THE CHANGING FACE OF CORPORATE GOVERNANCE REGULATION IN THE UNITED STATES: THE EVOLVING ROLES OF THE FEDERAL AND STATE GOVERNMENTS

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Since the 1930s, the United States federal government and the individual states have shared the responsibility for regulating the governance of public corporations.[1] In general, the states have regulated the substance of corporate governance, while the federal government has focused on regulating the communications of public corporations with investors and securities markets. This Article explores three topics related to this shared responsibility for corporate governance regulation: first, it discusses, in greater detail, the basic division of authority to regulate corporate governance between the United States federal government, on the one hand, and the individual states, on the other; second, it explores how this division of authority has evolved since the 1930s; and third, it offers some thoughts on the future of this shared regulatory responsibility, concluding that there is little to fear, and much to gain, from retaining the current system of shared regulatory responsibility.

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I. THE BASIC DIVISION OF REGULATORY AUTHORITY UNDER CURRENT U.S. LAW

A. The Role of the States

The use of corporations in the United States greatly expanded

incorporation laws.[2] Because corporations were creatures of state law, the states, not the federal government, regulated their internal affairs. Although states continue to play the primary role in regulating corporate governance today, this role is no longer exclusive. The summary of state corporate governance regulation that follows explores four basic features of state corporate law: first, the ability of businesses to choose where, within the United States, they would like to incorporate; second, the basic allocation under state law of authority between managers and shareholders; third, the devices that state law provides to constrain corporate managers from misusing their authority; and fourth, the on-going debate over the effectiveness of these devices.

1. Choice of State of Incorporation

In the United States almost all corporations are created by the individual U.S. states, not by the federal government.[3] As a result, organizers of corporations in the United States can obtain corporate

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this internal affairs rule applies *regardless of the location within the* .[5]

special provisions that promote the stability of Dela
law by requiring a special super-majority in both houses of the
rporation Law.[15]
But these three explanations, by themselves, do not seem sufficient to
orate charters because
other states could easily replicate these features and, at least in theory,
rporation business. Yet
while some states have tried this strategy, Delaware remains preeminent.[16] This suggests that other factors must at least contribute

something unique to Delaware that is not susceptible to easy copying.

which make it particularly dependent on the revenue it earns from its incorporation business.[17] This unique dependence on corporate fees

Delaware can be uniquely trusted not to alter its corporate laws in ways that public corporations dislike, because any detrimental change

jurisdiction, thereby depriving the state of a vital source of revenue.[18] Indeed, another U.S. state New Jersey, which was the first U.S. state to adopt a modern general incorporation law in the latter portion of the nineteenth century[19] and the early leader in U.S. incorporations
saw its advantage disappear when, in the early twentieth century, a tough New Jersey antitrust law led corporations to flee the jurisdiction

entice corporations to organize within their jurisdictions have, for the most part, failed to make inroads into De inant position.

2. Allocation of Authority Between Management and Shareholder; Rules Favoring Management over Shareholders

One of the primary functions of corporate governance regulation is the allocation of decision-making authority among the various corporate constituencies, particularly management, on the one hand, and shareholders, on the other. Although state law governance rules can generally be altered in the corporate charter or bylaws,[21] state corporate law generally provides a default allocation of power that plainly favors management over the shareholders. These state laws

the direc [22] and that the day-to-day operations of the corporation will be carried on by officers appointed by the directors,[23] and employees selected by the officers. Shareholder powers, on the other hand, are generally limited to certain discrete matters, such as: (1) electing the directors at the ting;[24] (2) adopting or amending corporate bylaws;[25] and (3) voting to approve fundamental corporate changes, like mergers,[26] assets,[27] and dissolutions.[28] In general, state laws provide shareholders with no role in ordinary corporate business decisions and state courts look skeptically on efforts to expand shareholder authority, unless the terms of those contracts are included in the [29]

21. *See* sources cited *infra* note 30.

22. *See, e.g.*, DEL. C

As noted above, the state law governance rules for corporations generally function as default rules that can be altered in the com [30] These alterations can cover almost all aspects of corporate governance, and can include provisions increasing or decreasing the powers of the shareholders to participate in corporate governance. For instance, the number of shares that must be represented at a shareholders meeting for business to be conducted, or the number of shares that must be voted in favor of a resolution for the resolution to pass, can typically be altered through properly ap
or its bylaws.[31] In practice, limitations on shareholder powers are far more common than expansions. For example, many public corporations in the United States take steps to limit the ability of shareholders to control the timing of corporate action by restricting the power of shareholders to call meetings and by eliminating the power of shareholders to act by written consent without a meeting. Further, even in the case of shareholder meetings convened by the directors, public corporations frequently require shareholders to give advance notice of any business they plan to bring before the meeting,

30. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2009) (providing for management of the *except as may be otherwise provided . . . in its certificate of incorporation* *id.* § 228(a) (providing that any action that can be taken by shareholders at a meeting can also be taken by written consent without a meeting, *certificate of incorporation* asis added)). However, some provisions of corporation law are mandatory and may not be altered, at least without unanimous consent of the shareholders. A prominent example is the ting under DEL. CODE ANN. tit. 8, § 211. *See, e.g.*,

annual meeting of shareholders could not be satisfied by shareholder action by written consent under § 228 unless the shareholder consent was unanimous).

31. *See, e.g.*, DEL. CODE ANN. tit. 8, § 216 (2009):

> Subject to this chapter in respect of the vote that shall be required for a specified action, *the certificate of incorporation or bylaws* of any corporation authorized to issue stock may specify the number of shares and/or the amount of other securities having voting power the holders of which shall be present or represented by proxy at any meeting in order to constitute a quorum for, and the votes that shall be necessary for, the transaction of any business, but in no event shall a quorum consist of less than one-third of the shares entitled to vote at the meeting, except that, where a separate vote by a class or series or classes or series is required, a ing to ay 0

thereby ensuring that management will be well prepared to respond to any resolutions shareholders may make.[32]

But while alterations designed to limit shareholder powers are *a. Right to Vote*

The right of shareholders to meet at least once every year to elect and remove directors is undoubtedly the most important shareholder right.[36] Because of its importance, courts generally treat the -

waivable.[37] Come what may, shareholders of United States corporations, particularly in Delaware, get at least one opportunity per year to meet and exercise their right to replace old directors with new ones. And if the directors fail to convene such an annual meeting within the statutory period, the courts will summarily order the meeting to be held upon the request of any shareholder.[38] As a result, directors who fail to act in the best interests of the shareholders face

rather than with management; in general, shareholders like most people prefer the devil they know to the one they do not.[47] Third, most ordinary shareholders will be largely apathetic about shareholder voting, since the financial consequences of any vote for any individual shareholder will generally be small.[48] As a result, the typical shareholder will ignore communications from his fellow shareholders and adopt the simple strategy of either voting as management recommends or not at all, except in the most extreme instances. Finally, as discussed above,[49] many corporate charters include limitations that make it difficult for shareholders to convene meetings, or to otherwise act without management consent, and provide management with advance notice of potential shareholder action, leaving management with ample time to plan and react. Consequently, shareholder voting may, in fact, function as a check on managerial misconduct, but only in the most extreme instances.

There are, of course, responses to this critique of shareholder voting. One common response focuses on the fact that, in many firms, particularly larger ones, institutional investors like insurance companies, pension funds, mutual funds, and hedge funds own a large percentage of the stock (often greater than 50%). This means that attracting an influential block of shares to a dissident share

least two reasons: first, institutional shareholders own larger blocks of stock and therefore do not face the same credibility problems that affect shareholders with lesser stakes; and second, institutional shareholders have greater resources to devote to shareholder communications and, in any case, may need to communicate only with a relatively small number of other institutional investors to secure the support of a majority (or at least a substantial portion) of [50] Disney Corporation provides a particularly noteworthy example of successful shareholder activism. In 2004, dissident Disney shareholders, led by former Disney directors Roy Disney and Stanley Gold, were able to convince shareholders owning

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of Michael Eisner as Chairman of the Disney board, leading to

Disney CEO.[51] However, it certainly remains true that outright victories by dissident shareholders and even indirect victories, as in Disney, are extremely rare.

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of managerial business decisions, except in extraordinary cases.[63] To overcome the protections of the business judgment rule (and thereby enable courts to assess the fairness of the challenged transaction or decision), plaintiffs must generally establish (1) that the challenged decision-maker (typically the board of directors or a committee of the board) lacked a disinterested majority,[64] (2) that the board was grossly negligent in informing itself before making its decision,[65] or (3) that *no* reasonable person could have concluded that the challenged transaction or decision was consistent with the best interests of the corporation and the shareholders.[66] As a result of these substantial protections of the business judgment rule, even in the relatively few cases involving disinterested business decisions (i.e., cases where a board has a disinterested majority) where demand has been excused, few shareholders are able to carry their burden at trial of showing a lack of business judgment protection for the challenged transaction or decision by a preponderance of the evidence.[67]

63. *See generally* HENN

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Again, an example from the Disney Corporation illustrates the point. In 1996, Disney dismissed its president, Michael Ovitz, after only thirteen months on the job. Disney paid Michael Ovitz a severance package alleged to be worth approximately $140 million for those thirteen months of service. Yet even with this extraordinary amount of severance pay, shareholders who commenced a derivative a very difficult time even obtain their duty to the corporation by, among other things, approving -fault termination. When the Delaware Chancery Court first heard the case in 1998 (well before the Enron/WorldCom debacle), it concluded that the complaint

ap judgment rule, because, among other things, the court could not conclude that no reasonable person would have agreed to a contract with such a high level of severance pay.[68] While the plaintiffs ultimately obtained a trial on the merits of their claim after the Delaware Supreme Court gave the plaintiffs a chance to replead their case with additional facts[69] and (following the Enron/WorldCom debacle) the Chancery Court agreed that the particularized facts alleged were sufficient to excuse demand,[70] in the end the trial judge ruled against the plaintiffs on all counts, finding, among other things,

terminate him without cause were protected by the business judgment rule.[71] decision, the Delaware Supreme Court concluded that the extraordinary amounts required to be paid to Ovitz under his employment contract did not constitute

committee and board in approving that contract, while far from perfect, were not legally defective.[72] Accordingly, like shareholder

bad faith; to establish bad faith, plaintiffs must show that directors were aware of their duty and intentionally violated it).

68. *In re* Walt Disney Co. Derivative Litig., 731 A.2d 342 (Del.Ch. 1998), , Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

69. Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

70. *In re* The Walt Disney Co. Derivative Litig., 825 A.2d 275 (Del. 2003).

71. *In re* The Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005), , 906 A.2d 27 (Del. 2006).

72. *In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27, 55 62, 73 75 (Del. 2006).

voting, the derivative suit may function as a check on managerial misconduct, but only in the most extreme cases.

Of course, some argue that the derivative suit, and potential managerial liability, must be limited to prevent shareholders (particularly those with limited financial stakes in the firm) and their attorneys from using the derivative suit in cases where the costs to the corporation might exceed the benefits.[73] The costs to the corporation of derivative litigation include such things as the distraction of management while the litigation is pending, as well as the costs and ex

somewhat less frequently than in the past.[81] In many of those successful takeovers, incumbent managers voluntarily dismantle the defenses when market and shareholder pressures to yield to the bid become too great.[82] Second, it may be necessary to limit the threat of hostile takeovers by making them a bit more difficult because managers and other employees who fear they might be easily removed from these statutes, as well as the limited role as a corporate governance regulator originally created for the SEC.

1. The Securities Act of 1933

One of the first statutory responses to the 1929 Stock Market Crash, the Securities Act of 1933 (the 1933 Act) had both a limited focus and a limited impact on corporate governance. Without going into detail, the Securities Act of 1933 was designed primarily to prevent the recurrence of the speculative frenzy in stock purchases that had marked the 1920s.[87]The idea underlying the Securities Act of 1933 was not to change the state law rules that governed the management of corporations, but instead to ensure that the investors who purchased securities did so only after receiving full information

fi urities.[88] Consequently, instead of tinkering with the internal governance of corporations, or limiting the types of securities that could be offered or sold to the public, the 1933 Act focused its attention single-mindedly on disclosure. Under the 1933 Act, corporations would be permitted to continue to issue securities to the public whenever they wished, and on terms of their own choosing, but only if they provided full and fair disclosure to prospective investors before the investment decision was made. Toward that end, the 1933 Act (as originally adopted)[89] did three things: first, it required issuers of securities to prepare and file with federal securities regulators (originally the Federal Trade Commission, but later the SEC) a detailed registration statement with extensive disclosures about the company, its business, its management, its properties and its financial affairs;[90] second, it mandated that the prospectus prepared as part of that registration statement be distributed to all investors who received written offers of sale or to whom securities were sold;[91] and third, it limited the use of

87. *See* THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 1.2[3](6th ed. 2009).

88. *See* Milton H. Cohen, , 79 Harv. L. Rev. 1340 (1960).

89. The original text of the 1933 Act can be found in H.R. REP. NO. 152 (1933) (Conf. Rep.) [hereinafter 1933 ACT CONFERENCE REPORT].

90. *See* Securities Act of 1933, § 5(a)(1), *reprinted in* 1933 ACT CONFERENCE REPORT, *supra* note 89, at 5.

91. *See* Securities Act of 1933, § 5(b), *reprinted in* 1933 ACT CONFERENCE REPORT, *supra* note .

non-statutory sales materials until the statutory prospectus had been provided.[92] In addition, to ensure the accuracy of the registration statement and statutory prospectus, the law subjected all those connected with the offering the company itself, its directors and principal officers, and the underwriters, securities dealers, and accountants associated with the offering to legal liability if information in the registration statement and prospectus proved to be materially inaccurate or incomplete.[93] The purpose of this regime was to ensure that all investors who were offered securities made their investment decision based on sober, complete information prepared in compliance with the federal securities laws, rather than on the basis of unsupported (and possibly unsupportable) hype of unaccountable corporate promoters.

The statute and related rules are, of course, far more complicated than this, but the key point for present purposes is that the Securities Act of 1933 did not give the federal authorities any substantial power to set standards of corporate governance; that power remained, as it

response to the 1929 Stock Market Crash and the Great Depression, at least in the Securities Act of 1933, was not to directly change the way corporations were governed, but to ensure that all relevant facts about the corporation, including information necessary to rahe ETsBT1 0 ernanc(rna)-3(nc(rna)-3(nc(rna)-3 underwriters and accountants to, in effect, certify the information in the registration statement through the liability provisions in section 11,[95] dishonest or less competent managers faced higher hurdles in hiring the professionals necessary to assist in a public offering than they had in the past.

The regulatory scheme established by the Securities Act of 1933 has undergone considerable change since it was first adopted. Some of these changes have resulted from statutory amendments,[96] but the most dramatic changes have been effected through SEC rulemaking.[97] However, much of the original statutory scheme for public offerings established in 1933 remains in place today, particularly for companies that are conducting their first public offerings and for companies that have been public for a relatively short time or have relatively few shares in public hands.[98]

naming them wherever such remuneration exceeded $2

2. The Securities Exchange Act of 1934

The first major response of the federal government to the 1929 Stock Market Crash, the Securities Act of 1933 did not stand alone for long. Indeed, its adoption was followed, one year later, by far more extensive regulation of securities transactions under the Securities Exchange Act of 1934 (the 1934 Act).[99] Unlike the Securities Act of 1933, which dealt almost exclusively with initial distributions of securities to the public, the Securities Exchange Act of 1934 focused on secondary trading in public securities markets. But while the focus of the two statutes was different, the two statutes had similar goals and took similar, though not identical, steps toward achieving those goals. To ensure that investors in public markets could have confidence in the markets themselves, and in the prices generated by those markets, the 1934 Act likeTm[(a)ithe

ownership stakes, their geographic dispersal, and their limited access to information about the corporation and the performance of management. As a result, Berle and Means concluded that the American corporation of the 1930s was marked by a separation of *ownership* by shareholders from *control* by managers that could result in corpora

managers, rather than in the interest of the owners. In Berle and

-run firms could be trusted to act in the public interest because, at least in the ideal world, the owners would be

nvisible hand to use the vast resources held in the corporate form to so

-controlled firms operated with no such constraint, leading to the danger that managers with control over vast corporate assets would

personal interests. In effect, Berle and Means saw the rise of the modern public corporation, and the related separation of ownership and control, as disrupting the basic market forces that in earlier eras guided the use of private property in the public interest.

Influenced by the work of Berle and Means, the drafters of the Securities Exchange Act of 1934 took the first steps at the federal level to change the ways in which public corporations were governed, and in the process introduced the two-tiered state-federal system of corporate governance regulation that the United States still has today. These first federal steps into corporate governance regulation were limited largely to a single subsection in the 1934 Act, designed primarily to improve shareholder voting: section 14(a) of the statute,

rules as [the SEC] may prescribe . . . , *to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security registered [under the 1934 Act]*[111] With this single subsection, Congress granted the SEC authority to control the methods and processes by which public corporations communicated with their shareholders. This power over the proxy solicitation process by no means authorized the SEC to displace the states as the primary setters of corporate governance standards, but it did give the SEC a foot in the door.

111. *See* Securities Exchange Act of 1934, § 14(a), *reprinted in* 1934 ACT CONFERENCE REPORT, *supra* note 99, at 15 (emphasis added).

The SEC made quick use of its new power, adopting its first proxy rules in 1935.[112] These initial proxy rules, like many subsequent modifications over the last seventy-five years, attempted to address the Berle and Means critique by increasing the likelihood that shareholders would vote their shares in an intelligent and informed fashion, rather than simply granting management general discretionary authority to vote shares as management saw fit on

1935 rules took just a small step towards this goal, requiring only that shareholders be given basic information identifying the various matters that management intended to present or consider at the meeting and specifying the actions management intended to take with respect to those matters.[113] Subsequent revisions of the proxy rules, beginning with the 1938 amendments,[114] strengthened the federal proxy rules in a variety of ways that are still with us today: these amendments required: (1) that shareholders be provided with greater information about the matters to be voted on at the meeting and about the identity of the person seeking the authority to act as a proxy, including any private interest of that person in the subject matter of the vote;[115] and (2) that shareholders be given the ability to direct, in the proxy, exactly how their shares should be voted.[116] The idea

112. SEC Release No. 34-378, 1935 WL 29270 (Sept. 24, 1935).
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underlying this scheme was to make corporate managers more UHeHV ° 0 RL`R H @£G0 ô€ À`R `(&`RFWG 0 G`R KHv ,6(&a shareholders, to address the separation of ownership from control that Berle and Means had identified. Accordingly, even though the 1934 Act did not confer on the SEC the power to directly alter state law governance rules, the SEC was nonetheless able to use its power to prescribe proxy rules that at least nudge the balance of corporate power in the sh

As with the 1933 Act, this basic regulatory scheme established by the 1934 Act largely remains in place today, albeit with some significant modifications, including a vast expansion in 1964 in the rules.[117] As a result of these changes, there are now approximately 15,000 U.S. corporations that are subject to the dual structure of governance regulation described above, with state law particularly that of Delaware providing the basic rules of corporate governance, and federal law largely controlling corporate disclosure and the proxy solicitation process.

Like the Securities Act of 1933, the periodic reporting and proxy rules under the Securities Exchange Act of 1934 primarily focus on regulating the disclosures required of public corporations. But, as in the case of public offering regulation under the 1933 Act,[118] these disclosure regulations can (and do) have the indirect effect of regulating corporate governance practices. As already discussed,[119] the

technically regulating only the content of proxy statex16x(a)-3(t)cussed,7( )] TJ1-7ábovriblre n are regulations where the SEC requires disclosure of certain categories of information, not so much because that in steps have been modest. More ambitious proposals those that would cause a fundamental shift of corporate governance regulation from the states to the federal government have been uniformly rejected. The subsections below address three topics related to the evolving roles of the state and federal governments in regulating corporate governance. These subsections discuss, first, the classic critique of state regulation of corporate governance standards; second, some of the steps that have been taken at the federal level to more greatly control the substance of corporate law; and third, some of the more dramatic steps that have been proposed but not taken at various times over the last century.

A. The Classic Critique

The classic critique of permitting the states, particularly Delaware, to act as the primary setters of corporate governance disclosure,[125] not because the federal courts were necessarily better than state courts, but because federal courts did not need to compete for business as the states did. Professor Cary used his critique as a basis to call for uniform federal standards of corporate responsibility that would apply to all public corporations, regardless of their state of incorporation.[126]

and hotly debated, particularly from the law and economics perspective. For instance, in the leading response to Professor Cary, Judge Winter argued that the same types of market forces that generally lead corporate managers to act consistently with shareholder interests, e.g., fear of ouster as a result of proxy contests or hostile takeovers and managerial concern with stock price, also discipline corporate man [127] For example, incorporation under a state law that offers terms that are unfavorable to shareholders, for instance by permitting managerial theft, will depress the stock price of firms incorporated in the state, triggering pressure by the market for corporate control for managers to change the state of incorporation. Thus, Winter argued that competition among the states for corporate charters would lead to a

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states that want to attract managers to organize corporations within their borders will compete by offering corporate laws that are *favorable* (not *contrar*y) to shareholder interests. In addition, others have argued that state chartering offers the additional benefit of a diversity of laws that permits shareholders and managers to choose the set of rules best suited for their particular circumstances.[129]

least some adherents among legislators and regulators, particularly in Congress and at the SEC, if not in the states.

125. *Id.* at 692 96.

126. *Id.* at 701.

127. Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

128. *Id.* at 254.

129. *See, e.g.*, Daniel R. Fischel, *ctions on* , 76 NW. U. L. REV. 913, 921 923 (1982).

B. SEC/Congressional Forays into Corporate Governance

Responding to critiques like those of Professor Cary, the SEC and Congress have taken steps over the years at the federal level that encourage or mandate changes in corporate governance practices of public corporations. But these steps, while certainly significant, tend to be more modest reforms, rather than wholesale displacements of odest

SEC is authorized to set disclosure standards for public corporations and to adopt proxy rules, but not to prescribe corporate governance standards more generally.[130] Congress, of course, can do as it pleases, but like the SEC, it too has taken more modest steps in the corporate governance arena, even in response to dramatic crises like the accounting scandals of the first years of this decade and the more recent financial crisis.[131] Several examples of the increased federal role in corporate governance since 1933 follow.

a. Disclosure Regarding the Honesty and Integrity of Management

The original text of both the 1933 Act and the 1934 Act authorized the SEC to require the disclosure of information with respect to officers and directors.[132] The SEC has long used this power to require detailed disclosures regarding the integrity of management in both registration statements filed under the 1933 and 1934 Acts and in periodic reports and proxy statements prepared under the latter statute.[133] The required disclosures cover such matters as self-dealing

130. *See supra* Part I.B.

131. For a discussion of current corporate governance reform proposals pending in the U.S. House of Representatives and the U.S. Senate, see *infra* note 202.

132. Securities Exchange Act of 1934, § 12(b)(1)(D), *reprinted in* 1934 ACT CONFERENCE REPORT, *supra* note 99, at 13 (authorizing the SEC to require dis
respect of *reprinted in* 1933 ACT CONFERENCE REPORT, *supra* note 89, at 16 17 (authorizing the SEC to require disclosure ddresses of the directors or persons performing similar functions, and the

provided in Schedule A, Section 10(b)(3) of the Securities Act of 1933 authorizes the SEC to re ormation as the Commission may by rules or regulations require as being necessary or ap *See* 1933 ACT CONFERENCE REPORT, *supra* note 89, at 9.

133.
Regulation S-K, which is codified at 17 C.F.R. §§ 229.10 229.802 (2009) [hereinafter Regulation S-K].

transactions,[134] indebtedness of management to the corporation,[135] the remuneration of directors and the five most highly compensated officers (now in far greed

proposal for shareholder action included in the proxy materials prepared by the corporation in connec
annual meeting.[141] The qualifying shareholder also is permitted to

proxy card must provide a space where shareholders can indicate

proposal.[142] Absent something like the shareholder proposal rule, it would be practically impossible for an ordinary shareholder to present a resolution to his fellow shareholders because of the cost and expense of preparing and circulating his own proxy materials to thousands and thousands of shareholders scattered across the nation and now the world. Although the shareholder proposal rule substantively alters the balance of power between management and shareholders, the SEC originally justified the rule on disclosure not corporate governance
practice of circulating proxy materials which failed to make reference to the fact that a shareholder intended to present a proposal at the annual meeting rendered the solicitation inher [143]
Consequently, with the shareholder proposal rule as well as with other rules discussed in this section, the SEC used a disclosure-oriented rule to effectively alter the substantive balance of power within the corporation.[144]

Designed to prevent the types of conduct prohibited by section 30A, the amendments to section 13(b) require public compa
and keep books, records and accounts, in reasonable detail, which

e and maintain a system of internal accounting controls

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e. Going Private Regulation

Another example of an SEC effort to influence corporate governance relates to so- [153] With relatively low stock prices in the mid-1970s, it became popular for the management of public corporations in the United States to take those corporations private for the company itself, or its affiliates, to purchase stock from the public shareholders in a transaction or series of transactions that would generally result in the complete or near complete elimination of public ownership, with the result that the

provide other information to the SEC under the federal securities laws would be terminated.[154] The SEC became concerned about these transactions, not only because those few public shareholders who might remain after a going private transaction would no longer have access to a liquid securities market or information filed under the federal s
were often marked by a lack of arms-length bargaining with public

be a mere formality because affiliates of the issuer already held the requisite percentage for approval) that presented management with a conflict of interest that could call into question the fairness of the terms offered to the public shareholders.[155] Although commentators called on the SEC to require that going private transactions satisfy a

152. *Id.*

153.
C.F.R. § 240.13e-3 (2009).

154.
private rules, see Going Private, SEC Release No. 34-14185, 42 Fed. Reg. 60,090, at *3 *4 (Nov. 23, 1977).

155. *Id.* at *13.

federal fairness standard, the SEC ultimately declined to directly regulate the substance of going private transactions, and instead limited itself to its more traditional disclosure-focused role.[156] Therefore, in 1979 the SEC adopted its going-private rule requiring

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minimize conflicts of interest for securities analysts.[166] This subsection, however, focuses on a different aspect of Sarbanes-Oxley: those provisions that relate to the obligations of public companies under the Securities Exchange Act of 1934, especially those that go

corporate governance regulation.

1. Audit Committees

financial information, 4) the responsibility of the signing officer for establishing and maintaining internal disclosure controls and the evaluation of those controls, 5) the disclosure by the signing officers

deficiencies in t nternal controls, as well as any fraud involving management or significant employees, and 6) the disclosure in the report of significant changes in internal controls or other factors that could significantly affect these controls in the future, including any corrective action to address significant deficiencies or weaknesses.[170] In addition, section 906 of Sarbanes-Oxley requires the CEO and CFO to certify, with respect to each periodic report communi ny of the

materially misleading.[174]

4. Prohibition of Personal Loans

Section 402 of Sarbanes-Oxley makes it unlawful for any issuer to provide or arrange for any extension of credit to or for any director or executive officer, except for certain loans provided in the ordinary nsumer credit business.[175] This provision is notable not so much for its practical importance as for its direct conflict with state corporation law. For example, the Delaware

may lend money to, or guarantee any obligation of, or otherwise assist any officer or other employee of the corporation or of its subsidiary, . . . whenever, in the judgment of the directors, such loan, guaranty or assistance may reasonably be ex [176]

Section 402 plainly preempts this provision of Delaware law, at least

175(d)(i)-9-13(y)230(t)-23 Tm(t)-2(iurohi)-2(bi)77ie9(or(a)-3(rr)10(a)-3(ng)1A)(S)4(e)-3(c)(i)-2(o 1934)-3(w)3(.)] TJETBT182.271

controls that occurred during the most recent fiscal quarter.[180] Like the CEO and CFO certifications discussed above,[181] the requirement of an internal control report represents much more than a mere disclo rnal operations by requiring management to tak(qui)-2(ri)-3(n)-312(r)10(9d106003>727.846003>728

all of these proposals, in each instance the U.S. Congress failed to act, leaving the states in general, and Delaware in particular, free to set corporate governance standards in the United States. [190]

efforts in Congress, this effort also failed when, in 1977, the U.S. Su tion with Rule 10b-5 extended only to outlawing conduct that involved some form of deception or manipulation.[194] Accordingly, conduct that corporate managers engaged in openly, even if plainly contrary to shareholder interests such as causing the corporation to engage in a securities transaction with its own shareholders on unfair terms or without a valid business purpose could not constitute a 10b-5 violation. The Supreme Court thereby made absolutely clear its belief that existing

[198] However, the federal court ultimately

proxy *process*, not to regulating the *substantive* voting rights of shareholders.[199] to extend its own powers to the substance of corporate law suffered the same fate as prior Congressional and judicial efforts to set federal standards of conduct for publicly traded corporations, leaving in place the traditional division of state and federal authority, with Delaware as the *de facto* national standard setter.

It is worth noting, however, that while the SEC may have lost the battle with Rule 19c-4, it ultimately won the war when it convinced the New York Stock Exchange, the Nasdaq, and the American Stock

had proposed.[200] This is a technique that the SEC has used effectively in more recent times to encourage the principal exchanges to adopt independence requirements for boards of directors and for nominating and compensation committees that supplement the independence standards for audit committees established by Sarbanes-Oxley.[201]

198. *See* Business Roundtable v. SEC, 905 F.2d 406, 410 (D.C. Cir. 1990).

199. *Id.* at 410 13.

200. *See* Floyd Norris, *New Amex Rule on Super Classes*, N.Y. TIMES, April 12, 1991, at D8 (noting th

III. THE FUTURE OF THE

makes clear that corporations can, in effect, opt out of the shareholder nomination process by eliminating the power of shareholders to nominate direc

shareholder nominees cannot comprise more than 25% of the board of directors. In the current atmosphere, with a new President, a new SEC Chair, and a new democratic majority on the SEC, one might have expected this revised proposal to be approved with ease. But approval still has not been obtained.

Business groups in the United States, as well as many leading

statutory authority by encroaching on the substantive governance area traditionally left to the states. At least in part due to this opposition, the SEC cancelled a meeting to consider the rule that had been scheduled for November 9, 2009, and delayed final consideration of the proposal until 2010.[211]

The bitter and continued opposition to this one SEC proposal suggests that the likelihood for more dramatic expansions of federal authority over corporate governance remains small.

IV. CONCLUSION

Should we lament the failure of the federal government to play a greater role in corporate governance regulation in the United States? In my 1 0 0 1 7273(w),(n)-10 1 7273(w),fh4.49 Tmiwtantiv(nd)-187(c)liwde3(l)-2(i)-2(ke)7(l)-2TJ nterest in avoiding the complete federalization of corporate law, there is little to fear, and much to gain, from leaving corporate governance standards where they have long resided: in the states.