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***Restoring Trust in American Business* edited by Jay W. Lorsch, Leslie Berlowitz, and Andy Zelleke, The MIT Press: Cambridge, Massachusetts, 2005, ISBN: 0-262-24048-3, pp. 185.**

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This is a careful scholarly study of the causes and consequences of corporate misfeasance and malfeasance with thought-provoking articles by some of this nation's leading scholars and corporate leaders. This volume is a who's who of experts in corporate law, corporate ethics, and corporate responsibility. Contributors also include well-known Chief Executive Offices, General Counsel and

business leaders. Public confidence in corporate morality and governance is marked by a legitimacy crisis after the catastrophic failures of ENRON, WorldCom, Adelphia Communications, Global Crossing and many other recent failures of governance. Each edition of *The Wall Street Journal* confirms that corporations are violating their social responsibility and serious structural reform is urgently required. This is not only a scholarly study of corporate governance but an attempt to prescribe solutions.

The purpose of this volume is to develop a blueprint for restoring trust in American business and financial institutions, which is a currency that has been devalued by corporate crime. The Academy of Arts and Sciences is one of the oldest and most prestigious independent research centers. The goal of this volume is not just to describe social problems created by corporate crime and abuses of fiduciary duty. The purpose of this volume is to promote greater responsibility. The contributors are from diverse fields: law, journalism, government, investment banking, corporate governance, management and a variety of other scholarly disciplines.

The overwhelming conclusion of this book is that the gatekeepers have failed us. Each of the chapters confirms how given “gatekeepers” have opened the floodgates of corporate profligacy. None of these intermediate institutions—corporate directors, auditors, regulators, lawyers, investment bankers, and business journalists — have stood up to the plate to protect the public interest.

Professor Mark Roe’s introductory essay sets the stage for this important study. He begins with the simple observation that these recent corporate legitimization crises seem new and different. Recent business scandals reveal a disturbing breakdown of values in corporate America. Professor Roe is one of this country’s most distinguished law professors in the field of corporate law. He contends that corporate governance is a problem largely because the business firm is not managed by owners. “Separation is the foundational instability of American corporate governance.” (p.9) Roe contends that the separation of ownership and management is the key to instability and illuminates our current crises. This simple concept sheds light in explaining why governance is fragmented, porous and ultimately ineffective. Roe notes that the endemic feature of separation of management and ownership has advantages as well as costs.

The benefit to this decentralization is that it prevents the possibility of a rigid regulatory monolith (p.10). This insight was first formulated by Berle and Mean’s *The Modern Corporation and Private Property* (1933). Roe notes how the separation of ownership and management permits firms to combine talent with capital. Flexibility is enhanced by permitting founders of companies to forge an

exit strategy. Separation “also allows investors to diversify, facilitating more efficient savings over time. And it facilitates product market competition, by easing the financing needs of start-ups and new entrants.” (p.12). He notes how the corporate governance crisis of the 1950s resulting from conferring too much power on managers. The 1960s crisis was the corporation’s tendency to expand sales without regard to profits. (p.13).

In the 1970s, the corporate crisis of the day was the hostile takeover. The excesses of the 1970’s and 1980’s led many academics to favor reforms to reduce the cost of separation. Ivan Boesky, Michael Milliken and other empire builders did not pay attention to the public interest or even the interests of shareholders in building their corporate castles of sand.

After reviewing each decade’s crisis, Roe concludes that the porosity of American regulation stems from the decentralized structure of corporate governance. In the final analysis, the SEC focuses on disclosure and trading in the securities market. Simple disclosure does have an impact both inside and outside the corporation. (p.21). However, Roe notes that there is no centralized “czar” to regulate corporations.

Congress, too, is part of the problem. While it sometimes acts to reform securities or other federal laws, its efforts are sporadic and fragmented. Roe next provides an interesting case study of the American Law Institute’s corporate governance project. Apparently, the esteemed corporate counsel, managers’ representatives and other big player ALI members did not check their economic interests at the door. The ALI drafters were soundly defeated by corporate interests. The ALI, too, failed as a gatekeeper when it “adopted a vague rule that permitted directors and state courts to do what they had previously been doing.” (p. 25).

Professor Roe’s article supports the capture theory of regulation. Loose corporate regulations are correlated with the fact that manager’s representative’s drafted the rules and quasi-rules (p. 26). His chapter is capped off with an analysis of today’s crisis. He explains how gatekeepers such as the accountants lobbied Congress for looser oversight. The message of the chapter is that the ability of the regulated to shape the regulators undermines any oversight by government or gatekeepers.

It is not surprising that when you cut regulations, undermine regulatory initiatives, and cut funding that the Enron’s become pigs at the corporate trough. Each of the other contributors suggests legal reforms for strengthening corporate governance. Lipton and Lorsch’s piece calls for a greater professionalization of the corporate director role. This theme is also echoed in the essays of Margaret Blair

and Michael Klausner. John Reed, Chair of the New York Stock Exchange also views Enron, WorldCom, Arthur Andersen, the Wall Street “settlement” and other recent events as evidence of a breakdown in values.

The unbridled greed witnessed in recent years makes the Gilded Age look like a Sunday School Picnic. As Mark Roe reminds us, these recent crises making headlines “won’t be the last time that corporate governance breaks and cracks in a key way.” (p.33) Free market law and economics scholars such as Richard Epstein believe that consumers flourish in an economy when there is lots of caveat for the poor and caviar for the rich. Professor Richard Epstein and other neo-conservative law professors and economists oppose thick government regulation. The anti-regulatory impulse dominating discourse at the federal level is spearheaded by ultra-conservative organizations such as the American Enterprise Institute, the Hudson Institute, and the Manhattan Institute. These anti-regulatory corporate think tanks have created backlash against government regulations. Neocons contend that the many faces of corporate fraud are self-correcting and that it is paternalistic to institute mandatory terms.

Many of the contributors in this volume would respectfully disagree. The contributors to this book closely examine the role of six “gatekeepers” for corporate conduct: auditors; lawyers, investment bankers, corporate directors; regulators, and business journalists. The overwhelming conclusion is that these gatekeepers have not sufficiently constrained corporate malfeasance and greed in recent years.

This volume is capped off by a Report of the American Academy’s Corporate Responsibility Steering Committee. The report notes that we need to rebuild professionalism for the twenty-first century. The Academy is unanimous in its conclusion that the free market approach is not working. The gatekeepers have failed us. The specific recommendations for directors includes the formulation of an oversight role, greater corporate ethics, revived professional standards, independent leadership, restructured executive compensation, shareholder input in director nominations, and auditor oversight. The Committee praised the role of the assignment of auditor oversights implemented in Sarbanes-Oxley. The Academy endorses financial disclosures going well beyond GAAP rules. (p. 168). Reforms for institutional shareholders including greater governance responsibilities, and firmed up governance standards. The Academy has also called for extensive reforms for each of the six gatekeepers. My only complaint about this book is that it lacks an index. It is a must acquisition for all academic law libraries. I would require all corporate gatekeepers to keep this volume as a desk reference.