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Federalized Corporate Governance: The Dream of William O. Douglas as Sarbanes-Oxley Turns 20

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FEDERALIZED CORPORATE GOVERNANCE: THE DREAM OF WILLIAM O. DOUGLAS AS SARBANES-OXLEY TURNS 20

Joan MacLeod Heminway[*]

ABSTRACT

The federalization of U.S. corporate governance has been a topic of conversation among policymakers from the very beginning of federal securities law in the New Deal era. Among the early proponents of a federalized system of corporate governance oversight was William O. Douglas—perhaps best known as the longest-serving U.S. Supreme Court justice, but who also was a former commissioner and chair of the U.S. Securities and Exchange Commission. Reflecting on Douglas's federal corporate governance ideas, Professor Roberta Karmel wrote a law review article for the Delaware Journal of Corporate Law*, published in 2005, commenting on the extent and nature of federalized corporate governance in the wake of the enactment of the Sarbanes-Oxley Act of 2002.*

This essay effectively picks up where Professor Karmel's article leaves off, highlighting a number of key legal happenings since the adoption of Sarbanes-Oxley that extend and supplement the work accomplished by that landmark federal securities legislation in forwarding federalized corporate governance. The essay also offers related observations about the future of federalized corporation governance. In the main, however, the essay is a tribute to Professor Karmel—a personal and professional heroine in my life who, as it turns out, was researching and writing about the federalization of corporate governance at the same time I was, but from a different angle. The structure of the essay parallels key aspects of Professor Karmel's 2005 article.

INTRODUCTION

Almost 20 years ago, unbeknownst to either of us, Roberta Karmel and I were both toiling away on parallel research tracks. Specifically, we each were exploring (along with a number of others) an aspect of the federalization of U.S. corporate governance in the wake of the Sarbanes-Oxley Act of 2002

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(Sarbanes-Oxley).[1] My work resulted in a laboriously lengthy 2005 article[2] that addresses "important considerations involved in determining whether a desired federal rule of corporate governance optimally should be legislated by the U.S. Congress, adopted by the U.S. Securities and Exchange Commission . . . , or instituted by the federal judiciary."[3] Roberta's efforts culminated in her 2005 article *Realizing the Dream of William O. Douglas — The Securities and Exchange Commission Takes Charge of Corporate Governance*,[4] in which she ultimately "analyzes some of the implications of shifting the regulation of corporate governance from state to federal authorities and inquires whether the shareholder primacy model upon which Sarbanes-Oxley is based is appropriate."[5]

This essay focuses on the federalization of U.S. corporate governance since Sarbanes-Oxley—and, more specifically, since Roberta's article was published in 2005—pulling forward key aspects of Roberta's work in *Realizing the Dream*. To accomplish this purpose, the essay first briefly reviews the contours of Roberta's article. It then offers observations on corporate governance in the wake of (among other things) the public offering reforms adopted by the U.S. Securities and Exchange Commission (SEC) in 2005,[6] the SEC's 2010 adoption of Rule 14a-11,[7] the 2010 enactment of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank),[8] the 2012 enactment of the Jumpstart Our Business Startups Act (JOBS Act),[9] and recent adoptions of corporate charter and bylaw provisions that constrain aspects of shareholder-initiated federal securities and derivative litigation.[10] Finally, before briefly concluding, the essay provides

1. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15 18, 28 and 29 U.S.C.).

2. Joan MacLeod Heminway, *Rock, Paper, Scissors: Choosing the Right Vehicle for Federal Corporate Governance Initiatives*, 10 FORDHAM J. CORP & FIN. L. 225 (2005).

3. *Id.* at 226.

4. Roberta S. Karmel, *Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP. L. 79 (2005).

5. *Id.* at 81–82.

6. *See* Securities Offering Reform, Securities Act Release No. 8591, Exchange Act Release No. 52,056, Investment Company Act Release No. 26,993, FR–75, International Series Release No. 1294, File No. S7–38–04, 70 Fed. Reg. 44,722 (Aug. 3, 2005).

7. *See* Facilitating Shareholder Director Nominations, Securities Act Release No. 9136, Exchange Act Release No. 62,764, Investment Company Act Release No. 29,384, File No. S7–10–09, 75 Fed. Reg. 56,668 (Sept. 16, 2010); Bus. Roundtable v. S.E.C., 647 F.3d 1144 (D.C. Cir. 2011) (vacating SEC Rule 14a-11).

8. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

9. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 315 (2012) (codified in scattered sections of 15 U.S.C.).

10. *See*, *e.g.*, Lee v. Fisher, No. 20-CV-06163-SK, 2021 WL 1659842 (N.D. Cal. Apr. 27, 2021) (enforcing a forum selection bylaw that requires the filing of derivative suits in Delaware state court to preclude an action brought under Section 14(a) of the Securities Exchange Act of 1934, as amended); Seafarers Pension Plan *ex rel.* Boeing Co. v. Bradway, No. 19 C 8095, 2020 WL 3246326 (N.D. Ill. June 8, 2020) (same); Salzberg v. Sciabacucchi, 227 A.3d 102 (Del. 2020) (holding that

brief insights on the overall implications for future corporate governance regulation of these and other occurrences since the publication of *Realizing the Dream*.

I. ROBERTA KARMEL'S FEDERALIZATION ANALYSIS IN *REALIZING THE DREAM*

As is obvious from the full title of Roberta's 2005 article, a touchstone in her analysis is William O. Douglas's vision of corporate governance regulation through federal securities regulation. Although perhaps best known as the longest sitting justice on the U.S. Supreme Court, Douglas (as I will refer to him throughout, consistent with the references in Roberta's article) served as a commissioner of the SEC in the late 1930s and as its chairman from September of 1937 through April of 1939.[11] Roberta's article expressly refers to Douglas and his ideas at key junctures. Her concise explanation of his overall "dream" is set forth in this brief passage:

> 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.[12]

Douglas died in 1980,[13] but his hopes for the federalization of U.S. corporate governance, as Roberta's article details, have lived on in various ways.

In its early pages, *Realizing the Dream* offers a useful (even enjoyable, at least for corporate governance wonks) walk through key parts of the pre-Sarbanes-Oxley history of successful and unsuccessful efforts to nationalize corporate governance through congressional, SEC, and judicial actions.[14] The tale Roberta tells offers not only broad insights into the public policies underlying our federal securities laws, but also specific observations on the mechanisms of federal regulation impacting corporate governance—from control over corporate board composition and board actions through accountant and attorney conduct regulation to stock exchange supervision. The article also tenders observations about the interaction between federal securities regulation and Delaware's nationally dominant corporate

federal-forum provisions relating to actions brought under the Securities Act of 1933, as amended, do not violate Delaware or federal law or policy).

11. *See SEC Historical Summary of Chairmen and Commissioners*, SEC, https://www.sec.gov/about/sechistoricalsummary.htm (last visited May 10, 2021).

12. Karmel, *supra* note 4, at 133.

13. Spencer Rich, *William O. Douglas Dies at 81*, WASH. POST (Jan. 20, 1980), https://www.washingtonpost.com/1980/01/20/william-o-douglas-dies-at-81.

14. *See* Karmel, *supra* note 4, at 82–95.

governance regime through a review of applicable decisional law.[15] The history Roberta relates illuminates a slow, yet halting, march toward a greater federal role in U.S. corporate governance.

Having addressed that history, *Realizing the Dream* proceeds to identify and assess eight different aspects of Sarbanes-Oxley that altered preexisting corporate governance rules or norms.[16] These areas of regulatory change span a wide array of corporate governance attributes, influences, and interactions, including: officer certifications; constraints on executive compensation and loans; the addition of disclosures on codes of ethics and protections for whistleblowers; mandates relating to audit committee structure and process; accountant regulation; attorney regulation; self-regulatory organization requirements for listed companies; and shareholder nominations of directors. Roberta's commentary incorporates references to the pre-Sarbanes-Oxley history in relevant part.

Finally, before concluding, Roberta outlines four implications of Sarbanes-Oxley by reference to larger facets of corporate governance regulation. First, she offers observations on the potential for aggressive enforcement and overregulation, reflecting on (among other things) Sarbanes-Oxley's expansion and addition of civil and criminal penalties for federal securities law (and related) violations—violations that, as corporate governance regulation increases in breadth and detail, become more likely.[17] Second, she comments on the federalization of U.S. corporate governance, calling out for special attention both the creation of the Public Company Accounting Oversight Board (PCAOB) and corporate board structuring provisions in Sarbanes-Oxley.[18] Next, Roberta assesses the effect of Sarbanes-Oxley on state law, positing "two opposite paths state law could take as a result of Sarbanes-Oxley" (those two paths being (1) increased or more vigorous state law enforcement of corporate governance rules and (2) a withering of state corporate governance regulation).[19] To close this last substantive part of *Realizing the Dream*, Roberta takes on the task of critiquing the "shareholder primacy model" on which, she avers, Sarbanes-Oxley is founded.[20]

In her conclusion, Roberta emphasizes several points addressed in her earlier analyses and offers some cogent commentary on Sarbanes-Oxley's actual and potential impact on corporate governance regulation. Among other things, she observes 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

15. *Id.* at 95–98.
16. *Id.* at 98–129.
17. *Id.* at 129–33.
18. *Id.* at 133–35.
19. *Id.* at 135–40.
20. *Id.* at 140–42.

> 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.[21]

Her conclusion also includes a caution on the over-use of federal regulation by *ex post* enforcement rather than regulation through *ex ante* investor protection mechanisms.[22]

Roberta's concluding observations portend a potential (maybe even likely) sea change in corporate governance—an increase in federalization consistent with Douglas's overall regulatory dream with shareholder primacy as a centerpiece. The extent to which events and conduct in the intervening years have fulfilled Roberta's prophecy or heeded her related counsel may be debatable. As a means of visiting those matters, however, the next two parts of this essay provide insights into the manner through which, and the extent to which, Congress or the SEC has been able to capitalize on the momentum and leverage created by the enactment of Sarbanes-Oxley and the implications of those insights for ongoing corporate governance regulation.

II. SELECTED CHANGES SINCE SARBANES-OXLEY

In *Realizing the Dream*, Roberta recognized an all-encompassing definition of corporate governance and, with it, the capacity of corporate finance and securities law principles, tools, and mechanisms to impact the internal governance affairs of corporations. This essay adopts the same wide-ranging view of corporate governance, one that embraces all aspects of the relationships between and among directors, officers, and shareholders in the management and control of the corporation and the law and norms impacting those relationships. This broad-based definition is consistent with the one I used in my 2005 *Rock, Paper, Scissors* article.[23]

Much has happened in corporate governance and corporate and securities regulation since Sarbanes-Oxley. This essay does not address every significant event or circumstance impacting corporate governance in the intervening time (almost twenty years at this writing). Rather, the essay highlights five selected post-Sarbanes-Oxley occurrences that interrelate with and impact corporate governance, chosen because of their relationship to the federalization of U.S. corporate governance.

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21. *Id.* at 143.
22. *Id.* at 144.
23. *See* Heminway, *supra* note 2, at 238 ("In this article, 'corporate governance' is used in a general, descriptive manner and is broadly defined to include references to any and all of the structural attributes and processes that determine the nature of, and relationships among, corporate constituents.").

A. SEC 2005 PUBLIC OFFERING REFORMS

In 2005, the SEC promulgated extensive changes to the regulation of public offerings of securities under the Securities Act of 1933, as amended (the 1933 Act),[24] especially as that regulation related to issuer communications before and during the pendency of a public offering.[25] The core purpose of the reforms was to clarify and simplify rules relating to communication and offering processes as a means of modernizing and facilitating the regulated public offering of securities.

> [C]onsistent with our belief that investors and the securities markets will benefit from greater permissible communications by issuers while retaining appropriate liability for these communications, we have sought to address the need for timeliness of information for investors by building on existing statutory provisions and processes without mandating delays in the offering process that we believe would be inconsistent with the needs of issuers for timely access to the securities markets and capital.[26]

The offering reforms became effective on December 1, 2005.[27]

It is important to note that, overall, the SEC's 2005 public offering reforms have significance as a gateway to the application of federal public company regulation under the Securities Exchange Act of 1934, as amended (the 1934 Act).[28] Firms that engage in public offerings of securities under the 1933 Act often trigger 1934 Act registration under Sections 12(a) and (b) or 12(g) of the 1934 Act[29] and, as a result, public company periodic and transactional reporting regulation under various subsections of Sections 13, 14, and 15 of the 1934 Act.[30] Many of the significant corporate governance provisions in and ramifications of these and other provisions in the 1934 Act are identified and addressed by Roberta in *Realizing the Dream* (owing to their genesis in the pre-Sarbanes-Oxley history of federalized corporate governance or their adoption in or through Sarbanes-Oxley).[31] In adopting the 2005 public offering reforms, the SEC expressly acknowledged the connection between 1933 Act public offerings and 1934 Act public company reporting.[32]

More particularly, the 2005 public offering reforms brought about several specific changes in federal regulation that affect corporate

24. 15 U.S.C. §§ 77a–77aa (2018).
25. *See* Securities Offering Reform, Securities Act Release No. 8591, Exchange Act Release No. 52,056, Investment Company Act Release No. 26,993, FR–75, International Series Release No. 1294, File No. S7–38–04, 70 Fed. Reg. 44,722 (Aug. 3, 2005).
26. *Id.* at 44,725.
27. *Id.* at 44,722.
28. 15 U.S.C. §§ 78a–78qq (2018).
29. *Id.* §§ 78l(a), 78l(b), 78l(g).
30. *Id.* §§ 78m, 78n, 78o.
31. *See* Karmel, *supra* note 4, at 82–95, 98–129.
32. Securities Offering Reform, 70 Fed. Reg. 44,722, 44,726.

governance. These include the introduction of new issuer classifications as they relate to the deregulation of certain pre-offering communications and rule changes impacting statutory liabilities for fraud or misstatements or omissions to state material fact outside the fraud context. Each offers a window on the potential leverage—if not incursion—of federal regulation on internal corporate affairs.

In deregulating pre-offering issuer communication through the 2005 public offering reforms, the SEC sought to limit the prospect of "gunjumping"—offering securities to the public without complying with the strictures of Section 5 of the 1933 Act.[33] Its deregulatory efforts included the creation of several new classifications of securities issuers. Specifically, issuers were classified into four basic groups: well-known seasoned issuers (WKSIs), seasoned issuers, unseasoned reporting issuers, and non-reporting issuers.[34] The assignment of an issuer to a particular classification is based on its relative experience in public reporting and, in the case of WKSIs, market capitalization and other factors.[35] As a general rule, the 2005 public offering reforms allow issuers with a longer public reporting compliance track record and more active public investor engagement more flexibility in their public offerings of securities.[36]

Consistent with this overarching regulatory purpose and policy judgment, the 2005 public offering reforms liberalize pre-offering communications most for WKSIs, next most for seasoned issuers, next most for unseasoned reporting issuers, and least for non-reporting issuers.[37] In doing so, the reforms channel the types of communications certain firms can use, thereby constraining corporate communications that otherwise would be within the full discretion of the corporation's board of directors under its authority as granted by state corporate law.[38] For example, while WKSIs can engage in free writing throughout the public offering process, other issuers may be restricted in the timing, content, or manner of their communications

33. 15 U.S.C. § 77e (2018).

34. *See* Securities Offering Reform, 70 Fed. Reg. 44,722, 44,726–31.

35. *See id.*

36. *See id.* at 44,726 ("[W]e believe that the most far-reaching revisions of our communications rules and registration processes should be considered for issuers that have a reporting history under the Exchange Act and are presumptively the most widely followed in the marketplace").

37. *See id.* at 44,734 (summarizing the new communication rules and noting that "under the rules we are adopting, eligible well-known seasoned issuers will have freedom generally from the gun-jumping provisions to communicate at any time, including by means of a written offer other than a statutory prospectus. Varying levels of restrictions will apply to other categories of issuers.").

38. Under generally applicable statutory law principles, a corporation is managed by or under the direction of its board of directors. *See*, *e.g.,* DEL. CODE ANN. tit. 8, § 141(a) (2016) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."); MODEL BUS. CORP. ACT § 8.01(b) (AM. BAR ASS'N 2006) ("[T]he business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors, subject to any limitation set forth in the articles of incorporation or in an agreement authorized under section 7.32.").

with shareholders, investors, and others (including, suppliers, distributors, and customers) in order to comply with gun-jumping safe harbor provisions.[39]

The SEC's 2005 public offering reforms also impact 1933 Act public and private enforcement against issuers and others or fraud and other misstatement and omission liability. For example, the introduction of free-writing prospectuses and new kinds of prospectus supplements among the included regulatory changes generated interpretive complications in the determination of applicable enforcement provisions.[40] Specifically, while certain communications are considered to be part of a registration statement at the time of effectiveness for purposes of liability under Section 11 of the 1933 Act,[41] others may only be actionable under Section 12(a)(2) or Section 17(a) of the 1933 Act.[42]

Public offering liability provisions under the 1933 Act provide obvious constraints on the actions of board of directors, incentivizing them to best assure the provision of materially accurate and complete information to investors. Even before the SEC's adoption of the 2005 public offering reforms, however, the enforcement matrix under the 1933 Act was complex—a web of provisions allowing for public and private enforcement of accurate and complete disclosures based on varied elements with differing remedies. While the introduction of additional complexity through the 2005 public offering reforms may or may not better constrain issuer or board malfeasance, it provides new liability considerations and possible distractions from the board's management of the corporation. In *Realizing the Dream*, Roberta notes this potential effect of liability provisions on the governance responsibilities of accountants and lawyers in the wake of Sarbanes-Oxley.[43]

B. PROXY ACCESS UNDER RULE 14A-11

A second area of concern in the post-Sarbanes-Oxley era has been shareholder access to public company proxy statements for the purpose of nominating individuals for service on the board of directors. Roberta addresses this concern in *Realizing the Dream*.[44] At the time *Realizing the Dream* was written, the SEC had proposed but not yet adopted Rule 14a-11,

39. Securities Offering Reform, 70 Fed. Reg. 44,722, 44,734; 17 C.F.R. §§ 230.163, 230.163A, 230.168, 230.169 (2021).

40. *See* Securities Offering Reform, 70 Fed. Reg. 44,722, 44,759, 44,765–70.

41. 15 U.S.C. § 77k (2018).

42. *Id.* §§ 77l(a)(2), 77p(a).

43. Karmel, *supra* note 4, at 130 ("[A]ccountants and lawyers may become more concerned about protecting themselves from possible liabilities than representing client interests.").

44. *Id.* at 123–29.

the proxy access rule.[45] The final rule was adopted in 2010—almost seven years after it originally was proposed.[46]

As should be evident from the lengthy period between proposal and adoption, the rule proposal and adoption were not without controversy. In fact, debates surrounding the rule continued after its adoption. In 2011, the District of Columbia Circuit Court of Appeals vacated the rule as "arbitrary and capricious" in *Business Roundtable v. SEC*.[47] Roberta urged caution in *Realizing the Dream*, referencing the history of proxy access regulation at the SEC before the 2003 rulemaking proposal.

> 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. In the current business-bashing political climate, such doubts seems [sp] to have been pushed aside. They should not be. Regulatory intrusion into the shareholder nomination process goes to the very heart of corporate governance and would drastically alter federal and state power to regulate internal corporate affairs.[48]

The court's 2011 *Business Roundtable* opinion represents a triumph of federalism over federalization—a push-back against federal assertions of control over the mechanics of shareholder voting, an important element of corporate governance.

There is an interesting footnote to this story. Notwithstanding the judicial invalidation of the SEC's Rule 14a-11, proxy access has been adopted voluntarily at the behest of management or shareholders at a significant number of firms—including especially Fortune 500 companies.[49] Formal shareholder proponents and proposals for proxy access must meet the requirements of Rule 14a-8[50] and proposals may be excluded by a public company on any proper basis set forth in Rule 14a-8(i).[51] Nevertheless, although shareholders may use the federally regulated shareholder process to put proxy access in front of their fellow shareholders for a vote, the

45. *See* Security Holder Director Nominations, Exchange Act Release No. 8626, Investment Company Act Release No. 26206; File No. S7-19-03, 68 Fed. Reg. 60,784 (Oct. 23, 2003).

46. Facilitating Shareholder Director Nominations, Securities Act Release No. 9136, Exchange Act Release No. 62764, Investment Company Act Release No. 29384, File No. S7–10–09, 75 Red. Reg. 56,668 (Sept. 16, 2010).

47. 647 F.3d 1144 (D.C. Cir. 2011).

48. Karmel, *supra* note 4, at 128–29 (footnotes omitted).

49. *See* SIDLEY AUSTIN LLP, PROXY ACCESS – NOW A MAINSTREAM GOVERNANCE PRACTICE, Feb 1, 2018, at 1, https://www.sidley.com/-/media/update-pdfs/2018/02/20180201-corporate-governance-report.pdf?la=en ("As of the end of January 2018, 65% of S&P 500 companies have adopted proxy access."); *see also* Holly J. Gregory at al., *The Latest on Proxy Access*, HARV. L. SCH. F. ON CORP. GOVERNANCE, Feb. 1, 2019, https://corpgov.law.harvard.edu/2019/02/01/the-latest-on-proxy-access/. ("Proxy access is now mainstream at S&P 500 companies (71%) and is nearly a majority practice among Russell 1000 companies (48%).").

50. 17 C.F.R. § 240.14a-8 (2021).

51. *Id.* § 240.14a-8(i).

achievement of proxy access for director nominations through that federally regulated process is a function of state corporate governance rules.

C. DODD–FRANK

The adoption by the U.S. Congress of Dodd–Frank[52] is yet a third post-Sarbanes-Oxley occurrence that presents food for thought in an evaluation of the progressive federalization of U.S. corporate governance. That food for thought comes in the form of both substantive and disclosure regulation of the internal governance of public companies. Certain provisions in Dodd-Frank, especially those involving substantive regulation, represent relatively direct incursions of the federal government into corporate governance.

Two sections of Dodd-Frank merit special attention for their substantive regulation of corporate governance: Sections 951[53] and 954.[54] Section 951 mandates that public companies obtain advisory votes from their shareholders about executive compensation and golden parachutes. Under Section 954, the SEC is obligated to direct national securities exchanges and associations to prohibit the listing of securities of public companies that have not implemented a compensation claw-back policy that complies with SEC regulation (also mandated under Section 954). By expressly requiring specific shareholder votes under Section 951 and directing the use of SEC authority over both public company issuers and stock markets to require and incentivize the adoption of claw-back policies by public company boards of directors under Section 954, Congress has forced the hand of public company directors on these two matters—requiring or coercing the approval of specific corporate governance mechanisms. As a result, Congress affirmatively limited the management discretion that otherwise could be exercised by those directors under state corporate law.[55]

Each of these federal corporate governance initiatives connects with matters addressed in *Realizing the Dream*. Section 951 echoes recommendations mandating shareholder approvals from a 2002 New York Stock Exchange Corporate Accountability and Listing Standards Committee report noted by Roberta in the article.[56] Section 954 picks up on Roberta's

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52. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

53. *Id.* § 951 (codified at 15 U.S.C. § 78n-1).

54. *Id.* § 954 (codified at 15 U.S.C. § 78j-4).

55. *See supra* note 38 and accompanying text.

56. *See* Karmel, *supra* note 4, at 109, 121 (suggesting and noting SEC approval of a requirement that shareholders vote on equity-compensation plans); *see also id.* at 122 (noting the support of the Business Roundtable for the same). Professor Marc Steinberg notes that the roots of Section 951 may extend even further back. Marc I. Steinberg, *The Federalization of Corporate Governance-An Evolving Process*, 50 LOY. U. CHI. L.J. 539, 541 (2019) ("[T]o some degree, the Dodd-Frank Act's shareholder say-on-pay advisory vote may trace its origins to a bill introduced in the midst of the Great Depression that required federal regulatory approval of officer compensation." (footnotes omitted)).

discussion of the role of stock exchange listing requirements in federalized corporate governance.[57]

Disclosure mandates adopted in Dodd-Frank provide examples of a key indirect way in which federal regulation, especially securities regulation, influences corporate governance. Mandatory disclosure is a principal tool of U.S. federal securities regulation.[58] I offer three Dodd-Frank provisions as illustrations of disclosure as a gateway to federalized corporate governance: Sections 952, 953, and 955.[59] Each typifies how federal securities disclosure regulation can influence, if not dictate, how corporations manage their internal affairs.

Section 952 of Dodd-Frank requires, among other things, disclosure about a public company's retention of compensation consultants and potential conflicts of interest relating to the work performed by those consultants.[60] These disclosures are required to be made "[i]n any proxy or consent solicitation material for an annual meeting of the shareholders (or a special meeting in lieu of the annual meeting)."[61] Section 952 called upon the SEC to promulgate related regulations, which were finalized in the summer of 2012 and included in Item 407 of Regulation S-K (entitled "Corporate governance").[62]

Dodd-Frank Section 953 requires additional compensation-related disclosures.[63] Specifically, Section 953 requires public company disclosure relating to pay-for-performance and the relationship (through the presentation of a ratio) of the compensation paid to the firm's chief executive officer to the compensation paid to all other company employees.[64] The SEC has proposed rules on pay-for-performance disclosures, but they have not been adopted.[65] The SEC's rulemaking on pay ratios is codified in Item 402(u) of Regulation S-K.[66]

Finally, in Section 955 of Dodd-Frank, Congress mandated additional disclosures on public company director and employee hedging against a

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57. *See* Karmel*, supra* note 4, at 92–94.

58. *See* Christopher T. Hines, *The Corporate Gatekeeper in Ethical Perspective*, 78 MO. L. REV. 77, 97 (2013) ("[W]hile in recent years federal securities law and regulation may have encroached into the historical role of states in respect of corporate governance, the fact remains that the federal securities regulatory system is primarily a system that mandates and enforces disclosure rules.").

59. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 952, 953, 955, 124 Stat. 1376 (2010).

60. *See id.* § 952 (codified at 15 U.S.C. § 78j–3(c)(2) (2018)).

61. *Id.*

62. *See* 17 C.F.R. § 229.407(e)(34)(iv) (2021) (requiring, with respect to identified compensation consultants, disclosure of the nature of any conflict raised in their work).

63. *See* Pub. L. No. 111-203, § 953 (codified at 15 U.S.C. § 78n(i)).

64. *Id.*

65. *See* Pay Versus Performance, Exchange Act Release No. 4835; File No. S7-07-15 (Apr. 29, 2015), *available at* https://www.sec.gov/rules/proposed/2015/34-74835.pdf. Reopening of Comment Period for Pay Versus Performance, 87 Fed. Reg. 5751 (Feb. 2, 2022) (offering the opportunity for additional analysis and comment on the SEC's 2015 proposed rules)

66. 17 C.F.R. at § 229.402(u).

decrease in the market value of the public company's stock.[67] Public companies were already invited to disclose their "equity or other security ownership requirements or guidelines . . . and any . . . policies regarding hedging the economic risk of such ownership" under Regulation S-K Item 402(b)(2)(xiii).[68] The core of the SEC's rulemaking implementing the mandate in Section 955, however, is embodied in Item 407(i) of Regulation S-K.[69]

Again, these Dodd-Frank disclosure directives echo themes explored in *Realizing the Dream*. In her article, Roberta describes the "full disclosure mandate" of the federal securities acts[70] and notes that Douglas criticized the disclosure focus of the emergent federal securities law regime in the 1933 Act as inadequate to the task of effective regulation.[71] She observes that even the more substantive regulation imposed under the 1934 Act does not truly change the disclosure-focused nature of these two core federal securities laws.[72] The same could be said today.

More specifically, the compensation disclosures required under Dodd-Frank are reminiscent of the management compensation disclosure initiatives of the late 1970s and 1990s. Roberta highlights both in *Realizing the Dream*.[73] In the process of recounting the latter, she aptly observes that "[t]he SEC's traditional approach to executive compensation was through disclosure regulation, with an implicitly strong suggestion that the compensation committee should be composed of independent directors."[74] She then notes how Sarbanes-Oxley addressed continuing concerns about management compensation and offered ideas about how the new rules may be used to expand the SEC's authority over this aspect of corporate governance.[75]

D. THE JUMPSTART OUR BUSINESS START-UPS ACT

The JOBS Act presents a fourth area for exploration of the federal regulatory intrusion on corporation governance in the years since *Realizing the Dream* was published. This wide-ranging legislation deregulated aspects of both securities offerings and public reporting.[76] The overall goal was to

67. *See* Pub. L. No. 111-203, § 955 (codified at 15 U.S.C. § 78n(j)).

68. 17 C.F.R. at § 229.402(b)(2)(xiii).

69. 17 C.F.R. at § 229.407(i).

70. *See* Karmel, *supra* note 4, at 82–84.

71. *Id.* at 83 ("Shortly after the Securities Act was passed, William O. Douglas . . ., who was to exert considerable influence on the SEC as an early Chairman, criticized the full disclosure philosophy of the statute. In his view, the Act was a failure . . . .").

72. *Id.* at 83–84.

73. *Id.* at 88-89; 103–05.

74. *Id.* at 104.

75. *Id.* at 105–06.

76. *See*, *e.g.*, Erik F. Gerding, *Against Regulatory Stimulus*, 83 LAW & CONTEMP. PROBS. 49, 58 (2020) ("Parts of the statute (the so-called 'emerging growth company' provisions) reduce the periodic disclosure requirements for public companies that have $1 billion or less in total annual

make it easier for start-ups and small businesses to access funding from a broader group of investors through U.S. capital markets as a means of catalyzing job growth.[77]

As deregulatory legislation, the JOBS Act apparently pulls back from certain aspects of the federal regulation of capital raising. More specifically, in the JOBS Act, Congress set the stage for less SEC regulation of and engagement with securities issuers that may engage in significant capital raises by providing for: lighter disclosure and reduced shareholder approval obligations—including as to management compensation—for emerging growth companies (a new classification of securities issuer created under the JOBS Act) under Title I;[78] unregistered public offerings of securities through securities crowdfunding in Title III (separately entitled the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act (the CROWDFUND Act));[79] and both an overall increase in, and related new exemptions from, the shareholder count thresholds requiring 1934 Act registration in Titles III and V.[80] Exemptions from the pre-existing requirements for registering public offerings of securities under the 1933 Act and for registering public companies under the 1934 Act free firms of some of the SEC's core leverage over their corporate governance since the full panoply of registration statement disclosures under the 1933 Act depend on the existence of a registration requirement[81] and periodic and transactional reporting (the latter including, for these purposes, proxy, tender offer, and

gross revenue."); Michael D. Guttentag, *Patching A Hole in the Jobs Act: How and Why to Rewrite the Rules That Require Firms to Make Periodic Disclosures*, 88 IND. L.J. 151, 175 (2013) (noting congressional testimony from Harvard Law School Professor John Coates characterizing shareholder-of-record changes in the JOBS Act as "the riskiest proposals being discussed" and "radical deregulation"); Renee M. Jones, *The Unicorn Governance Trap*, 166 U. PA. L. REV. ONLINE 165, 169–70 (2017) (noting that the JOBS Act "had the principal objective of reducing regulatory burdens that discouraged IPOs").

77. Rutheford B Campbell, Jr., *The New Regulation of Small Business Capital Formation: The Impact-If Any-of the Jobs Act*, 102 KY. L.J. 815 (2014) (observing that the JOBS Act "was—at least apparently—driven by the desire to promote job creation by facilitating small business capital formation"); Rutheford B Campbell, Jr., *The SEC's Regulation A+: Small Business Goes Under the Bus Again*, 104 KY. L.J. 325, 344–45 (2016) ("Considered as a whole, the JOBS Act . . . offered the Commission the opportunity to construct three essentially new and rational paths for small business capital formation."); Patricia H. Lee, *Access to Capital or Just More Blues? Issuer Decision-Making Post SEC Crowdfunding Regulation*, 18 TRANSACTIONS: TENN. J. BUS. L. 19, 26 (2016) (briefly describing the stimulus to passage of the JOBS Act and quoting President Obama's statement on its purpose).

78. Pub. L. No. 112-106, 126 Stat. 306, §§ 101-08 (2012).

79. *Id.* §§ 301–305.

80. *E.g.*, *id.* § 303 (providing an exemption for crowdfunded equity); *id.* § 501 (raising the overall shareholder threshold for registration to 2,000 persons or 500 persons who are not accredited investors); *id.* 502 (providing an exemption for "persons who received the securities pursuant to an employee compensation plan in transactions exempted from the registration requirements of section 5 of the Securities Act of 1933").

81. *See* 15 U.S.C. §§ 77e, 77f, 77g (2018) (providing for the registration of securities offerings, the filing of the registration statement, and the contents of the registration statement).

going-private regulation) under the 1934 Act depends on public company status.[82]

Yet, aspects of the complex deregulation introduced in the JOBS Act also keep the SEC engaged with the very issuers targeted by the legislation. The regulatory exemptions provided to emerging growth companies are intended to be temporary since the classification itself is not permanent.[83] Moreover, issuers of securities in offerings exempt from registration under the CROWDFUND Act do have limited reporting obligations. But perhaps more importantly, the CROWDFUND Act introduced a new federal private right of action under Section 4A(c) of the 1933 Act for material misstatements or misleading material omissions.[84] Importantly, under that CROWDFUND Act provision, any of the following may be liable to a person purchasing securities in the offering:

- the issuer that offers or sells the security in an offering exempted from registration under the CROWDFUND Act;
- any "director or partner of the issuer";
- "the principal executive officer or officers, principal financial officer, and controller or principal accounting officer of the issuer (and any person occupying a similar status or performing a similar function)"; and
- any other person who offers or sells the security in the offering.[85]

Negligent misrepresentations or omissions appear to be enough to generate liability under this provision.[86] However, a plaintiff bringing an action under Section 4A(c) must be ignorant of the "untruth or omission," and the issuer may overcome the plaintiff's claim by sustaining "the burden of proof that such issuer did not know, and in the exercise of reasonable care could not have known, of such untruth or omission."[87]

The private action created in Section 4A(c)—especially as it relates to corporate management—has the capacity to recalibrate, if not the effect of

82. *See* 15 U.S.C. § 78m(a) (providing for periodic reporting by 1934 Act registrants—i.e., "[e]very issuer of a security registered pursuant to section 78*l* of this title"); *id.* § 78m(e) (providing for SEC regulation of repurchases of equity securities by "an issuer which has a class of equity securities registered pursuant to section 78*l* of this title"); *id.* § 78n(a) (providing for SEC regulation of the solicitation of "any proxy or consent or authorization in respect of any security . . . registered pursuant to section 78*l* of this title"); *id.* § 78n(d) (providing for SEC regulation of certain tender offers for "any class of any equity security which is registered pursuant to section 78*l* of this title").

83. *See* 15 U.S.C. § 78c(80) (delineating the characteristics and duration of emerging growth company status).

84. *Id.* § 77d-1(c)(1).

85. *Id.* § 77d-1(c)(3). The creation of this summary requires some interpretation, since the statute itself is not drafted clearly. *See* Alan R. Palmiter, *Pricing Disclosure: Crowdfunding's Curious Conundrum*, 7 OHIO ST. ENTREP. BUS. L.J. 373, 407 (2012).

86. *See*, *e.g.*, Palmiter, *supra* note 85, at 374 ("[T]he new law creates a lower negligence threshold for antifraud liability, which applies both to the company raising the capital and the securities firm or portal serving as intermediary.").

87. 15 U.S.C. § 77d-1(c)(2); *see also* Palmiter, *supra* note 85, at 405.

recalibrating, corporate governance norms and shift enforcement to federal forums. In Section 4A(c), investors (including corporate shareholders) are afforded a federal cause of action against some members of corporate management for the breach of their duty to accurately and completely disclose all material information in connection with a crowdfunded offering. This is significant as a matter of corporate governance in that, as Roberta notes, "[t]raditionally, derelictions of duty by officers and directors have been tested in derivative actions or injunctive actions in state courts."[88] Moreover, a failure to comply with disclosure obligations may signal or result from breaches of state corporate law fiduciary duties; the two are closely related (especially through the obligation to act in good faith).[89] Federal securities disclosure litigation and state law shareholder derivative claims are not proxies for each other, but each can independently be a tool of corporate governance.[90]

E. Forum Selection Charter and Bylaw Provisions

Finally, a fifth important potential area for review in assessing the federalization of U.S. corporate governance is the recent series of actions challenging the validity of provisions in Delaware corporate organic documents (charters and bylaws) directing plaintiffs to bring legal claims arising under specific federal securities laws in specific forums. Corporate

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88. *See* Karmel, *supra* note 4, at 138.

89. *E.g.*, Donald C. Langevoort & Hillary A. Sale, *Corporate Adolescence: Why Did "We" Not Work?*, 99 TEX. L. REV. 1347, 1376 (2021) (observing that "good faith, and the disclosure discourse inherent in it, is designed to play a role in establishing internal controls—even in start-ups and even more problematically with longer term corporate adolescents."); Hillary A. Sale & Donald C. Langevoort, *"We Believe": Omnicare, Legal Risk Disclosure and Corporate Governance*, 66 DUKE L.J. 763, 786 (2016) [hereinafter *Omnicare*] (advising that "board members must ask enough questions about significant legal-risk matters to be comfortable that neither the words making up the disclosure nor their fair implications could be misleading to investors."). Professors Sale and Langevoort offer a cogent explanation of the corporate governance connection to firm disclosure management.

> Importantly, the connection between directors and disclosure is not new. Indeed, over time, the SEC has reiterated the role that the board is expected to play in monitoring disclosures or, put differently, the role that disclosure plays in corporate governance. Outside directors are rarely "speakers" on behalf of issuers, except in the context of director-signed offering and proxy documents. They are, however, disclosure monitors, which arguably is their role in the context of offerings as well—"tak[ing] ... care in ensuring the accuracy of the statements" made.

Sale & Langevoort, *Omnicare*, *supra*, at 791–92; *see also* Hillary A. Sale, *Disclosure's Purpose*, 107 GEO. L.J. 1045, 1050–51 (2019) ("[T]he regulatory structure inserts directors into the disclosure space, requiring them to play a role in diminishing information asymmetries and detecting fraud, which helps to decrease shareholder monitoring costs, facilitate capital raising, and diminish the impacts of publicness." (footnote omitted)).

90. *See* Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections Upon Federalism*, 56 VAND. L. REV. 859, 860 (2003) ("[F]ederal securities law and enforcement via securities fraud class actions today have become the most visible means of regulating corporate governance.").

organic documents, especially bylaws, have been popular vehicles for the modulation of corporate governance in recent years. State courts often have blessed carefully crafted corporate governance regulation through provisions included in corporate organic documents.[91] As a result, the corporate governance regulatory tilt leans clearly away from federalization and toward federalism in this area—an area that Roberta notes, in *Realizing the Dream*, may get less attention than it deserves.[92]

Salzberg v. Sciabacucchi[93] has gotten significant, leading attention in the decisional law on "federal-forum provisions" (or "FFPs," for short). In *Salzberg*, the Delaware Supreme Court validated provisions in three Delaware corporate charters (those of Blue Apron Holdings, Inc., Roku, Inc., and Stitch Fix, Inc.) that mandated a federal forum for legal actions brought by a shareholder under the 1933 Act. In its opinion, the court referenced not only state statutory provisions authorizing charter provisions "for the management of the business and for the conduct of the affairs of the corporation" and "creating, defining, limiting and regulating the powers of . . . the stockholders,"[94] but also applicable interpretive decisional law and Delaware and federal public policy. In addressing Delaware public policy, the *Salzberg* court characterized the scope of the state charter authorization as "broadly enabling";[95] noted that under Delaware law "stockholder-approved charter amendments are given great respect";[96] and averred that Delaware's corporate statutory law "allows immense freedom for businesses to adopt the most appropriate terms for the organization, finance, and

91. *See*, *e.g.*, Lee v. Fisher, No. 20-CV-06163-SK, 2021 WL 1659842 (N.D. Cal. Apr. 27, 2021) (validating a forum selection provision that compelled derivative actions be brought in the Delaware Court of Chancery); Seafarers Pension Plan *ex rel.* Boeing Co. v. Bradway, No. 19 C 8095, 2020 WL 3246326 (N.D. Ill. June 8, 2020) (same); Salzberg v. Sciabacucchi, 227 A.3d 102 (Del. 2020) (validating charter provisions mandating a federal forum for shareholder actions under the 1933 Act); Boilermakers Loc. 154 Ret. Fund v. Chevron Corp., 73 A.3d 934 (Del. Ch. 2013), *judgment entered sub nom.* Boilermakers Loc. 154 Ret. Fund & Key W. Police & Fire Pension Fund v. Chevron Corp. (Del. Ch. 2013) (validating forum selection bylaws requiring that internal affairs shareholder litigation be brought on the Delaware Court of Chancery); Stroud v. Grace, 606 A.2d 75 (Del. 1992) (validating bylaws providing qualifications and procedures for director nominations); Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 403 (Del. 1985) (validating bylaw amendments that mandated, e.g., unanimous presence of directors for a quorum at a board meeting and a unanimous required vote of directors for all board and committee action); *but see* Galaviz v. Berg, 763 F. Supp. 2d 1170 (N.D. Cal. 2011) (invalidating a director-adopted bylaw mandating that derivate actions be brought in the Delaware Court of Chancery); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 652 (Del. Ch. 1988) (invalidating bylaw amendments increasing the size of the corporation's board in response to a perceived corporate threat).

92. *See* Karmel, *supra* note 4, at 95 ("Much has been written on the regulatory competition between the states for corporate charters while less attention has been given to competition between the SEC and state legislators and judges.").

93. *Salzberg*, 227 A.3d 102.

94. DEL. CODE ANN. tit. 8, § 102 (2020); *Salzberg*, 227 A.3d at 113.

95. *Salzberg*, 227 A.3d at 115.

96. *Id.* at 116.

governance of their enterprise."[97] As to federal public policy, the *Salzberg* court, citing to *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[98] maintains that "the United States Supreme Court held that federal law has no objection to provisions that preclude state litigation of Securities Act claims."[99]

Overall, *Salzberg* represents a decided assertion of state corporate governance control over federal claims under the 1933 Act. The summary conclusion in the opinion offers strong support for a Delaware corporation's authority to manage shareholder litigation through private ordering. Although the conclusion refers specifically in several places to the 1933 Act, much of the language used by the court in that part of the opinion is relatively broad and not apparently confined to either 1933 Act causes of action or private ordering accomplished through corporate charters. The final paragraph of the opinion broadly states that the General Corporation Law of the State of Delaware "was intended to provide directors and stockholders with flexibility and wide discretion for private ordering and adaptation to new situations."[100]

Opinions in two subsequent federal district court actions cite to *Salzberg* in validating forum selection provisions in corporate bylaws. Although these cases involved bylaw provisions (rather than charter provisions) mandating state court forums for derivative actions (rather than a federal court forum for 1933 Act causes of action), the forum selection clauses challenged in them have the same overall litigation management purpose. In confirming the legal validity of these forum selection clauses, the trial court opinions in both cases indicate a clear preference for allowing corporate boards of directors to manage the corporation's business and affairs, including by recalibrating or otherwise regulating the powers of the shareholders through provisions in corporate bylaws.

In *Seafarers Pension Plan on behalf of Boeing Co. v. Bradway*,[101] a 2020 decision in the U.S. District Court for the North District of Illinois, the court validates and enforces a bylaw provision that requires shareholder derivative actions to be filed in Delaware state court. The plaintiff shareholder had brought a derivative claim against Boeing Company under Section 14(a) of the 1934 Act—a derivative claim that only can be brought in federal court as a matter of federal law.[102] Thus, the plaintiff shareholder argued, Boeing's forum-selection clause prevented it altogether from bringing its derivative claim. The court, in enforcing Boeing's forum-selection bylaw, noted both

97. *Id.*
98. Rodriguez de Quijas v. Shearson/American Exp. Inc., 490 U.S. 477 (1989).
99. *Salzberg*, 227 A.3d at 132.
100. *Id.* at 137.
101. No. 19 C 8095, 2020 WL 3246326 (N.D. Ill. June 8, 2020).
102. *Id.* at *1 ("[A] Boeing shareholder . . . may not file a derivative suit in federal court and a state court does not have jurisdiction to hear a federal derivative suit.").

the availability of a substitute Delaware state law action and the principal governance rationale for forum-selection bylaws: "the avoidance of multi-forum litigation."[103]

On the eve of publication of this essay, the district court's judgment in *Seafarers Pension Plan* was reversed in a 2-1 decision by the U.S. Court of Appeals for the Seventh Circuit.[104] By way of summary explanation, the court (perhaps predictably) averred that,

> [b]ecause the federal Exchange Act gives federal courts exclusive jurisdiction over actions under it, applying the bylaw to this case would mean that plaintiff's derivative Section 14(a) action may not be heard in any forum. That result would be contrary to Delaware corporation law, which respects the non-waiver provision in Section 29(a) of the federal Exchange Act, 15 U.S.C. § 78cc(a).[105]

The Seventh Circuit opinion expressly distinguishes *Salzberg*, concluding (among other things) that "*Salzberg* neither applies to claims brought under the Exchange Act of 1934 nor bars securities plaintiffs from bringing as-applied challenges to federal forum provisions."[106] Judge Easterbrook dissents,[107] attacking multiple elements of the majority's reasoning and offering that, in any event, the "plaintiff retains its right to sue directly under § 14(a) in federal court, and jurisdiction to enforce the Exchange Act is not exclusive in the way my colleagues understand it."[108] It is unclear at the time of this writing whether any reconsideration or appeal of the Seventh Circuit's judgment is forthcoming.

In *Lee v. Fisher*,[109] a federal District Court judge in the Northern District of California validated and applied a forum selection bylaw that required the filing of derivative suits in the Delaware Court of Chancery. Like the plaintiff in *Seafarers Pension Plan*, the plaintiff in *Lee* brought an action under Section 14(a) of the 1934 Act. In granting the defendants' motion to dismiss, the *Lee* court cited the *Seafarers Pension Plan* district court opinion, offered similar reasoning, and concluded that the plaintiff, Lee, had not established "that enforcing the forum selection clause would contravene a strong public policy of this forum."[110]

Salzberg, the trial court opinion in *Seafarers Pension Plan*, and *Lee* evidence a relatively strong body of law rooting corporate governance in state (specifically Delaware) corporate law. Even where an overlap with federal securities law is direct and complete, the court easily deflects the assertion

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103. *Id.* at *3.
104. Seafarers Pension Plan v. Bradway, No. 20-2244, 2022 WL 70841 (7th Cir. Jan. 7, 2022).
105. *Id.* at *1.
106. *Id.* at *6.
107. *Id.* at *11-*14.
108. *Id.* at *11.
109. No. 20-CV-06163-SK, 2021 WL 1659842 (N.D. Cal. Apr. 27, 2021).
110. *Id.* at *6.

that federal law is controlling or that federal policy supervenes state policy. However, it is important to note that these cases involve corporate organic document provisions that have strong roots in state corporate governance rules and norms and serve the clear and common purpose of shareholder litigation management—a purpose that has largely been blessed (to date) as a valid exercise of state corporate governance regulation. Having said that, the Seventh Circuit's opinion in *Seafarers Pension Plan*, if it stands or its influence extends to other federal courts, portends possible limitations on the strength of those state corporate governance roots, at least when a plaintiff is left without a viable forum for a chosen *bona fide* federal claim.

III. IMPLICATIONS OF CORPORATE GOVERNANCE CHANGES SINCE SARBANES-OXLEY

In Part IV of *Realizing the Dream*, Roberta offers commentary on the corporate governance implications of Sarbanes-Oxley.[111] Fast-forward over twenty years. Considering the post-Sarbanes-Oxley occurrences described in Part II, where do we now stand on the corporate governance concerns Roberta expressed in *Realizing the Dream*, including the federalization of U.S. corporate governance? This part offers some brief contemporary reflections.

A. AGGRESSIVE ENFORCEMENT AND OVERREGULATION

In *Realizing the Dream*, Roberta observes that "[e]xcessively zealous prosecution and overregulation can lead to a number of results contrary to the interests of shareholders or the public."[112] She cites to managerial risk aversion, shareholder complacency owing to SEC enforcement through monitoring, incentivization of going-private transactions, and outsized personal liability concerns on the part of accountants and lawyers as negative ramifications of Sarbanes-Oxley. Do occurrences since the publication of *Realizing the Dream* substantiate or allay Roberta's concerns?

The 2020 annual report from the SEC's Enforcement Division notes that the number of enforcement actions was down 17% in 2020 as compared to 2019.[113] Nevertheless, tips, complaints, and referrals (TCRs) were higher in 2020 than in 2019,[114] and the whistleblower program (which under certain circumstances, rewards people who tip the SEC about corporate misconduct) had its best year yet in terms of both the amounts awarded and the individuals

111. Karmel, *supra* note 4, at 129–42.
112. *Id.* at 130.
113. U.S SEC'S & EXCH. COMM'N, ENFORCEMENT DIVISION, 2020 ANNUAL REPORT 16 (2020), https://www.sec.gov/files/enforcement-annual-report-2020.pdf.
114. *Id.* at 19 ("In Fiscal Year 2020, the Commission received over 23,650 TCRs, a substantial increase over the approximately 16,850 TCRs received in Fiscal Year 2019.").

paid rewards.[115] Increased TCRs and a greater possibility of whistleblower rewards may incentivize increased enforcement activity, at least some of which may be directed to corporate management or otherwise impact corporate governance.

Moreover, as noted in Part II, the CROWDFUND Act introduced a new private right of action for material misstatements and omissions under Section 4A(c) of the 1933 Act.[116] Corporate management may be held liable under Section 4A(c).[117] No reported decisions brought under this new federal liability provision have been located at the time of this writing. However, the scope of potential liability under Section 4A(c) is broad, and its use may impact both capital-raising and the relations between the corporate management of issuers of securities offered or sold in crowdfunded offerings (who may be defendants) and the holders of the crowdfunded securities of those issuers (who may be plaintiffs).

Although it may be observed that the JOBS Act disincentivizes 1934 Act registration and, therefore, decreases the importance—if not the number—of public companies, the capacity for SEC monitoring and enforcement extends beyond the public company realm.[118] Actions brought under Section 10(b) of, and Rule 10b-5 under, the 1934 Act cover purchases and sales of securities generally, including those issued by both private and public company issuers.[119] Other liability provisions—including the liability provisions codified in Section 12(a)(1) of the 1933 Act and Section 4A(c) of the 1933 Act referenced in the preceding paragraph—also do not depend on public company status.[120]

B. FEDERALIZATION OF U.S. CORPORATE GOVERNANCE

At the core of this essay and *Realizing the Dream* are questions about the extent to which the SEC—or even the U.S. Congress—has appropriated the regulation of corporate governance from the states. In *Realizing the Dream*, Roberta's specific concern was with the impact of Sarbanes-Oxley in that

115. *Id.* at 20 ("Fiscal Year 2020 was a record-breaking year for the whistleblower program. The Commission issued awards totaling approximately $175 million to 39 individuals, both greater than any other year in the program's history.").

116. *See supra* notes 84–90 and accompanying text.

117. *See supra* note 85 an accompanying text.

118. *See supra* Part II.D.

119. 15 U.S.C. § 78j(b)(2018); 17 C.F.R. § 240.10b-5 (2021).

120. *See* 15 U.S.C. § 77l(a)(1) (specifying liability for offers or sells a security in violation of Section 5 of the 1933 Act, without regard to whether the issuer is a public company); *supra* Part II.D (regarding CROWDFUND Act liability under Section 4A(c) of the 1933 Act). Offerings exempt from 1933 Act registration under the CROWDFUND Act may only be made by issuers exempt from 1934 Act registration—in other words, by issuers that are not public companies. 17 CFR § 227.100(b)(2) (providing that offerings by issuers subject to the reporting requirements of the 1934 Act under Section 13 or Section 15(d) are ineligible for the registration exemption provided in the CROWDFUND Act).

regard.[121] She asked: "Has the vision of William O. Douglas finally been realized in Sarbanes-Oxley? The answer is not yet, but the groundwork has been laid."[122]

Indeed, additional federal corporate governance infrastructure has been built since Sarbanes-Oxley. Aspects of the SEC's 2005 public offering reforms, Dodd-Frank, and the JOBS Act (including the CROWDFUND Act within it) manifest additional incursions into the realm of corporate governance.[123] Nevertheless, both the current regulatory resolution of proxy access under Rule 14a-11 and the current overall state of decisional law adjudicating FFPs and other forum selection provisions offer evidence that the federalization of U.S. corporate governance continues to be subject to constraints.[124]

Having said that, however, it seems important to note Senator Elizabeth Warren's introduction, in 2018, of the Accountable Capitalism Act.[125] This legislative action comes the closest in modern memory to realizing Willliam O. Douglas's vision. The Congressional Research Service's bill summary offers a brief précis of the proposed legislation.

> This bill imposes various duties and limitations on companies and entities that qualify as large entities, including by: (1) imposing on such an entity a duty to create a general public benefit as articulated in its charter, (2) requiring a director of a large entity to balance the pecuniary interests of shareholders with the interests of persons materially affected by the entity, (3) restricting when officers and directors may sell certain securities related to the entity, and (4) requiring shareholder and director approval of the entity's political expenditures. The bill also establishes the Office of U.S. Corporations, which shall have various duties such as reviewing and granting charters for large entities.[126]

Although the bill did not move forward, Senator Warren's initiative represents additional fuel for the long-burning federal corporate governance fire.[127]

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121. *See* Karmel, *supra* note 4, at 81.
122. *Id.* at 133.
123. *See supra* Part II.A, Part II.C, Part II.D.
124. *See supra* Part II.B & Part II.E.
125. S.3348, 115th Cong. (2017-2018).
126. S.3348 - Accountable Capitalism Act, https://www.congress.gov/bill/115th-congress/senate-bill/3348.
127. *See* Steinberg, *supra* note 56, at 540 ("[W]e now have our most recent salvo—Senator Elizabeth Warren's 'Accountable Capitalism Act,' which returns to concepts of yesteryear: mandating federal chartering of relatively large publicly held enterprises as well as regulating director composition, conduct, stock trading practices, and specified other matters.").

C. EFFECT ON STATE LAW

Roberta posits, in *Realizing the Dream*, two alternative ways in which state corporate law may react to federal encroachment on the regulation of corporate governance.[128]

> 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.[129]

Do indicators point one way or another now that almost twenty years have passed?

Even if state officials are not "stricter policemen," they have been alert cops on the beat. The recent forum selection bylaws decisions (excepting the Seventh Circuit's opinion in *Seafarers Pension Plan*) offer one example of continued state engagement and leverage in important corporate governance debates.[130] Benefit corporation and other state-enacted social enterprise statutes represent new forms of entity that respond and add to state corporate governance rules and norms.[131] Moreover, although intrastate crowdfunding initiatives are principally corporate finance regulation, they represent a clear sign that state government regulators are willing to step in when the federal government leaves a void.[132]

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128. Karmel, *supra* note 4, at 135.

129. *Id.*

130. *See supra* Part II.E.

131. *See*, *e.g.*, Brett H. McDonnell, *From Duty and Disclosure to Power and Participation in Social Enterprise*, 70 ALA. L. REV. 77, 80 (2018) ("Benefit corporations and their cousins deploy two main corporate governance mechanisms: duty and disclosure."); Kyle Westaway & Dirk Sampselle, *The Benefit Corporation: An Economic Analysis with Recommendations to Courts, Boards, and Legislatures*, 62 EMORY L.J. 999, 1006 (2013) ("[T]he rise of the benefit corporation, as an empirical gesture, indicates that the basic rules toward which corporate governance has been evolving for the last two hundred years have allowed directorial duties to fall short of what is necessary for an ordered society, or at least a well-ordered one."); David G. Yosifon, *Opting Out of Shareholder Primacy: Is the Public Benefit Corporation Trivial?,* 41 DEL. J. CORP. L. 461, 493 (2017) ("[T]he rigid requirements of the public benefit corporation may be designed to protect shareholders from corporate governance designs that would otherwise waste or distribute to other groups too much of what should go to the stockholders.").

132. *See*, *e.g.*, Christine Hurt, *Pricing Disintermediation: Crowdfunding and Online Auction IPOs*, 2015 U. ILL. L. REV. 217, 240 (2015) ("Several states have passed or are considering intrastate crowdfunding regulations ahead of final regulations for federal crowdfunding, making crowdfunding efforts that meet the requirements of intrastate offerings exempt from both state and federal regulation."); Andrew A. Schwartz, *Inclusive Crowdfunding*, 2016 UTAH L. REV. 661, 669 (2016) ("The primary impetus for intrastate crowdfunding appears to be the delay in finalizing regulations for retail crowdfunding under Title III of the JOBS Act."); Lawrence J. Trautman et. al., *Some Key Things U.S. Entrepreneurs Need to Know About the Law and Lawyers,* 46 TEX. J. BUS. L. 151, 187 (2016) ("[T]he SEC stalled for three long years before adopting in October 2015 final regulations to implement the crowdfunding exemption. In the interim, some states enacted crowdfunding exemptions for certain types of intrastate crowdfunded securities offerings." (footnotes omitted)).

There is little, if any, sign of state corporate governance atrophy. In general, federal corporate governance initiatives since the adoption of Sarbanes-Oxley have been more additive to state regulation than a replacement for it. The SEC's 2005 offering regulations, Dodd-Frank, and the JOBS Act (together with the included CROWDFUND Act), for example, primarily supplemented applicable state and federal corporate governance (and corporate finance) rules. As a result, there is no need for state law to wither away.

D. The Shareholder Primacy Model

As a parting shot in *Realizing the Dream*, Roberta takes aim at the shareholder primacy model that underlies Sarbanes-Oxley, especially given the rise of the institutional investor as a primary market force in publicly traded firms and markets. Her observations?

> 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.[133]

These reflections accurately capture continuing concerns about shareholder governance. Short-termism and political objectives continue to characterize institutional investing and confound corporate governance architects.[134] The archetypal shareholder on which a shareholder primacy corporate governance system was founded is not dominant or even, any longer, prototypical.

The recent rise of meme stocks—publicly traded stocks that investors buy and sell based on markets generated through social media and internet discussion board posts rather than the firm's assets, earnings, or cash

133. Karmel, *supra* note 4, at 141–42.

134. *See*, *e.g.*, Lucian A. Bebchuk & Robert J. Jackson, Jr., *Shining Light on Corporate Political Spending*, 101 GEO. L.J. 923, 967 n.47 (2013) (noting shareholder proposals brought by institutional shareholders that related to political issues); Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265, 296 (2012) ("Transient institutional investors place undue emphasis on short-term results."); David Millon, *Shareholder Social Responsibility*, 36 SEATTLE U. L. REV. 911, 913 (2013) ("Many institutional shareholders pursue short-term investment strategies."); Cary Martin Shelby, *Profiting from Our Pain: Privileged Access to Social Impact Investing*, 109 CAL. L. REV. 1261, 1280 (2021) ("Fund advisers may use their power as institutional shareholders to shift initiatives of underlying allocations towards more socially beneficial outcomes. This is a prevalent strategy in the pension plan space . . . .").

flow[135]—puts a point on that assessment. Meme stock trading has added a new and perplexing piece to the shareholder governance puzzle. A meme stock investor would seem to be even less equipped to govern than an institutional investor. For example, the strong reliance federal securities regulation places on mandatory disclosure as a tool of corporate governance seems misplaced with investors who may have little concern about holistic governance and do not base investment decisions on corporate fundamentals. Meme stock trading and, in general, the gamification of the securities markets cast doubt on the efficacy of a shareholder primacy governance model.

CONCLUSION

In the conclusion of *Realizing the Dream*, Roberta predicts that "[i]t is unlikely that the current SEC . . . 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."[136] Although the political culture in Washington, D.C. is different now than it was when Roberta penned those words, they continue to represent a sound prophesy. Revolutionary shifts toward federal corporate governance are improbable.

Yet, almost two decades ago, both Roberta and I realized (as we toiled away in our separate scholarly tasks in response to Sarbanes-Oxley) that federal corporate governance through congressional and SEC action was a reality and likely to continue to be a strong and growing force. It is telling that my 2005 article focused on how—not whether—federal corporate governance initiatives should be implemented.[137] I wrote then: "Sarbanes-Oxley has awakened many of us to the reality that corporate governance initiatives now are a potentially growing part of the federal rulemaking agenda."[138]

Ultimately, Roberta and I share a key concern, however, that underlies the ongoing trend toward more federal engagement with corporate governance. That concern is that the federal securities laws continue to do the work that they were enacted to do. Roberta offered two important, contextual public policy justifications for federal securities regulation in *Realizing the Dream*: "to foster investor confidence in order to encourage

135. *See*, *e.g.*, Paulina Likos, *How Meme Stocks Changed Investing*, U.S. NEWS, Oct. 8, 2021, https://money.usnews.com/investing/articles/how-meme-stocks-changed-investing ("A meme stock is a stock that captures online attention, usually from a younger generation of investors on online forums such as Reddit, and ends up going viral."); Nicholas Rossolillo, *What Are Meme Stocks?*, MOTLEY FOOL, Sept. 23, 2021, https://www.fool.com/investing/stock-market/types-of-stocks/meme-stocks/ ("Meme stocks are created when a company's shares catch fire with individual investors on social media platforms such as Reddit and quickly skyrocket in price.").

136. Karmel, *supra* note 4, at 143.

137. *See* Heminway, *supra* note 2, at 228 ("The primary objective of this article is the encouragement of an analytical, comparative approach to institutional choice14 in the establishment of federal rules of corporate governance.").

138. *Id.* at 232.

capital formation" and "to put reasonable safeguards around the pension fund savings of millions of workers."[139] I now offer my three public policy justifications (emanating from the SEC's overall charge and overlapping significantly with Roberta's two justifications) for consideration in the more general context of this essay: the promotion of capital formation, the protection of investors, and the maintenance of fair markets.[140] Sustaining this mission must be the SEC's key, core task, and any attendant corporate governance initiatives, whether mandated by Congress for SEC implementation or interpretation or initiated by the SEC under existing congressional authority, must serve those policy objectives.

139. Karmel, *supra* note 4, at 144.

140. *See*, *e.g.*, Paul Atkins, *Materiality: A Bedrock Principle Protecting Legitimate Shareholder Interests Against Disguised Political Agendas*, 3 HARV. BUS. L. REV. 363, 364–65 (2013) ("The SEC's mission is to maintain fair, orderly, and efficient markets, facilitate capital formation, and to protect investors by ensuring that market participants have accurate material information about SEC-registered securities." (footnote omitted)); Cary Martin, *Private Investment Companies in the Wake of the Financial Crisis: Rethinking the Effectiveness of the Sophisticated Investor Exemption*, 37 DEL. J. CORP. L. 49 (2012) ("The Securities and Exchange Commission . . . fulfills this obligation by actively pursuing its mission to protect investors, maintain fair, efficient, and competitive markets, and facilitate capital formation.").