeting analysts' composite expectation may not be sufficient. *See* Scott Thurm, *Cisco's Net Jumps 27% But Stock Falls*, WALL ST. J., Aug. 6, 2003, at A3 ("[Because] Cisco merely met, rather than exceeded, *Wall Street* expectations . . . investors sent its shares down 5% in after hours trading.").

76. MITCHELL, *supra* note 2, at 133. Billionaire investor Warren Buffet has long advocated that companies cease proving quarterly earnings guidance to analysts. Several companies, including Coca-Cola and the Washington Post, have heeded Buffet's advice. *See*, *e.g.*, Monica Langley, *Rare Advice: In Tough Times for CEOs, They Head to Warren Buffet's Table*, WALL ST. J., Nov. 14, 2003, at A1.

77. MITCHELL, *supra* note 2, at 133.

78. *See*, *e.g.*, Stephen J. Choi, *Promoting Issuer Choice in Securities Regulation*, 41 VA. J. INT'L L. 815 (2001); Stephen J. Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, 88 CAL. L. REV. 279 (2000); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998).

raising revenue. The Mitchell proposals would represent a return to the "bad old days" when politicians and bureaucrats attempted to use taxation to achieve a myriad of worthwhile and not-so-worthwhile non-revenue objectives.

4. Punitive Taxes on Short Swing Stock Option Profits

One of the great myths corporate America has perpetrated is the notion that stock options lead to management stock ownership, thus tying executives more closely to the fortunes of their companies and reducing "agency costs." Nothing could be further from the truth. The invariable pattern is to borrow money, exercise the options, immediately sell the shares in the market, pay off the loan, pay the taxes on the gain, and pocket the cash. In addition, the great amount executives stand to win based upon their stock options creates a moral hazard. Executives manage, or even manufacture, earnings to propel share prices upward so as to make their options more valuable.

The current debate in the United States centers around the notion that the current value of stock options should be deducted as a business expense at the time the options are granted. Several high profile U.S. companies, such as Coca-Cola, have voluntarily begun to expense options.[79] Other companies, particularly in high tech industries, in which generous option grants are the rule, oppose any mandatory rule.[80]

I would not favor the Mitchell proposal, partly for the reasons stated. Tax law should be used to raise revenue, not to achieve non-revenue policy goals. I would instead place a one year holding period so that executives who exercise stock options would not be free to sell the shares until one year had passed. If they sell, all gains from the sale of the shares would be forfeited to the company (not the government). Private attorneys generally would be authorized to bring suit if companies did not do so, as is presently the case under section 16(b) of the U.S. Securities Exchange Act.[81]

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79. *See*, *e.g.*, Alfred Rappaport, *Manager's Journal: Choosing a Useful Option*, WALL ST. J., Sept. 24, 2002, at B2 ("Over 100 companies, including Coca-Cola Co., General Electric Co., and Amazon have already announced that they will voluntarily expense their options costs for the sake of investor confidence in their financial reports.").

80. *See*, *e.g.*, Gregory Zuckerman, *Tech Companies Find Options Hard to Kick*, WALL ST. J., Aug. 11, 2003, at C1.

81. 15 U.S.C. § 78(p)(b) (2000).

With a one year holding period, the moral hazard involved with stock options would be reduced. The myth that options encourage ownership would also be less of a lie.

5. Capitalize Employee Training and R & D Investments

When alone, I reassure myself repeatedly, "I am not a chartered accountant, I am not a chartered accountant." So limited in my skill set, I cannot comment knowledgeably about all of the "ins" and "outs" of this Mitchell proposal. On the surface, I like it. Generally accepted accounting principles (GAAP), and their application, should always remain true to a first principle, that is, that financial statements reflect, as nearly as is possible, underlying economic reality.

To me the reality is that well-trained workers and managers are an asset. Costs sunk into R & D seem an asset as well, likely to produce earnings year in and year out. In that sense, they are no different than a piece of heavy machinery which would be treated as a capital asset. Thus, the machine's cost would be amortized over its useful life rather than deducted in its entirety as an expense in the year in which it was purchased.

The Sarbanes Oxley Act of 2002, the shotgun federal legislation in the United States emanating out of the Enron and WorldCom scandals, has a little noticed provision which commands the U.S. Securities and Exchange Commission (SEC), together with self regulatory authorities such as the Financial Accounting Standards Board (FASB), to study carefully proposals to convert from "rule based" to "principles based" accounting.[82] There may be a forum in which to evaluate proposals such as Professor Mitchell's.

CONCLUSION—MUCH ADO ABOUT NOTHING?

Throughout his book, Professor Mitchell notes that he was writing in 2000. In April 2000, the dot.com stocks collapsed, followed by a severe crash in high tech, telecommunications, and other market sectors over the following summer and autumn. Day traders disappeared. Longer term investors returned to old economy stocks, such as banks, regulated (non-Enron) electric

82. *See* Sarbanes Oxley Act of 2002, Pub. L. No. 107-204, § 108(d), 116 Stat. 745, 769 ("Study and Report on Adopting Principles-Based Accounting: The Commission shall conduct a study on the adoption by the United States Financial reporting system of a principles-based accounting system.").

and natural gas utilities, manufacturing and retail concerns, food companies, and other neglected market sectors.

From the late 1980s to the mid 1990s, and then some, the United States experienced unprecedented, and real, economic growth. Throughout history, however, share markets overreact to periods of unprecedented growth. When the economic growth slows, share markets overshoot underlying reality, creating a bubble. It was as true in the late 1990s as it was with "tulip mania" in 1635-1637 and the South Sea Bubble in 1720.[83] Eventually, the bubble bursts, with severe dislocations for investors, managers, and employees. We have not figured out yet how to have the growth but prevent the bubble.[84] At most, by law and Kensiyan economics, we can dampen it down a bit.[85]

The point? An alternative thesis could be that Professor Mitchell's book was obsolete as he finished writing it in the Spring of 2000. Yet future bubbles will occur. Eras of financial swashbuckling and casino capitalism will return from time to time. *Corporate Irresponsibility* will have relevance in the years to come but, in my view, neither the evils it describes nor the prescriptions it advocates are likely to become permanent fixtures on our governance and financial landscapes.

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83. *See* Peter M. Garber, *Tulipmania*, 97 J. POL. ECON. 535 (1989) (stating that some individual bulbs sold for as much as the price of a house). The South Sea Bubble is described in, *inter alia*, Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 19 (2002). *See generally* PETER M. GARBER, FAMOUS FIRST BUBBLES: THE FUNDAMENTALS OF EARLY MANIAS (2000).

84. *But see* Advertisement, Morgan Stanley, *Blowing Bubbles in a Post-Bubble Economy*, NEW YORKER, May 12, 2003, at 43.

85. *See generally* Theresa A. Gabaldon, *John Law, With A Tulip, In the South Seas: Gambling and the Regulation of Euphoric Market Transactions*, 26 J. CORP. L. 225 (2001); Larry E. Ribstein, *Bubble Laws*, 40 HOUS. L. REV. 77 (2003).