The Continuing Debate on Corporate Governance

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The debate on the role of governmental restrictions on business corporations is as old as corporations themselves. When the modern American business corporation came of age early in the nineteenth century, federal and state enabling legislation restricted corporate power, much as the English precedents dating back to the exploration and trading corporations of Elizabethan times had done.1 Although the location, form, and scope of these restrictions have changed dramatically over time, there is little doubt that the debate between proponents and opponents of the restraint of private enterprise will continue throughout the 1980s. Large corporations dominate the economic scene in the United States,2 and multinational enterprises — most privately owned, but some having a state ownership interest — have come to dominate the world economy. The very size of these enterprises and the domestic and political impact

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1. Of course, the history of the American corporate form of doing business must refer to the Dartmouth College case, Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819), where the state attempted to restrict the powers previously granted the college by the legislature in the Dartmouth charter. Chief Justice Marshall found such an attempt unconstitutional as an abridgment of contract. Thereafter, enabling legislation has normally contained a reservation of power to meet just such a situation. See G. Gunther, Constitutional Law 555 (10th ed. 1980).

of their attendant power are a source of considerable public concern. The debate thus centers on the ownership and control of this economic power and how it should be regulated — by the free enterprise economy or through governmental constraints. Two questions are particularly relevant. First, should these enterprises be permitted to continue to combine and grow? And second, must governmental regulatory schemes also grow larger and more complex to adjust to the size of the large corporations? Or is there some middle ground, where a corporation and the government can properly respond to society's legitimate demand for efficient services and fairly priced quality products? The authors of both The Modern Corporate Manager and The Limits of Corporate Power have given some focus to this debate on corporate size and governance.

I

The scope of the coverage in both books is striking. Groening, retired corporate counsel of the Dow Chemical Company, ostensibly addresses himself to the civil and criminal sanctions applied to all levels of the corporation — the enterprise and its officers, directors, and other managerial personnel who have day-to-day responsibilities. This personal approach is in contrast to the more theoretical coverage of Millstein and Katsh, both partners in a New York City law firm. They examine the legal aspects of government regulation, but also discuss the economic, political, and social environment in which private enterprise must operate today. Both books deal with existing constraints on corporate power, Groening in sometimes painful detail, Millstein and Katsh generally and philosophically. The authors all try to carry forward the debate over the advisability of more (or less) governmental restraint on corporate activity. Millstein and Katsh note:

Undoubtedly, some readers will conclude that a sufficient number of effective constraints exist in all (if not too many) areas, while others will assert the inadequacy of the present matrix [of corporate freedom of action and statutory or economic constraint] on both quantitative and qualitative grounds. And there will obviously be a wide spectrum of opinion in between. What we stress here is only that a complex matrix of constraining forces [limiting the exercise of a large corporation's power in any or all areas] does exist, and that if the country is seriously concerned about the issues of corporate size and governance, it behooves us all to enter the discussion with a solid basis of facts about the accountability of corporations today. [P. xx.]

Whatever side one takes in the debate — for or against more govern-
mental regulation of corporations — all will surely find a wealth of interesting material in both books.

Both texts discuss the effect of governmental influence on corporate decision-making (what I believe Groening would call government interference). Each finds the scope of governmental regulation to be quite pervasive. Millstein and Katsh give several illustrations, including:

— The General Accounting Office has identified one hundred and sixteen federal agencies with regulatory responsibilities, and simply cataloging the myriad different programs takes hundreds of pages. [P. 129]³

— [F]ederal laws and regulations seeking to achieve environmental goals have over the past ten years mandated an enormous allocation of capital resources to the protection and enhancement of the environment. Many companies have been forced to spend as much as 20 percent of their capital and 10 percent of their operating budgets for pollution control. [P. 166]⁴

— The Federal Regulation of Lobbying Act⁵ requires that corporate activities designed to influence the passage of legislation must be disclosed. This alone can serve to diminish the flexibility available to the corporation since it may decide it would prefer not going on record with respect to a particular issue. [P. 201]

What these points fail to draw to the reader's attention is that most regulatory measures adopted by Congress or the state legislatures were enacted to correct perceived corporate abuses (Groening, p. 264). These measures are the products of a delicate balancing process. On the one hand, society is increasingly suspicious of the uses to which the very powers it has granted corporations are being put. We resist nationalization or overregulation, but are equally repelled by corporate libertinism. On the other hand, the larger corporations grow, the more important to the national interest their performance becomes. Consequently, corporations and the government must work together to find an acceptable middle road (Millstein & Katsh, pp. xvi-xvii). How these competing interests will ultimately be re-

³. (Citing REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES, FEDERAL REGULATORY PROGRAMS AND ACTIVITIES (1978)). The authors then select a limited number of areas as illustrations of the governmental regulation phenomenon: labor relations, including occupational safety and health, pp. 147-66; environmental laws, pp. 166-78; consumer protection of the FTC, the Consumer Product Safety Commission, and consumer credit laws, pp. 178-96; the political process, including campaign financing, corporate lobbying activities, and foreign corrupt practices, pp. 196-206; and an energy discussion of information gathering, price regulation, conservation and encouragement of technological development through direct federal loans or investment and encouragement of private investment, pp. 206-20.


solved is far from clear. In 1932, Professors Berle and Means predicted:

The rise of the modern corporation has brought a concentration of economic power which can compete on equal terms with the modern state — economic power versus political power, each strong in its own field. The state seeks in some aspects to regulate the corporation, while the corporation, steadily becoming more [economically and politically] powerful, makes every effort to avoid such regulation. Where its own interests are concerned, it even attempts to dominate the state. The future may see the economic organism, now typified by the corporation, not only on an equal plane with the state, but possibly even superseding it as the dominant force of social organization.6

They thought that the political power of corporations would quickly grow to match their economic power.

It is interesting to note that Berle and Means’s 1968 revised edition, in contrast to their 1932 volume, concluded that the twentieth-century American economic revolution had made the corporation a dominant form of organization and production, but had left it a relatively neutral political force.7 Since 1968, however, the situation has changed. Corporate organizations, such as the Business Roundtable (one of the sponsors of the Millstein book), as well as individual corporations, have become more politically active. One only has to open general circulation magazines and newspapers to see public interest, nongeneric advertising on issues of social concern, bought and paid for by America’s largest corporations. Probably the most widely known are the multi-media advertisements of the Mobil Corporation concerning wide-ranging issues in the energy field. Continued attempts to influence public opinion by corporations will no doubt have some impact on legislation and consequent government regulation. The conclusion of Berle and Means that corporate power is politically neutral, therefore, will bear close scrutiny.

II

In attempting to resolve this central problem, the two books take very different approaches. Each is directed at a different audience. Groening writes for modern corporate managers — those who through their activities will cause legal sanctions to be visited on the corporation and possibly themselves. A detailed checklist examining many diverse areas of civil and criminal law is the result. This

checklist traces corporate and individual responsibility, sometimes in excruciating detail. It is doubtful, for example, that any corporate manager will want to know all of the facts of a 1973 Louisiana Supreme Court decision\(^8\) on the liability of a corporate manager, as a principal, for the activities of subordinates. It is similarly doubtful that the manager will peruse the details of section 16(b) of the Securities Exchange Act of 1934,\(^9\) the discussion of which covers ten pages, as opposed to just one paragraph covering shareholder proposals under rule 14a-8\(^10\) of that same statute. In fact, it seems likely that Groening overwhelmingly emphasizes those areas of governmental regulation with which he was concerned while general counsel of Dow Chemical. Food and drug regulation, environmental regulation, the securities laws (particularly the provisions of the 1934 Act concerning insider stock transactions), and ERISA,\(^11\) are given very detailed discussion, much beyond that required to give managers insight into the legal rules and sanctions affecting their employment behavior.

Millstein and Katsh, on the other hand, have resisted an author's normal tendency to write about everything that he has experienced in a given area and have thus produced a much more readable text. *The Limits of Corporate Power* attempts to sketch the economic, social, and political limits on a corporation's power to act, and is not merely a checklist of the various regulations affecting corporations.

Both texts are well-researched and impressively footnoted. The serious reader will appreciate the trouble that the authors have taken in the footnotes to draw attention to the applicable statutes and agency regulations, as well as to the important commentary of legal scholars. Mr. Groening approaches his sources as a classical corporations scholar, citing many of the well-known leaders in the field since the 1930s. He uses the works of Berle and Means, Alfred Conrad, William Cary, Ernest Folk, and the treatment of corporate problems in the major law reviews, including the American Bar Association Section of Corporation, Banking and Business Law's *Business Lawyer*, to illustrate the principles that he outlines. Millstein and Katsh have adopted a more modern approach in their thoughtful text. While they, too, cite the 1970s articles discussing the role of the corporation, their volume is meant to stimulate the reader's

\(^8\) P. 14 (discussing Canter v. Koehring Co., 283 So. 2d 716 (La. 1973)).  
thought by general consciousness raising. As noted above, both volumes provide citations to regulations and statutory sections in massive detail. I often wondered if this was really necessary, especially in the Millstein and Katsh book. Groening includes the citations because he hopes that his readers — corporate managers who are not legally trained — may find them helpful as they confront particular problems in their day-to-day activities.

Both books discuss the regulations relating to the creation, structure, and management of the corporation, including the limited liability and management roles of shareholders, officers, directors, and managers. Groening then examines the penalties visited on corporations and their managers for violations of the laws relating to regulated industries, antitrust, products liability, the environment, employee relations, and the securities laws. Because of his emphasis on the individual liability of the director, officer, and manager, he also discusses indemnification and liability insurance. Millstein and Katsh, after discussing the creation and structure of the corporation, look to the economic constraints of the free market (including the antitrust and securities laws), restraints on business activities inherent in the federal tax system, and the direct regulation of corporate decision-making through the labor, consumer protection, energy, political activity, and regulated industries laws.

As one would expect from the backgrounds of the authors of both texts, additional governmental regulation of the corporation is not encouraged. I particularly enjoyed the Millstein and Katsh volume because it so thoroughly questioned regulatory policy. Chapter three, for example, examines the federal tax system's influences on the discretionary powers of corporate managers. The chapter emphasizes the tremendous influence that the tax system has on corporate decisions relating to capitalization, mergers and other acquisitions, capital investment, employment, political activity, foreign operations, and the like. Although there is little discussion of the effect that state tax laws have on these decisions, the federal income tax consequences of business decisions seem generally well covered. The analysis of tax policy in light of congressional intent is

12. Millstein & Katsh, ch. 1; Groening, chs. 1, 2 & 3.
13. Chs. 4-9.
14. Ch. 11.
15. Chs. 2-4.
16. A major concern of corporations today is tax abatement, forgiveness, and any other measures by which local and state taxing authorities provide incentive for corporate location and specific action that may create jobs.
particularly interesting. The authors consider several examples to determine whether the particular tax provision was intended to influence corporate decision-making. For example, they examine the difference between debt and equity financing, and note that the corporation is allowed no deductions from its income for dividends paid, but that interest on debt is normally deductible (pp. 89-91). They conclude:

There is no indication Congress intended the tax system to bias corporate capitalization decisions toward debt financing . . . . [Furthermore,] the more highly dependent a corporation is on debt, the more vulnerable it becomes to pressures from creditors and to financial difficulties in periods when the economy is weak . . . . [It will be placed at a disadvantage relative to a corporation that is not as heavily "leveraged." . . . Beyond these implications, moreover, the fact that corporations are encouraged by the tax laws to incur debt may mean that the equity market is in a sense artificially constricted. [P. 90.]

Over-reliance on debt financing is a side effect of the tax laws that, with the consequent depression in the equities market, has in turn produced "much of the increased merger activity in recent years" (p. 91). In carefully explaining the complex relationships among tax and other business laws, Millstein and Katsh have provided a real service.

In the area of tax constraints on decision-making, however, it is amazing how many aspects of the discussion in both books need to be updated as a result of the 1981 changes in the tax law. 17 New incentives for capital investment have resulted from changes in the tax treatment of capital gains at a maximum long-term rate of twenty percent, which will significantly affect the willingness of individuals and businesses to dispose of real property, plant and equipment, as well as securities; from improved depreciation and research and development write-offs; from the new asset life assumptions for depreciable property; from changes in individual and Keogh Retirement Plans; and from the change permitting a ten percent charitable contribution deduction (raised from five percent) to encourage corporate largesse at a time when individuals will probably donate less to charity because of changes in the estate tax laws. 18

I found the coverage in both books of corporate governance and social responsibility especially stimulating. Both comment on the oft-charged anticorporate bias in the news and broadcast media. This bias, the authors conclude, has placed corporations in a position of having to justify to the public at large both their existence and

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their economic power. In light of proposed new federal regulatory statutes and revisions of old ones, this bias is likely to become more, not less, important. Millstein and Katsh illustrate the bias against corporations with a quotation from an article in the *Harvard Business Review*:

Broadly speaking, mass media news selection and interpretation feeds the public's suspicions about corporate practice (with a certain amount of help from business malefactors), and interprets corporate affairs with a negative bias. This situation has prompted the choruses of anti-media hates that dominate many business panel sessions and conversations . . . . There is . . . a long standing bias against corporate business in the general media. . . . The reasons are complicated and range from simple ignorance of corporate practice to a mindless pursuit of the kinetic or sensational.19

As a result of this activity, Millstein and Katsh conclude, "the prospect of hostile press reports must be taken into account by corporate management in the decision-making process" (p. 233). This is not a ground-shaking conclusion, but a very practical one often overlooked by corporate decision-makers. Both books take the optimistic view that the multinational corporations can accomplish much in influencing public opinion. Groening, in particular, believes that they can perhaps even reverse the trend toward overregulation (p. 254).

III

The real strength of both texts appears to be in the concluding essays. Again, similarities crop up. Both discuss the need for corporate managers to attune themselves to society's needs and to recognize social values espoused by different constituencies within society. To the extent that the corporation's activities are able to respond to the needs and perceptions of society regarding responsible economic, employee, customer, investor, and related corporate behavior, the pressure for additional governmental regulation will lessen.

The corporate organizational structure, it has been argued, is not responsive to public concerns. If it is true that boards of directors have essentially abdicated their function as watchdogs of management (*Groening*, p. 233), and managers are not responsive to society's needs, as argued by many critics of corporations in the 1970s, forced change will take place.20 In fact, both authors recognize the emer-

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19. P. 232 (citing *Banks, Taking On The Hostile Media*, HARV. BUS. REV., Mar.-Apr. 1978, at 123, 125, 129) (where the original and the reprinted versions differ, the text follows the original).

20. One of the prime critics of corporate behavior has been Ralph Nader. However, he has
gence of a new class of directors in the large corporation, one representing a particular constituency. While "public interest" directors as such have probably not yet been selected, leaders of groups not formerly represented on corporate boards, such as unions, consumer groups, and minorities, have been placed on various corporate boards as a result of an increased awareness by corporate management that it is better to respond voluntarily to society's perceptions than to be forced to do so through legislated change.21

The optimism of Groening and of Millstein and Katsh is contagious. American business has succeeded because of the profit motive, which encourages individual initiative. A balance between corporate initiative and responsibility to the public as well as to investors and coworkers has become an accepted price for their continuing to do business in their present form. As a new generation of corporate managers takes the helm in the 1980s, most of us believe that they will be responsive to societal needs.22 If the events in Washington during the past year have any bearing, government regulation at the national level will decrease. It is too early to tell whether this deregulation will result in adverse economic consequences, such as wide-scale bankruptcies of now unregulated commercial airlines or interstate truckers, or economic success, like that which followed the deregulation of the railroads; or if unregulated corporate activity will be socially detrimental because uncontrolled corporations will ignore their social and economic responsibilities. But if corporations are inherently evil because they are motivated solely by profit, society will again rise up and demand governmental constraints on corporate decision-making. In fact, pervasive abuses in the private sector might well cause the government to take over large corporations representing important segments of the national economy. Both books offer sobering appraisals of this possibility.

However, those who manage the large multinational and domes-
tic corporations that control significant elements of our domestic and world economy have shown themselves to be responsive to the needs and desires of society. As long as a dialogue exists between the critics of the modern large corporation and corporate managers, internal responses to perceived problems can be achieved. Society expects much from the corporation and its management. It has become clear that the pursuit of profit can no longer be the only goal of the American corporation. But if corporations govern themselves with prudence and awareness, governmental action constraining their behavior should be unnecessary. The authors of both volumes have provided information concerning corporate behavior that will help to create a meaningful dialogue on governmental regulation. This dialogue may, in time, result in reforms that adequately control corporate behavior without resort to complicated and burdensome regulations.