authority under the Exchange Act because if the SEC were permitted to control the distribution of voting power, it would assume an authority that the Exchange Act's proponents disclaimed any intent to grant.\textsuperscript{271} Rather, Congress believed that so long as investors received enough information, shareholder voting could work, and therefore it gave the SEC power over voting procedure instead of substantive control of voting power.

In its rule proposal regulating shareholder access to the proxy process, the SEC recognized that provisions of state law regarding director elections are fundamental factors upon which many of the assumptions, projections and analyses in the proposing release depend although those provisions are not identified.\textsuperscript{272} The proposing release attempts to avoid a conflict with state law by asserting that its proposed rules are conditioned on the existence of shareholders rights under state law, but does not cite to any such laws.\textsuperscript{273} Rather, the proposing release states that a company would not be required to include a director nominee if that would violate state law.\textsuperscript{274}

Much could be said about corporate abuses over the past few years and the detrimental effect of the bursting of the 1990s stock market bubble on investors and particularly pension fund beneficiaries. Such rhetoric forms much of the basis for the SEC's new proxy rules. Older Americans who contemplated retirement are angry, and pension funds are embarrassed. Still, a large shareholder or group is not necessarily more representative of the interests of the shareholders as a body, than management and the board who owe fiduciary duties to all of the shareholders.\textsuperscript{275} By contrast, one shareholder or a minority group does not have any fiduciary duties to other shareholders.\textsuperscript{276}

The SEC twice before proposed the idea of shareholder nominations as a way to ensure better corporate governance, but backed away for, among other reasons, doubts concerning its authority to mandate such a regulation.\textsuperscript{277} In the current business-bashing political climate, such doubts seems to have been pushed aside. They should not be. Regulatory intrusion into the shareholder nomination process goes to the very heart of

\textsuperscript{271}\textit{Id.} at 411.


\textsuperscript{273}\textit{Id.} at 60,808.

\textsuperscript{274}\textit{Id.} at 60,787.


\textsuperscript{276}See BAINBRIDGE, supra note 98, at 335-36. A controlling shareholders may have a duty to minority shareholders, but this is an exception to the general rule. \textit{Id.}

\textsuperscript{277}Statement by SEC Commissioner Paul S. Atkins, supra note 264.
corporate governance and would drastically alter federal and state power to regulate internal corporate affairs.

IV. IMPLICATIONS OF SARABANES-OXLEY

A. Aggressive Enforcement and Overregulation


In July 2002, a multi-agency task force was created to consolidate the federal government's prosecution of white-collar crimes, and, in July 2003, the White House was happy to report that task-force prosecutors had obtained more than 250 corporate-fraud convictions or guilty pleas. See Greg Hitt, Corporate Reform: The First Year: SEC Chief Says Worst of Fraud Is Likely Past; Federal Task Force Set Up to Investigate Wrongdoing Marks a Year on the Beat, WALL ST. J., July 23, 2003, at C9. The Chairman of the SEC suggested that this record of criminal prosecutions had led to a renewed public confidence that partially accounted for recent stock market strength. The SEC is nevertheless urging Congress to give the agency even more remedies in administrative actions, make its investigations easier by improving access

288Id.
to bank records and grand jury information, and remove barriers to the production of privileged information.\textsuperscript{288}

It could be argued that such prosecutorial zeal is an appropriate reaction to the infectious greed and financial frauds of the past decade. It could also be argued that it is inappropriate and bad policy for the SEC to have the means, as a practical matter, through the new regulatory tools given by Sarbanes-Oxley, to investigate and prosecute every CEO and CFO of every public company. Coupled with the SEC’s new mandates regarding corporate governance, the SEC now possesses enormous leverage to shape the boardroom to fit its ideas about corporate conduct. These ideas are bureaucratic and based on an adversarial model of corporate structure in which independent directors wrest control from corporate managers and become accountable to the SEC as a surrogate for shareholders. Proposals that thus far have not yet become law, like the initial model for a “financial expert”\textsuperscript{289} and the QLCC,\textsuperscript{290} suggest the SEC’s ambitions to regulate the corporate boardroom are designed to make the board and its advisors answerable to the SEC, rather than other constituencies.

Excessively zealous prosecution and overregulation can lead to a number of results contrary to the interests of shareholders or the public. Corporate managers and directors may become overly conservative and adverse to taking risks, concerned more about complying with SEC regulations than tending to their business affairs.\textsuperscript{291} Shareholders may become lulled into thinking the SEC is monitoring corporate behavior so there is no need for them to do the difficult work of assessing investment opportunities.\textsuperscript{292} Smaller companies, unable to bear the costs of compliance with Sarbanes-Oxley, could also go private to the detriment of existing public shareholders.\textsuperscript{293} Finally, accountants and lawyers may become more concerned about protecting themselves from possible liabilities than representing client interests.


\textsuperscript{289}See supra notes 188-91.

\textsuperscript{290}See supra notes 223-29.


\textsuperscript{293}See Peter A. McKay, Though Their Stock Is Publicly Held, Companies Adopt a Private Mentality, WALL ST. J., July 28, 2003, at C1.
On the other hand, all of these horrible consequences may not come to pass and corporations may instead engage only in honest and transparent financial reporting. In a report marking the one-year anniversary of Sarbanes-Oxley, the House Financial Services Committee expressed the view that the statute had led to improvements in accounting, auditing and corporate governance and that startup costs for implementing the act had been unsubstantial.294 Further, the Report asserted that there was no evidence that Sarbanes-Oxley was creating a trend toward going private.295 The current chairman of the SEC similarly expressed the view that Sarbanes-Oxley has restored investor confidence in the securities markets.296

Much of the criticism of Sarbanes-Oxley by the business community has centered on section 404 and PCAOB Auditing Standard 2.297 These rules require auditors to do a full scale audit of a company's internal controls and then opin on their effectiveness.298 It has been estimated that this effort may increase auditing costs of U.S. companies by forty percent.299 The chairman of the NYSE has questioned whether the cost of compliance with Sarbanes-Oxley is worth the cost.300 Still, some believe that the corporate backlash against these costs proves that Sarbanes-Oxley is a good law.301 A former Federal Reserve Board chairman and former SEC chairman have argued that the burdens of Sarbanes-Oxley are worth its costs.302

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295Id. at 22.

296See Hitt, supra note 286, at C9.


299Id. at 3. It has been estimated that the increased auditing costs of foreign companies will increase by one hundred percent. See John Thain, SARBANES-OXLEY: IS THE PRICE TOO HIGH?, WALL ST. J., May 27, 2004, at A20.

300Thain, supra note 299.

301See LONG & SHORT CORPORATE REGULATION MUST BE WORKING—THERE'S A BACKLASH, WALL ST. J., June 16, 2004, at Cl.

During the one year since Sarbanes-Oxley was passed, a multi-agency task force obtained 250 corporate fraud convictions or guilty pleas, including those of twenty-five CEOs.\(^3\) When a high percentage of public corporations and their chief executive and financial officers have engaged in the dissemination of fraudulent financial information, it may be concluded that there has been a serious ethical failure in the top echelons of the business community and that the proper response is new regulation and a prosecutorial crackdown on white collar criminals. On the other hand, one could conclude that the regulatory system and financial reporting standards are faulty and that more of the same—more financial regulation, more prosecutions, more power to the SEC—will not solve the underlying economic, political and sociological causes of the 1990s stock market bubble and its inevitable collapse. Causes other than executive misconduct could be found. The sheer complexity of financial reporting could lead to a search for a better accounting framework.\(^4\) The disconnect between tax and financial reporting and the resulting distortions in corporate finance caused by tax law and policy could be addressed.\(^5\) The relentless push by institutional investors for ever-increasing quarterly earnings was irresponsible and unhealthy, but the only way in which the SEC addressed investor obsession with quarterly results was through a regulation dealing with inside information abuses.\(^6\) Since SEC regulatory policy is based on investor protection, the SEC is disinclined to focus on questionable behavior by investors and portfolio managers because this might unmask the fiction upon which all SEC financial regulation is based.

The focus of enterprise should be on business profitability. This focus is increasingly difficult in a complex, highly competitive global economy where there is a demand for ever greater productivity. Without

\(^3\)See Hitt, supra note 286.


condoning the "infectious greed"\textsuperscript{307} of the higher echelons of corporate America in the 1990s, or the intentional manipulation of financial reporting at many corporations, this article questions the Sarbanes-Oxley solutions of imposing more regulations on public companies and increasing the sanctions for financial fraud. The financial misreporting at Enron, Adelphia, WorldCom, and elsewhere was already illegal, indeed criminal. Sarbanes-Oxley has caught the attention of corporate managers and directors and no doubt will result in better financial disclosure, at greatly increased expense, for the immediate future. But will it prevent a reoccurrence of irrational exuberance and financial fudge at the top of the next bull market? Perhaps more importantly, will officers and directors and their accountants and attorneys become so bogged down in procedures to comply with Sarbanes-Oxley that they have no time for core business decision making, problem solving, and strategic thinking?\textsuperscript{308} Although the problems with regard to practical implementation of Sarbanes-Oxley and the federalization of corporate governance are separate issues, these issues are related. State law regulation of corporate governance has been largely permissive with flexible judicial oversight and has encouraged differentiation and experimentation. Federal regulation under Sarbanes-Oxley, on the other hand, is proscriptive and applies to all public companies regardless of their size, age, or business structure.

B. Federalization of Corporate Governance

William O. Douglas envisioned a federal agency with the mandate to regulate large multinational corporations by directing their governance. Realizing that this was a task too great for a small agency like the SEC, he set forth a model of self-regulation with business codes of conduct to be developed by business leaders under government oversight. This was a model designed to save capitalism during the Great Depression when even Americans were flirting with the idea that socialism might be better than the existing economic system that had failed so badly. Has the vision of William O. Douglas finally been realized in Sarbanes-Oxley? The answer is not yet, but the groundwork has been laid.

\textsuperscript{307}Alan Greenspan is reported to have said: "[A]n infectious greed seemed to grip our business community, our historical guardians of financial information were overwhelmed." John M. Berry, Fed Chief Says Economy is on Recovery Path, WASH. POST, July 17, 2002, at A01.

\textsuperscript{308}See Chandler \& Strine, supra note 34, at 7-8, 46. The cost of Sarbanes-Oxley is not only the out of pocket costs to lawyers and accountants to assure regulatory compliance with bureaucratic regulations, but also the cost in management time and attention. See Deborah Solomon \& Cassell Bryan-Low, Companies Complain About Cost of Corporate-Governance Rules, WALL ST. J., Feb. 10, 2004, at Al.
The creation of the PCAOB may be seen as the kind of regulatory initiative that Douglas had in mind when describing the relationship between securities regulation and business. This model has not yet been imposed on business generally, but rather only the accounting profession now dominated by four large multinational firms. If the SEC eventually obtains the ability to license and discipline all executive officers and directors of public companies, one can envision the creation of a self-regulatory organization like the NASD to develop fair and equitable standards of business conduct and to then extend the SEC's prosecutorial powers by disciplining its members for failure to live up to those standards. In the wake of the scandals over executive compensation at the NYSE, there have been calls for the creation of a body like the PCAOB to oversee the regulation of listed companies.\(^3^0\) Before the next series of financial scandals occur, it might be worthwhile for policy makers to inquire whether this is the kind of regulatory infrastructure that would serve the country well.

The keystone of the SEC's corporate governance policy is the independent director. The author has long felt that this model is flawed.\(^3^1\) Independent directors are part-time participants in a corporation's affairs. By definition they are outsiders. However intelligent, hardworking or strong-minded they may be, they do not have the time or the mandate to challenge management's judgements, except as to a discrete number of issues. If they spend all of their time trying to audit the auditors and assure that executive compensation is reasonable, then they will have no time to focus on important business and strategy matters. If they become essentially full-time directors, then they will no longer be independent. If they repeatedly challenge the judgments of a CEO, then the CEO will lose authority and be forced to resign. Corporations are essentially hierarchical and need a strong leader. Some of the most highly regarded U.S. corporations have had authoritarian CEOs who have rewarded shareholders over a long period of time.\(^3^1\) This does not mean that independent directors are a bad idea, but corporations should have greater freedom to experiment with board structures than Sarbanes-Oxley permits. Further,


\(^3^1\)The corporations run by Warren Buffet (Bershire Hathaway), Jack Welch (General Electric), and Bill Gates (Microsoft) come to mind as examples. See Helen Stock, Buffet Admonishes Fund Directors, WASHINGTON POST, Mar. 7, 2004, at A15.
since the independent director board simply cannot carry the freight the SEC has placed upon it, it is bound to disappoint and cause investor and public dissatisfaction as well as a loss of confidence. The collegial board has its flaws and there are times when management deserves to be challenged and even thrown out of office, but the prevailing model has actually served the U.S. economy well over a long period of time. The consequences of changing it, and giving control of board structure to a federal government agency are unknown.

In addition to setting up an adversarial relationship between the board, and especially the audit committee and the CEO, Sarbanes-Oxley has given the SEC extensive authority over CFOs and outside auditors and attorneys, which the SEC is likely to use to set up adversarial tensions with CEOs. Indeed, one of the most important consequences of Sarbanes-Oxley is that it has strengthened the SEC's authority to regulate CFOs. The proposed "noisy withdrawal" provisions and the idea of a QLCC are examples of the premises underlying the SEC's implementation of Sarbanes-Oxley. In the view of the SEC, different players on the corporate team should be watching one another suspiciously to assure compliance with the federal securities laws, and should be prepared to blow the whistle. Although such checks on the power of a bad CEO may be salutary, such checks on the power of a good CEO may undermine his or her leadership to the point of diminishing the competitiveness of a business corporation. Perhaps business leaders deserve enhanced scrutiny in view of their wrongdoing during the 1990s, but whether the prescriptions of Sarbanes-Oxley will benefit the national economy over time is unclear.

C. Effect on State Law

There are two opposite paths state law could take as a result of Sarbanes-Oxley. State officials may try to be stricter policemen than the SEC under state anti-fraud statutes and in judicial decisions involving corporate governance. On the other hand, state law could atrophy with respect to corporate governance matters. The first response is evident in the actions by the New York Attorney General in cases involving post-Enron scandals on Wall Street. With respect to the regulation of research analysts, the Attorney General instituted prosecutions against the largest Wall Street firms at a time when rulemaking and enforcement cases were

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pending at the SEC. State attorney generals similarly took the lead away from the SEC with regard to illegal mutual fund trading. The second response is evident in the failure of the states to adopt legislation requiring corporations to provide their shareholders with annual financial reports.

State blue sky commissioners and attorney generals have not traditionally utilized blue sky laws to sue public companies or their officers or directors for fraud. Yet, some of these statutes are very broad and could be utilized in such a fashion. The New York Martin Act, for example, prohibits any device, scheme, or artifice to defraud or obtain money by means of any false pretense, representation or promise, fictitious or pretended purchase or sale, any concealment, suppression, fraud, false pretense or false promise in connection with the sale of securities, or offering investment advice. The New York Attorney General has taken the position that no purchase or sale of stock is required, nor are intent, reliance or damages required elements of a violation of the Martin Act, in

313The SEC approved new NASD Rule 2711 and amendments to NYSE Rule 472 with respect to research analysts and research reports on May 10, 2002. Self-Regulatory Organizations; Order Approving Proposed Rule Changes by the National Association of Securities Dealers, Inc. and the New York Stock Exchange, Inc. and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 2 to the Proposed Rule Change by the National Association of Securities Dealers, Inc. and Amendment No. 1 to the Proposed Rule Change by the New York Stock Exchange, Inc. Relating to Research Analyst Conflicts of Interest, Exchange Act Release No. 45,908, 67 Fed. Reg. 34,968 (May 16, 2002). On May 21, 2002, the New York Attorney General announced an agreement by Merrill Lynch to enact "significant and immediate reforms that will further insulate securities research analysts from undue influence from its investment banking division" and to change the way analysts are compensated. Press Release, Office of N.Y.S. Attorney General, Spitzer, Merrill Lynch Reach Unprecedented Agreement to Reform Investment Practices, at http://www.oag.state.ny.us/press/2002/may/may21a_02.html. (May 21, 2002). This competition between the SEC and Eliot Spitzer continued as further actions were brought both with regard to research analysts and underwriters. See Kip Betz & Richard Hill, Regulation of Securities: Financial Services Chairman, SEC Talking About Role of State Securities Regulators, 35 Sec. Reg. & L. Rep. (BNA) 643 (Apr. 21, 2003). Pending legislation would require the states to remit any civil penalties or disgorgement from prosecutions that set national market system standards to the SEC. Securities Fraud Deterrence & Investor Restitution Act, H.R. 2179 § 8(b), 108th Cong. (2003).


315N.Y. GEN. BUS. LAW § 352(c) (McKinney 1996).
contrast to section 10(b) of the Exchange Act.\textsuperscript{316} Although the NSMIA prohibits any state from directly or indirectly prohibiting, limiting, or imposing any conditions on the use of any proxy statement, report to shareholders, or other disclosure documents relating to a covered security,\textsuperscript{317} there is an exception for "the laws, rules, regulations, or orders, or other administrative actions of the State of incorporation of the issuer."\textsuperscript{318} Thus far, the New York Attorney General has not used the Martin Act in connection with post-Enron scandals against broker-dealers and their customers, though he has shown a willingness to go into other areas.\textsuperscript{319} Whether the New York Attorney General and other similar state officials will be so inspired by their financial and political success in cases against broker-dealers and tobacco companies as to sue issuers of fraudulent financial statements remains to be seen.\textsuperscript{320} It would not be the first time that multiple law enforcement officials "pile on" in cases involving egregious facts. Further, it is unclear whether Congress will have the desire to further preempt state action in favor of SEC regulation.\textsuperscript{321}

State legislation in response to Sarbanes-Oxley is also possible. For example, two Delaware Chancery Court judges have suggested that the Sarbanes-Oxley reforms will result in boards with few officers and, therefore, the traditional Delaware method for testing breaches of fiduciary duty in suits against directors may not be adequate in the future. Therefore, they recommend that the Delaware legislature consider amending Delaware corporate law so that officers are liable for breaches of fiduciary duty even


\footnotesize{317}A covered security is, essentially, a security listed on a national securities exchange or Nasdaq. 15 U.S.C. § 77r(a)(2) (2001).

\footnotesize{318}15 U.S.C. § 77r(a)(2)(B) (2001). There is also an exception permitting any "[s]tate to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions." 15 U.S.C. § 77r(c)(1) (2001).


\footnotesize{320}See Russell Gold & Andrew Caffrey, United Crime Buster—Chasing Bad Guys Together, State Attorneys General Win Big Cases, Attain New Clout, WALL ST. J., Aug. 1, 2002, at B1. Recoveries from these settlements have been used to help balance state budgets in difficult economic times, a possible spur to further activism by state blue sky commissioners and attorney generals. Id. A recent North Carolina statute strengthened its securities laws to prohibit the use of a deceptive device to manipulate the market, including issuance of false or misleading financial statements. 2003 N.C. Sess. Laws 413.

\footnotesize{321}See Hill, supra note 92.
if they are not directors. They also recommend that Delaware consider new regulation of the director election process to install a more open process for the election of directors. The SEC is also considering how to make the director selection process more open, an example of what may become a competitive race between the SEC and the states for further reform. States may also believe that new legislation is necessary concerning the disciplining of accountants and attorneys, since the SEC can prevent a professional from practicing before the SEC but cannot disbar a professional for all purposes.

Traditionally, derelictions of duty by officers and directors have been tested in derivative actions or injunctive actions in state courts. Since Sarbanes-Oxley does not create new civil liabilities, with a few exceptions, failure to comply with its provisions may result in state court actions. This could involve suits over failure to comply with stock exchange listing requirements or executive compensation, among other things. Civil litigation under the federal securities laws has given rise to many corporate governance reforms. It can be anticipated that this trend will continue under Sarbanes-Oxley in the state courts as well as in the federal courts.

A very different reaction to Sarbanes-Oxley may be a hollowing out of state law protections for shareholders as the result of a comprehensive federal regulatory scheme. This can result in a kind of de facto, as opposed to a de jure, preemption. Although state law could legally impose shareholder protection requirements on corporations, they would be duplicative of federal regulation, and therefore of little practical value or efficacy under a cost-benefit analysis. One of many examples that could be chosen is the failure of state law to develop a requirement that corporations provide their shareholders with annual financial statements.

The obligation to provide shareholders with an annual financial statement in advance of an annual meeting was first imposed upon public companies by a NYSE listing requirement. This obligation was then picked up in the Exchange Act, initially as to listed companies and later to

322Chandler & Strine, supra note 34, at 72-3. They point out that this will involve changes not only to the substantive law, but the service of process provisions.
323Id. § 5.
324See supra text accompanying notes 246-57.
325An exception is section 306(a) of Sarbanes-Oxley, 15 U.S.C. § 7244(a) (2002), which creates liability for insider trading during pension fund blackout periods.
326Chandler & Strine, supra note 34, §§ 3, 5.
327Thompson & Sale, supra note 312, at 903-04.
almost all publicly held companies. Although the Revised Model Business Corporation Act requires that every corporation must furnish to its shareholders annual financial statements, including a balance sheet and an income statement, most state corporation law statutes do not require corporations to provide shareholders with annual financial statements. Some states, like New York and New Jersey, provide that upon a shareholder's request such financial information must be furnished. California follows the Revised Model Business Corporation Act and requires a board of directors to send an annual financial report to shareholders containing a balance sheet and an income statement. Delaware has no requirement that shareholders be furnished annual financial statements. While state corporation law is often criticized for being overly protective of managers and not sufficiently protective of shareholders, in an area where federal law is so comprehensive and detailed, such as the financial disclosure provisions of the federal securities law, there is little incentive for states to enact legislation. Indeed, businesses would likely complain about redundancy and unnecessary costs of compliance.

One problem with the allocation of responsibilities for shareholder protection, however, is that smaller companies are either excessively regulated if they have become public or hardly regulated at all if they have remained private. Although the SEC and the SROs have paid some lip service to the problems that smaller public companies may have in complying with Sarbanes-Oxley, few concessions have been made to them. By contrast, non-public companies will not be subject to any of

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329 Initially the Exchange Act regulated only listed issuers, but in 1964 was amended to extend to almost all public companies. These are commonly known as registered and reporting companies. See 15 U.S.C. § 78j (2002). Issuers which are registered and reporting companies must send shareholders annual audited financial statements prior to their annual meetings. See id. § 78n-1.


332 CAL. CORP. CODE § 1501(a) (West 1990)


the Sarbanes-Oxley reforms unless there is state legislation passed addressing board structure and composition.

D. The Shareholder Primacy Model

Sarbanes-Oxley is premised on a shareholder primacy model. Since the SEC is charged with investor protection, all of its policies necessarily take that objective into account. Yet, shareholders have changed dramatically since 1934 when the SEC was created. Instead of individual retail shareholders, the stock market is dominated by institutional investors who rely on their portfolio managers for decisions as to when to buy and sell stocks. Institutions owned 61.4% of the equity in the top 1,000 corporations in 2000, and 55.8% of equities in the market overall in 2001. While some of these investors hold for the long term, many do not. Average turnover on the NYSE was only 19% in 1970, but increased to 36% in 1980, 46% in 1990 and by 2001 was 100%. Further, their portfolio managers are interested in quarterly performance, not long-term returns. This is not a healthy environment in which to expect shareholders to monitor corporate governance.

Many of the evils of the dot-com bubble were caused by institutional investors and their portfolio managers, who first insisted that corporate officers have equity interests in their companies instead of relying upon cash compensation and who then pressured issuers to achieve higher earnings every quarter. Compensated with stock and stock options, CEOs and other officers and directors naturally became preoccupied with share prices instead of earnings per share or price earnings ratios. Even outside advisors, including attorneys, caught this equity fever and came to be compensated in stock options. Director pension plans were eliminated on the theory that they made directors think more like employees than stockholders, and they were generally replaced with stock option plans.

333CONFERENCE BOARD COMMISSION, supra note 247, at 25.
336Id. at 26.
338In fact, a pension plan can encourage a director to think like a creditor—which might not have been such a bad result for the many high flying companies now in bankruptcy. Nevertheless, corporations were urged to compensate directors in stock and stock options. See Edward S. Adams, Corporate Governance After Enron and Global Crossing: Comparative
Sarbanes-Oxley reinforced rather than questioned this shareholder primacy model.

Yet, Sarbanes-Oxley also makes shareholder primacy something of a legal fiction. For purposes of service on the audit committee, a director is deemed "independent" by Sarbanes-Oxley only if he is not an "affiliated" person of the company or one of its subsidiaries. This was interpreted in SRO rulemaking as ownership of ten percent or more of an issuer's equity securities. Therefore, venture funds, leveraged buy-out owners or other large stockholders who are not managers of the corporation may not serve as audit committee directors, and if the audit committee definition of independence is carried over onto the compensation and nominating committees, will not be able to serve as directors at all. Yet, these are the very stockholders who have the greatest incentive to assure that a corporation's financial reporting and compliance with other securities law requirements are up to standard. If managers who own shares and major shareholders are not fit to serve as directors, and a high percentage of other shareholders operate as traders rather than owners, exactly which shareholders is the SEC protecting?

While a discussion of problems with the shareholder primacy model goes beyond the scope of this article, these problems are significant to a consideration of whether Sarbanes-Oxley is an appropriate solution to the problems of the wave of financial fraud that broke out in the 1990s. Moreover, the SEC may be embarked on a program to push the reforms of Sarbanes-Oxley further by mandating contested elections for corporate directors. This notion has unleashed a barrage of negative comment because it would upend the selection of corporate directors in the United States and give institutional shareholders the power to challenge CEOs and other managers. Many of these shareholders are short-term traders who have no real interest in a corporation's long-term business success. Many others are political players, such as state and local governmental pension funds. Some shareholders might well be appropriate and responsible parties to propose replacements for ineffective board members, but before such a radical reform is instituted the SEC should further consider whether further reinforcement of the shareholder primacy model is a good idea. If


shareholders are to be given more power, they should also be allocated much more responsibility for assuring long-term corporate success.

V. CONCLUSION

In 1937, when the president of the NYSE was caught misappropriating a client's securities, the gleeful reaction of William O. Douglas, then chairman of the SEC, was that "the Stock Exchange was delivered into my hands." 341 Douglas was then able to investigate the NYSE and disclose "the whole anatomy of Wall Street chicanery and corruption" and arrange for the appointment of William McChesney Martin as chairman. 342 The reaction of the SEC to the financial scandals that preceded the enactment of Sarbanes-Oxley was similar. Corporate America was finally delivered into the hands of the SEC because of widespread chicanery and corruption during the dot-com boom years. The imperial CEOs of large public companies could finally be brought to heel and some to jail. The SEC could at last obtain the power to direct the corporate governance of public companies.

Is this simply a matter of politics and wrestling power from business into the hands of government, or has the SEC long had a vision of the purpose of enterprise that is different from the vision of business leaders? If one returns to the initial criticism that William O. Douglas made of the Securities Act, during the year after its passage, the answer could be yes. Douglas asserted that the Securities Act was politically significant. "It is symbolic of a shift of political power. That shift is from the bankers to the masses; from the promoter to the investor. It means the government is taking the side of the helpless, the suckers, the underdogs." 343 Then Douglas expressed the view that the Securities Act "falls far short of making significant progress because of the really superficial way in which it covers the object of its control. It is safe to say that the greatest impact of the Act is on well-established going concerns . . . ." 344 According to Douglas, what was needed instead of a full disclosure statute was serious merit regulation.

It is apparent that the thing industry needs is constructive planning and organization conditioned by the requirements of the public good. When these become articulate, security

342 Id. at 290-91.
343 Douglas, supra note 8, at 522.
344 Id. at 527.
regulation will be seen to be an integral part of the whole programme of industrial organization and regulation. . . . Any comprehensive and consistent control of the type which . . . the New Deal envisage[s] must inevitably embrace within it control over security issues. That in essence means control over access to the market. 345

The debate over the efficacy of the Securities Act in which Douglas participated resonates in the debate today over Sarbanes-Oxley. There is no doubt that Sarbanes-Oxley has been politically significant. Some claim that it is extremely important and far reaching legislation that will restore investor confidence.346 Others argue that it is superficial and a ploy to bolster the status quo.347 It is unlikely that the current SEC operating in a very conservative administration is planning to implement a New Deal merit regulation system where only corporations with good corporate governance will be allowed to access the capital markets. But one of the arguments this article sets forth is that the SEC is an agency with a very long institutional memory that has always acquired more power in response to crisis and scandal, and the future use it may make of the additional power it has acquired pursuant to Sarbanes-Oxley is unknown. The SEC now has the leverage to impose its model of corporate governance—a board of independent directors serving as a check on the CEO; a regulated CFO; and auditors and attorneys who must divide their allegiance to their clients with an allegiance to the SEC—on SEC registered corporations. The next step in these reforms will be greater shareholder democracy, whatever that means. The questions that deserve some debate are: What are the objectives or ends to be served by this reformed corporate governance? Will the SEC try to ameliorate the profit motive to serve general social needs or will the SEC be concerned with total return to shareholders over time? Will problems of agency capture result in an alliance between the SEC and big business which will stifle competition and be detrimental to entrepreneurial activity by small business or startups?

345Id. at 530-31.
There are two important justifications for federal securities regulation. One is to foster investor confidence in order to encourage capital formation; the other is to put reasonable safeguards around the pension fund savings of millions of workers. To some extent these justifications are contradictory, not complementary. While many dot-coms went bust, many others have become scions of American industry and stalwarts of the U.S. economy. Without free access to capital, these new enterprises would not have flourished. On the other hand, when the stock market collapsed after the dot-com bubble, many Americans lost their retirement savings. Still it is unclear how Sarbanes-Oxley and its future administration by the SEC will address these needs of the national economy. Much of the legislation, and much of the SEC's efforts since it was passed, are intended to punish those businessmen and women who failed and whose companies went down in financial scandal. While after the fact enforcement, which is the SEC's strongest suit, may give some satisfaction to those who lost their jobs and their savings, it is not a substitute for the encouragement of capital formation and the protection of pension fund investments.