

The Ivory Tower on corporate governance

Scholarship has been diverse, but since 1976 scholars have helped shift power from managers to owners, especially institutional investors.

By Lawrence A. Cunningham

In 1976, this journal's founding year, two influential academic works in corporate governance appeared: Berkeley law professor Melvin Eisenberg urged transforming the board from an advisory role to a monitoring model and mandating significant internal control systems, while University of Rochester economists Michael Jensen and William Meckling portrayed the firm as a nexus of contracts whose optimal design is for participants to choose.

These contrasting visions — obligatory uniformity versus free tailoring — have defined the field since, setting the boundaries of debate and helping participants think through positions. Into the early 1980s, the Eisenberg view dominated, with Columbia University law professor William Cary urging preemptive federal oversight of the field, traditionally handled by state law, and a generally pro-regulatory atmosphere imposing fiduciary mandates on independent directors and board committees.

But the nexus of contracts school soon ascended to greater influence, through the 1990s, after law professors such as Frank Easterbrook (now a judge) and Daniel Fischel, both of the University of Chicago, explored how the separation of ownership from control is a problem of agency costs, best addressed by contractual devices geared to maximizing shareholder value. Rather than federal mandates, states should experiment to offer a menu of tools for different corporations to tailor. Yale University law professor (also now judge) Ralph Winter theorized that competition

among states for corporate charters constrained managers to promote shareholder interests.

While normative corporate governance scholarship has divided between the pro- and anti-regulatory camps of the 1970s and 1980s, the best academics learned from their intellectual opponents to refine stances and often forge consensus. For example, though assessments of the deal decade's disruptive takeovers and comparative studies of non-U.S. practice found a place for non-shareholder constituents in corporate governance, a shareholder primacy norm nevertheless took root.

Even as both schools of thought contributed to the discourse, each had their heyday when current events cut in their favor. So the 1990s boom was a time of great enthusiasm for the economic approach, adding a productive trend of increasingly sophisticated empirical research, including on the value of state competition in corporate law.

After the burst, however, and as widespread accounting fraud was revealed, scholars cited Eisenberg to diagnose failures to monitor and control — and prescribed cures found in the Sarbanes-Oxley Act (SOX). An industry-specific version of the dynamic transpired after the financial crisis, culminating in the Dodd-Frank Act.

In each case, scholarship was diverse, as pragmatic centrist resolution of pending challenges, exemplified by Columbia's John Coffee, contended with cries on both normative sides of either too little or too much regulation (Yale's Roberta Romano called SOX "quack governance"). Such episodes updated the Cary-Winter debate: full-scale feder-

al preemption is probably dead but, as Harvard University law professor Mark Roe explained, less due to state competition than the threat to states of incremental federal incursion, a la SOX and Dodd-Frank.

Since 1976, scholars have helped shift power from managers to owners, especially institutional investors. Today, scholars such as Harvard law professor Lucian Bebchuk urge continued expansion of shareholder power, while others, like UCLA law professor Stephen Bainbridge, observe and support a propensity toward director primacy instead. In the balance is the fate of shareholder activism, which though novel in some ways, at bottom raises issues debated for 40 years, particularly agency cost mitigation. *Plus ça change, plus c'est la même chose.*

Lawrence A. Cunningham is the Henry St. George Tucker III Research Professor at George Washington University Law School. He is an authority on corporate governance, corporate culture, and corporate law, and teaches business-related courses that span these fields. He has written dozens of books and scores of articles (including several for *Directors & Boards*) on a wide range of subjects in law and business. He has developed an expertise on Berkshire Hathaway and Warren Buffett with such best-selling books as *The Essays of Warren Buffett: Lessons for Corporate America* and *Berkshire Beyond Buffett: The Enduring Value of Values*. Earlier in his career he taught at the Benjamin N. Cardozo School of Law, where he served a five-year term as director of the Heyman Center on Corporate Governance. He has served on the boards of several nonprofits as well as a private investment firm and twice been nominated by shareholders in proxy contests for public companies.



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