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RETHINKING THE CORPORATION (AND RACE) IN AMERICA: CAN LAW (AND PROFESSIONALIZATION) FIX "MINOR" PROBLEMS OF EXTERNALIZATION, INTERNALIZATION, AND GOVERNANCE?

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INTRODUCTION

Much misconduct has been laid at the doorstep of the modern corporation, particularly in light of a historic surge in corporate corruption beginning in 2001.[1] On many levels, this has resulted in a healthy rethinking of the premises of the modern corporation and whether some degree of legal restructuring is needed.[2] This Article takes a different path. It focuses on what is right about the modern publicly held corporation and attempts to decouple these attributes from the

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[1] *See The Ethics of Business*, ECONOMIST, Jan. 22, 2005, at 20–21 (linking the rise of the so-called corporate social responsibility movement to the corporate scandals of the early years of the twenty-first century); *Trials and Errors*, ECONOMIST.COM, Jan. 14, 2005, http://www.economist.com/agenda/displaystory.cfm?story_id=3572974 (noting the increased volume of criminal prosecutions arising from corporate frauds, along with the harsher sentences brought about by the Sarbanes-Oxley Act of 2002, but questioning whether such criminal exposure will serve to clean up corporate America or just deter executives from taking risks).

[2] *See, e.g.*, LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT 276–78 (2001) (finding that American corporations are plagued by a focus on short term profitability and that the law is limited in its ability to address this central failing); Roberta S. Karmel, *Should a Duty to the Corporation Be Imposed on Institutional Shareholders?*, 60 BUS. LAW. 1, 3, 18–21 (2004) (proposing fiduciary duties for institutional investors and stating that so long as Sarbanes-Oxley reforms are imposed upon a shareholder primacy model of corporate governance, they are not likely to prevent future episodes of corporate corruption); Adam Winkler, *Corporate Law or the Law of Business?: Stakeholders and Corporate Governance at the End of History*, 67 LAW & CONTEMP. PROBS. 109, 111 (2004) (arguing that dilution of shareholder primacy norms expands managerial discretion and does not necessarily operate to protect other stakeholders).

debate about what needs to be fixed.[3] It therefore attempts to show that much of this "blame game" is ill-founded and misdirected.[4] It instead argues for a more austere restructuring that would actually transcend the corporation per se and focuses on the apparent locus of the difficulties—the management of the large, publicly held business enterprise.[5]

The misdeeds commonly attributed to the corporation are hardly inherent to the corporation, or the inexorable result of exclusive attributes of the corporation.[6] The essence of the modern corporation consists of two important elements: (1) limited liability; and (2) the ability to lock in capital regardless of the desires of individual owners or creditors.[7] Combined with the shareholder primacy principle, which holds that a corporation operates chiefly for the benefit of stockholders,[8] these elements have maximized the flow of capital from passive investors to

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[3] *See* Douglas Litowitz, *Are Corporations Evil?*, 58 U. MIAMI L. REV. 811, 829 (2004) ("The endless focus on large multinational corporations is a tacit admission that small corporations are not correlated with evil, thereby raising the possibility that wrongdoing is more accurately tied to some factor other than corporate status.").

[4] Perhaps the most extreme voice against corporations is the highly successful litigator Gerry Spence. *See* GERRY SPENCE, FROM FREEDOM TO SLAVERY: THE REBIRTH OF TYRANNY IN AMERICA 71 (1993) (stating that corporations are "inherently evil").

[5] Litowitz, *supra* note 3, at 815 (promoting the idea of "looking beyond individuals and beyond corporations to the pernicious effect of *large institutions* staffed by desperate and pliant workers"). This Article uses "public corporation" or "publicly held corporation" to mean a corporation which has shares that are traded on a national securities exchange and is required to register with the Securities and Exchange Commission ("SEC"). *See* 26 U.S.C. § 162(m)(2) (2000) (defining "publicly held corporation"); 17 C.F.R. § 240.12g–1 (2005) (allowing exemption from registration for non-traded securities).

[6] Typically, scholars today associate five attributes, common transnationally, with the corporation: (1) legal personality; (2) limited liability; (3) transferable shares; (4) centralized management; and (5) shared investor ownership. REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 5 (2004).

[7] *See* Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 393 (2000) (claiming that partitioning assets from claims allowed businesses to be assured that assets were permanently committed to venture); *see also* Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387, 389–90, 454 (2003) (suggesting that limited liability and the ability to pledge capital to an institution for lengthy periods of time, free of claims of individual owners, were keys to why corporations developed into the central means of organizing business activity in the nineteenth century).

[8] *See* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders.").

productive enterprises and rightfully make the corporation a candidate for the "greatest single discovery of modern times."[9] These elements explain why society has, and needs, the modern corporation.[10] These elements need not be associated with the misconduct that corporations happen to perpetrate. Nor do these elements logically create inappropriate incentives or proclivities toward such misconduct.

This is not to say there are no structural problems with the modern corporation. The corporation is a profit-maximizing institution.[11] As such, it will rationally seek to externalize as many costs associated with its activities that it possibly can within the bounds of the law.[12] This is the cost externalization

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[9] Nina A. Mendelson, *A Control-Based Approach to Shareholder Liability for Corporate Torts*, 102 COLUM. L. REV. 1203, 1209 n.14 (2002) (quoting William J. Rands, *Domination of a Subsidiary by a Parent*, 32 IND. L. REV. 421, 423 (1999) (quoting unnamed Columbia University president)). Other commentators have stated that the corporation is the "most important organization in the world" and "the best hope for the future of the rest of the world." JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA, at xv (2003).

[10] Much discussion over time has focused on the efficiency of limited liability. *See generally* MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 234–36 (9th ed., unabr. 2005) (showing that scholars have had difficulty in justifying the efficiency of limited liability in the case of tort creditors, but have recognized the advantages when dealing with contract creditors). From an efficiency perspective, however, tort law does not generally impound costs associated with activities upon individuals lacking control. Since shareholders are stripped of control, it is not necessarily efficient to impose costs upon them for the conduct of the corporation. *See* DEL. CODE ANN. tit. 8, § 141(a) (2001) (stating that the business and affairs of corporations are to be managed by the board of directors). It would appear sufficient for the corporation, in terms of allocative efficiency, to impound such costs on the corporation itself so that management can weigh the costs and benefits of particular conduct. In those relatively rare circumstances where inefficiency may result from the limited liability of non-control individuals, these costs seem well outweighed by the macroeconomic effects of limited liability in achieving a lower cost of capital. *See generally* Steven A. Ramirez, *The Law and Macroeconomics of the New Deal at 70*, 62 MD. L. REV. 515, 517 (2003) (highlighting the need for the law to provide macroeconomic legal infrastructure that operates to lower the cost of capital). There can be little doubt that limited liability insulates passive shareholders from virtually any risk of liability and thus leads to a lower cost of capital. I do not in this Article undertake to prove that the macroeconomic benefits of limited liability outweigh losses from allocative inefficiency, but given the transnational pervasiveness of limited liability, it would appear that it does.

[11] PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (1994) (declaring that "a corporation . . . should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain").

[12] *Id.* § 2.01(b)(1) (maintaining that even if unprofitable, a corporation must still

issue. Similarly, a corporation will fail to see and exploit socially desirable investments which yield external benefits in excess of costs if it cannot internalize sufficient benefits to justify its investment costs.[13] This is the benefit internalization issue. There are also problems associated with corporate governance. A chief executive officer ("CEO") of a modern corporation will often wield tremendous economic power and be tempted to use such power to enrich himself without regard to the welfare of the corporation.[14] This is the agency costs issue. These three issues pose economic challenges to the institutional structure of the corporation, but they do not give rise, inevitably, to the corporate misbehavior that has been a recurring historical experience. Because these issues transcend the corporation and are not inherent to the corporation, I term these problems "minor" problems even though I recognize they impose major economic costs. Essentially, these problems go to the management of the public corporation rather than corporate structure per se. Thus, the challenge to the law is to permit society to exploit fully the benefits of the corporation while minimizing the costs associated with externalization, internalization, and governance.

This Article seeks to highlight these central points, in the specific context of race in America.[15] Part I will seek to show what is right and wrong with the modern corporation. Part II will demonstrate, in general, how the law should respond to this realization of the fundamental strengths and the more "minor" weaknesses of the modern corporation. Part III will apply these lessons to the problems of race in America in 2005. The Article

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act according to the law). Under the American Law Institute's principles of corporate governance, a corporation "may," but is not required to, curtail its profit-seeking activities in accordance with "ethical considerations." *Id.* § 2.01(b)(2).

[13] *See* ADAM SMITH, THE WEALTH OF NATIONS 473–74 (Prometheus Books 1991) (1776) (stating that private actors will forgo certain investments if benefits cannot be sufficiently captured by any single actor to justify investment costs).

[14] *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 306 (1976) ("It is generally impossible for the principal or the agent at zero cost to ensure that the agent will make optimal decisions from the principal's viewpoint."). The problem of agency costs within the corporation has bedeviled shareholders and scholars from the very incipiency of corporate power. *See* MICKLETHWAIT & WOOLDRIDGE, *supra* note 9, at xviii.

[15] Race is an excellent context in which to test the power of any theory of corporate reform because it has rightfully been termed the nation's "oldest and most intractable problem." Richard Delgado, *Derrick Bell and the Ideology of Racial Reform: Will We Ever Be Saved?*, 97 YALE L.J. 923, 923 (1988).

concludes that law plays an important role in the dementia of corporate wrongdoing but that the legal foundation of the corporation itself is not to blame. Instead, the blame lies largely in the legal infrastructure (or lack thereof) surrounding the corporation.[16] The real question that recent corporate misconduct raises is whether it is now past time to insist upon professional management of publicly held companies.[17]

This Article suggests a road map for racial reformers thinking about the central role that the corporation has played in our economy. It is certainly the case that as the central economic institution in America, the public corporation transmits and amplifies racial oppression and inequality resulting from race.[18] When, on May 17, 1954,[19] America finally turned its back on large-scale apartheid ensconced in law,[20] virtually all the capital locked into corporate America was racist capital, dominated and controlled by a racially exclusive power elite.[21] Nevertheless, the problem in terms of race is not the foundation of our corporate

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[16] This may explain why virtually all "economically important jurisdictions" have legally fabricated entities akin to the American corporation insofar as its essential attributes are concerned. *See* KRAAKMAN ET AL., *supra* note 6, at 5.

[17] The author proposes a professional management system for corporations similar to that of the securities brokerage industry. *See* Steven A. Ramirez, *The Professional Obligations of Securities Brokers Under Federal Law: An Antidote for Bubbles?*, 70 U. CIN. L. REV. 527, 532, 537–38 (2002) (describing the role of federal law in curbing misconduct of professional broker-dealers).

[18] *See* Steven A. Ramirez, *Games CEOs Play and Interest Convergence Theory: Why Diversity Lags in America's Boardrooms and What To Do About It*, 61 WASH. & LEE L. REV. 1583, 1590–92 (2004) (explaining how the process of allowing a CEO to pick the board of directors "effectively perpetuates yesteryear's tradition of racial apartheid").

[19] On May 17, 1954, *Brown v. Board of Education*, 347 U.S. 483 (1954), was decided. It held that separate was not equal and school segregation based on race denied African-American children educational opportunities. *Id.* at 493.

[20] It was not until June 12, 1967 that the United States Supreme Court struck down state statutes prohibiting interracial marriage. *See* Loving v. Virginia, 388 U.S. 1, 12 (1967) ("To deny [the] fundamental freedom [of marriage] on so unsupportable a basis as the racial classifications embodied in these statutes . . . is surely to deprive all the State's citizens of liberty without due process of law.").

[21] The first African-American director of a Fortune 500 company was elected on June 23, 1964. RICHARD L. ZWEIGENHAFT & G. WILLIAM DOMHOFF, DIVERSITY IN THE POWER ELITE: HAVE WOMEN AND MINORITIES REACHED THE TOP? 78 (1998). Even as recently as 1980, one study of the demographic background of the corporate elite estimated that there were only ten African-American directors. THOMAS R. DYE, WHO'S RUNNING AMERICA?: THE BUSH RESTORATION 278 (5th ed. 1990). The senior executive ranks were apparently even more racially exclusive—as of 1980 only three of 1700 senior managers were African American. ZWEIGENHAFT & DOMHOFF, *supra*, at 89.

structure but the apex of that structure.[22] Specifically, our system of corporate governance is dysfunctional in terms of permitting excessive externalization, allowing systematic failure to internalize mass investment benefits, and permitting managers to enrich and entrench themselves at the expense of shareholders.[23] Indeed, governance is so dysfunctional as to have transmogrified shareholder primacy into CEO primacy.[24] Our system of CEO primacy is fraught with problems, particularly with respect to race.

I. WHAT IS RIGHT AND WHAT IS WRONG WITH THE MODERN CORPORATION

This part of the Article will attempt to articulate a unified economic theory of the corporation as a means of isolating strengths and weaknesses of the corporate structure from a microeconomic and macroeconomic perspective. At its foundation, this means showing that limited liability and the ability to lock in capital serve to enhance efficiency as well as

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[22] CEOs are tempted to use homogeneity in general and racial homogeneity in particular in strategic ways that serve to enhance their power and compensation. *See* Ramirez, *supra* note 18, at 1589–91, 1613 (noting that "executives will seek to fill boards with demographic and cultural reproductions of themselves").

[23] If a CEO succumbs to the temptation to use race strategically as an instrument to enhance power and compensation, this would compromise his ability to lead a corporation to exploit diversity in a profit-maximizing manner. *See* Steven A. Ramirez, *Diversity and the Boardroom*, 6 STAN. J.L. BUS. & FIN. 85, 118–19 (2000) [hereinafter Ramirez, *Diversity*]. It will also undermine board performance. *See* Steven A. Ramirez, *A Flaw in the Sarbanes-Oxley Reform: Can Diversity in the Boardroom Quell Corporate Corruption?*, 77 ST. JOHN'S L. REV. 837, 845–56 (2003) [hereinafter Ramirez, *Flaw in Reform*] (emphasizing how board diversity leads to enhanced scrutiny and monitoring which result in better board performance and increased value to shareholders).

[24] JOHN BOGLE, THE BATTLE FOR THE SOUL OF CAPITALISM 28 (2005) (stating that a "pathological mutation" has gripped corporate governance as owners' capitalism has become managers' capitalism and executive compensation soared resulting in the transfer of trillions in wealth from shareholders to CEOs and other insiders). The CEO typically holds ultimate control over management and decisive control over the selection of directors. *See* Thomas W. Joo, *A Trip Through the Maze of "Corporate Democracy": Shareholder Voice and Management Composition*, 77 ST. JOHN'S L. REV. 735, 744–47 (2003) (demonstrating the very weak voting rights of shareholders). This Article does not address the issue of whether the CEO is typically the most highly compensated individual associated with the vast majority of public companies, including any individual shareholder. Nevertheless, it is clear that executive compensation has grown dramatically as legal constraints upon management have succumbed to special interest power held by corporate managers. *See infra* notes 84–96.

macroeconomic growth and stability. On the other hand, the fact that the corporation "leaks" investment opportunities because of its fragmented capital base and inability to capture all investment benefits means that macroeconomic growth is sacrificed and investment transactions are foregone.[25] Externalities impose economically unjustified costs upon society generally that also impose costs of inefficiencies and associated macroeconomic drags.[26] Corporate governance flaws lead to a higher-than-necessary cost of capital that is inefficient and stunts growth while creating conditions of financial instability.[27] I will start with the corporation's strengths.

Limited liability has certainly been a success.[28] The vast majority of productive assets in the United States are held by publicly held corporations.[29] This is not an accident. Investors likely have insisted upon it. Every publicly held company in the United States enjoys limited liability.[30] Any company that did not enjoy limited liability would no doubt face a significantly higher cost of capital.[31] Limited liability, therefore, is properly seen as essential to a modern economy and conducive to macroeconomic growth.[32] Any significant pull back from limited

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[25] *See* Steven A. Ramirez, *Fear and Social Capitalism: The Law and Macroeconomics of Investor Confidence*, 42 WASHBURN L.J. 31, 49–50, 70–73 (2002) (positing that public investment function is needed to implement all possible productivity-enhancing investments).

[26] I define externality to be a social or monetary cost of economic activity which is not born by the actor. BUSINESS LAW TERMS 243 (Bryan A. Garner, ed. 1999). One form of externality arises if corporations are given too much political power such that they may extract various forms of government largess to the detriment of society as a whole. President Rutherford B. Hayes recognized this problem over one hundred years ago when he stated that the United States was "a government of corporations, by corporations and for corporations." MICKLETHWAIT & WOOLDRIDGE, *supra* note 9, at xiv.

[27] *See* Ramirez, *supra* note 25, at 41–44, 59–68 (suggesting that impaired investor confidence leads to a higher cost of capital and compromised macroeconomic performance).

[28] KRAAKMAN ET AL., *supra* note 6, at 8–9 ("[T]oday limited liability has become a nearly universal feature of the corporate form. This evolution indicates strongly the value of limited liability as a contracting tool and financing device.").

[29] *See* WILLIAM L. CARY & MELVIN ARON EISENBERG, CORPORATIONS 243–44 (7th ed. 1995). In 1998, corporations generated ninety percent of the revenues reported by American businesses. *See* MICKLETHWAIT & WOOLDRIDGE, *supra* note 9, at 200 n.11.

[30] Indeed, "almost all large-scale business firms adopt a legal form" that includes limited liability. KRAAKMAN ET AL., *supra* note 6, at 1.

[31] *See* Jensen & Meckling, *supra* note 14, at 331–32.

[32] *See* John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law*

liability would impose severe macroeconomic costs as investors would shun public capital investments, thereby driving the cost of capital higher.[33] Thus, regardless of the efficiency of limited liability, it is fundamental to the macroeconomic performance of modern industrial society.[34] In any event, it is difficult to see the efficiency in imposing costs upon shareholders who do not exercise control over the activities generating the costs.[35]

Similarly, it is difficult to quarrel with the legal innovations of the nineteenth century—fundamental to the history of the corporation—which allowed capital to be committed to business enterprises free of the disruptive claims of shareowners and their creditors.[36] One may think of this element of a corporation as a dimension of legal personality, but, in any event, the effect is to shield the assets of the corporation from the creditors of shareholders.[37] These claims were effectively transferred to the value of the shares themselves and the cash flows associated with those shares.[38] This bit of legal hocus-pocus meant real benefits in terms of giving business enterprises an infinite investment horizon and the certainty of committed capital.[39] The law thus eliminated unnecessary risks that had previously plagued the capital formation process.[40]

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and the State in the Separation of Ownership and Control, 111 YALE L.J. 1, 5 (2001) ("A growing body of research suggests that an active securities market is an engine for economic growth.").

[33] *See* MICKLETHWAIT & WOOLDRIDGE, *supra* note 9, at 45 ("Unlimited liability restricted a firm's ability to raise capital.").

[34] Many commentators suggest that as a default contract provision, limited liability lowers the cost of capital, but that it may not be economically desirable in a tort context. *See* KRAAKMAN ET AL., *supra* note 6, at 8–10, 74–75.

[35] *See* Mendelson, *supra* note 9, at 1301–03 (asserting that efficiency arguments in favor of limited liability are strongest "in the case of the individual shareholder that holds a small percentage of stock").

[36] Blair, *supra* note 7, at 454–56. Corporations meant that "[i]nvestments could be made in long-lived and specialized physical assets, in information and control systems, in specialized knowledge and routines, and in reputation and relationships, all of which could be sustained even as individual participants in the enterprise came and went." *Id.*

[37] *See* KRAAKMAN ET AL., *supra* note 6, at 7 (identifying a rule of liquidation providing that the "personal creditors of an individual owner" cannot "foreclose on the owner's share of firm assets").

[38] *Id.* at 7–8.

[39] *See id.* (explaining that "strong form" legal personality, along with limited liability, allows the free trade of shares).

[40] It is noteworthy that the ability of the corporation to lock in capital must be by operation of law as a consequence of the difficulty of negotiating with shareholder creditors, present and future. *See id.* at 8.

As tempting as it may be, caution is also warranted in modifying the shareholder primacy value.[41] Dilution of the shareholder primacy norm is necessarily a dilution of shareholder rights. Diluting shareholder rights, in turn, would lead to a high cost of capital as shareholders would naturally be unwilling to pay the same amount of money for a smaller bundle of rights within the corporate entity. It is difficult to see how there would be any offsetting benefits to this cost of capital increase. Indeed, it appears that the dilution of shareholder primacy may well be associated with corporate governance deficiencies.[42] While some nations have emphasized a corporate purpose beyond shareholder wealth maximization, the dominant universal business form adheres to shareholder primacy.[43] This suggests that shareholder primacy has real value that may well exceed any costs.[44]

To some extent, my focus on a cost of capital justification has been effectively challenged by other commentators. For example, Professor Lynn Stout has demonstrated that arguments that treat shareholders as owners of the corporation are difficult to square with the actual powers of shareholders over a corporation, including their ability to receive distribution only when decided by directors.[45] I take issue with Professor Stout, however, on a number of levels. First, if an individual owns all of the shares of a corporation, there is no reason to doubt that he can operate the firm as if he enjoys all of the emoluments of ownership. As such, why should a fragmented ownership structure lead to a legally cognizable diminution of those very real ownership rights? Second, there is little evidence that labor would find the value of control or earnings to be as high as shareholders find it to be. In fact, the evidence seems to the contrary.[46] Finally, reducing

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[41] *See, e.g.*, Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders.").

[42] *See generally* Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1200–01 (2002) (citing Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001)).

[43] *See, e.g.*, KRAAKMAN ET AL., *supra* note 6, at 61–70 (discussing German and Dutch provisions for employee representation in corporate governance).

[44] *See id.* at 14–15, 64 (stating that deviation from shareholder primacy only occurs "sometimes").

[45] *See* Stout, *supra* note 42, at 1190–99.

[46] *See supra* notes 41–45 and accompanying text.

shareholder primacy neglects the fact that investors in public corporations seem particularly ill-suited to negotiate in advance for their rights[47] yet particularly inclined toward panics when their rights are destabilized.[48] This poses significant macroeconomic risks.[49]

Nevertheless, the heart of my analysis is that granting the shareholder primacy norm to stockholders is in accordance with their reasonable expectations for investing, and diminishing those rights in a legally cognizable fashion is not costless. Indeed, the costs may well be more significant than is generally believed. While major changes in corporate governance law have gone largely unnoticed in capital markets, significant threats to shareholder interests tend to result in a large loss in market value and thereby lead to large increases in the cost of capital that can have significant macroeconomic impact.[50]

In the end, limited liability, committed enterprise capital, and shareholder primacy clearly work in the sense that capital markets are founded on these premises and that deep and developed capital markets are associated around the world with superior economic performance.[51] Moreover, financial experts and economists have demonstrated that more austere versions of investor protection and minority shareholder rights are associated with less effective legal regimes from an economic perspective.[52] Therefore, it appears that these elements of the corporation should be preserved pending evidence that alternative models can match the largely successful results yielded by the current legal model of the corporation.[53]

This is different from suggesting that all is well with the corporation. In fact, much ails the modern corporation. Indeed,

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[47] *See* KRAAKMAN ET AL., *supra* note 6, at 14 (noting that "investors are often the most difficult to protect simply by contractual means").

[48] *See, e.g.*, Ramirez, *supra* note 25, at 34–35 (recounting numerous financial panics triggered by mass shareholder exit from equity holdings).

[49] *Id.* at 39–40.

[50] *Compare* EISENBERG, *supra* note 10, at 101–07 (surveying weak evidence of corporate law impact upon equity prices), *with* Ramirez, *supra* note 25, at 31–34 (surveying the impact of crisis on investor confidence in mid-2002).

[51] *See* Coffee, *supra* note 32, at 5 (noting that an active securities market is an engine for economic growth).

[52] *See* Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1151 (1998) (postulating that nations with common-law traditions protect investors better than countries with civil-law origins).

[53] *See generally* KRAAKMAN ET AL., *supra* note 6, at 215–26.

Professor Mitchell's book on corporate irresponsibility is a virtual "little house of horrors" of the problems plaguing the modern corporation.[54] I simply seek to isolate the malady beyond the shareholder primacy norm, limited liability, and the fact that corporate law provides enterprises with committed capital. For the most part, I conclude that the problem with the corporation is the lack of professional management, particularly within public corporations, and not the essential structural elements of the corporation.

For example, the corporation has been attacked for its proclivity to maximize profits by ruthlessly externalizing costs.[55] Professor Mitchell has called the corporation a "perfect externalizing machine."[56] This attack, in many respects, is an attack on the shareholder primacy norm and limited liability.[57] Yet, as Professor Litowitz has persuasively highlighted, this

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[54] *See* MITCHELL, *supra* note 2, at 276 (noting that the system, although based on democratic ideals, "has gone seriously awry").

[55] *See* Litowitz, *supra* note 3, at 820, 823–24 (explaining that the single-minded pursuit of profits leads to externalizing costs).

[56] MITCHELL, *supra* note 2, at 49, 53.

[57] *See id.* at 54 (stating that the combination of limited liability and shareholder primacy is "deeply immoral" because it encourages excessive externalization). Professor Mitchell's analysis is compelling. Nevertheless, he would agree that when a corporation engages in tortious or unlawful conduct, there are typically at least three sources of recovery available to victims. First, the individual wrongdoer would be exposed to fund the losses suffered by any individual because a corporation can only act through its agents. Second, any profits retained in the corporation as capital free of the claims of shareholders or their creditors—which is one essential feature of a corporation—would be available to fund such losses, regardless of whether the profits are associated with the misconduct, so long as the mischievous employee was acting within the scope of employment and therefore covered under the doctrine of respondeat superior. *See* RESTATEMENT (SECOND) OF AGENCY § 219(1) (1956). Third, any capital contributed to the corporation by shareholders would be available to victims. In addition to these three sources of recovery, in certain circumstances, the assets of shareholders could be available to plaintiffs pursuant to veil-piercing doctrine. *See, e.g.*, Dean Operations, Inc. v. One Seventy Assocs., 896 P.2d 1012, 1014 (Kan. 1995) (holding that corporate form may not be used to perpetuate a fraud or injustice through the inappropriate control of shareholders). Given these sources of recovery, it is hard to see how a corporation is any more perfect at externalizing costs than a partnership, which can be easily dissolved years before many claims come to fruition and lacks the ability to attract capital that public corporations have indisputably demonstrated. Ironically, in part because of limited liability and shareholder primacy, corporations' ability to attract capital is the very reason that large public corporations are every plaintiff's "deep-pocket" defendant. Simply put, corporations may well give victims more secure sources of recovery than probably any other business form. Indeed, shareholders who exercise no control over a corporation probably should not be liable for its torts, as imposing costs upon those with no control over tortious conduct serves no economic rationale.

effort to seek profits through the externalization of costs is hardly inherent to the corporation.[58] Partnerships, sole proprietorships, and individuals will all seek to externalize costs in the name of profit maximization.[59] Professor Litowitz also recognizes that corporations may serve to depersonalize and institutionalize profit-enhancing, cost-externalizing decisions that individuals themselves may not make.[60] Still, here the problem is not corporations per se but large institutions in general.[61] "In other words, cruelty is inversely correlated with proximity to the victim."[62] This suggests that scholars should largely focus on legal structures external to corporate law to prevent excessive externalization of costs by all large institutions.[63] Thus, the primary problem here is not corporate law, but rather the constraints of non-corporate law and its inadequacy in light of the size and scale of the modern public corporation.

Similar considerations govern the issues of internalization of mass investment benefits and governance. The problem is not the corporate structure per se, but considerations that transcend that structure to businesses generally and the large public corporation in particular. The next section therefore focuses upon potential solutions that transcend the corporation.

II. WHAT CAN LAW DO TO FIX THE "MINOR PROBLEMS" IN THE MODERN CORPORATION?

With respect to the problem of internalization of potential benefits from mass-investment activities that generate widely distributed benefits, this problem is not inherent solely to the corporation. Instead, this problem materializes in any system of fragmented capitalization that lacks any centralized means of

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[58] *See* Litowitz, *supra* note 3, at 820, 823–24.

[59] *See id.*

[60] *See id.* at 820 (observing that the corporation's identity as an institution can force officers to act more like machines than human beings (quoting Robert Hinkley, *Neither Enron nor Deregulation*, COMMONDREAMS.ORG, May 19, 2002, http://www.commondreams.org/views02/0519-07.htm)).

[61] *Id.* at 840 ("The real evil lies in *institutions* of a certain size that can dwarf the individual and reduce him to an agentic state of submission while distancing him from the effects of his actions.").

[62] *Id.* at 839.

[63] KRAAKMAN ET AL., *supra* note 6, at 17; *see also* Winkler, *supra* note 2, at 132–33 (arguing that non-shareholder corporate stakeholders have primarily obtained important protections through non-corporate law).

weighing costs and benefits from mass investment. In other words, the problem of internalization of investment benefits is a fundamental feature of any free market system of capitalism that recognizes private property as the primary means of holding wealth within a society. This problem, therefore, transcends the legal foundation of the modern corporation. Indeed, when Adam Smith identified the problem over 225 years ago, he did not limit the issue to one of corporations.[64] Smith focused on the problem of private versus public benefits—terming public benefits those which no single private actor could capture.[65] Consequently, Smith's prescription for the problem did not focus on corporate law but on the role of government.[66]

Smith maintained that the government should fill in the role of investor of last resort, at least for those investment projects—mass investment—that throw off widely diffused benefits.[67] The problem is that after 225 years of experience, it is painfully clear that the government is less than facile at identifying and funding such projects. Certainly, government has occasionally stepped in to make massive investments in projects that have proven to pay tremendous returns, including the Interstate Highway System and the G.I. Bill.[68] These projects generated benefits that far exceeded their costs.[69] Still, this process has neither been institutionalized nor rationalized.[70]

Today, the landscape is pocked with government investment activity that cannot be considered justified by cost, and is dominated by special interest influence and directed into projects that can only be termed looney.[71] For example, consider missile defense. The threat it addresses seems contrived—we have

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64 SMITH, *supra* note 13, at 473–74.

65 *Id.* at 474.

66 *Id.* at 468.

67 *See id.* at 474.

68 *See* Ramirez, *supra* note 10, at 555, 557–59 (describing the positive impact that governmental investment projects during the New Deal had on both employment and the economy).

69 *Id.* at 558 (showing that tax benefits of the G.I. Bill alone were five to twelve times the cost to the government).

70 *Id.* at 555, 559 (arguing that the failure to institutionalize governmental investment projects, such as those under the New Deal, is due in part to a failure by lawyers to establish the necessary legal institutions to facilitate such investment).

71 *See* Jay Bookman, Editorial, *The Legend of Missile Defense*, ATLANTA J.–CONST., Dec. 19, 2004, at 8D (likening the belief in the efficacy of missile defense systems to believing in Santa Claus).

never been attacked by missiles, and any nation that permitted a missile to be launched from its territory against the United States would face certain annihilation.[72] The benefits seem even more contrived. Indeed, after numerous tests the interceptors have significantly failed to hit simulated ballistic missiles—unless the mock missile carries a homing beacon.[73] The interceptor also fails to distinguish between decoy missiles and actual missiles.[74] Yet, through 2004, total expenditures have reached $130 billion with a projected $53 billion more to come over the next five years[75] and $230 billion over the next ten years.[76] The last two tests[77] of the interceptor rockets failed to get off the ground at all—literally.[78] Even the Pentagon itself has acknowledged that the program has been marred by a trivialization of failures and an aggressive "rush to failure."[79] Apparently, even if the system functioned, it could be easily overcome.[80]

Given the central failure of government mass investment,[81]

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[72] Stephen M. Walt, *"Rush to Failure": The Flawed Politics and Policies of Missile Defense*, HARV. MAG., May–June 2000, at 31, *available at* http://128.103.142.209/archive/00mj/mj00.browser.home.html.

[73] *See* Elizabeth Sullivan, *Anti-Missile System Looks Awfully Shaky*, PLAIN DEALER (Cleveland), Feb. 24, 2005, at B9.

[74] Editorial, *The Data Are Garbage*, ST. LOUIS POST-DISPATCH, Mar. 6, 2002, at B6.

[75] Op-Ed., *Starry-Eyed Wars*, INT'L HERALD TRIB., Dec. 17, 2004, at 6.

[76] *The Data Are Garbage*, *supra* note 74.

[77] The Pentagon has apparently called the failure to launch something other than a "test." *See* Editorial, *3-2-1 . . . Pfft!*, ST. LOUIS POST-DISPATCH, Dec. 22, 2004, at B10.

[78] Sheldon Alberts, *Missile Shield Fails Critical Test Again: "The Target Launched Fine, the Interceptor Did Not"*, NAT'L POST (Canada), Feb. 15, 2005, at A9.

[79] MISSILE DEFENSE AGENCY, DEPARTMENT OF DEFENSE, REPORT OF THE PANEL ON REDUCING RISK IN BALLISTIC MISSILE DEFENSE FLIGHT TEST PROGRAMS (WELCH REPORT) 24 (1998), *available at* http://www.mda.mil/mdalink/pdf/welchrpt.pdf.

[80] Kim Murphy, *Russia Tests Missile That Could Evade U.S. Defense*, L.A. TIMES, Feb. 19, 2004, at A1 (describing how new developments in Russian strategic missile systems could easily evade U.S. missile defense systems).

[81] The missile defense fiasco is just one example of many of a distorted mass investment function in the context of the American legal system. I have previously posited that the mass investment function had been hopelessly compromised by political expediency and chaotically deployed. *See* Ramirez, *supra* note 25, at 71. To counter this, I have proposed a depoliticized investor of last resort that could utilize government investments to counter cyclical economic trends and could channel such investments to their highest and best productive use. *See id.* at 72–74. In the course of articulating these positions, I fully recognized the lack of political appeal for Congress to cede control over billions of government investment monies. *See id.* at 73–74. To the extent the economic strength of the public corporation can be

can the fragmentation of capital implicit in private property and free markets be overcome to assure a mass investment function that fully comprehends the total investment benefits accruing to society from mass investment projects? Perhaps, to some extent, it can.[82] What is needed is elimination of legal barriers and legal structures to encourage consortium investments.[83] Naturally, a comprehensive analysis of the legal structures that could accomplish this goal is beyond the scope of this Article. Nevertheless, there is no reason to think that this is a less important area of inquiry than the issue of cost externalization.

I have addressed the issue of corporate governance in depth in another article.[84] I have argued that corporate governance suffers from two fatal flaws: (1) the tremendous special interest influence that corporate managers hold over the corporate governance regulatory environment; and (2) the distorting impact of an antiquated system of corporate federalism.[85] There can be no "race to the top" in terms of corporate governance regimes that are economically optimized in the absence of a depoliticized regulatory regime that reduces special interest influence and allows an expert administrative agency to articulate governance standards based upon the most scientifically proven corporate governance standards,[86] just as a depoliticized agency of economic experts determines monetary

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harnessed to fulfill the vacuum left by a politically impaired government investment function, perhaps corporate mass investment could leave fewer mass investment opportunities behind.

[82] There are inherent limitations to private mass investment in terms of organizing consortia for investments which yield widely diffused benefits. For example, some putative investors may attempt to enjoy the benefits of the investment without bearing the costs. Similarly, some participants may be tempted to hold out for more favorable terms. In the terminology of law and economics, these are the familiar "free-rider" and "hold-out" problems. *See* JEFFERY HARRISON, LAW AND ECONOMICS 67–68, 197 (2002). These problems are just some of the transaction costs facing businesses that see mass investment opportunities.

[83] Currently, virtually any collaboration among competitors triggers antitrust scrutiny. *See* FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS 2 (2000), *available at* http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf ("These Guidelines describe an analytical framework to assist businesses in assessing the likelihood of an antitrust challenge to a collaboration with one or more competitors.").

[84] Steven A. Ramirez, *The End of Corporate Governance Law: Optimizing Legal Structures to Secure a Race to the Top* (unpublished working paper, on file with author).

[85] *Id.*

[86] *Id.*

policy in the United States.[87] This leaves us hobbled with a system of corporate governance that is subject to periodic special interest raids resulting in a "race to the bottom."[88] My proposed remedy is a depoliticized corporate governance authority with the ability to articulate optimized corporate governance norms based upon empirical analysis.[89]

These structural problems are manifest in the precise terms of corporate governance that prevail in the United States today. For example, "directors are selected by management and not elected by shareholders."[90] While there was an initiative to reform the federal proxy rules to give shareholders a real opportunity to have a voice in director selection, managers were able to use their special interest influence to preclude this reform.[91]

The Sarbanes-Oxley Act and the Enron scandals seem to have had little impact upon executive compensation.[92] Indeed, the long-term trend has been termed "troublesome" by key regulators and lawmakers; in 1993, executive compensation at

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[87] *Id.*

[88] *Id.*

[89] *Id.*; *see also* Steven A. Ramirez, *Depoliticizing Financial Regulation*, 41 WM. & MARY L. REV. 503, 560–63, 570–74 (2000) (arguing that political influence, such as well-funded lobbying efforts, has been the primary cause of weakening constraints on corporate managers).

[90] Ramirez, *Flaw in Reform*, *supra* note 23, 856–57; *see also* Joo, *supra* note 24, at 742–47 (stating that on corporate boards "[h]omogeneity [b]egets [h]omogeneity").

[91] The SEC proposed expanding shareholder franchise rights in the wake of the Enron scandals. The status of this reform initiative was well stated in a story about the legacy of SEC Chair William Donaldson:

> Other initiatives are still vulnerable to concerted business lobbying—or simple neglect. Take the chairman's push to give shareholders an easier process to replace errant directors—a vital concern to both individual and institutional investors seeking better corporate governance. The Business Roundtable, representing Corporate America's top CEOs, fought Donaldson's proposals vigorously. The SEC's plan was diluted to the point that dissidents would have to persuade a majority of shareholders to withhold their votes—and would still have to run a two-year-long gauntlet to get their own candidate onto a proxy ballot. The agency hasn't yet passed that measure, and a new chairman would probably shelve the effort rather than expend precious political capital.

Amy Borrus & Mike McNamee with Emily Thornton, *A Legacy That May Not Last*, BUS. WK., June 13, 2005, at 38.

[92] *Rep. Frank Welcomes Securities Regulators' Comments on Runaway Executive Compensation*, U.S. FED. NEWS, Apr. 21, 2005 (reporting that following implementation of the Sarbanes-Oxley Act, the issue of executive compensation was raised at a Financial Services Committee hearing).

public companies totaled 4.8% of profits, and, by 2003, compensation totaled more than 10%.[93] In 2004, executive compensation increased by 25% while stock prices and wages for other workers stagnated.[94] Shareholder primacy is supposed to ensure that shareholders control corporations and that profits of the corporation inure to the primary benefit of the shareholders.[95] It is increasingly clear, however, that the balance on both of these fronts is tipping more than ever in favor of management, and is in fact approaching a CEO primacy model. Management has used its political power, backed by the corporate wealth with which it is entrusted to systematically tilt corporate governance in its favor.[96] This special interest influence must be quelled through the creation of a more depoliticized regulatory framework.

An additional means for creating a more optimal internalization of costs and benefits, as well as securing superior corporate governance, is to professionalize America's corps of senior officers and directors, akin to the effort to professionalize the securities brokerage industry.[97] Like the securities brokerage business, there is a macroeconomic basis for imposing a federal professionalization regime for directors and officers of

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[93] *Id.*

[94] *Id.*

[95] *See* KRAAKMAN ET AL., *supra* note 6, at 13 ("[I]n an investor-owned firm, both the right to participate in control—which generally involves voting in the election of directors and voting to approve major transactions—and the right to receive the firm's residual earnings, or profits, are typically proportional to the amount of capital contributed to the firm.").

[96] Ramirez, *supra* note 89, at 572 ("The most distinctive aspect of the last decade in corporate law was the celerity with which traditional constraints on corporate managers weakened."(citing Joel Seligman, *The Case for Federal Minimum Corporate Law Standards*, 49 MD. L. REV. 947, 949 (1990))). Professor Seligman wrote this before the enactment of the most promiscuous weakening of constraints on corporate management, the Private Securities Litigation Reform Act ("PSLRA") of 1995 which significantly insulated corporate managers from liability through private actions pursuant to the federal securities laws. *See* Steven A. Ramirez, *Arbitration and Reform in Private Securities Litigation: Dealing with the Meritorious as Well as the Frivolous*, 40 WM. & MARY L. REV. 1055, 1093 (1999) [hereinafter Ramirez, *Arbitration and Reform*]. "[T]he PSLRA merely rigs private securities claims so that defendants almost always win" risking "the long term stability of our securities markets." *Id.*

[97] Beginning in the 1930s and continuing to the present day, federal law has operated to impose a comprehensive system of professionalization of the securities brokerage industry. *See* Ramirez, *supra* note 17, at 532 (showing that the federal securities laws operate to protect investors from the professional misconduct of broker-dealers).

publicly held corporations.[98] Specifically, a loss of investor confidence in the integrity of corporate governance and transparency can threaten macroeconomic performance and stability.[99] As such, the senior officers and directors of our publicly held corporations wield tremendous economic power in ways that impact more than the narrow interests of the corporations they captain.[100] This economic power pervades virtually all aspects of the lives of our citizens, from employment to health care to retirement to environmental hazards.[101]

Given the very broad definitions of professionals in other contexts, from lawyers to doctors to hairdressers,[102] it is easy to think of senior officers and directors as meeting the definition of a professional.[103] Professionals typically owe non-waivable, extra-contractual duties to their clients.[104] Professional relationships are generally imbued with a high degree of public interest—either in protecting the client, as in an attorney-client relationship, or for federal professional standards to protect investor confidence and macroeconomic performance, as in the securities broker-client relationship.[105] The professional relationship between managers and the publicly held corporation is at least as important to the economy as the broker-client

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[98] *See id.*

[99] *See* Ramirez, *supra* note 25, at 31–35.

[100] I have long argued that special interest influence has compromised corporate governance for at least the past few decades. *See* Ramirez, *supra* note 89, at 575 ("For many decades politics had foiled financial institution regulatory reform.").

[101] *See* CHARLES DERBER, CORPORATION NATION: HOW CORPORATIONS ARE TAKING OVER OUR LIVES AND WHAT WE CAN DO ABOUT IT 1, 87–88, 305 (2d ed. 2001) (detailing feelings of employee "powerlessness" created by corporations, the pharmaceutical industry's influence over healthcare, and corporate spending to defeat environmental initiatives).

[102] *See* Pratt v. E. W. Edwards & Son, 227 A.D. 210, 212, 237 N.Y.S. 372, 374 (4th Dep't 1929) (holding that by soliciting patronage, a beauty shop operator assures the public that he or she has the requisite skill and knowledge to discharge the occupation); *see also* W. PAGE KEETON ET AL., PROSSER AND KEETON ON TORTS 185 (5th ed. 1984) (listing occupations held to the professional standard of care including pharmacists, pilots, nurses, karate teachers, veterinarians, travel agents, skiers, construction inspectors, and doctors).

[103] *See* Ira M. Millstein, *The Professional Board*, 50 BUS. LAW. 1427, 1440 (1995) (proposing a modest version of professionalization for directors only).

[104] In the context of broker-dealer regulation, this duty requires that customers always be treated in accordance with "'just and equitable principles of trade.'" Ramirez, *Arbitration and Reform*, *supra* note 96, at 1129 (quoting 15 U.S.C. § 78f(b)(5) (2000)).

[105] *See* Ramirez, *supra* note 17, at 528.

relationship.[106] Moreover, shareholders are as much at informational disadvantages as are clients of lawyers or patients of doctors.[107] There is also reason to believe that serving as a senior officer or director of a public corporation is ever more complex and requires specialized training.[108] For example, after the Sarbanes-Oxley Act of 2002,[109] it is clear that many members of the board are going to require increasing legal expertise and accounting facility.[110] The time is past where individuals without specialized training can serve at such lofty positions without serving in a professionally competent capacity.[111] All things considered, it is difficult to articulate any reason why managers

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[106] Indeed, it was a failure of corporate governance and not a failure of the brokerage industry that led to the meltdown in investor confidence in 2002. *See* Ramirez, *supra* note 25, at 31–32.

[107] Ira Millstein has stated the reality of enhanced need for professionalism at the corporate board level in terms of information required for directors to monitor management, as well as the increased need for sophistication among directors:

> In our free market system, the board of directors is the oversight mechanism charged with monitoring management and providing accountability to shareholders, while allowing managers the freedom they need to run the business. While, historically, the U.S. board tended to passivity, in the past decade, boards have become more independent and active, and real oversight has increased. Ideally, meaningful monitoring is aimed at detecting and responding to performance problems before they develop into crises. To do so requires that the board's role expand beyond hiring and removing managers after long-term failure, their traditional form of activation, into more substantive areas, including participation in strategic planning (with performance monitoring vis-á-vis the corporate plan) and creation of incentives linked to corporate performance. This expansion of the board's role increases the demands on directors' time, on their need for information about and education in the business, and on their level of "professionalism."

Millstein, *supra* note 103, at 1428.

[108] *See id.*

[109] 15 U.S.C. 7201 (Supp. II 2004).

[110] Among the requirements of the Sarbanes-Oxley Act ("SOX") applicable to board directors are: (1) each publicly held company is required to have a financial expert on its audit committee or explain why there is no such expert; (2) the audit committee must supervise the corporation's auditor in a detailed fashion; and (3) the audit committee is to be independent of management. In addition, SOX creates incentives for an independent Qualified Legal Compliance Committee to screen reports of possible violations of law or regulations. *See generally* Subcommittee on the Annual Review, *Annual Review of Federal Securities Regulation*, 58 BUS. LAW. 747, 749–50 (2003) (indicating that directors will have more responsibilities and, therefore, need broader expertise).

[111] *See* RESTATEMENT (SECOND) OF TORTS § 299A (1965) ("[O]ne who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade . . . .").

of publicly held companies should not have to endure some kind of qualification exam and bear professional obligations.

Recently, Congress federalized the accounting profession, specifically auditors of public corporations, for the sake of rescuing investor confidence and protecting the macro-economy.[112] This effort to federalize the auditing profession has its roots in the spectacular accounting scandals of 2001–2002, including Enron, WorldCom, and a host of others.[113] Although many of these scandals could be blamed upon an errant accounting industry, the accountants were hostage to the "infectious greed" originating in the CEO's suite and the boardroom, not the other way around.[114] Consequently, the justification for federal intervention seems stronger for corporate managers than for auditors.[115] While it is true that Sarbanes-Oxley and related "reform" initiatives did revamp much of the role of the board of directors, federal law has never operated to mandate professional obligations for corporate managers as it now has for both accountants and securities brokers.[116] This

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[112] *See* 15 U.S.C. § 7211 (Supp. II 2004) (mandating the creation of the Public Company Accounting Oversight Board ("PCAOB") to supervise auditors of publicly traded corporations). Notably, the PCAOB is a self-funded agency that is free of the congressional appropriations process. *Id.* § 7219. Nevertheless, it is subject to the plenary power of the SEC over virtually all aspects of its affairs. *Id.* § 7217. It is still an open question whether the PCAOB will be sufficiently resistant to special interest influence. *See* Ramirez, *supra* note 25, at 64; *see also* Joel Seligman, *Cautious Evolution or Perennial Irresolution: Stock Market Self-Regulation During the First Seventy Years of the Securities and Exchange Commission*, 59 BUS. LAW. 1347, 1348–49 (2004) (comparing the structure of the PCAOB to the federal self-regulatory structure for securities broker-dealers).

[113] *See* Ramirez, *supra* note 25, at 31–32, 63–64.

[114] Alan Greenspan, Chairman, Fed. Reserve Bd., Semiannual Monetary Policy Report to the Congress Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate (July 16, 2002), *available at* http://www.federalreserve.gov/boarddocs/hh/2002/July/testimony.htm (stating that "infectious greed" within the business community overwhelmed the "guardians of financial information" as "[t]oo many" corporate executives sought to "harvest" illicit gains).

[115] This fact has not been lost on the auditing industry. *See generally* Douglas Guerrero, *The Root of Corporate Evil*, INTERNAL AUDITOR, Dec. 2004, at 37. Guerrero cites a study undertaken by the Conference Board—an organization of business leaders dedicated to helping the corporate sector perform better—that found that the corporate crises of 2001–2002 had their causes in a short term focus by management in pursuit of "excessive compensation." *Id.* at 38. Guerrero concludes that "executive compensation issues . . . [were] not addressed at all by Sarbanes-Oxley" and that therefore future frauds are likely as corporate executives are not likely to "self-regulate." *Id.* at 40.

[116] In general, the reforms wrought by SOX regarding corporate governance focus upon the audit function and the audit committee. Thus, public companies must

seems anomalous given the power of managers of public corporations and the manifest breakdown of state-law regulatory systems to appropriately control manager malfeasance.[117] Therefore, I propose a comprehensive scheme of professionalization for senior officers and directors of public corporations—complete with examinations, professional norms and discipline, continuing education, and professional liability.

Inherent in the concept of professional obligations is the concept of training and qualification in order to assure the competency of those serving as directors or officers of publicly held corporations. In the securities brokerage industry, representatives must pass a qualification examination before they can do business with the public.[118] These standards and examinations are administered by the industry itself pursuant to a self-regulatory regime imposed by Congress and supervised under the plenary authority of the Securities Exchange Commission ("SEC").[119] In other words, the brokerage industry itself sets brokerage industry standards.[120] Although there are constraints upon the industry's ability to promulgate promiscuous professional standards, perhaps the most significant is the economic self-interest of the industry itself.[121] I have

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have a financial expert on the audit committee (or explain why they do not have such an expert), the audit committee must meet certain independence requirements, the audit committee must essentially supervise the firm's auditor, and the auditor is restricted in providing non-audit services to the firm. *See* 15 U.S.C. §§ 7231, 78j–1. A further reform mandates that CEOs and CFOs certify financial statements. *Id.* § 7241. Finally, executives are required to give back certain incentive compensation when there is a restatement of earnings necessary due to material noncompliance. *Id.* § 7243.

117 *See, e.g.*, *supra* note 24 and accompanying text.

118 Ramirez, *supra* note 17, at 541.

119 *See id.* at 540–42. Congress provided for the registration and regulation of statutorily defined self-regulatory organizations ("SROs"). These SROs must register with the SEC and adhere to certain statutorily defined supervisory responsibilities. Each broker-dealer, and each representative of a broker-dealer, must in turn register with at least one SRO. The most notable SROs, in terms of public profile, are the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers ("NASD"). *See id.* at 540–43.

120 *See id.* at 542. Each SRO is governed by its membership, which is comprised of the broker-dealers registered with that SRO. *Id.* at 542.

121 The SEC has the power to "abrogate, add to, and delete from" any SRO rule. 15 U.S.C. § 78s(c). In addition, the SEC may enforce SRO rules. *See id.* § 78u(d)(1). The SEC is also empowered to sanction SROs that fail in their supervisory role. *See* Ramirez, *supra* note 17, at 542–43, 543 n.99. The SEC reviews any SRO sanction de novo. *See* 15 U.S.C. § 78s(e)(1).

argued that professionalism in the securities industry has over time enhanced the market niche occupied by securities broker-dealers.[122] This should come as no surprise to those familiar with economic inefficiencies imposed by agency costs. Typically, legal infrastructure that serves to minimize agency costs implicit in all agency-principal relationships also serves to enhance market outcomes for both agent and principal.[123] "In general, reducing agency costs is in the interests of all parties to a transaction, principals and agents alike."[124] When a principal faces reduced transaction costs, like agency costs, he is willing to pay more for the agent's services.[125] Thus, professionalizing corporate governance for public companies is likely to be both economically efficient, as well as macroeconomically beneficial, as it enhances investor confidence thereby reducing panics and lowering the cost of capital.[126]

Another important dimension of professional competency is the duty of care.[127] The duty of care had never really operated to generate much liability of directors of public corporations.[128] Other than cases involving financial institutions, it is difficult to find cases where directors or senior officers have been held liable for breaches of the duty of care. I have argued that the most famous duty of care case which actually held outside directors liable, *Smith v. Van Gorkom*,[129] had little to do with the directors' duty of care and everything to do with the professional responsibility of attorneys.[130] In any event, professionalizing the securities industry may only marginally expand director liability, as that liability would be measured by the standards of the industry and would turn in the end on the testimony of

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[122] *See* Ramirez, *supra* note 17, at 566.

[123] *See* KRAAKMAN ET AL., *supra* note 6, at 22.

[124] *Id.*

[125] *See id.*

[126] This has been the experience in the securities brokerage industry. *See* Ramirez, *supra* note 17, at 559–64.

[127] *See id.* at 557 (explaining how a duty of care obligates professionals to "exercise a professional standard of care" when they "implicitly warrant that they will exercise the degree of skill and judgment that can reasonably be expected from similarly situated professionals").

[128] *See* Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1094–95 (1968).

[129] 488 A.2d 858 (Del. 1985).

[130] *See* Steven Ramirez, *The Chaos of* Smith, 45 WASHBURN L.J. (forthcoming 2005).

experts.[131] Thus, the directors' industry itself would define liability to a very large degree.[132] Moreover, this prospective definition of duty of care obligations, pursuant to more detailed professional standards, would avoid the uncertainty and risks inherent in fiduciary duty adjudications that in the end turn upon ad hoc factual findings.[133] Perhaps, after centuries of struggle, a professional duty of care for senior managers and directors of public corporations would get this issue just about right.[134]

This is particularly so if a regulated self-regulatory regime similar to that in the securities industry were imposed.[135] A broad code of ethics, that transcended mandatory law, could impose expertly promulgated standards that could provide detailed guidance to professional managers on a prospective basis.[136] In addition, this code could be enforced, as are many such professional codes, without regard to whether misconduct caused losses and through sanctions that do not run afoul of

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[131] Professional liability typically requires expert testimony. *See* Cross v. Huttenlocher, 440 A.2d 952, 954 (Conn. 1981) ("To prevail in a malpractice case the plaintiff must establish through expert testimony both the standard of care and the fact that the defendant's conduct did not measure up to that standard."); *see also* Boyle v. Welsh, 589 N.W.2d 118, 124 (Neb. 1999) (requiring expert testimony in an attorney malpractice case); Wessel v. Erickson Landscaping Co., 711 P.2d 250, 253 (Utah 1985) (holding that a structural engineer could establish the standards applicable to landscapers in building a retaining wall).

[132] *See* McCann v. Davis, Malm & D'Agostine, 669 N.E.2d 1077, 1078 (Mass. 1996) (explaining how violation of professional standards is evidence that may support a jury finding of negligence).

[133] I have previously argued that actions for breach of fiduciary duty, anchored in more amorphous equitable principles, may inject unnecessary risk and uncertainty into professional relationships. *See* Ramirez, *supra* note 17, at 550–53. Under traditional tort concepts, professional standards define negligence except in egregious circumstances. *See, e.g.*, Helling v. Carey, 519 P.2d 981, 983 (Wash. 1974) (holding a physician liable for malpractice, notwithstanding compliance with professional standards, for failure to administer low cost glaucoma test).

[134] One example of the depths of the problems with our system of corporate governance is the recent scandal at Refco Group Ltd., the largest futures broker in the United States. The CEO of Refco successfully hid $430 million dollars in debt to a company he controlled. The company went public in the late summer of 2005, and was bankrupt just a few months later. This all occurred after the SOX reforms, and has served to put all investors on notice that they must conduct their own thorough due diligence before buying securities in the U.S. capital market. Ramirez, *supra* note 130, at nn. 128–38. Of course, this asks the impossible.

[135] *See* Ramirez, *supra* note 17, at 542–48 (summarizing professional standards prevailing in securities brokerage industry).

[136] *See id.* at 543–44.

traditional concerns about disproportionate liability.[137] In the securities brokerage industry, sanctions include suspension, censure, fines, or a permanent bar from the industry.[138] All of this could be administered without expanding the federal bureaucracy through the authority of a self-regulatory organization supervised by the SEC as is the case in the brokerage industry.[139] In short, a professional code of ethics could help prevent future Enron scandals without generally burdening those corporations that already adhere to sound principles of corporate governance.[140]

There is more to being a professional, however, than competency. Professionals are not permitted to simply enter into arm's-length transactions that benefit themselves at the expense of the client.[141] Professionals face the prospect of career termination for failing to adhere to professional standards of conduct.[142] In addition, professionals must be abreast of, and guided by, the best learning extant.[143] In the corporate context, this entails a thorough understanding of the externalization problem, the internalization problem, and the manner in which these problems interact with governance activity to make the corporation too often a vessel for destructive mischief. Professor Litowitz has stated the need here well: "In the end, the problem

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[137] Traditionally, directorships have been associated with excessive liability exposure. *See* Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155, 1160–61 (1990) (describing how individuals began either not to accept board positions or resign from boards in order to avoid liability).

[138] Ramirez, *supra* note 17, at 541.

[139] *See id.* at 535–36 (describing the policy basis for the self-regulatory regime in the securities brokerage industry).

[140] One problem with government regulations is the increased cost to public companies. For example, SOX has reportedly increased the cost of being a public company by at least 130%. Adrian Michaels, *The Downside To Staying Public*, FIN. TIMES (London), June 4, 2004, at 10. Thus, a number of companies appear to have exited the public securities markets. *See id.* It is notable that all companies subject to SOX bear these costs regardless of whether they suffered the kind of scandals and governance meltdowns associated with Enron and WorldCom. *See id.* (discussing how SOX caused all public companies to pay more in legal fees, audits, directors' compensation, and insurance).

[141] In the securities industry, professionals must adhere to "'just and equitable principles of trade.'" *See* Ramirez, *supra* note 17, at 528 (quoting 15 U.S.C. § 78f(b)(5) (2000)).

[142] *Id.* at 541.

[143] *Id.* at 537–38.

with corporate law is that it lacks fail-safe mechanisms . . . ."[144] I posit that a regime of professional self-regulation, supervised by an expert regulatory agency, would be such a fail-safe device.

The ability for business to exploit the proven value of the corporation is a powerful economic privilege which in the end exists and is embedded in law to serve the economic needs of society.[145] Too often it fails even on its own economic terms, and this stark reality is simply beyond cavil.[146] Requiring these privileges to be exercised under professional stewardship, complete with a tutored understanding of both the strengths and blind spots of the modern public corporation, is the least that society should insist upon to secure the corporation's economic benefits.[147] Indeed, one nearly magical element of professionalization is that in the long run it tends to serve the commercial interests not only of the client, but also of the professionals themselves, while at the same time securing important public policy goals.[148]

The next part of this Article seeks to exit the realm of abstraction and enter the realm of application. I chose race to be the testing ground of this idea of professionalization as a means of illustrating its potential, specifically because I believe race is a

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144 Litowitz, *supra* note 3, at 830.

145 *See* KRAAKMAN ET AL., *supra* note 6, at 18 (positing that because the corporation exists as a matter of law, it should serve the overall interests of society).

146 Mitchell has noted how corporations have not catered to the interests of society:

> [T]he business corporation has also been a subject of horror. Horror for the way its limited liability permits it to dump the costs of production onto . . . victims of environmental pollution, consumers of dangerous and poorly made products, and workers whose wages have . . . in real terms, dropped. Horror as continuing massive layoffs treat workers . . . as little more than disposable chattel . . . .

MITCHELL, *supra* note 2, at 1.

147 Imbuing individuals with a grander vision of their environment is central to professionalism. At the heart of professionalism is the tragedy of the "commons" problem. When one broker uses his position to line his own pockets at the expense of a client, it harms the collective reputation of all brokers. Federalization of the remedy of professionalism seems to occur when macroeconomic considerations exacerbate this problem of the commons. In other words, when the brokerage industry sacrifices its collective reputation in the name of immediate enrichment, it raises the cost of capital across the economy. *See* Ramirez, *supra* note 10, at 535–36 (suggesting that the professionalization of the securities brokerage industry was intended to restore investor confidence and address macroeconomic growth and stability challenges posed by the Great Depression).

148 *See* Ramirez, *supra* note 89, at 565–66.

central economic problem of our age.[149]

III. RACE AND THE MODERN CORPORATION

Race is a compelling problem in America today, exacting catastrophic macroeconomic costs.[150] Although economists have not recently quantified these costs, I have estimated that race exacts a toll of $1 trillion per year.[151] I also maintain that race problems are inextricably linked to economics: "The very concept of race amounts to the wanton and pervasive destruction of human capital."[152] Moreover, if race is centrally an economic problem, then the modern corporation, as our central economic institution, must play a role. Indeed, the largest five hundred corporations in America control over seventy-five percent of our nation's most productive assets;[153] those assets are almost exclusively under the control of white males who have powerful incentives to continue to perpetuate a racially monolithic power structure.[154]

Nevertheless, a corporate legal structure—broadly defined to include the fundamental parts of the definition of the corporation, as well as the environment in which it operates—requires the perfect internalization of costs and benefits, as well as the optimization of corporate governance. This would maximize the economic performance of the institution as well as serve to reduce drastically the costs of race in America. For example, if race inflicts costs of $1 trillion on our economy annually, then it would significantly benefit corporate America to eliminate the destruction of human capital that is central to race.[155] This suggests that investment consortia consisting of

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[149] *See generally* Steven A. Ramirez, *What We Teach When We Teach About Race: The Problem of Law and Pseudo-Economics*, 54 J. LEGAL EDUC. 365, 374–75 (2004). Given the huge costs of race in America and the centrality of the modern corporation to our economic system, race is the perfect field for the study of any proposed restructuring in corporate law.

[150] *Id.*

[151] *Id.* at 375.

[152] Steven A. Ramirez, *Bearing the Costs of Racial Inequality:* Brown *and the Myth of the Equality/Efficiency Trade-Off*, 44 WASHBURN L.J. 87, 88 (2004).

[153] Ramirez, *Flaw in Reform*, *supra* note 23, at 837.

[154] Ninety-five percent of all board seats are held by whites and ninety percent of all senior officers of Fortune 1000 companies are white males. *See* Ramirez, *Flaw in Reform*, *supra* note 23, at 838.

[155] The analysis of the cost of race has its roots in two sources: first, the inadequate exploitation of the current stock of human capital within the African-

major corporate sponsors could conceivably privatize the mass investment function envisaged by Adam Smith some 225 years ago, in a fashion consistent with profit maximization.[156] The devastation of human capital implicit in race could conceivably be stemmed through a massive recapitalization of previously marginalized communities. The facilitation of such investment consortia basically operates to allow a broader capture of the benefits of this kind of mass investment initiative.[157] Indeed, it may well be that the pursuit of a program of reparations could be profitably pursued by a consortia of corporations that in the past have profited from sordid racial policies.[158]

Similarly, race in America has always operated in a manner that indulged an individual's need for domination, exploitation, and subjugation at the expense of a victim's ability to be a fully contributing member of society.[159] In other words, racial

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American community; and second, inadequate human capital development within the African-American community. Ramirez, *supra* note 149, at 372 (citing Andrew F. Brimmer, *The Economic Cost of Discrimination Against Black Americans*, *in* ECONOMIC PERSPECTIVES ON AFFIRMATIVE ACTION 11, 11 (Margaret C. Simms ed., 1995)). These costs lead to compromised earnings within the African-American labor pool. It should be noted, however, that these costs extend beyond the African-American community. Virtually every producer suffers losses from the depleted economic actualization of the African-American community to the extent that diminished buying power impairs the ability of entrepreneurs to bring innovative products to market. Virtually every employer is faced with higher labor costs because of the underdeveloped human capital within the African-American population and because of the underexploited stock of human capital in this community.

156 I have recently argued that massive recapitalization of human capital within communities of color is essential to resolve race and is macroeconomically beneficial to our society. *See* Ramirez, *supra* note 84.

157 *See generally* Ramirez, *supra* note 152, at 100–04 (demonstrating the high likelihood that investments in human capital pay benefits exceeding their costs).

158 This proposal is akin to a recent effort to show that reparations can be largely privatized. The difference is that I posit that human capital recovery programs, human capital recapitalization, and community redevelopment need not be exclusively "charitable" but can be founded upon profitable investments by consortia of corporations that are positioned to harvest the economic benefits from such efforts. Thus, large corporations with economic potential in Detroit, Michigan may band together to strengthen the quality of labor pools and buying power in that community. *See* Saul Levmore, *Privatizing Reparations*, 84 B.U. L. REV. 1291, 1307–08 (2004).

159 Of course, the underlying dynamics of race transcend economic rationality. *See* Richard H. McAdams, *Cooperation and Conflict: The Economics of Group Status Production and Race Discrimination*, 108 HARV. L. REV. 1003, 1084 (1995) ("I have argued for a sober appreciation that solidarity for some often means enmity for others."). *See generally* Richard Delgado, *Rodrigo's Roadmap: Is the Marketplace Theory for Eradicating Discrimination a Blind Alley?*, 93 NW. U. L. REV. 215 (1998)

oppression results in externalities. In the corporate context this means indulging racial mythology at the expense of rational hiring decisions, or using race strategically to achieve higher levels of compensation.[160] Of course, it also means massive distortions in our system of developing and harnessing our nation's human capital because of the central role of the corporation in our economy.[161] Public corporations have always been governed by the white male elite; they were so governed in 1954 when America finally started to turn its back on apartheid, and they are so governed today.[162] As I have demonstrated previously, this reality appears powerfully related to the economic destruction implicit in race and issues relating to a system of corporate governance that facilitates homosocial reproduction as a means of entrenching the power of governing white elites.[163] More specifically, the reason that human capital is depleted today in racialized communities is the direct result of the point of racialization—the pervasive and wanton destruction of human capital as a means of subordination.[164] The reason the bastions of power are dominated by an exclusive elite of white males is because CEOs who select members of this cadre have powerful incentives to engage in homosocial reproduction—it enhances their power and their compensation.[165] In other words, these racial problems are rooted in the fragmented capital

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(book review) (suggesting that discrimination is an extra-economic phenomenon that is rooted in human need for domination).

[160] Ramirez, *supra* note 18, at 1590–91.

[161] This distortion is in addition to the already prodigious distortions plaguing human capital formation in the United States as a result of race. *See* Ramirez, *supra* note 149, at 366–72.

[162] *See* ZWEIGENHAFT & DOMHOFF, *supra* note 21, at vii, 4, 6–7, 177.

[163] Token diversity alone seems unlikely to disrupt the apartheid system of corporate governance prevailing in the United States. *See id.* at 176–94 (demonstrating that even diverse members of the power elite must demonstrate adherence to the norms of the dominant group). A true embrace of diversity, however, does seem to alter the prevailing pattern of corporate governance. *See* Ramirez, *Flaw in Reform*, *supra* note 23, at 845–56 (examining the possible positive effects of diversifying American corporate boards). Professionalism would seemingly reinforce this movement from a CEO-dominated board to a more diverse and less obsequious board.

[164] Ramirez, *supra* note 149, at 375.

[165] *See* Ramirez, *supra* note 18, at 1589–90 (citing James D. Westphal & Edward J. Zajac, *Who Shall Govern? CEO/Board Power, Demographic Similarity, and New Director Selection*, 40 ADMIN. SCI. Q. 60, 77, 79 (1995) (showing that powerful CEOs pick demographically similar directors and achieve higher compensation)).

structure inherent in private property—implying a distorted mass investment function—and flawed corporate governance.

Nor are the effects of this homosocial reproduction limited to the commanding heights of corporate America. I have shown previously that diversity at virtually all levels of the corporation enhances financial performance.[166] In fact, this is now such mainstream management science that the *Harvard Business Review* recently published a case study of the results of diversity initiatives at IBM and its successful measurement of those results.[167] But diversity programs are not likely to succeed without strong senior level support.[168] Managers engaging in homosocial reproduction do not provide strong leadership sufficient to support the success of diversity within their corporations.[169] Thus, once it takes hold in the boardroom, homosocial reproduction is likely to take root throughout the corporation to distort hiring and advancement.

Professionalization is not likely to fully remedy all of these shortcomings in the law surrounding the modern corporation.[170] Nevertheless, tutoring senior officers and directors in concepts of broad professional responsibility and the role of the corporate privilege in our society is likely to result in a greater appreciation of the stewardship extended to the captains of industry. Lawyers and stockbrokers still commit malpractice and engage in unethical behavior at the expense of their clients,[171] yet there is little doubt that the self-regulatory policing encourages a

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166 *See* Ramirez, *Diversity*, *supra* note 23, at 90–109 (showing that diversity in corporate America produces various positive effects on business, creating a more innovative business environment which eventually sparks productivity and overall performance).

167 *See generally* David A. Thomas, *Diversity as Strategy*, HARV. BUS. REV., Sept. 2004, at 98 (demonstrating significant improvement in both productivity and performance after diversity initiatives were undertaken).

168 Ramirez, *Diversity*, *supra* note 23, at 111.

169 *See id.* (noting the pronouncement of the Labor Department's Glass Ceiling Commission that "change must come from the top" for corporate diversity initiatives to exist and succeed).

170 For example, no amount of professionalization will eliminate the problem of externalities if there are flaws in the non-corporate law that encourages externalizing costs. *See* KRAAKMAN ET AL., *supra* note 6, at 17 (observing that "many constraints [are] imposed on companies by bodies of law designed to serve objectives that are largely unrelated to the core characteristics of the corporate form").

171 Indeed, much of the articulation of professional standards in the securities brokerage industry is the result of SRO or SEC adjudication of putative violations of professional norms. *See* Ramirez, *supra* note 17, at 542–48.

superior professional culture in terms of competency, loyalty, and diligence.[172] With respect to the securities industry, it is clear that the professionalization of the industry—at least when supervised by the SEC—has eliminated many excesses.[173] With respect to attorneys, the relatively frequent disbarment of errant professionals certainly creates an incentive for other lawyers to put their clients ahead of their narrow, short-term self-interest.[174] Thus, professionalization of the management of the publicly held corporation should lead to more adept business leadership with greater fidelity to shareholders and to society in general.[175] If professionalization can help optimize the conduct of corporate operations, then one would expect that some marginal resolution of the problem of race in America would naturally follow.

Professionalizing the management of the public corporation has other advantages. At the root of much corporate dysfunction is the "club" atmosphere at the top of corporate America.[176] Professionalism should replace this culture with one of

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[172] *See, e.g.*, William T. Gallagher, *Ideologies of Professionalism and the Politics of Self-Regulation in the California State Bar*, 22 PEPP. L. REV. 485, 492 (1995) (describing self-regulating professional organizations, such as bar associations, as "collective voices of often powerful professions . . . [that] potentially wield enormous influence in society . . . [and] clearly play a prominent role in shaping and articulating professional values and ideology").

[173] *See* Ramirez, *supra* note 17, at 543 ("[The] combination of primary industry self-regulation with close government supervision and government-backed enforcement has proven to be a powerful recipe for high standards of professional conduct."); *see also* Seligman, *supra* note 112, at 1347 ("Far from being a panacea, industry self-regulation subject to SEC supervision generally has been effective in its major applications when the Commission has been willing to threaten or actually use its regulatory authority to create incentives for securities industry self-regulation.").

[174] *See generally* JOHN F. SUTTON, JR. & JOHN S. DZIENKOWSKI, CASES AND MATERIALS ON THE PROFESSIONAL RESPONSIBILITY OF LAWYERS 20–21 (2d ed. 2002) (stating that although it may be difficult to legislate morality, the Model Rules have the virtue of creating an external effect on attorney conduct in addition to any internal morality-based constraints).

[175] *See, e.g.*, Ramirez, *supra* note 17, at 543–44 (recognizing that professionalization in the securities brokerage field by way of self-regulation in response to the "SEC and the prospect of further federal legislation" yielded a code of conduct that "both protects customers and allows the industry to impose efficient business practices").

[176] This "club" atmosphere is certainly manifest in the extreme racial and gender homogeneity at the apex of corporate governance. *See supra* note 154 and accompanying text.

competency.[177] A value for the full success of the enterprise should thereby supplant the current model of CEO primacy.[178] These professionals can be trained to exploit mass investment opportunities and to avoid externalities.[179] The idea of simply running a corporation for the exclusive benefit of the corporation could become an anathema similar to churning in the securities brokerage industry.[180] Those managers who violate these professional norms could face sanction or bars. Therefore, while professionalization is not likely to eliminate all problems with corporate management, there is good reason to believe that it could move corporate governance closer to an optimal structure[181] and help quell externalization of costs while encouraging a more proficient vision of mass investment opportunities.[182]

Moreover, given the history of corporate reform, professionalization is likely to outshine other options being tapped to remedy corporate misanthropy. Most recently, SOX has been subject to mixed reviews and seems to be of dubious efficacy in terms of sustainable reform of corporate governance.[183]

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[177] The securities brokerage industry requires examinations and continuing professional education. *See, e.g.*, Ramirez, *supra* note 17, at 537–38, 540–42, 547–48.

[178] *See supra* notes 84–96 and accompanying text (emphasizing the sway of corporate management's special interests over corporate governance and asserting the need for more depoliticized regulatory framework).

[179] In fact, if a legal framework existed to exploit mass investment endeavors, it would likely be a success. Unlike many securities-brokerage standards, a standard to seek out and exploit investment opportunities is not counter to the self-interest of the professional as are churning prohibitions and suitability requirements. *See* Ramirez, *supra* note 17, at 544–46.

[180] *See id.* at 545–46 ("The prohibition against 'churning' precludes a broker from using control over a customer's account to generate excessive trading activity . . . . [T]he SEC long ago recognized that a broker may inappropriately control an account even in the absence of a formal grant of discretionary trading authority.").

[181] *See* KRAAKMAN ET AL., *supra* note 6, at 38 (recognizing consensus among commentators that "good corporate governance depends on numerous 'best practices'" and listing several such practices).

[182] *See supra* note 179 and accompanying text. Articulating the precise contours of professional requirements is beyond the scope of this Article. At a minimum, however, this Article suggests a qualification exam, a continuing education requirement, membership of all managers in a self-regulatory organization empowered to mete out sanctions, and adherence to a comprehensive code of conduct that reflects the best learning of the science of corporate governance and the role of the corporation. *See supra* notes 112–40 and accompanying text (discussing standards and obligations that potential professionalization of corporate governance entails).

[183] *See* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1602 (2005) (describing SOX as "seriously

Imposing judicial rigor upon corporate governance is as likely to lead to political backlash as it is to reform effectively the corporation as an institution.[184] The SEC seems politically incapable of leading any sort of broad corporate reform as special interests appear to have inordinate sway over that agency under normal circumstances.[185] One must turn the pages of history all the way back to the Great Depression in order to observe fundamental and sustainable reform taking root.[186] Consequently, professionalizing the corps of officers and directors at the pinnacle of corporate America could be a viable reform strategy for the next time that a precipitous erosion in investor confidence threatens the macroeconomy and prompts legislative reform activity.[187] Therefore, reformers should recognize professionalization as a possible means both to enhance corporate performance and to secure greater diversity in corporate America.[188]

CONCLUSION

At its foundations, the modern corporation is a powerful tool for economic progress and is sound from both a microeconomic and macroeconomic perspective. None of the problems associated with the modern corporation inhere to these foundational elements. Instead, the problems flow from issues of externalization, internalization, and governance—issues that

misconceived").

[184] This is essentially what occurred when the *Smith v. Van Gorkom* decision—finding outside directors liable—was issued. *See supra* notes 129–30 and accompanying text.

[185] *See* ARTHUR LEVITT WITH PAULA DWYER, TAKE ON THE STREET: WHAT WALL STREET AND CORPORATE AMERICA DON'T WANT YOU TO KNOW 236 (2002) ("During my . . . years in Washington, . . . nothing astonished me more than witnessing the powerful special interest groups in full swing when they thought a proposed rule or a piece of legislation might hurt them, giving nary a thought to how the proposal might help the investing public.").

[186] *See* Ramirez, *supra* note 25, at 34 ("[T]he Crash of 1929 and the ensuing Great Depression led to the New Deal, which provided for wide-ranging federal regulation of financial markets . . . .").

[187] *See id.* at 33–34 (highlighting the federal government's economic intervention following the 2001 terrorist attacks, describing them as "intended to stem panic: panic that was reflected in investor psychology, which . . . had eroded to a point that had negatively and manifestly influenced stock market performance").

[188] *See* Ramirez, *supra* note 18, at 1583–84 (identifying obstacles preventing greater corporate racial diversification and pointing to SOX as "a wasted opportunity to disrupt legally the homosocial reproduction that plagues board selection processes").

plague all conceivable business forms, and indeed, humanity generally. Oftentimes, governance issues and agency costs are a struggle against greed. Greed is inherent to humans, not the corporation. It is true that the corporation is insatiable, but that simply means that the legal infrastructure *around* the corporation must take this into account as it must with humans generally. Law is responsible for creating structures that channel such greed productively.

The thesis of this Article is if law can resolve such issues, at least to the maximum extent possible, then the corporation can operate to advance broad societal goals. Indeed, a properly structured corporate law holds the promise of solving many of the most challenging problems, such as race. Professionalizing the management of public companies may facilitate such a resolution of the externalization, internalization, and governance challenges. Yet instead of a professionalized corps of managers, our corporate sector seemingly teeters on the edge of a CEO primacy model. Such a model is unsustainable as investors will not continue to permit CEOs to garner a disproportionate share of corporate earnings. Professionalization is not a cure-all, but it can serve to trump the exclusive atmosphere that currently rules corporate America. This should help put an end to homosocial reproduction, excessive externalization, excessive agency costs, and a lack of mass investment.

These outcomes would allow America to continue to make racial progress. Professionalism could mean a less exclusive class of corporate managers, which would encourage diversity throughout the corporation. Finally, a professionally managed public corporation sector could begin to think about methods of mass investment that could help resolve the economic albatross that is race in America.