# Public Governance

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ABSTRACT

*This Article develops a theory of public governance as a form of publicness by exploring corporate governance and decision making, and developing them with a more textured understanding of the nature of corporations and their role. It does so through the lens of two recently enacted federal statues, Sarbanes-Oxley and Dodd-Frank, and by deconstructing the "private" zone and reconceiving it with an understanding of publicness.*

*Corporate actors who govern without this deeper understanding of their roles and relationships lose their self-regulation privileges. The most recent increase in the federalization of corporate governance occurred when corporate actors failed to exercise their choices with an understanding of the nature of publicness. They took private ordering for granted. They treated it as a right rather than a privilege. They failed to grasp the actual and potential roles of the media, stakeholders, politicians, and others who wanted changes in the distribution of corporate power and who could succeed after scandals. Publicness, both as a process and an outcome, grows when corporate actors are greedy, when they cheat, and when they fail. The resulting crises and scandals become the vehicle for publicness.*

*Simply put, corporate failures expose "private" choices. Actors outside of the corporation and Wall Street scrutinize the failures. Think Occupy Wall Street and bloggers more generally. The scrutiny and concomitant increase in publicness make transparent the privileged nature of the corporate private zone. They reveal the lawmakers' choices about private ordering and self-regulation. They highlight the spaces not yet legally defined: those that were omitted. They create pressure for more reform and public governance. The result is more publicness.*

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## Introduction

The nature of governance in corporations is shifting. The term "corporate governance" is generally used to refer to the balance of duties and decisionmaking between shareholders, officers, and directors. Divvying up the powers and rights of these parties has traditionally been the prerogative of state lawmakers, who have largely let the actors self-regulate. This deference to private ordering effectively placed many governance decisions outside the zone of direct regulation. Many corporate actors failed to self-regulate, however, and in some cases, they engaged in misconduct. These actors failed to consider how their actions affected the economy and society in general.[1] In response to their failures, the media, bloggers, and the general public called for direct regulation, and Congress obliged: it passed the Sarbanes-Oxley Act of 2002[2] and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[3] As a result, the parties relevant to corporate governance have grown, and the traditional understanding of governance has shifted. The outcome has been a movement from private ordering to more public decisionmaking. Corporate governance is becoming public governance.

I have described this theory as "publicness" elsewhere,[4] and use it here to explore publicness and its growth in the context of state and federal corporate governance. Publicness is both a process and an outcome. When corporate actors lose sight of the fact that the companies they run and decisions they make impact society more generally, and not just shareholders, they are subjected to publicness. Outside actors like the media, bloggers, and Congress demand reform and become involved in the debate. Decisions about governance move from Wall Street to Main Street.[5] The process for deciding who should earn what, for example, becomes a subject of public debate and scrutiny.

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1 *See generally* Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 Geo. L.J. 337 (2013) (positing that when the incentive structures in corporations generate risks that impact the public, they also generate public responses like legislation).

2 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

3 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

4 *See* Hillary A. Sale, *The New "Public" Corporation*, 74 Law & Contemp. Probs. 137, 141 (2011).

5 *See id.* at 139–40.

The result is also publicness. The range of outcomes publicness produces is quite broad. It may result in a change as to which decisionmakers (the board instead of officers, for example) get to decide about certain expenditures. When corporate decisions impact society in a fashion as dramatic as the financial crisis, however, publicness involves a wider range of actors and outcomes.[6] In the corporate realm, the outcome has been legislation replacing common law, rules replacing standards, and public governance replacing private ordering. This Article focuses on that aspect of publicness—the imposition of explicit, substantive federal corporate law upon the traditional private ordering model favored by state corporate regulators and judges.

In particular, this Article analyzes the Sarbanes-Oxley Act and the Dodd-Frank Act to further develop the theory of corporate publicness.[7] Even with the inevitable political erosion that occurs, Sarbanes-Oxley and Dodd-Frank both added thick layers to federal corporate law.[8] In fact, they are so robust that they moved basic corporate relationships and decisions from the state-based system of corporate governance, which privileged private ordering and gave the power to the corporate actors themselves, to a federally mandated system. The result has been the erosion of the privilege formerly given to the private ordering of corporate governance. Relationships that were internal have been externalized, and public governance has taken the place of private ordering. The Sarbanes-Oxley and Dodd-Frank Acts exemplify this aspect of the theory of publicness.[9]

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6 *See id.* at 142–48 (discussing publicness in the context of the financial crisis).

7 This Article focuses on only one aspect of publicness, the shift in the federal and state balance of power and the resulting growth of public governance. I envision publicness as being much broader, however, and have used it in a prior piece to refer to the relationship of corporations to the various actors that both run and influence them. Sale, *supra* note 4, at 139–41. The term is much more capacious than the so-called "relevant" and traditional corporate governance parties (shareholders, officers, and directors). *Id.* In fact, many groups influence the way in which corporations and corporate decisionmaking evolve, including many "outside" actors like the media and, of course, Congress. *Id.* Put differently, corporations are subject to a variety of pressures and interests; some are internal, but many are external. Those outside pressures and influences have been increasing over time, but have been neglected in scholarship.

8 *See* John C. Coffee, *The Political Economy of Dodd-Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019, 1030 (2012) (discussing how industry pushes back on enacted legislation and, thus, through regulatory, judicial, and later legislative processes, diminishes the impact).

9 The status of certain corporate decisions as private or public is not foreordained. That status is also not permanent. It is, in fact, just a construct. The old version of governance represented a policy decision to defer to the private choices of corporate actors. The new version is a different policy choice. It is more public and is a form of publicness. The boundaries are shifting. *Cf.* MARTHA MINOW, MAKING ALL THE DIFFERENCE: INCLUSION, EXCLUSION, AND AMERI-

## I. The States and Public Governance

Corporations, of course, are creatures of state government. Recall that corporations originally were created for specific purposes, through charters and with the permission of the government.[10] They were and still are defined by the state. Today they are easily formed and dissolved, in both cases by filing papers with the state's secretary of state.[11] They remain, however, entities that exist with the permission of the government. In that sense, corporations have always been public, and all corporations are subject to publicness regardless of their legal status as "publicly" or "privately" held. Many of the decisions of corporate actors, and the processes through which those decisions are made, however, have not historically been subject to public scrutiny and input. Disclosure of the inner workings of corporations has not traditionally been required because state lawmakers did not mandate it.[12]

State law has been the locus of the rules for the corporate governance power structure.[13] These state rules attempt to address the potential for opportunism on the part of those most actively involved with the entity on a daily basis. That opportunism can harm outside shareholders.[14] As the number of outside shareholders increases, so

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can Law 277–79 (1990) (discussing the line between public and private in the context of the government's role in the family law zone and how it has changed over time).

10 *See generally* Samuel Williston, *History of the Law of Business Corporations Before 1800*, 2 Harv. L. Rev. 105 (1888); *see also* Frances E. Olsen, *The Family and the Market: A Study of Ideology and Legal Reform*, 96 Harv. L. Rev. 1497, 1515–17 (1983) (noting that during the feudal period both the market and the family were also heavily state regulated).

11 Section 101 of the Delaware Corporation Code, for example, governs the formation of corporations, and directs any person who wishes to incorporate to file a certificate with the Department of State. Del. Code Ann. tit. 8, § 101(a) (2012). Section 275(d) governs dissolution. *Id.* § 275(d). In order to properly dissolve a corporation, a certificate of dissolution needs to be filed with the state. *Id.*

12 *See* Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 Va. L. Rev. 669, 691 (1984) ("In Delaware and most other states today, firms may choose almost any set of organizing principles they desire. These statutes typically require little or no ongoing disclosure by operating firms . . . .").

13 *See* Cort v. Ash, 422 U.S. 66, 84 (1975) ("Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation."); *see also* Roberta S. Karmel, *Is it Time for a Federal Corporation Law?*, 57 Brook. L. Rev. 55, 76–78 (1991) (discussing how the Supreme Court has applied the principle that, in general, state law governs the internal affairs of corporations).

14 Under section 144(a) of the Delaware Corporation Code, an interested director transaction can be avoided or the directors can be subject to rescission damages unless the transaction is: (1) authorized by a majority of disinterested directors after full disclosure, (2) approved in good faith by the shareholders of the corporation after a full disclosure, or (3) is fair to the

does the potential for agency problems.[15] Adjusting the balance of power between the officers, directors, and shareholders is one mechanism for managing these agency issues.[16]

Although I refer specifically to Delaware because of its prominence in the corporate law sphere, the principles developed in this Article apply to other state legal regimes as well.[17] Delaware's corporate law is a system of default rules.[18] It is designed to provide basic rules that firms can, for the most part, tailor in different ways to suit their own choices about governance and other issues.[19] The result is a form of private ordering that reflects a state legislative choice favoring self-regulation. The laws, by definition, are public, i.e., promulgated by the legislature or courts, but corporate governance itself has been privately defined. Of course, the law shapes corporate governance both when it explicitly directs corporate action and when it leaves the corporate actors to choose for themselves.[20]

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corporation at the time it was authorized. DEL. CODE ANN. tit. 8, § 144(a); *see also* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 80–81 (1991) (noting that state legal rules encourage managers to submit issues to shareholders for approval in situations where "the need for monitoring is high").

15 *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 312–13 (1976) (discussing the agency costs generated between managers and outside shareholders).

16 *See id.* at 323–25 (developing an economic model to demonstrate the increase in the total value of a firm when the owner-manager is subject to external monitoring of outside equity holders).

17 *See* Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV 588, 590 (2003) (noting that Delaware has "won" the race for state incorporations). Estimates of the number of large corporations incorporated in Delaware vary. The Delaware Department of State recently estimated that more than fifty percent of all publicly traded U.S. companies, including sixty-four percent of the Fortune 500, are incorporated in Delaware. *About Agency*, STATE OF DELAWARE (last updated Mar. 25, 2013, 10:02 AM), http://www.corp.delaware.gov/aboutagency.shtml.

18 *See* CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 166 (6th ed. 2010) ("Most state corporation law norms take the form of default rules—for example, that all shares have the same voting and economic rights or that centralized power resides with the board."); Tamar Frankel, *What Default Rules Teach Us About Corporations; What Understanding Corporations Teaches Us About Default Rules*, 33 FLA. ST. U. L. REV. 697, 699 (2006) ("Rather than reducing the level of the breach of duty of care or the remedies for such a breach, Delaware converted the rule concerning this duty into a default rule. It allowed corporations to limit the damages that directors would pay for breach of their duty of care."); *see also* Charles R.T. O'Kelley, *Delaware Corporation Law and Transaction Cost Engineering*, 34 GA. L. REV. 929, 946–53 (2000) ("exploring" Delaware's default rules).

19 *About Agency*, *supra* note 17.

20 *Cf.* Laura A. Rosenbury, *Between Home and School*, 155 U. PA. L. REV. 833, 846–50 (2007) (discussing, in the context of family law, how legal doctrine shapes childhood both through substance and through omissions).

## II. Public Governance Federalized

### A. Disclosure and Public Governance

Since the 1930s, federal law has played a significant role in the regulation of corporations. Its primary role was regulating and defining the relationships between corporate actors and shareholders.[21] This Article focuses largely on corporate governance relationships and fiduciary duties, which initially were located in the state law space, but are increasingly becoming the province of federal governance measures. For example, federal law governs the process through which internal corporate actors communicate externally with shareholders and others.[22] Federal law also regulates the proxy fight process.[23] Nevertheless, the standard view is that the federal role in corporate governance is largely one of disclosure, rather than substance.[24] Sub-

21 *See* J. Robert Brown, Jr., *Corporate Governance, the Securities and Exchange Commission, and the Limits of Disclosure*, 57 CATH. U. L. REV. 45, 49–51 (2007) ("[T]he Securities Exchange Act of 1934 delegated to the SEC the authority to regulate the disclosure of public companies . . . . The Exchange Act also addressed governance concerns with respect to shareholders . . . . The Commission, therefore, was expected to play a role in the governance process."); Donald E. Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L.J. 545, 562 (1984) ("The most fundamental impact of federal law on corporate governance is through the basic federal securities laws, the Securities Act of 1933 and the Securities Exchange Act of 1934 . . . . [T]he 1934 Act impacted upon a number of areas of basic corporate-shareholder relations, such as the periodic furnishing of information to shareholders, restricting insider trading, and most important, regulating the solicitation of proxies . . . ."). *See generally* Arthur H. Dean, *Twenty-Five Years of Federal Securities Regulation by the Securities and Exchange Commission*, 59 COLUM. L. REV. 697 (1959).

22 For a discussion of the corporate proxy process and shareholder communications, see Hillary A. Sale, *Of Corporate Suffrage, Social Responsibility, and Layered Law: Teaching Basic Business Law Through Federal Securities Law*, 34 GA. L. REV. 809 (2000).

23 *See* Roe, *supra* note 17, at 607 (stating that in the 1950s, "[f]ederal authorities effectively overran state rules governing proxy fights").

24 *See id.* at 615–16 ("[T]he formal division of authority is said to be that the SEC forces disclosure and regulates stock trading while the states handle the internal affairs of shareholder-director relations . . . ."); Myron T. Steele, *Sarbanes-Oxley: The Delaware Perspective*, 52 N.Y.L. SCH. L. REV. 503, 506–07 (2008) (Chief Justice Steele, current Chief Justice of the Delaware Supreme Court, stated that "the focus of . . . federal [regulation] has always been . . . market fraud and disclosure. On the other hand, monitoring the structure of internal corporate governance is the focus of [state regulation]."); Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 860 (2003) ("State corporate law has occupied the center stage in the legal portion of this landscape, with federal securities law playing a supporting role . . . . The New Deal's securities legislation eschewed a general federal corporations statute in favor of a more focused federal role emphasizing disclosure and antifraud protections for those who purchase and sell securities."); E. Norman Veasey, *Corporate Governance and Ethics in a Post Enron/Worldcom Environment*, 72 U. CIN. L. REV. 731, 733 (2003) (Justice Veasey, then-Chief Justice of the Delaware Supreme Court, stated that "[f]ederal securities laws are traditionally designed to focus on financial disclosure

stantive regulation has been, albeit with "federal permission," state-law based, and thus a matter of private ordering.[25]

Sarbanes-Oxley dramatically changed that regime. It shifted basic governance decisions from private ordering, as the states had authorized, to the federal level. Importantly, it did so explicitly.[26] In so doing, the Act increased the role of government in corporate governance and expanded the corporate zone of publicness. Dodd-Frank does the same.[27] Therefore, both pieces of legislation make excellent case studies for developing the theory of corporate publicness.

Sarbanes-Oxley was enacted in 2002 in response to corporate scandals at Enron, WorldCom, and other companies.[28] Accounting issues drove the discussions about reform, resulting in reforms that focused on accounting issues.[29] The reforms, however, also tie directly

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that directly affects securities markets," whereas "[s]tate corporation law traditionally focuses on the internal affairs of corporations.").

25 *See, e.g.*, Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491, 2494 (2005) (pointing out that Washington can take away any or all of Delaware's authority to make laws governing corporations).

26 *See* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523 (2005) ("The federal regime had until [Sarbanes-Oxley] consisted primarily of disclosure requirements rather than substantive corporate governance mandates, which were traditionally left to state corporate law . . . . [Sarbanes-Oxley] alters this division of authority by providing explicit legislative directives for SEC regulation of what was previously perceived as the states' exclusive jurisdiction."); *see also* Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 625 (2004) ("Many commentators have criticized the Sarbanes-Oxley Act of 2002 as evidence of the 'creeping federalization of corporate law.'"); Roberta S. Karmel, *Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79, 79 (2005) ("The Sarbanes-Oxley Act of 2002 . . . has markedly changed the boundary between the federal securities laws and state corporation law with regard to corporate governance.").

27 *See* Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1821 (2011) ("Like their predecessors in [Sarbanes-Oxley], the six key corporate governance provisions of Dodd-Frank . . . displac[e] state regulation with federal law.").

28 *See* Robert B. Thompson, *Collaborative Corporate Governance: Listing Standards, State Law, and Federal Regulation*, 38 WAKE FOREST L. REV. 961, 965 (2003) ("The SEC took several actions in the wake of the Enron scandal and related reports of corporate misdeeds. The WorldCom fiasco helped propel Congress toward legislation and within a month, the President had signed the Sarbanes-Oxley Act of 2002."); Paul Beckett, *Executives' Hot Seats Get Hotter—CEOs Could Face $5 Million in Fines, 20 years in Prison Under New Governance Law*, WALL ST. J., July 31, 2002, at C7 ("The push for having CEOs and finance chiefs attest personally to the accuracy of their results has stemmed directly from the crisis of confidence in corporate responsibility amid scandals from Enron Corp. to WorldCom Inc."); *see also* Langevoort & Thompson, *supra* note 1, at 374 (stating that "nearly all the examples of the melding of investor and broader social interests that have changed the meaning of publicness are reactions to highly salient (usually scandalous) events involving large public companies").

29 Then-Chairman of the Securities and Exchange Commission, Harvey Pitt, explained the

to the duties of officers and directors.[30] Those duties had generally been the prerogative of state lawmakers and judges, who had left them to the realm of private ordering.[31] Further, those duties were largely enforced—if they were enforced at all—on an ex post basis through litigation over fiduciary breaches.[32]

Sarbanes-Oxley shifted the line from this state law based form of private ordering and governance to one of public governance.[33] Indeed, despite its accounting focus, Sarbanes-Oxley also contained changes that arguably created direct federal government intervention in the balance of power for the first time.[34] Prior to these changes, federal securities law impacted corporate decisionmaking and governance, but it did so in a largely indirect manner. Sarbanes-Oxley, however, imposed actual duties and decisionmaking responsibilities on corporate officers and directors.[35]

Professor Robert B. Thompson and I have written about this type of federal corporate governance regulation elsewhere and refer to it as "information-forcing-substance" regulation.[36] The theory is that the federal securities laws are (or were) disclosure based. The Securities and Exchange Commission ("SEC") has long promulgated regulations that say how much and what type of information corporations must disclose.[37] So, for example, when a company files its annual report, the 10-K, SEC regulations require it to make a myriad of disclosures about how the corporation does business and whether it adheres to various practices.[38]

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rationale underlying the proposed Public Company Accounting Oversight Board: "Ineffective oversight of public-company audits has damaged [investor] confidence. [The Board] is necessary to help restore faith in our markets and in the accounting profession." Harvey L. Pitt, Op-Ed., *Auditing Reform Can't Wait for Congress to Act*, WALL ST. J., June 19, 2002, at A18.

30 *See* Sale, *supra* note 4, at 137–38.

31 *Id.* at 138. *See also, e.g.*, Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 157 (Del. 1996) (holding that directors could decide for themselves both whether a fiduciary breach was implicated in a decision and whether to raise it with the board as a whole).

32 *See* Thompson & Sale, *supra* note 24, at 860–61.

33 *Id.* at 861.

34 Sale, *supra* note 4, at 141.

35 Thompson & Sale, *supra* note 24, at 872–86.

36 *See id.* at 875 (describing required disclosure as "presumably forcing substance in contexts in which conflicted loyalty might be at issue"). This same concept was later coined "information-forcing-substance" regulation. *See* Hillary A. Sale, *Independent Directors as Securities Monitors*, 61 BUS. LAW. 1375 (2006); Sale, *supra* note 4, at 143 & n.33.

37 *See* Thompson & Sale, *supra* note 24, at 869.

38 *See* 17 C.F.R. § 240.13a-14, .15d-14 (2012) (requiring certification of certain disclosures required in 10-K reports); Thompson & Sale, *supra* note 24, at 869–70.

The regulations that govern 10-K disclosures divide topics of disclosure into "Items."[39] These Items run the gamut from disclosures about environmental programs and policies to disclosures about pending litigation.[40] The SEC has selected topics for disclosure over time based on the materiality of the issues.[41] When corporate officers and directors draft disclosure documents, they must disclose information about the Items. If they do not have the policy or program to which some Items refer, they can "skip" the Items or leave them blank. Leaving an Item blank, however, might send the message that the company does not think that something deemed "material" by the SEC is actually important.[42]

As a result, rather than leaving an Item blank, companies may make the substantive change in their structure or practices in order to be able to provide the requested information.[43] This choice remains in the hands of those providing the disclosures, and it is therefore a form of private ordering. The choice, however, is not solely within the realm of the private because the reports are public and subject to scrutiny.[44] As a result, the effects of the choice extend beyond the private realm. In this manner, the disclosure regulations become indirectly substantive.

There are additional ways in which the regulations have an indirect substantive impact as well. For example, Item 303 of Regulation

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39 *See* Standard Instructions for Filing Forms Under Securities Act of 1933, Securities Exchange Act of 1934, and Energy Policy and Conservation Act of 1975, Regulation S-K, 17 C.F.R. § 229.10(b)(2) (2012).

40 *See, e.g.*, *id.* § 229.101(c)(1)(xii) (requiring the disclosure of certain costs of complying with environmental laws); *id.* § 229.103 (requiring a description of pending legal proceedings to which the corporation or its property is a party).

41 *See, e.g.*, John C. Coffee & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 753 (2009) (noting that many provisions of Regulation S-K contain "specific materiality thresholds, or rules"); Mark J. Loewenstein, *The SEC and the Future of Corporate Governance*, 45 ALA. L. REV. 783, 807–08 (1994) ("Following a public outcry over the size of executive compensation, the Commission reacted in 1992 by adopting a rule that required increased disclosure of executive compensation in the annual proxy statement.").

42 *See generally* Thompson & Sale, *supra* note 24, at 873–79 (discussing the impact of federal disclosure law on director decisionmaking).

43 *See id.* at 879.

44 *See* David Cay Johnston, *10-K's: A Good Read for the Curious Investor*, N.Y. TIMES, Jan. 20, 2002, at B12 (instructing investors how to effectively examine a 10-K, and noting that access to disclosure documents "has become much easier since the mid-1990's, when the S.E.C. embraced electronic filing and the Internet"); *cf.* Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 569–70 (1984) (noting that, because of the activities of professional traders, the market price of a security reflects these disclosures even though "[m]any traders are too unsophisticated to make full use of the technical accounting information contained in mandated disclosure reports").

S-K requires issuers to provide "Management's Discussion and Analysis."[45] This provision requires the disclosure of information about liquidity, capital resources, and operational results.[46] Liquidity, of course, is important to company operations. It is also important to careful and smart corporate fiduciaries; thus, one might assume they would pay attention to it absent the regulation. The regulation, then, enforces the fiduciary duty of care.[47] Item 303 also requires management to identify deficiencies that might impact the company's liquidity and discuss the action taken to remedy those deficiencies. Here, the regulation is actually substantive. It does not just enforce the duty of care, it defines it, albeit indirectly. These regulations, and others like them, therefore, also constitute an indirect form of publicness.[48]

### B. *The Public Governance of Sarbanes-Oxley*

Sarbanes-Oxley illustrates a direct form of publicness. It explicitly regulates the responsibilities of corporate boards and officers.[49] Thus, it removes the privilege of self-regulation from private actors and, instead, delineates choices and structures for those actors. The result is increased federal involvement in corporate governance.

Consider these changes: The Sarbanes-Oxley Act lays out responsibilities for corporate financial reports by making specific corporate actors individually responsible for their content.[50] It also requires companies to develop internal controls to better manage corporate structures and decisionmaking.[51] The Act also defines duties that were formerly the prerogative of the "private" parties to the corporate relationship. For example, it sets boundaries for the interaction of auditors with board audit committees.[52] It also specifies the type of directors eligible for audit committee service.[53] Further, the Act prohibits conflicts of interest between officers and their companies by, for

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45 17 C.F.R. § 229.303 (2012).

46 *Id.*

47 *See* Thompson & Sale, *supra* note 24, at 873.

48 *See id.*

49 Sarbanes-Oxley requires that a public company's audit committee members are independent, and that CEOs and CFOs must certify that they have reviewed financial reports and the reports do not contain untrue material facts. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, sec. 301, § 10A(m)(3), 116 Stat. 745, 776 (codified at 15 U.S.C. § 78j-1(m)(3) (2006)) (auditor independence); *id.* § 302 (codified at 15 U.S.C. § 7241) (CEO certification).

50 *Id.* § 302, 116 Stat. at 777.

51 *Id.* § 302(a)(4), 116 Stat. at 777.

52 *Id.* § 301, 116 Stat. at 776.

53 *Id.*

example, barring personal loans to corporate officers and directors,[54] and demands forfeiture of certain "ill-gotten" gains.[55]

These changes exemplify publicness in several ways. First, they abrogate a group of choices that had traditionally belonged to the corporate actors about how to do their jobs.[56] These choices were forms of private governance. Second, they replace those choices with uniform federal provisions designed to ensure that corporate actors are doing their jobs in a specific way.[57] Here, too, Sarbanes-Oxley increases public involvement in corporate governance, and is, therefore, an example of publicness.

Third, the provisions highlight the fact that context is key to the evolution of publicness. Congress passed Sarbanes-Oxley in the wake of Enron and WorldCom and those scandals were instrumental to its passage.[58] The failures of private corporate actors to prevent or adequately respond to those scandals—to self-regulate—were also extremely important. Those failures resulted in more public scrutiny of corporations and corporate decision making, which, in turn, created pressure for Congress to do something.[59] Sarbanes-Oxley was the result.

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54 *Id.* § 402, 116 Stat. at 787.

55 *Id.* § 304, 116 Stat. at 778.

56 *See, e.g.*, Easterbrook & Fischel, *supra* note 12, at 691.

57 *See, e.g.*, Thompson & Sale, *supra* note 24, at 873–79.

58 *See supra* notes 28–29 and accompanying text.

59 All companies are subject to this pressure and scrutiny, and this is where publicness exceeds the technical legal definition of "public" company. For example, the law's construct of the "public" company has been one based on securities sales and listing choices. In this sense, the law has distinguished only between companies that qualify as publicly traded and those that do not. *See, e.g.*, Sale, *supra* note 4, at 138. The former are subject to the federal securities regime. Main Street, however, sees publicness differently. Corporate choices and decisions impact the economy and people's livelihoods. These decisions face scrutiny by the media and others. *See id.* Thus, publicness exists for both "public" and "private" companies and has for a very long time. *See supra* Introduction.

Consider, for example, the way in which J.P. Morgan was scrutinized eighty years ago, when it was a private company. In 1933, while investigating the causes of the Great Depression, the Senate Committee on Banking and Currency's Pecora hearings, led by Ferdinand Pecora, exposed "excessive salaries, failures to pay income taxes, and a litany of other abuses." Brady Dennis, *In Original Reformer, a Model*, WASH. POST, Sept. 16, 2009, at A16. The public scrutiny caused Charles E. Mitchell, the head of Citibank's precursor, National City Bank, to resign and left J.P. Morgan, head of J.P. Morgan Chase and Morgan Stanley, with a "battered reputation." *Id.* This scrutiny led to passage of the Securities Act of 1933 and the Securities Exchange Act of 1934, as well as the establishment of the SEC and FDIC. *Id. See generally* MICHAEL PERINO, THE HELLHOUND OF WALL STREET: HOW FERDINAND PECORA'S INVESTIGATION OF THE GREAT CRASH FOREVER CHANGED AMERICAN FINANCE (2010); Alan Brinkley, *When Washington Took on Wall Street*, VANITY FAIR, June 2010, at 156. Even in the 1930s, companies failed to comprehend their publicness.

Consider how Sarbanes-Oxley replaced self-regulation with public governance. The Act provides a set of federal rules that combine with the fiduciary duties of care, good faith, and loyalty formerly governed by state law. Those duties, however, were only generally defined by state law.[60] They were flexible standards, not firm rules, and they permitted room for substantial private ordering.[61] Under state law, then, corporate actors had permission to self-regulate. They could choose how to manage and implement these standards or, in some cases, could choose to waive them. The only check on the decisionmaking of private actors was the extremely rare threat of successful litigation.[62]

Sarbanes-Oxley replaces private ordering with legal rules. It requires corporations to adopt specific policies and practices. Title III, for example, is named "Corporate Responsibility,"[63] and contains several sections, all of which specifically regulate business decisions that states previously had permitted corporate boards and officers to manage as their prerogative. Comparing Title III to previous Delaware state law reveals how corporate governance choices are now publicly regulated and subject to publicness.

Section 301 of Sarbanes-Oxley, titled "Public Company Audit Committees," requires the SEC to promulgate rules that, through exchange listing requirements, now delineate both responsibilities for board audit committees and the characteristics of the committee members.[64] Prior to Sarbanes-Oxley, Delaware law did not have any requirements for audit committee members. It still does not. It also did not have laws requiring that the board or audit committee develop

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60 *See supra* Part I.

61 *See* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 559–60 (1992) ("[A] rule may entail an advance determination of what conduct is permissible, leaving only factual issues for the adjudicator . . . . A standard may entail leaving both specification of what conduct is permissible and factual issues for the adjudicator."); *see also* Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1691 (1976) (discussing "formalities," or "legal institutions whose stated object is to facilitate private ordering"); Pierre Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 379 (1985) (discussing the differences between "bright line rules" and "flexible standards").

62 *See* Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1138 (2006) (finding, "[a]s an empirical matter, out-of-pocket liability for outside directors over the last several decades has been rare"). The authors found liability under state corporate laws particularly rare, discovering only one state law trial that resulted in liability for outside directors. *Id.* at 1065 tbl.1.

63 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, tit. 3, 116 Stat. 745, 775–85.

64 *Id.* § 301, 116 Stat. at 775–77.

specific procedures for hiring auditors or developing and managing potential complaints about company accounting or auditing fraud.[65]

Instead, audit committee decisions were in the zone of self-regulation. The judgments about members of the committee and the scope of its work or its charter were generally subject to the business judgment of the board.[66] The decisions were thus subject to private ordering. The corporate actors had the power to create such procedures and rules. But, as a matter of law, barring conflicts of interest or other financial concerns, these decisions were subject to review only under the lenient duty of care standard.[67] Today, specific federal laws and regulations now control this space.

Section 302, "Corporate Responsibility for Financial Reports," has a similar impact.[68] Again, through SEC rulemaking, it establishes specific responsibilities for the Chief Executive Officer and the Chief Financial Officer through a certification requirement.[69] CEOs and CFOs now must include certifications with quarterly and annual reports stating that they have reviewed the report and that it is truthful and fairly presents the company's financial conditions and results of operations.[70] In addition, those officers must certify that they are responsible for establishing and maintaining internal controls.[71] The

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65 *See* Steele, *supra* note 24, at 508 ("[Section 301] attempts to define independence by describing nineteen ways in which a director is not independent .... Whether one is an independent director cannot be analyzed carefully based on a predetermined laundry list of disqualifiers. In Delaware, the only way one can determine a director's independence is to address the director's ability to render an objective judgment based upon the context in which the decision was or would be made . . . .").

66 The business judgment rule is "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled in part by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

67 *See* Lawrence A. Hamermesh, *Why I Do Not Teach* Van Gorkom, 34 GA. L. REV. 477, 487 (2000) ("[D]irectors must 'inform[ ] themselves, prior to making a business decision, of all material information reasonably available to them.' This sounds like a real legal rule at first blush, until one recognizes that (a) it is qualified by the holding that only a 'grossly negligent' failure to become informed will violate the duty of care, and (b) the notion of gathering all 'reasonably available' information is completely unrealistic in a world in which information is essentially limitless, and in which that limitless supply is becoming increasingly 'available' at the stroke of a key." (quoting Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985))); *see also* Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456, 488 (2004) ("[A]llegations related to conflicts of interest or a fiduciary's personal interests implicate loyalty. The duty of care issue arises when a director's omission or misstatement occurs in good faith, but results from the director's 'erroneous judgment.' In such a situation, the duty of loyalty is not implicated . . . .").

68 Sarbanes-Oxley Act § 302, 116 Stat. at 777–78.

69 *Id.* § 302(a), 116 Stat. at 777.

70 *Id.* § 302(a)(1)–(3), 116 Stat. at 777.

71 *Id.* § 302(a)(4)(A), 116 Stat. at 777.

purpose of those controls is, in part, to ensure that the officers receive material information.[72] Thus, this provision is designed to eliminate plausible deniability and, presumably, to ensure that the officers in fact set up and maintain the requisite systems.

This provision represents a serious intrusion into the formerly private decisions about the governance structure of publicly held companies. Although it is disclosure based, Section 302 is inflexible in its implementation. The officers must sign the exact language as promulgated by the SEC,[73] and in order to do so, the officers must have actually created and maintained the programs.[74] The choice to have internal control systems is no longer a matter of self-regulation. Further, SEC reports without the certifications are incomplete and delinquent, and the companies are then subject to delisting.[75]

Section 302, therefore, moves beyond the earlier-described "information forcing substance" approach by establishing job responsibilities for corporate officers. Congress (and the SEC), not the board of directors, now dictates to officers what their jobs are and how to do them. As a result, a formerly "private" business decision is now externalized and subject to publicness.

Section 404 of Sarbanes-Oxley takes this type of publicness one step further. Titled "Management Assessment of Internal Controls," it requires that companies, in conjunction with their auditors, assess and report on the adequacy of their control of financial reporting.[76] This provision of Sarbanes-Oxley was subject to considerable criti-

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72 *See id.* § 302(a)(4)(A)–(B), 116 Stat. at 777.

73 The adopting release emphasizes that the certification language may not be changed in *any* way, even if the change appears to be inconsequential. *See* Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. 57,276, 57,280 (Sept. 9, 2002).

74 *See* 17 C.F.R. §§ 240.13a–14, .15d–14 (2012). Indeed, the SEC firmly rejected the attempts of companies to end run around these certifications with their own language, rather than that contained in the rule. Arguably, when pushing back on the certification language, the companies were really pushing back on publicness and pressing for the private-ordering realm they preferred.

75 *See id.*; *see also Listed Company Manual*, NYSE, http://nysemanual.nyse.com/LCM Tools/PlatformViewer.asp?selectednode=chp_1_9&manual=%2Flcm%2sections%2Flcm-sections%2F (last visited Apr. 8, 2013) (Rule 802.01E states that a company that fails to file its annual report with the S.E.C. in a timely manner will be subject to the delisting procedure in Rule 804); *NASDAQ Stock Market*, NASDAQ OMX, http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp_1_1_4_3&Manual=%2Fnasdaq%2Fmain%2Fnasdaq-equityrules%2F (last visited Apr. 8, 2013) (Rule 5250(c)(1) states that a company that fails to file its annual report with the SEC in a timely manner will be subject to the delisting procedure in Rule 5801).

76 Sarbanes-Oxley Act § 404, 116 Stat. at 789.

cism, particularly with respect to the costs of implementation.[77] And indeed, some changes to the provision were made, including delaying its implementation.[78] Regardless, the provision and the accompanying regulations still require companies to produce a report as part of the annual 10-K filing, stating that management is in fact responsible for establishing and maintaining internal controls and procedures for financial reporting.[79] As a result, this provision also establishes a set of federalized, uniform rules delineating certain duties and responsibilities for corporate officers.

Section 402, which makes loans to corporate officers and directors illegal, is yet another provision of Sarbanes-Oxley that externalized corporate decisionmaking.[80] Again, this was an area traditionally defined by state law that the states had left to self-regulation.[81] Although state conflict of interest law applied to such decisions, the provisions were very permissive.[82] By providing "cleansing mechanisms" for these decisions, state law made the loans, and thus the conflicts, easily allowable.[83] The abuse was significant: the CEO of WorldCom

77 *See* Kara Scannell & Deborah Solomon, *Business Wins Its Battle to Ease a Costly Sarbanes-Oxley Rule*, WALL ST. J., Nov. 10, 2006, at A1 ("[C]ompanies, both large and small, have complained that the way Section 404 is interpreted is overly broad and requires them to spend many hours and millions of dollars documenting things that have nothing to do with the integrity of their financial statements."); Deborah Solomon, *Accounting Rule Exposes Problems but Draws Complaints About Costs*, WALL ST. J., Mar. 2, 2005, at A1 (noting that the rule is "fattening the bottom lines of accounting firms while costing other companies billions of dollars").

78 *See* Amendments to Rules Regarding Management's Report on Internal Control over Financial Reporting, Exchange Act Release No. 55,929, 72 Fed. Reg. 35,310 (June 27, 2007); Commission Guidance Regarding Management's Report on Internal Control over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, 72 Fed. Reg. 35,324 (June 27, 2007); *see also* Scannell & Solomon, *supra* note 77, at A1 ("Business has won the battle to ease one of the most controversial requirements mandated by Sarbanes-Oxley corporate reform law .... [S]ecurities and accounting regulators are yielding to pressure for a more flexible reading of a provision of the law known as Section 404."). Dodd-Frank further downsized the provision by exempting filers with market capitalizations under certain thresholds from auditor certifications and delaying the provisions for new filers. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 989G, 124 Stat. 1376, 1948 (2010) (codified at 15 U.S.C. § 7262 (Supp. IV 2011)).

79 Sarbanes-Oxley Act § 404, 116 Stat. at 789; 17 C.F.R. § 229.308 (2012).

80 Sarbanes-Oxley Act § 402, 116 Stat. at 787.

81 *See, e.g.*, DEL. CODE. ANN. tit. 8, § 143 (2012) (specifically authorizing loans of corporate funds to corporate officers and directors "whenever, in the judgment of the directors, such loan, guaranty or assistance may reasonably be expected to benefit the corporation").

82 *See generally* Jayne W. Barnard, *Corporate Loans to Directors and Officers: Every Business Now a Bank?*, 1988 WIS. L. REV. 237 (criticizing insider loans and calling restrictions against them "illusory").

83 *See* Lyman P.Q. Johnson & Mark A. Sides, *The Sarbanes-Oxley Act and Fiduciary Duties*, 30 WM. MITCHELL L. REV. 1149, 1211 (2004) ("Loans to officers, or to officer-directors,

borrowed $408 million and did not repay it, Enron's CEO borrowed $70 million, and Tyco's CEO borrowed $270 million.[84] Sarbanes-Oxley took this choice away from the corporate actors and externalized it.[85] Later, the legal industry's response muted the effectiveness of the statutory provision,[86] but the provision still exists.[87] As a result, the loans became a matter of public debate and a matter of public governance. These are not the only provisions of the Sarbanes-Oxley Act that exemplify publicness, but they are the most dramatic.

### C. *The Public Governance of Dodd-Frank.*

The Dodd-Frank Act, another legislative provision borne out of the corporate failure to self-govern, contains more examples of publicness. Indeed, the Act itself was borne out of the need for a federal bailout (a clear form of publicness), and the public's desire for a quid pro quo or retribution. Here, as with Sarbanes-Oxley, the result is increased publicness.[88]

For example, Dodd-Frank intervenes in corporate governance processes by requiring that the directors on the compensation committee be independent.[89] This provision directly regulates the choice

raise a conflict of interest issue and, accordingly, courts insist that such transactions be handled in a way that complies with the borrower's duty of loyalty. This may be done by the borrower proving, if the transaction later is challenged, that the loan is 'fair' to the company. Alternatively, the borrower may make full disclosure of the material facts and seek approval of the transaction by disinterested and independent directors or shareholders.")

84 Coffee, *supra* note 8, at 1042.

85 The only exception to this prohibition is for issuers who are in the business of making loans, such as banks. *See* Sarbanes-Oxley Act sec. 402(a), § 13(k)(2), 116 Stat. at 787 (codified at 15 U.S.C. § 78m (2006)).

86 *See* Press Release, Goodwin Proctor LLP, Interpretive Issues Under Section 402 of the Sarbanes-Oxley Act of 2002 (Oct. 17, 2002), *available at*http://www.goodwinproctor.com/~media/Files/Publications/Newsletters/Public%20Company%20Advisory/2002/Interpretive_Issues_Under_Section_402_of_the_Sarbanes_Oxley_Act_of_2002.pdf (presenting a joint outline released by twenty-five major law firms "describing a variety of interpretive issues . . . under Section 402 of the Sarbanes-Oxley Act of 2002").

87 *See* Sarbanes-Oxley Act sec. 102(a), § 13(k)(2), 116 Stat. at 787.

88 Arguably, the only viable response was a federal one. No one state could "bail out" the national banks.

89 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 952, 124 Stat. 1376, 1900 (2010) (codified at 15 U.S.C. § 78j-3 (2006)). Is independence the perfect solution? *Compare* Sanjai Bhagat & Roberta Romano, *Event Studies and the Law: Part II: Empirical Studies of Corporate Law*, 4 AM. L. & ECON. REV. 380, 403 (2002); Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231, 231 (2002); Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Compensation and Firm Performance*, 54 BUS. LAW. 921, 922 (1999); Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 131 (2010), *with* Vidhi Chhaochharia & Yaniv Grinstein, *CEO Compensation and Board Structure*, 64 J. FIN. 231,

about the type of person eligible to serve on a compensation committee. It parallels the Sarbanes-Oxley audit committee requirements and thus provides an example of one of the ways in which publicness can reproduce itself.[90] Dodd-Frank also requires that these committees hire independent consultants[91] and assigns the directors the sole discretion to make consultant choices.[92] With both provisions, Dodd-Frank explicitly shifts the balance of power between the actors (here officers and directors) and sets limits on their range of choices. By deciding who decides, these provisions externalize what was previously private ordering about who makes these decisions.

Delaware gave the power to self-regulate to the corporate actors. They failed to do so; so Congress did.[93] Put differently, the financial crisis and the bailout resulted in public outrage. They also fueled the perception that the corporate actors were not thinking about or acting with independence, and were not exercising sufficient control over internal processes.[94] The result was pressure on Congress to "do something." Now, the decisions formerly allotted to the private sphere are regulated by the federal government and subjected to public scrutiny.

Dodd-Frank also directly regulates the substantive terms of executive compensation agreements. For example, the Act mandates that issuers recoup, or "claw back," compensation from executive officers

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232 (2009) (finding that a significant decrease in CEO compensation occurred at firms required to implement stock exchange board oversight requirements, including majority board independence, after the 2001 and 2002 corporate scandals); James F. Cotter, Anil Shivdasani & Marc Zenner, *Do Independent Directors Enhance Target Shareholder Wealth During Tender Offers?*, 43 J. FIN. ECON. 195, 214 (1997) (finding that independent boards enhance target shareholder gains from takeovers); Michael S. Weisbach, *Outside Directors and CEO Turnover*, 20 J. FIN. ECON. 431, 457 (1988) (finding that independent boards are more likely to replace a CEO in response to poor performance).

90 *Compare* Sarbanes-Oxley Act sec. 301, § 10A, 116 Stat. at 775–77, *with* Dodd-Frank Act sec. 952, § 10C, 124 Stat. at 1900.

91 *See* Listing Standards for Compensation Committees, 77 Fed. Reg. 38,422, 38,430 (June 27, 2012) (to be codified in 17 C.F.R. pts. 229, 240).

92 *Id.*

93 *See, e.g.*, William D. Cohan, Op-Ed., *Make Wall Street Risk It All*, N.Y. TIMES, Oct. 8, 2010, at A27 (editorializing that even with post-financial reform, "bankers' potentially reckless behavior" is still a risk).

94 *See* MAJORITY STAFF OF H. COMM. ON OVERSIGHT & GOV'T REFORM, 110th CONG., EXECUTIVE PAY: CONFLICTS OF INTEREST AMONG COMPENSATION CONSULTANTS, at i (Comm. Print 2007) (prepared for Chairman Henry A. Waxman) (finding that executive compensation firms provided additional services, other than executive compensation advice, to at least 113 of the Fortune 250 companies, and the non-compensation services were worth almost eleven times the value of the compensation work); Martin J. Conyon, *Executive Compensation Consultants and CEO Pay*, 64 VAND. L. REV. 399, 409–14 (2011) (surveying recent empirical data on the relation between compensation consultants and CEO pay, and analyzing the Waxman report).

who received incentive-based pay (and virtually all do)[95] during a timeframe for which material financial restatements were required.[96] Here, too, issuers previously had the private power to do clawbacks, but the government now regulates and requires it. Still more dramatic is the provision that requires certain financial institutions to disclose incentive-based compensation to regulators in order to allow the regulators to determine whether the compensation is either excessive or "could lead to material financial loss."[97] These two Dodd-Frank changes subject actual compensation choices, not just the decisionmakers and the processes they follow, to government review.[98]

Finally, the so-called "say-on-pay" provisions of Dodd-Frank provide an excellent example of public governance and how it grows. The legislation requires issuers to submit for a precatory shareholder vote the approval of executive compensation, with provisions to ensure that disclosures about compensation are tied to the issuer's financial performance.[99] State law did not require say-on-pay votes and corporations chose not to hold them. This provision is thus quite unusual. It implements a voting requirement (albeit nonbinding) where before shareholders had no power except the indirect power to withhold votes against directors who approved the compensation.[100] In effect, the provision provides shareholders direct access into the executive compensation arena. Although the nonbinding nature of the provision arguably strikes some balance between regulation and private ordering, it is still a very strong and direct intrusion into the private governance realm. Private ordering is diminished and public

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95 Internal Revenue Code section 162(m) limits the deduction of certain employee compensation expenses to one million dollars annually per "covered" employee; however, performance-based compensation is not subject to the limit if it meets certain requirements. *See* I.R.C. § 162(m) (2006); Treas. Reg. § 1.162-27(e)(1) (as amended in 1996).

96 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 954, § 10D, 124 Stat. 1376, 1904 (2010) (codified at 15 U.S.C. § 78j-4 (2006)).

97 *Id.* § 956(a)(1), 124 Stat. at 1905.

98 Dodd-Frank also requires regulations to "prohibit any type of incentive-based payment arrangement . . . that . . . encourages inappropriate risks" for financial institutions. *Id.* § 956(b), 124 Stat. at 1905. And, it gives regulators the power to regulate the types of compensation that are inappropriate. *Id.* § 956(d), 124 Stat. at 1905–06 (titled "Enforcement").

99 *Id.* sec. 951, § 14A, 124 Stat. at 1899; *id.* § 956, 124 Stat. at 1905; *see also* 17 C.F.R. § 229.402(a)(2) (2012) (requiring "clear, concise and understandable disclosure of all plan and non-plan compensation awarded to, earned by, or paid to the named executive officers"); 17 C.F.R. § 229.402(b)(2)(vii) (the executive compensation disclosure should "reflect the named executive officer's individual performance and/or individual contribution to [the issuer's] performance").

100 Shareholders can always refuse to vote their shares in support of a particular director or directors. *See* 17 C.F.R. § 240.14a–21.

regulation prevails, shifting the balance of power between shareholders and directors.

Say-on-pay does more, however, than just shift the balance of power between internal corporate actors. The creation of the voting process and standards is itself a form of public governance. And it, in turn, is increasing scrutiny and publicness in executive compensation. Although the votes do not bind corporate actors, they do have traction.[101] Additional access and the focal point of voting created the opportunity for sustained attention to executive compensation decisions by the media and advocacy groups. It created space in and added actors to the compensation debate. The result is the externalization of compensation decisions and an increase in the publicness of compensation and the decisions surrounding it.[102]

For example, many actors in the say-on-pay zone have responded to the opportunity for involvement and scrutiny. Institutional investors have recommended "no" votes on some compensation packages that were not tied to risk or performance,[103] and corporate directors

101 According to Institutional Shareholder Services ("ISS"), the most influential proxy advisory firm, when shareholder support for executive compensation falls below seventy percent it "should trigger an examination." Brett Philbin, *Banker Pay Heads to Ballot*, WALL ST. J., Jan. 12, 2012, at C1 (internal quotations omitted); *see also* INSTITUTIONAL S'HOLDER SERVS. INC., 2012 U.S. PROXY VOTING SUMMARY GUIDELINES (2011), http://www.issgovernance.com/files/2012USSummaryGuidelines.pdf. This traction can extend beyond individual compensation packages, and affect those who authorize the packages. The Sequoia Fund, a major institutional investor, took "the rare step to oppose the re-election of a Goldman Sachs board member who approves compensation for many of the bank's top executives." Ben Protess, *In Latest Pay Rebuke, Investor to Oppose Goldman Director*, N.Y. TIMES DEALBOOK (Apr. 19, 2012, 6:37 PM), http://dealbook.nytimes.com/2012/04/19/investor-to-oppose-goldman-director/.

102 This access, and the burden on companies that accompanies it, is tiered. The United Kingdom, for example, implemented nonbinding say-on-pay in 2002. After a decade, the U.K. unveiled a measure that would give "shareholders a binding vote on how much executive directors are paid and requir[e] companies to annually publish a simple figure totaling how much they received." Cassell Bryan-Low, *U.K. Unveils Plan on Executive Pay*, WALL ST. J., June 21, 2012, at B3. The U.K.'s actions may indicate that American companies that fail to account for the new shareholder voice present after Dodd-Frank's say-on-pay reforms may risk the possibility of the nonbinding vote becoming binding. This tiered response, and additional scrutiny, is also publicness. *See* DEP'T FOR BUS. INNOVATION & SKILLS, EXECUTIVE PAY: SHAREHOLDER VOTING RIGHTS CONSULTATION 14–21 (2012), http://www.bis.gov.uk/assets/biscore/business-law/docs/e/12-639-executive-pay-shareholder-voting-rights-consultation.pdf.

103 ISS, the influential proxy advisory service, "recommended that shareholders vote against Citigroup's executive compensation package because of the size and nature of the pay package" and "because parts of [the CEO's] awarded pay were not based on Citigroup's financial performance." Steven M. Davidoff, *Citigroup Has Few Options After Pay Vote*, N.Y. TIMES DEALBOOK (Apr. 18, 2012, 12:38 PM), http://dealbook.nytimes.com/2012/04/18/citigroup-has-few-options-after-pay-vote/; *see also* Protess, *supra* note 101, at 2 ("[I]n the case of Citigroup, the nonbinding 'no' vote on pay came at the hands of major institutional investors.").

subsequently rejected some of those packages.[104] Some issuers have publicized and discussed their packages in advance of meetings, no doubt in response to pressure from shareholders, the media, and advocacy groups.[105] Some shareholder meetings have had contentious discussions about compensation.[106] And importantly, new parties have become involved in the discussions—think Occupy Wall Street.[107] As a result, companies feel the need to better explain,[108] and in some cases modify,[109] their compensation choices.

The say-on-pay provision, then, exhibits several layers of publicness. First, it increases participation by the "private" governance actors—the shareholders—in the compensation decision. They receive more information and have a direct mechanism for expressing their views. Second, the information and the voting outcomes generate media coverage, adding an additional layer of publicness. And third, negative votes attract even more media coverage and raise questions about the choices of the corporate decisionmakers.[110] The initial pub-

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104 In 2011, thirty-seven Russell 3000 companies failed their say-on-pay vote (approximately 1%). As of June 6, 2012, forty Russell 3000 companies have already failed their say-on-pay vote (approximately 2.5%). SEMLER BROSSY, SAY ON PAY RESULTS: RUSSELL 3000, at 2 (June 6, 2012), *available at* http://www.semlerbrossy.com/wp-content/uploads/2012/06/SBCG-SOP-2012-06-06.pdf; *see also* Suzanne Kapner, Joann S. Lublin & Robin Sidel, *Citigroup Investors Reject Pay Plan*, WALL ST. J., Apr. 18, 2012, at A1.

105 *See* Joann S. Lublin, *Pay Starts to Bend to Advisory Votes*, WALL ST. J., July 29, 2011, at C3 ("[C]ompanies are tweaking some elements of pay packages and spending more time promoting compensation plans to institutional investors, signs [Dodd-Frank] is beginning to increase investor involvement in pay decisions.").

106 *See* David Enrich, *Barclays Shareholders Vent on Pay*, WALL ST. J., Apr. 28, 2012, at B2 ("At [Barclays'] annual meeting, a parade of Barclays shareholders grumbled about a smorgasbord of issues . . . . But compensation was by far the most popular topic."); Nelson D. Schwartz, *Bank of America Investors Complain, but Approve Chief's Pay*, N.Y. TIMES, May 10, 2012, at B3 ("Despite noisy protests inside and outside Bank of America's annual meeting here Wednesday, shareholders signed off on the $7 million 2011 pay package for the chief executive . . . .").

107 *See* Peter Eavis, *Addressing Pay and Protestors at Morgan Stanley's Annual Meeting*, N.Y. TIMES DEALBOOK (May 15, 2012, 12:05 PM), http://dealbook.nytimes.com/2012/05/15/addressing-pay-and-protesters-at-morgan-stanleys-annual-meeting/ ("Morgan Stanley's chief executive, James P. Gorman, never visited the Occupy Wall Street protesters at Zuccotti Park. But on Tuesday morning [at the firm's annual meeting], the protestors visited him.").

108 Additionally, issuers that lost a say-on-pay vote feel increased pressure to get authorization for their pay plans, and some are taking outside steps to reform compensation practices. *See* Emily Chasan, *'Say on Pay' Changes Ways*, WALL ST. J., Feb. 22, 2012, at B4 (noting that "over the past year, the boards of many of the companies that failed the [pay] votes have consulted with investors and hired outside compensation advisors and proxy solicitors").

109 For example, following a shareholder vote of no confidence, Occidental Petroleum's CEO agreed to step down from the position and accept a smaller pay-package. The company also cut the pay of two other executives, and gave dissidents a seat on the board. *See* Joann S. Lublin, *Occidental CEO to Exit, Slims Pay*, WALL ST. J., Oct. 18, 2010, at B3.

110 In April 2012, Citigroup's shareholders voted to oppose Vikram Pandit's' executive

licness, a required vote, leads to even more publicness: discussions, analysis, criticism, and changes.[111]

## III. Public Governance and Publicness

The above analysis reveals how Sarbanes-Oxley and Dodd-Frank exemplify publicness. Both Acts move aspects of corporate decisionmaking from the state law domain, a zone that has favored permissive, flexible, and private ordering, into the federal law domain, which imposes uniform regulations on corporations.[112] The private ordering zone shrank. Corporate actors lost the privilege of self-regulation, and internal corporate decisionmaking and relationships were externalized.[113] The result is more public corporate governance.

The Acts also provide a valuable window into how publicness happens. The externalization of corporate governance is occurring because corporate actors failed to govern with a real understanding of the tentative nature of the private zone. Their understanding of the ramifications of their choices was too narrow. They treated their decisions, which the state legal structure permitted them to make in a private fashion, as, in fact, private. They failed to self-regulate. Their failures and scandals, however, were inevitably public. More public governance is the result.[114]

Importantly, the existence of public governance is not new. Private ordering was always a privilege and that privilege is subject to erosion. Government was there from the beginning, allowing private ordering to exist.[115] But what is given can be taken away; Sarbanes-

compensation package. He was paid only one dollar in the prior year. The rejected package would have provided Pandit with almost fifteen million dollars, despite the fact that Citigroup's stock had declined by more than ninety percent since Pandit became CEO in 2007. The media followed up the vote by questioning what Citibank is doing about Pandit's compensation. *See, e.g.*, Davidoff, *supra* note 103; Francesco Guerrera, *Citigroup's Pay Fiasco: Wake-Up Call for Board*, Wall St. J., Apr. 24, 2012, at C1; David Reilly, *The Sound of Silence From Citigroup on Pandit's Pay Rebuke*, Wall St. J., June 29, 2012, at C18; Davidoff, *supra* note 103.

111 *See* Stephen Joyce, *Firms Retooling Compensation Practices Rewarded with Positive Say-on-Pay Votes*, 10 Corp. Accountability Rep. (BNA) 609, 609–10 (June 22, 2012) (finding that companies with failed say-on-pay votes, as well as companies with a lower approval percentage than they had hoped, have made changes to their pay practices in response); *see also* Che Odom, *Say-on-Pay Votes May Have Caused Shift in CEO Compensation, Expert Says*, 10 Corp. Accountability Rep. (BNA) 749, 749–50 (June 22, 2012) (discussing the results of a study, which found that in 2011, long-term incentives rose as a percentage of an executive's compensation while base salary fell, and which attributed these results, at least partially, to say-on-pay votes).

112 *See supra* Parts II.B–C.

113 *See supra* Part II.

114 *See supra* Parts II.B–C.

115 The Jumpstart Our Business Startups ("JOBS") Act, Pub. L. No. 112-106, 126 Stat. 306

Oxley and Dodd-Frank both prove that point. They highlight the privileges previously accorded, arguably abused, and now lost.

Further, when the federal government stepped in to regulate, it did so in many ways that challenge the traditional understanding of corporate governance. It allocated power between "internal" actors.[116] In some companies and situations, it subjected compensation to government approval. All companies, however, now operate with regulatory requirements about who can evaluate compensation and which directors can be on the compensation committee.[117] All companies must also make disclosures about compensation and face shareholder votes on it.[118] The disclosures and votes, in turn, increase media participation and the role of groups like Occupy Wall Street. The result, attributable to a failure of self-regulation, is both diminished private ordering and increased public governance.

The circumstances surrounding the enactment of these two pieces of legislation also reveal just how public "private" decisionmaking can become. Corporate actors who want to maintain a zone of self-regulation must act with an understanding of the nature of corporate publicness. The failure to do so will result in further pressure for more public governance because, of course, Sarbanes-Oxley and Dodd-Frank are by no means the last word. They are legislative reactions to specific situations.[119] Both create new legal bounds. In so doing, they

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(2012), is an excellent example of regulatory privilege and publicness. Ironically, industry wanted the JOBS Act passed because it removes some types of offerings from regulation and thereby provides greater flexibility for raising capital. Many have decried the JOBS Act for that very flexibility and the fraud they see as likely to occur in its wake. *See, e.g.*, Jesse Eisinger, *Jobs Bill Will Provide Help, but for All the Wrong People*, N.Y. TIMES, Mar. 15, 2012, at B7 (internal quotations omitted) (referring to the JOBS Act as the "boiler room legalization act"); Michael Rapoport, *Investors' Prying Eyes Blinded by New Law*, WALL ST. J., Apr. 6, 2012, at C1 ("But to the extent eligible companies take advantage of the legislation's provisions, investors may not find out as much in the future about companies' ability to prevent errors and fraud.").

Perhaps the most interesting question is what the JOBS Act makes clear: the designation of a company or an offering of securities as within or outside of a particular realm of regulation is just a choice. It is a construct. It is a matter of publicness.

116 *See supra* Part II.

117 *See supra* Part II.

118 *See supra* Part II.B–C.

119 And as such they are subject to criticism. *See* Romano, *supra* note 26, at 1523 ("[Sarbanes-Oxley] was enacted in a flurry of congressional activity in the runup to the midterm 2002 congressional elections after the spectacular failures of the once highly regarded firms Enron and WorldCom."); Roberta Romano, *Regulating in the Dark* 2 (Yale Law & Econ. Research Paper Grp., Paper No. 442, 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstractid=1974148 ("[E]ven the most informed regulatory response—which Congress's reaction in the recent crisis was not—will be prone to error, and is likely to produce backward-looking regulation that takes aim at yesterday's perceived problem, rather than tomorrow's . . . .").

also make clear that additional bounds can be created whenever corporate actors do not self-govern in a way that is acceptable to the public, to Congress, to the media, to advocacy groups, and, of course, to shareholders.[120] A key lesson of Sarbanes-Oxley and Dodd-Frank is that they add to publicness, but they do not define or limit it.

## Conclusion

This Article develops a theory of public governance as a form of publicness by exploring corporate governance and decisionmaking and developing them with a more textured understanding of the nature of corporations and their role. It does so by analyzing two recently enacted federal statutes, Sarbanes-Oxley and Dodd-Frank, and tying them to corporate actors. It also deconstructs the "private" zone and reconceives it with an understanding of publicness. Corporate actors who govern without this deeper understanding of their roles and relationships lose their self-regulation privileges. The private ordering they enjoyed decreases.

The increasing federalization of governance occurs because corporate actors failed to exercise their choices with an understanding of the nature of publicness. They took private ordering for granted. They treated it as a right rather than a privilege. They failed to grasp the actual and potential roles of the media, stakeholders, politicians, and others who wanted changes in the distribution of corporate power and who could succeed after scandals. Publicness, both as a process and an outcome, grows when corporate actors are greedy, when they cheat, and when they fail. The resulting crises and scandals become the vehicles for publicness.

Key to an understanding of publicness, though, is that the group demanding governance is larger than the stated partners (i.e., shareholders, directors, and officers) and includes outside actors. Employing a crabbed definition of this group is actually part of the problem. Those "outsiders" scrutinize decisionmaking and incentives. They monitor failures of internal governance, press for more external governance, and then publicness grows.

Simply put, corporate failures result in publicness. They expose corporate choices. The choices draw the attention and the participation of actors beyond the traditional groups. Actors outside of the corporation and Wall Street scrutinize disclosures and failures, and those actors change over time, as demonstrated by the Occupy Wall

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120 *See supra* Part II.

Street movement and bloggers more generally.[121] Moreover, the scrutiny and concomitant increase in publicness makes transparent the privileged nature of the private zone in which the corporations were operating. They reveal the lawmakers' choices about private ordering and self-regulation. They highlight the spaces not yet legally defined, and those that have been omitted.[122] They create pressure for more reform and public governance. The result is more publicness.

121 *See, e.g.*, Jean Eaglesham & Dan Fitzpatrick, *Probe of J.P. Morgan Widens*, WALL ST. J., June 1, 2012, at C1 ("Federal regulators are using powers they gained in the Dodd-Frank financial overhaul law to ramp up an inquiry into the recent trading blunders at J.P. Morgan Chase & Co. . . . ."); Victoria McGrane & Alan Zibel, *Officials Grilled On J.P. Morgan*, WALL ST. J., June 7, 2012, at C1.

122 *Cf.* Rosenbury, *supra* note 20, at 848 ("The rights of parents to control childrearing in the home pursuant to notions of family privacy, and the right of the state to control—or at least regulate—childrearing that takes place at school, means that these spaces of home and school are salient to children, parents, and the rest of society.").