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Lawrence E. Mitchell, Corporate Irresponsibility – America's Newest Export (Yale University Press, New Haven, Connecticut, 2001)

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Abstract
[extract] Unlike his fellow scholars, however, Mitchell's complaint is that American methods are not superior at all. Indeed, his breast beating paean is that U.S. corporations are more irresponsible than others. But, from beginning to end, he does maintain that U.S. methods are, or soon will be, universal. In fact, the book ends on that note: "the overwhelming power and influence of American capital are changing everything, creating nearly irresistible pressures on corporate systems throughout the world to replicate the U.S. model for the benefit of American investors."

Lawrence E. Mitchell, *Corporate Irresponsibility – America's Newest Export* (Yale University Press, New Haven, Connecticut, 2001)

*Reviewed by: Douglas M. Branson**

Why is corporate irresponsibility "America's newest export?" The last time I looked, of the 100 largest multinational corporations, 46 were headquartered within the European Union, with the United States a close second at 46.[1] Is Professor Mitchell telling us that the Anglo Dutch Unilever is more responsible than, say, Procter & Gamble? Is Total-Fina, the French petroleum giant, more responsible than, say, U.S. based Chevron-Texaco or Mobil Exxon? After all, at least in name, it was Total, and not the U.S. based Union Oil, that was the general manager of the Myanmar pipeline construction with which Mitchell opens his book, as an example of corporate irresponsibility.[2] International human rights organizations are suing on behalf of Myanmar citizens brutalized when Total and Union Oil used the Burmese army as a subcontractor to provide security on the pipeline project.[3]

The U.S. does not have a monopoly on corporate irresponsibility any more than Australia or the United Kingdom do. In fact, on a relative basis, it is the United Kingdom, and not the United States, which has the highest number of publicly held corporations.[4]

Mitchell's fallacy is one Americans frequently engage in, namely, the unstated assumption that American ideas, methods of governance, laws, and legal concepts are both superior and universal, or should be. I have railed elsewhere against this chauvinistic assumption made by my countrymen.[5]

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1. *See* the Forbes Global 500, available on <http://www.forbes.com> (Visited June 24, 2003)(compilation by nationality by the author).
2. *See* Lawrence Mitchell, *Corporate Irresponsibility – America's Newest Export* at 22-25 (2001) (hereinafter cited as Mitchell) ("Unocal and Corporate Slavery").
3. *See Doe v. Unocal Corp.*, 248 F.3rd 915 (9th Cir. 2000)(affirming dismissal of Total for lack of personal jurisdiction in California). *See also Doe v. Unocal*, 2002 WL 31063976 (9th Cir. 2002)(upholding complaint), *rehearing in banc granted* 2003 WL 359787 (Feb. 14, 2003).
4. See John C. Coffee, Jr., The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications, 93 *Nw.. U. L. Rev.* 641, 663 (1999).
5. See Douglas M. Branson, 'The Very Uncertain Prospect of "Global" Convergence in Corporate Governance', 34 Cornell Int'l L. J. 321 (2001).

Unlike his fellow scholars, however, Mitchell's complaint is that American methods are not superior at all. Indeed, his breast beating paean is that U.S. corporations are more irresponsible than others. But, from beginning to end, he does maintain that U.S. methods are, or soon will be, universal. In fact, the book ends on that note: "the overwhelming power and influence of American capital are changing everything, creating nearly irresistible pressures on corporate systems throughout the world to replicate the U.S. model for the benefit of American investors."[6]

This is poppycock. Professor Mitchell has absolutely no data with which to back up his assertions on the universality of American business methods. In fact, there is a considerable backlash in many developed and newly industrializing countries against the adoption of American methods and "corporate systems," to use Mitchell's words. We see it in the protests of the anti globalization forces, who view globalization as a Trojan Horse for large multinationals to bulldoze down all cultural and other barriers to multinationals doing business anywhere, anytime, and any way they like. On a more sophisticated plane, we see resistance to American methods in developing countries which resent what they perceive as International Monetary Fund and World Bank efforts to force adoption of U.S. style economic laws, what author Thomas Friedman refers to as the "golden strait jacket."[7] Never mind that the IMF and World Bank do no such thing. What they desire to see are modern laws, user friendly to direct foreign investment and trade, not American style laws.[8] If anything, World Bank and IMF staffers have a bias against wholesale, or even partial, transplant of U.S. style laws.

The other assertion Mitchell seems to make is that most of the world's investment capital is in the U.S. Ergo, the rest of the world must dance to the tune played by large U.S. investors and multinationals. In fact, there is money, and lots of it, in Sydney (although AMP is working diligently to reduce the amount), Singapore, Hong Kong, Shanghai, Riydah, Milan, Paris, Frankfurt, London, and elsewhere around the globe.

So I intend to review Professor Mitchell's book without the subtitle, "America's Newest Export."

The question then becomes more universal: "is there something endemic in the governance and operation of large modern corporations which causes them to

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6. Mitchell at 275. See also id. at 7 ("American ideas about business and American styles of management appear to be taking over the world.").
7. Thomas L. Friedman, *The Lexus and the Olive Tree* (2000) at 101-111 (Chapter 6, "The Golden Straightjacket").
8. From 1999-2002, the author served as a USAID sponsored consultant to the Ministry of Justice in the Republic of Indonesia, advising on corporate law reform, corporate governance, capital markets law, and asset securitization. He has also formulated or worked on projects in Afghanistan, Bulgaria, Macedonia and the Ukraine.

trample other non-shareholder constituencies, such as labor, consumers, the environment, local economies, and so on?" The further question is "what, as a legal and policy matter, can governments, 'best practices' governance working groups, and other relevant actors do about it?"

I also intend to cease bashing Professor Mitchell, who is a friend and one with whom I agree on many things. Overall, I find his book to be rather one-sided and overstated – but provocative. There is as much here with which I agree as with I disagree.

Mitchell's Central Thesis.

The evil is "stock price maximization" at all costs, by corporations, their managers, and investors. This leads to short termism and to the trampling of the aforesaid non-shareholder constituencies (labor, consumers, the environment, local communities). Corporate managements pander to the share markets, and to share markets alone.

Again, there are unstated assumptions here with which I disagree. One is that all managers engage in short term stock price maximization to the exclusion of all else. I seem to find many companies in which I invest in which managers do not engage in stock price maximization. In fact, in many of the companies in my portfolio, I wish managers would do more of this "stock price maximization."[9]

I think what Professor Mitchell refers to is the practices of high flying high tech, telecommunications and other hot companies at the peak of the 1990s bull market, or bubble, as well as leading to the bubble. Managers of many of those companies did place stock price maximization in the ascendancy, to the exclusion of all else. But Professor Mitchell never so limits his analysis. He passes it off as a universal practice of U.S. public companies.

He also impliedly asserts that stock price maximization is a zero sum game. If managers attempt to maximize the share price, other constituencies are necessarily hurt. For example, with regard to workers, "[t]he premise ... is that the mandate of stockholder profit maximization encourages managers to treat workers poorly."[10] Stock price maximization, to Mitchell, means a loss of professionalism, "professional ethic," and "professional purpose" among middle managers and other employees.[11]

9. More seriously, for example, I have invested in regional and community banking organizations and local service telecommunications providers for whom the mantra is community service, high regard for customers and employees, and steady, sure growth for stockholders. Especially since the burst of the dot.com bubble, in April, 2000, these stock have done quite well.
10. Mitchell at 211.
11. Id. at 236.

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

I think where Mitchell may go awry is his assumption of the old "command and control" model of management in its relationship with rank-and-file employees. Indeed, he cites to Frederick Winslow Taylor, whose early twentieth century method of "scientific management" epitomized command and control.[12] Management theorists, and many managers, however, have long ago moved on to "collaborative" production methods, away from command and control. And, indeed, they have had to do so to insure product quality and to keep employees energized and productive over careers that may span 20 or 25 years.

Even in his description of the evil endemic to the corporate system Professor Mitchell often lapses into a lack of analytical precision. He slides into describing the evil to be avoided as "profit maximization" rather than just "stock price maximization" or, (what I think he really means), shorter term "stock price maximization."[13] Micro economics teaches us that in competitive markets firm managers must maximize profits. If they do not do so, the firm will wither and die.[14] Profit maximization, or at least non ruthless profit maximization, is a desirable goal. Further, while it may be related, it is not necessarily the equivalent of stock price maximization.

The excesses of the 1990s demonstrate that stock price maximization often involves making up profits by manages who, in reality, have failed to maximize. They thus improperly recognize revenue, engage in earnings management, use slush funds and other devices to "smooth out" quarterly earnings, and bribe securities analysts to upgrade or at least maintain favorable recommendations on their stock. Recent cases have involved permitting an analyst to sit as a de facto member of the board of directors (Worldcom) and the upgrade of a stock (AT & T) by an analyst in return for the favor of admission of his children to an exclusive New York kindergarten.[15] Those events are symptoms of the evil to which Professor Mitchell addresses himself, short term and headlong stock price maximization. Standing alone, profit maximization is not evil.

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12. Id. at 219, note f.
13. See, e.g., id. at 234 ("Workers ... have no doubt what their purpose is. It is not to make the best product ... It is to maximize corporate profit").
14. See, e.g., Richard G. Lipsey & Peter O. Steiner, *Economics* at 170-71 (profit maximization) & 241-46 (equilibrium in competitive markets)(3rd ed. 1972)
15. See, e.g., Erik Portanger, "Banned on Wall Street, but All Right Abroad - Analysts Still Pitch Deals In Some Non-U.S. Settings", *Wall Street Journal*, June 6, 2003, at C1.

Penultimate Causes of the Ultimate Cause (Stock Price Maximization Leading to Widespread Corporate Irresponsibility).

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

1. Laws, which bestow upon corporations all the rights of natural persons without adequately recognizing the lack of a moral compass which would inform exercise of those rights.[16]

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

3. Provision of limited liability to corporations and the resulting moral hazard: "limited liability separates corporate decision making from the effects of those decisions and their consequences to others."[17]

4. The failure of large institutional and other "relational" investors to propound social proposals [18]and, rhetoric aside, their headlong pursuit of stock price maximization in their investment portfolios

5. The prevalence of day traders (who accounted for 17 percent of trading volume in the 1990s)[19] and other "casino stockholders" who are "completely detached from corporations in which they invest."[20]

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

16. Mitchell at 45-46 ("You have some belief or system of beliefs that directs you in your daily life .... [Y]ou have some limits to what you will do in pursuit of your self interest. You have a sense that sometimes, at least, the ends do not justify the means.... [T]he corporation is different. The corporation has one end, and that is to maximize its stock price. And the officers and directors that animate it do so with that end in mind.
17. Mitchell at 61.
18. Which, in the United States, shareholders may do in management's annual proxy solicitation sent to shareholders at corporate expense. *See* SEC Rule 14a-8, 15 CFR §240.14a-8.
19. Mitchell at 149
20. Mitchell at 134.

1. No Moral Compass.

Addressing himself to a mythical human reader, Professor Mitchell asserts:

> You have some belief or system of beliefs that directs you in your daily life .... [Y]ou have some limits to what you will do in pursuit of your self interest. You have a sense that sometimes, at least, the ends do not justify the means.... [T]he corporation is different. The corporation has one end, and that is to maximize its stock price. And the officers and directors that animate it do so with that end in mind.[21]

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

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

Third, even though, to paraphrase the first Baron Thurlow, "the corporation has neither a soul nor an arse to kick," Professor Mitchell never explains why in many cases corporate managers, and the board of directors, cannot supply the moral compass the corporation, as an artificial being, lacks. Instead, he attempts to convince with conclusionary rhetoric:

> Instead of animating the corporation, the corporation animates them [officers and directors]. It's like the soldiers of Troy who piled into the Trojan horse. ... [O]nce inside the horse they collectively took on the horse's form and could go only in the direction the horse was designed to pursue.[22]

But why is that so? And, experience tells us, that often is not the case. Time after time in the 1990s boards of directors removed not just underperforming but misguided or wrongdoing CEOs. Officers and directors live among us, share our

21. Mitchell at 46.
22. Mitchell at 44.

values, and attempt to serve well their employees, neighbors and families, as well as shareholders.[23]

2. The Legal Model's Incorporation of Profit Maximization.

There is no such thing. Yet, one footnote disclaimer aside,[24] Professor Mitchell repeatedly states that the law requires profit maximization. Thus, there exists "the legal constraint imposed upon the corporation itself ... that mandates that the corporation maximize its profit."[25] Warming to his thesis, Mitchell states that "[t]he structure and laws governing the corporation create a situation in which the American citizenry learns to maximize profits, to make its decisions in reference to the maximization of profits, and to hone its skills primarily in the pursuit of maximizing profit."[26] Later still, rising not only to, but above, the occasion, Mitchell claims that corporate law requires managers and directors to maximize shares prices.[27]

There are only two instances, that I know of at least, in which U.S. courts have come close to saying that directors' fiduciary duty is tantamount to a duty to shareholders only. First was the Michigan Supreme Court in 1919, in *Dodge v. Ford Motor Co*,[28] when it ordered Henry Ford to pay dividends to his shareholders out of the huge surplus Ford had accumulated. "A business corporation is

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23. In the *New Industrial State (1967)* at 70-71, Harvard economist John Kenneth Galbraith posited the existence of shared values in the middle management layer he denominated the "technostructure," a group "no longer confined by profit maximization" and which would act as a force for corporate social responsibility:
    [This] group is very large .... It embraces all who bring specialized knowledge, talent or experience to group decision making. This, not the management, is the guiding intelligence - the brain - of the enterprise. There is no name for all who participate in group decision making ... I propose to call this organization the Technostructure."
    Later, in *Economics and the Public Purpose* (1973), he recanted, but without explanation. *See generally* Douglas M. Branson, "Corporate Governance "Reform" and the New Corporate Social Responsibility", 62 *U. Pitt. L. Rev.* 605, 608-11 (2001).
    Often it is true that corporate manages over-identify with the corporate purpose, leaving behind in whole or in part their moral compass and sense of social responsibility. But it is far from being the universal phenomenon Mitchell posits.
    Professor Mitchell paints with an overly broad brush here and gives no satisfactory answer as to why, in some cases, mangers and directors leave their values behind at breakfast table.
24. *See* Mitchell at 67, note b ("Note that I say 'maximize profits.' The law has never demanded, except in one rare circumstance, that the corporation maximize *stock price*. (In fact it is questionable whether the law has actually ever demanded that the corporation *maximize* profit.)").
25. Mitchell at 67.
26. Id. at 94.
27. See, e.g., id. at 112 ("the structure of corporate law focuses directors on stock prices") & 132 (law incorporates a "stock price maximization rule").
28. 204 Mich. 459, 170 N.W. 668, 684 (Mich. 1919).

organized and carried on primarily for the profit of its stockholders," the court noted, and "[t]he powers of the directors are to be employed for that end."

The other instance is a 1986 decision of the Supreme Court of Delaware, *Revlon, Inc. v. MacAndrews & Forbes Holdings*,[29] in which the court held that, in a takeover situation, once it became inevitable that the corporation would be broken up or sold, "[t]he directors' role change[s] from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."

No U.S. court has ever held directors liable for "failure to maximize profits." Whether by way of dictum or otherwise, no U.S. court has phrased directors' duty as one involving maximization of profits. Rather, universally U.S. courts have been vague and somewhat coy, stating only that directors' duty is to "act in the best interests of the corporation." That may be largely but not wholly congruent with stockholders' interests but courts do not so state. They create a tent large enough to protect many diverse stakeholder groups. And, at times, as in some of the corporate law insider trading cases, courts have pointedly held that directors' duties run to the corporation and not to any one group or individual within it, such as a selling shareholder.[30]

Under U.S., or Australian, or most other corporate laws, directors may oversee a corporation making only lackluster profits, or no profits at all, but no court would hold the directors liable on that ground alone. It is simply legal error to state, with the two exceptions above noted, that the U.S. (or any other) legal model of the corporation incorporates, or ever has incorporated, as an element thereof profit maximization in any way, shape or form.

3. The Moral Hazard of Limited Liability.

Limited liability is not, as Professor Mitchell intimates, the result of some diabolic plot to shift costs of doing business unto the shoulders of an innocent populace. Rather, limited liability flows naturally from recognizing a collective of individuals as a separate juridical person. As such, the new person, and not the individuals behind it, is responsible for its debts.[31]

29. 506 A.2d 173, 182 (Del. 1986).
30. See, e.g., *Goodwin v. Agassiz*, 283 Mass. 358, 186 N.E. 659 (Mass. 1933)("The contention that directors also occupy a position of trustee toward individual shareholders is plainly contrary to the repeated decisions of this court ...). *Percival v. Wright* [1902] 2 Ch. 421, is an early English holding to the same effect.
31. By contrast, a somewhat troubling trend in the U.S. has been legislative bestowal of limited liability "from the top down" rather than from the bottom up, with enactments such as limited liability company and limited liability partnership laws at the behest of lobbyists and others. See, e.g. Symposium, "Entity Rationalization: What Can or

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

There also exist legal doctrines that permit courts to disregard "corporateness" when the corporate form has been abused, resulting in loss of limited liability. Piercing the corporate veil in small corporations, or in subsidiary parent relationships, and the doctrine of enterprise liability applicable to corporate groups,[32] are important footnotes to the limited liability story but ones seeming absent from Professor Mitchell's presentation.

Then, too, if corporation mangers left their moral compass at home, and also could hide behind the veil of limited liability with impunity, why is that many (most) corporations purchase insurance for all, or most all, risks that are insurable?

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

4. Half Hearted or Duplicitous Institutional Investor Activism.

I quite agree with Professor Mitchell that institutional investor activism was oversold in the first half of the 1990s, mostly by academics but by some managers of public employee and trade union pension plans as well.[33] First, the circle of potential players was actually quite small, limited only to a subset of public employee and union plans.[34] Second, as Dr. Geof Stapledon at the University of Melbourne has demonstrated, in Australia and the United Kingdom, the marginal effort pension fund managers are willing to devote to activism is small. For instance, they may be willing to network with one or two other managers on an agenda item at a specific company's general meeting but they will not, generally speaking, attempt any broader based form of networking or activism.[35]

Should Be Done About the Proliferation of Business Organizations?", 58 *Bus. Law.* 1003 (2003).

32. See, e.g., Arthur M. Pinto and Douglas M. Branson, *Understanding Corporate Law* (1999) 35-64
33. See, e.g., Mitchell at 166: "Legal scholars in the early to mid-1990s embraced the hegemony of the institutional investor with almost messianic fervor. Here, they argued, was the solution to the long-standing problem of the separation of ownership from control. Some people believe this. But the bloom is off the rose".
34. See generally Edward B. Rock, "The Logic and (Uncertain) Significance of Institutional Shareholder Activism", 79 *Geo. L. J.* 445 (1991).
35. G. P. Stapledon, *Institutional Investors and Corporate Governance* (1997).

But, that said and done, it does not take a small city, or even a whole village. A few high profile activist institutional investors may accomplish quite bit. In the U.S., the two poster children for institutional investor activism are TIAA-CREF, the superannuation fund for most of high education and much of the non-profit sector, and CalPERS, the California public employee pension fund. Both are very active but Mitchell faults them because TIAA-CREF has propounded only one social proposal at a portfolio company annual meeting and CalPERS has propounded none.[36]

What Mitchell does not disclose, let alone discuss, is that TIAA-CREF and CalPERS have made a conscious choice to emphasize governance and process issues rather than specific corporate social responsibility proposals. Thus, these two relational investors push for supermajorities of independent directors, strong nominating committees, diversity of viewpoints and demographics on boards, confidential shareholder voting, bifurcation of the offices of CEO and Chairman, and so on. The byproduct of these governance improvements is that when social responsibility proposals are propounded they may well find a neutral, or positive reception, at the board of directors level and be implemented by the directors. Alternatively, if social proposals go to a shareholders vote, confidential voting and other improvements may increase their chance for success.

Institutional investment managers are not the pack of rapacious jackals Mitchell describes.[37] They are not focused solely on stock price maximization issues, such as disarming poison pill takeover defenses and other measures that will lead to an increase in the number of hostile takeover bids. My sense is that, while not a panacea, institutional investor activism has shown more than modest growth and has contributed to more socially responsible corporate behavior. So, again, my conclusion is that Mitchell conveniently tells only half, or less than half, of the institutional investor story.

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

If, in Mitchell's view, institutional investment managers are rapacious jackals (my words, not his), individual investors are mongrels and curs, entitled to no allegiance or privilege whatsoever. To Mitchell, individual investors are the "living dead."[38] They all are principal villains in the headlong stock price maximization saga.

36. See Mitchell at 177 & 179.

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

38. Id. at 135.

He points out that, in the United States, the number of individuals directly or indirectly owning shares of publicly traded companies has increased from 30.5 million in 1970 to 78.7 million in 1999.[39] Roughly, that is one third of the U.S. population, and over on half of the adult population. However large the group may be, however, legal or regulatory protection of them is secondary, or even unimportant.

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

Mitchell does not mince words: "[D]ay traders are the mercenaries of the corporate world, claiming allegiance to no corporation at all and moving in for the kill to take advantage of price movements with speed and stealth, grab their gains, and get back out ...."[40] Or, " [d]ay traders destabilize the market by their excessive in and out trading ... they do nothing to move the [share] price in the right direction because they typically know nothing about the corporations in whose stock they trade ...."[41] Citing what appears to be late 1990s data, Mitchell points out that day traders "make up some 17 to 18 percent of the daily trading volume on the New York Stock Exchange and the NASDAQ."[42]

As to the latter, although I have no data, I believe it safe to say that with the 2000-2002 market crash many of those day traders are now gone. They have either lost their capital in the return to old economy stocks and investment values, or they have pulled out what capital was left to purchase real estate, or to take a long vacation (to Australia perhaps).

I believe that a more representative individual investor model is a purchaser of mutual funds or an old fashioned "stock picker." Individual investors I know still buy shares in a local or regional bank, dabble in a few more established high tech company shares, delve into some of the old economy stocks that show promise, and so on. I have extensive involvement in the securities field. I have only met one person who styled himself a "day trader," and he was a law student, presumably without much money (and maybe making it all up).[43]

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39. Id. at 139. *See also id.* at 147 (U.S. share ownership has gone from 19 percent of households in 1983 to 48.2 percent of households in 1999).
40. Mitchell at 149.
41. Id. at 151.
42. Id. at 149.
43. Moreover, many of the stock pickers I know apply one or more social screens to their stock picking. They do not invest in tobacco companies, or in multinationals engaged in less developed countries and "plantation production" practices, such as those of Nike, and so on.

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

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

> [y]ou have a logic that denies the uniqueness of any single company, and instead argues for understanding such companies as nothing more than the risks and returns associated with their stock. ... It is the logic of the day trader ... who cares what the company does, what the company makes, what the company's long term prospects are - or for that matter, how it behaves?[44]

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

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

Mitchell's shaky evidence is thin reed upon which to base abandonment of allegiance to individual investors, who for decades have been encouraged to engage in "shirt sleeve" and "participatory" capitalism.[45] There are important socio-economic reasons for policymakers and others to continue to encourage direct ownership of shares in public companies. Direct investment makes capitalism real. Direct investment creates another group of individuals who monitor and comment on corporate managers' behavior.[46]

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44. Mitchell at 144.
45. See generally Douglas M. Branson, "Securities Regulation After Entering the Competitive Era" The Securities Industry, SEC Policy, and the Individual Investor", 75 *Nw. U. L. Rev.* 857, 860-61 (1980).
46. Professor Mitchell's disregard for shareholders is reminiscent of the American consume advocate Ralph Nader's suggestion in the late 1970s that stockholders deserved little protection because they were "only gamblers in the stock market lottery." Nader seemed to have no clue as to the important function trading markets have in society.

Professor Mitchell's Prescriptions To Curb or Eliminate the Evil of Stock Price Maximization.

1. Create a new "peerage" of lifetime directors (or, as a compromise, elected for five year terms) to eliminate the necessity of pandering to shareholders in order to be re-elected.[47]

2. Eliminate required quarterly, semi-annual or even annual reporting of financial results, to encourage long term management outlooks.[48]

3. Place confiscatory taxes on day traders' and other short term investors' profits.[49] Also, cap the income of professional money managers that can be based upon short term share trading.[50]

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

5. Treat employee expense such as training and a portion of wages, along with research and development expenditures (R & D), as capital assets, to be amortized over a long period, rather than expensed as they occur.[51]

The only proposals that intrigue me are numbers 2 and 5.

1. Life (or Five Year) Peers.[52]

Perhaps, as the Blair government in the UK lessens the role of the House of Lords, Professor Mitchell's proposal will give many peers hopes for a new sinecure. More

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47. Mitchell at 129 ("[I]t's hard to imagine a serious disadvantage to freeing up boards [from the need to be re-elected periodically] and relatively easy to imagine an improvement in the current state of affairs"). See generally id. 128-32.
48. Mitchell at 132-34 & 157.
49. Mitchell at 162 ("[W]e might impose a sliding-scale tax on trading that occurs within an irrationally short period of time - say, a punitive tax of 75 percent of profits for trades that take place within a twenty-four hour period. ... The amount of tax could go down by, say, several percentage points for each twenty-four or forty-eight hour additional holding period ....")
50. Mitchell at 184 ("We might also want to think about ways of limiting the amount of money manager compensation that is tied to short term performance ....").
51. Mitchell at 245-50. See, e.g., id. at 245-46 ("My principal proposal to make the worker central is to change the accounting rules to treat employees as assets instead of liabilities. ... [C]hange the tax laws and accounting rules to require corporations to capitalize workers' salaries above a stipulated amount.").
52. Mitchell, who favors lifetime directorships, borrows the five year term idea from New York takeover lawyer Martin Lipton. *See* Martin Lipton & Steven Rosenblum, *A Proposal for a New System of Corporate Governance: The Quinquennial Election of Directors*, 58 *U. Chi. L. Rev.* 187 (1991), discussed in Mitchell at 129-32.

seriously, in the United States the dominant model is the staggered, or classified board, in which directors serve three year terms or, in Nevada and New York, possibly four year terms.[53] New research demonstrating that board classification creates a powerful deterrent to hostile takeover bidders will accelerate the trend toward classified boards.[54] Three year or four years as opposed to five year terms does not seem to be a large difference.

In his heart of hearts, rather than five years terms, Mitchell wants self-perpetuating boards, in order to eliminate most shareholder influence.[55] In the United States, one of the black holes of corporate regulation is the not-for-profit corporate sector, in which, by and large, boards are self-perpetuating. Besides producing a whopper of a scandal from time to time, such as the United Way debacle a few years back, self perpetuating board schemes seem to result in a total lack of accountability, bordering on invisibility.

The self perpetuating board idea also bucks the trend, which is to shorter overall board tenure. No longer do directors serve for 20 or 25 years They serve two, or three terms (6 or 9 years) on a specific board of directors. Then they move on to other things.[56]

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

2. Shift Away from Mandatory Quarterly Financial Reporting.

Not too along ago Australia did not require quarterly reporting of financial results. Today, pick up any newspaper, whether it be the *Daily Australian*, *The Melbourne Age*, or the *Sydney Morning Herald*. The financial pages will be awash not merely in reports of quarterly performance but with news stories written about each and every reporting company. It is striking; it has become obsessive.

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53. See Douglas M. Branson, *Corporate Governance* §1.10, at 29 & note 143 (1993)(with supplements).
54. See Lucian A. Bebchuk, John Coates IV, & Guhan Subramanian, "The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy", 54 *Stan. L. Rev.* 887 (2002). See also Bebchuk, Coastes & Subramanian, "The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy: Further Findings and a Reply to Symposium Participants", 55 *Stan. L. Rev.* 885 (2002).
55. See, e.g., Mitchell at 132 ("I prefer the self-perpetuating board ....")
56. Compare Ralph D. Ward, *Twenty First Century Board* (1997) at 45 (board tenures of up to 60 years in times gone by) with id. At 352-55 (younger, more diverse directors with higher turnover).

Pull up a financial website such as *Yahoo Finance*. As to each stock, the research page details quarter by quarter analysts' earning projections, matched with actual performance numbers. Falling just 3 percent, or five percent, shy of analysts' composite projections, a matter of a few cents, can cause a stock to lose 15-20 percent of its value almost overnight.

Professor Mitchell's imperative?

> [Change] the securities laws to lengthen the periods between financial reports. We'd certainly want to eliminate quarterly reporting. And we might also get rid of annual reports. Maybe we'd require them every two years or every three years ...[57]

Really what Professor Mitchell would do is eliminate the "one size fits all" approach to financial reporting which allows no room for different circumstances in different industries and other variances:

> Nothing would stop companies from voluntarily reporting more frequently. In fact there may be entire industries, like those involved in high technology, for which more frequent reporting reflects business realities .... But in the new environment, frequent reporting would be a risky business: live by the short term, die by the short term ....[58]

Other scholars are saying similar things, or at least recognizing the drawbacks of the historical "one size fits all" approach. In the securities law area, a considerable body of work now advocates permitting securities markets to compete against one another on the basis of differing listing standards, disclosure standards, governance rules, and financial reporting requirements.[59]

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

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

I have two difficulties with these proposals. One, they represent an unwarranted intrusion on personal liberty and freedom of contract. Two, both in the United

57. Mitchell at 133.
58. Id.
59. See, e.g., Stephen J. Choi, "Promoting Investor Choice in Securities Regulation", 41 *Va. J. Int'l L.* 815 (2001); Choi, "Regulating Investors not Issuers: A Market Based Proposal", 88 *Cal. L. Rev*/ 279 (2000): Roberta Romano, "A Market Approach to Securities Regulation", 107 *Yale L. J.* 2359 (1998).

States and elsewhere around the globe, tax policy makers have steered tax policy away from utilizing taxes to achieve policy goals other than raising revenue. The Mitchell proposals would represent a return to the "bad old days" when politicians and bureaucrats attempted to use taxation to achieve a myriad of worthwhile and not-so-worthwhile non-revenue objectives.

4. Punitive Taxes on Short Swing Stock Option Profits.

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

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

I would not favor the Mitchell proposal, partly for the reasons stated. Tax law should be used to raise revenue, not to achieve non-revenue policy goals. I would instead place a one year holding period requirement. Executives who exercise stock options would not be free to sell the shares until one year had passed. If they do so, all gains from the sale of the shares would be forfeit to the company (not the government). Private attorneys general would be authorized to bring suit if companies did not do so, as is presently the case under the U.S. Securities Exchange Act section 16(b).[60]

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

5. Capitalize Employee Training and R & D Investments.

When alone, I reassure myself, repeatedly, "I am not a chartered accountant, I am not a chartered accountant." So limited in my skill set, I cannot comment knowledgably about all the "ins" and "outs" of this Mitchell proposal. On the surface I like it. Generally accepted accounting principles (GAAP), and their

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60. 5 U.S.C. §78(p)(b).

application, always should remain true to a first principle, that is, that financial statements reflect as nearly as is possible underlying economic reality.

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

The Sarbanes Oxley Act of 2002, the shotgun federal legislation in the U.S. emanating out of the Enron and WorldCom scandals, has a little noticed provision which commands the American SEC, together with the self regulatory authorities such as the Financial Accounting Standards Board (FASB), to study carefully proposals to convert from "rule based" to "principles based" accounting.[61] There may the forum in which to evaluate proposals such as Professor Mitchell's.

Conclusion - Much Ado About Nothing?

Professor Mitchell mentions several times in his book that he was writing in early 2000. In April 2000, the dot.coms stocks collapsed, followed by a severe crash in high tech, telecommunications, and other high flying stocks over the following (northern hemisphere) summer and autumn Day traders disappeared. Longer term investors returned to old economy type stocks, such as banks, regulated (non Enron) electric and natural gas utilities, manufacturing and retail concerns, food companies, and other long neglected market sectors.

From the late 1980s to the mid 1990s, and then some, the United States, as well as many other countries, had experienced unprecedented, and real, economic growth. Throughout history, however, shares markets overreact to periods of unprecedented growth. When the economic growth slows, market overshoot the market, creating a bubble. It was as true in the late 1990s as it was with the South Sea bubble in 1720. Eventually, the bubble bursts, with severe dislocations for investors, managers, and employees. We have not figured out yet how to have the growth but prevent the bubble at the end.[62] At most, by law and Kensiyan economics, we can dampen it down a bit but that is all we can do.

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61. See Sarbanes-Oxley Act of 2002, Pub. Law No. 107-204, 116 Stat. 745, §108(d), "Study and Report on Adopting Principles-Based Accounting": "The Commission shall conduct a study on the adoption by the United States Financial reporting system of a principles-based accounting system."
62. But see Advertisement, Morgan Stanley, "Blowing Bubbles in a Post-Bubble Economy," *New Yorker*, May 12, 2003, at 43.

The point? An alternative thesis could be that Professor Mitchell's book was obsolete a few months after he had completed writing it, in Spring, 2000. As aforesaid, the day traders disappeared, or at least were humbled and vastly reduced in number. Corporate managers and investors, at least when they returned to the market, were similarly chastised. They shifted their focus away from the headlong and short term stock price maximization Professor Mitchell so roundly condemns.

Yet future bubbles will occur. Era's of financial swashbuckling and casino capitalism will return, from time to time. My feeling is that we get an era of this financial craziness every twenty years or so. So, viewing matters longer term, as Professor Mitchell exhorts me to do, Professor Mitchell's book is not obsolete. I will mark my calendar to re-read *Corporate Irresponsibility* in another 15 years.