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Use the word "corporation" in mixed company – that is, any group comprised of more than accountants, MBAs, attorneys or economists – and the image you are likely to evoke will be that of a large, impersonal business enterprise headed by a Board of Directors, managed by a team of executives headed by a well paid CEO, with millions of customers, thousands of employees, offices throughout the world, and perhaps tens of thousands of big and small investors who claim some stake in the company. Say the name of a particular corporation – for example, Microsoft, Enron, Toyota, WorldCom, Sony, Tyco, or Apple -- in that same group and the conjured up images are likely to be as diverse and opined as the group itself.

Taken out of mixed company and placed in context, the modern corporation's image becomes clearer in purpose if not in form or reputation. At least within the jurisdictional sphere where Anglo-American norms and interests predominate,[1] a consensus view has emerged among those whose livelihood depends on these salient social-cultural-economic-political actors. This consensus holds that the raison d'etre of corporations – their very existence and success – is tied to their pursuit of value on behalf of shareholders. That is the *pervasive* and *defining* view among students and practitioners of the modern corporate arts and sciences. Moreover, that consensus is as strongly held by corporate critics as it is by its defenders (e.g., Herman, 1981, Stone, 1975).

While this consensus view of corporate purpose is not without its historical and intellectual challengers, the practical result of its dominance has been to focus and set parameters around debates about corporate behavior and possible solutions to corporate governance problems in the Anglo-American context. As that context has become both increasingly more complex and globally hegemonic, however, that consensus has become

[1] Despite the awkwardness of the label "Anglo-American," I intend for it to encompass those nations and cultures (social, legal, political and economic) associated with the British governance tradition. Alternative labels (e.g., "Commonwealth", Anglican, etc.) might have been used, so the choice is offered arbitrarily and with apologies to readers.

more problematic both within and outside its formal jurisdictions. This has been made especially clear with the passage and implementation of Sarbanes-Oxley in 2002 (SOx).

While designed as a politically expedient response to a moral panic fed by media frenzy (Gabilondo, 2006), SOx has brought to the fore fundamental issues about the nature of the modern corporate form that have lain fallow for nearly a century among Anglo-American scholars. The debate about the nature of the corporation was preemptively dismissed as mere scholastic banter by no less an authority than John Dewey in 1926[2] and has only intermittently been revisited.[3]

The argument presented here attempts to reopen those discussions with the intent of reasserting a perspective on the purpose of corporations that allows us to assess corporate governance reforms such as Sarbanes-Oxley. The perspective I put forward is anchored in contention that modern governance – public as well as private -- is at its core based on some form of accountability. Accountability-based governance, in this view, emerged historically as an effective response to the central dilemma facing secular rulers of the embryonic nation-state in the late medieval period – that is, how to maintain and sustain authority over autonomous subjects who were becoming increasingly aware of their capacity for discretionary action. The modern corporate form, I will argue, developed as part of that solution in Anglo-Norman England, and it is in light of those historical roots that contemporary corporate governance and corporate governance reforms efforts should be assessed.

<u>"Purpose" and the assessment of corporate governance reform:</u>

The assessment of a law or public policy can be approached in three ways: prospectively, retrospectively or perspectively. The prospective approach, common to many professional policy analysis efforts, is to assess the potential or possibility of a proposal. It reflects the role of assessment as part of the policy design process. Retrospective

[2] See Dewey, 1926 as well as Smith, 1928. The contemporary reader will be surprised at the "postmodern" and Foucauldian nature of the argument presented in both these works.
[3] See Avi-Yonah, 2005, Blumberg, 1990, Kitagawa, 1960, McLean, 1999, Bratton, 1989.

approaches, in contrast, are generally associated with technical or critical evaluations of past performance of the program or its implementers. In seeking to undercover the underlying logic or ontological context of a policy, perspective assessments are most helpful for analytic and critical tasks.

In this paper I undertake a perspective assessment of Sarbanes-Oxley with the objective of measuring the law and its implementation against a model of the "historical purpose" for which corporate governance regulation and reform legislation has been developed over the past millennium. As sweeping and daunting as that task might seem, it proves feasible because in Anglo-American law the corporate form is historically and inherently linked to the primary purpose of modern governance: accountability.

As a first step in this (or any) assessment, we must distinguish among the various foci that might draw our attention. There are several candidate focal points for a policy assessment. In theory at least, all formalized laws and policies are expected to have an explicit statement of *intent* – the goals or objectives its authors sought to address – and where these are clear they provide the grounds for assessment of programs associated with those intentions. This seems simple enough, except for the practical matter that intent is rarely so clear, especially in matters of law and policy (Waldron, 1999).
A second focus for assessments could be the *functional* role played by a set of policies or laws. Among political scientists, for example, public policies and programs are evaluated as much for their symbolic value as their intended impacts (Edelman, 1964, Edelman, 1971), and more proactive would regard direct government actions in some policy arenas (e.g., civil rights, environmental protection) to be a functional means to greater ends (Le Grand, 1997).

A more familiar focus for policy analysts are the *impacts* that a policy or other government action has on various segments of the environment (Ichimura and Taber, 2000). Benefit-cost analyses are at their core measurements of the projected impacts (positive and negative) of a proposal, and studies of the implications of a given regulation or tax code change or interest rate increase on a segment of the population also fit this category. A fourth focal point of assessments is the unintended, secondary or delayed *consequences* derived from the laws, policies or programs (Gillon, 2000).

One focus rarely considered is that of *purpose*, and here we look beyond immediate intent and function (which are the most closely related) to the underlying -- and yet overarching -- rationale of the policy effort. This assessment standard is best explained by example. The *intent* of a government campaign to deal with a national AIDS epidemic in a developing country is to prevent it spread and treat the infected, but in the process it *functions* as a means for improving the capacity of health and social services at the community level. Its *impact* on specific population segments – e.g., children under age six, members of a certain ethnic community – is also subject of assessment, as is the program's long term *consequential* impact on government legitimacy. The *purpose* of the program, however, is the meta-goal of improving the quality of life for all, and the question becomes: how does this particular anti-AIDS campaign measure up against that objective?

In a comparable way, the purpose of any contemporary US national security policy (assuming the conventional perspective) is maintaining world order, and a particular government decision (e.g., the invasion of Iraq in 2003) can be assessed against that higher standard as well as evaluated according to its intent (e.g., to depose Saddam Hussein), function (what it contributes to stabilizing – or not -- the Middle East), impact (the number of Iraqi civilians killed as a result), and consequence (the bolstering of anti-American sentiment throughout the world).

The seeming indifference to purpose by most analysts is, in part, a result of consensus that is typically associated with metagoals within a dominant political ontology at any particular time and place. That is the case with any anti-AIDS program under globalized conditions across populations where previous experience with the epidemic generates as much empathy as sympathy for the afflicted. Where that consensus has broken down – as in the case of US policy in Iraq – the issue of purpose comes to the fore and becomes part of the overall assessment and debate over the situation.

The relevance of all this to the subject of this paper, the Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley Act, or SOx), emerged as we approach the fifth anniversary of the law and face a growing number of assessments that raise a range of issues. Some of the studies, many published immediately after passage of the act, focus on the intentions of SOX. Characterizing it as "legislated ethics" (Rockness and Rockness, 2005, Gagne et al., 2005) and "legislated risk-management" (Linsley, 2003), it was generally assessed as a means for improving corporate governance through tougher disclosure requirements and other mechanisms (Baynes, 2002, Perino, 2002, Ribstein, 2002, Bratton, 2003, Coffee, 2003, Cunningham, 2003, Gates, 2003, Geiger and Taylor, 2003). As the law was implemented, more attention was given to the functional implications of SOx. Some focused on how it became a vehicle for extending the global reach of US market regulation (Gates, 2003, Vagts, 2003, Hollister, 2005, Ryan, 2005) while others considered its role in promoting the nationalization of US corporate governance policy (Clark, 2004, Romano, 2005b, Romano, 2005a). Whether intended or not, SOx also has begun to function as the standard for best practices in non-public firms (Dalton and Dalton, 2005).

Impact studies of SOx have also proliferated, covering the obvious targets such as CEOs, CFOs and corporate directors (Geiger and Taylor, 2003, Aguilera, 2005, Keenan, 2004, Linck et al., 2007) to its influence on management in general (Coustan et al., 2004) as well as accountancy, record keeping practices and auditing within the firm (Bratton, 2003, Schwarzkopf and Miller, 2005, Stephens, 2005, Tackett et al., 2004, Tackett et al., 2006). Among the consequences of SOx, the policy's role in raising the cost of doing business (Carney, 2006, Ribstein, 2005) as well as its role in reshaping the very nature of the corporate culture (Power, 2005) are starting to be scrutinized.

What has not been examined as yet is how SOx measures up to the historical purpose of corporate governance policy. This is in large part due to the general indifference to such purpose inherent in the consensus discussed earlier. To remedy this I begin by making explicit what that purpose is by uncovering the historical roots and development of those governance policies and their ties to a particular political ontology the highlights the need for accountability. My goal is to take the measure the SOx by applying a framework that allows us to critically assess various approaches to improving corporate accountability.

Uncovering the Historical Purpose of Corporate Governance:

> Origins are always obscure. If we endeavour to explain the genesis of any event that happens in our own days and seemingly before our very eyes, a scientific discovery, a new religion, a war, a revolution, we never get back to the simple fountain-head, the initial impulse whence it is derived. The stream we follow upwards brings us at length to difficult marshes and underground pools, never to a clear spring. If that is true of near events, how much harder is the task to trace the origins of social phenomena in the unknown and ever receding past. (MacIver, 1926, p. 25).

MacIver's observation provides fair warning about an exercise such as the present one, for in seeking a historical foundation for the purpose of corporate governance policy we are heading into murky waters.

The modern corporate form as hybrid: The first thing to note is that there are three major claims to the parentage of the modern corporate form, one ecclesiastic (Berman, 1983), one Italian, and another English (Schmitthoff, 1939).[4] Each reflects a distinct view of that form as a legal actor.

An early corporate form, with roots in Roman law (Maitland, 1900), is found in medieval canon law as a means for dealing with the status of church property which was *held* in perpetuity but *used* by individuals in their ecclesiastic roles. Thus, an artificial and passive entity was necessary as a legal instrument representing a collectivity (the church or an order) that would transcend the actions of its membership (Berman, 1983, Stone, 1975, pp. 11-13). This canonical form is manifest today in approaches that stress that the

[4] Each of these forms corresponds with a corporate "personality" type in American law; see Blumberg, 1990. Blumberg also discusses the recent emergence of a fourth corporate personality that regards it as a composite of corporate entities. Also see Stone, 1975.

corporation is nothing more than a “legal fiction” (*persona ficta*; see Deiser, 1908) with an existence (i.e., legal standing) independent of its members.

The Italian – actually Genoan -- claim regards the modern corporation as an outgrowth of a particular joint-stock company form developed by debt holders to handle privately assumed public debts that spread from 15th century Genoa northward throughout the continent and then England. Unlike the passive canonical form, this corporate form is an active contractual association of individual shareholders with a common (most often fiduciary) interest (see Deiser, 1909a).

Alternatively, a case is made that the modern corporate form evolved from partnerships and chartered gilds and related entities of 10th and 11th century England. What evolved was the corporate form perceived as a distinct autonomous (“rights-and-duty-bearing”) entity with “real” interests, such as proving charitable services or the pursuit of profits in an open market where it competes with other “real” persons (corporate and otherwise).[5]

The modern business corporation that is the subject of SOx and related laws is perhaps best seen as a hybrid of all three forms, for while it has legal standing as an artificial person and the structural characteristics of the joint stock form, its existence is closely tied to the same “realist” logic that as forms the foundation of municipalities, associations and other collectivities recognized as active persons under law (Hein, 1963). The development of that hybrid genre was nowhere more advanced than in England and its colonial offspring, and for that reason the “stream we follow upwards” (in MacIver’s terms) is located in the British Isles.

That “genre” was most clearly defined by US Chief Justice John Marshall in *Dartmouth College v. Woodward* (1819) in passages worth quoting at length:

> A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those

[5] While I use a narrative that focuses on Anglo-Norman England for reasons that become clear below, the theory behind this view is associated with the German political theorist and historian Gierke; see Gierke, 1958. For an effective attempt at outlining Gierke’s theory as it relates to corporate forms, see Deiser, 1909b.

> properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created. Among the most important are immortality, and, if the expression may be allowed, individuality; properties, by which a perpetual succession of many persons are considered as the same, and may act as a single individual. They enable a corporation to manage its own affairs, and to hold property, without the perplexing intricacies, the hazardous and endless necessity, of perpetual conveyances for the purpose of transmitting it from hand to hand. It is chiefly for the purpose of clothing bodies of men, in succession, with these qualities and capacities, that corporations were invented, and are in use. By these means, a perpetual succession of individuals are capable of acting for the promotion of the particular object, like one immortal being. But this being does not share in the civil government of the country, unless that be the purpose for which it was created. Its immortality no more confers on it political power, or a political character, than immortality would confer such power or character on a natural person. It is no more a state instrument, than a natural person exercising the same powers would be. . . . (17 U.S. 518, 637)
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> The objects for which a corporation is created are universally such as the government wishes to promote. They are deemed beneficial to the country; and this benefit constitutes the consideration, and in most cases, the sole consideration of the grant. (17 U.S. 518, 638)

Two important points about Marshall's definition need highlighting. First, the corporation in question, Dartmouth College, was a specific type of corporation – an "eleemosynary institution" engaged in the charitable work of providing education. Second, although business corporations do exist at the time of the decision (1819), it would be twenty-five more years before the British Parliament passes the Joint Stock Companies Act 1844 (see Micklethwait and Wooldridge, 2003) that provides for incorporation through a registration process rather than through royal charters or acts of legislation.[6] Thus, despite strong associations with business enterprises, the "purpose" of a corporation is not found in its type (e.g., charitable, proprietary, etc.).

Nevertheless, at the time of Marshall's decision there were already well known business enterprises with corporate forms, mainly in Britain where royal or parliamentary charters

[6] There are two other means for an entity to assume corporate status. One is through a finding in common law court where a non-corporate entity might be given de facto standing as a corporation to facilitate judgment (see Maitland, 1900); and the other is through "implication" via legislation or other government action that treats an organizational form (e.g., a voluntary association; a labor union) as a distinct corporate entity (see [HLR], 1917).

were required to deal in lucrative ventures involving exploration or foreign trade, or in activities that involved charging tolls and fees for the provision of public roads, water and sewer systems, etc. For most of the 17th and 18th centuries outside these arenas there were few advantages for business enterprises to seeking corporate status (which were costly to procure and often restrictive) and a good many non-corporate enterprises, operating along the lines of the joint-stock company model emerging out of Italy, thrived.

A turning point came in 1719 when Parliament passed the infamous Bubble Act[7] which required enterprises that "presumed to act as a corporation" to either seek a charter or face legal action as "public nuisances" (Patterson and Reiffen, 1990, esp. pp. 167-171). That Act was terminated in 1735, and during the period between the 1730s and 1844 a number of changes took place that would eventually result in the Companies Act of that year as well as related legislation applicable to banking (Evans, 1908b, Evans, 1908a). At that point the benefits of incorporation - especially the cover it provided shareholders through limited liability -- became extremely attractive and the rush was on in the United Kingdom, and eventually in the United States where several states enacted favorable laws of incorporation.

Despite the transformation of the corporation into a form most often associated with business enterprises today, in terms of "purpose" it retains its association with its historical roots reflected in Marshall's definition. But where do those roots lead?

<u>Inventing the corporate form:</u> While no less an authority than Blackstone had attributed the invention of the corporation to the Romans (Maitland, 1900, p. 336), our corporate (canonical-Italian-English) hybrid has comparatively modern (or at least late medieval) connections. In tracing the genesis of the corporation a century ago, Robert L. Raymond offered an evolutionary narrative that highlighted the emergence of collectivities in both secular and ecclesiastic realms. While initially not recognized in law or by any

[7] Formally the Royal Exchange and London Assurance Corporation Act of 1719. The law went into effect in 1720, a few weeks before the "South Sea Bubble" fiasco that it is associated with took place.

generalized form of governance, these “natural” collectivities[8] (e.g., towns, convents, villages, monasteries, boroughs, gilds) developed into important economic and social (religious) actors and key factors in the political dramas that played out in 11th and 12th century Europe, and especially in England. Their very existence outside the dominant legal arrangements of the time, argued Raymond, called for a “new legal theory” that would provide a common approach to all the various forms that these many-bodies-acting-as-one entities. “The oneness had to be given a place in business and in law as something definite.” What eventually emerged was the idea (taken from the developing body of canon law) of a “fictitious” or “artificial” person (Raymond, 1906, esp. pp. 359-362), one that took an identity in law and governance distinct from the non-fictitious bodies (*corpi*) it included. And thus as formally recognized through charters and other legal actions, the “incorporated” entity was born.

Raymond places so much stress on the natural evolution of the corporate form that he overlooks the implications of the early acts of formal recognition which are central to our understanding of the purpose of corporate governance, i.e. the issuance of the first known royal charters to a corporate-like entities (boroughs, towns, gilds), particularly by William I and William Rufus, his successor. In a fashion similar to the rush to incorporation by businesses in the 19th century, the early charters were sought by those collectivities for the protections and rights they bestowed. But it is critical to our understanding of “purpose” to note that these charters were granted in name of the sovereign within the context of newly emerging form of governance initiated under William I and developed under his successors. In fact, if there was a watershed event that punctuated the evolution of the modern corporation in its early stages, it was the form of accountable governance created in 1086 at Salisbury when William I convened a meeting of representatives from all segments of his English realm and required of them an oath of fealty.

The historical importance and distinctiveness of that event must be understood in context. The 11th century was a time of considerable political turmoil. The collapse of the Holy

[8] Raymond terms them “unit interest or oneness”.

Roman Empire had created a political void, and the Papal state in Rome had yet to consolidate its hold on power. Authority over both ecclesiastic and temporal matters throughout Europe had ontologically and practically devolved to the level of feudal lords, rendering the old political order weakened and leaving open opportunities for expansion and conquest by the strongest among the lesser nobility. This was the setting in which William, Duke of Normandy, pursued his claim to the throne of England based on a promise made by Edward the Confessor and the support of the papacy. Having succeeded at Hastings, he faced the task of (1) subduing (and often replacing) the defeated but still powerful Anglo-Saxon lords, (2) making good on his promise to Rome that he would regain control of ecclesiastic affairs in England, (3) satisfying the desires of his Norman supporters for the spoils of war, and (4) legitimizing his rule in a land where the foundations and traditions of governance ran counter to his interests. Unless he succeeded in dealing with these pressures he would go down in history as just another invader from northern Europe who had landed, conquered and left a minor mark on the British Isles.

William effectively had three options for dealing with these problems: extended conquest (force of arms), oaths and charters. He put all three approaches to use. After twenty years of consolidating his rule of England mainly through force of arms that extracted pledges of fidelity from the most recalcitrant among his new subjects, he turned to a different type of oath in 1086, just a year before his death. In English law,[9] the tradition of fealty oaths was long standing (Wormald, 1994) and there was a requirement that all “free men” pledge to a lord. What was controversial about William’s approach was the claim for such a pledge directly to the king. Moreover, as significant was that the Salisbury Oath was pledged immediately after the completion of the Domesday census which effectively had given legible form[10] to the size and content of the English realm that William had conquered and ruled.

[9] William and his successors made a point in their own coronation oaths and other known statements that they planned to honor the “law of King Edward” the Confessor, and thus explicitly adopted the pledge requirement and similar practices.

[10] On the significance of “legibility” in governance, see Scott, 1998.

Thus this oath involved more than a pledge of fidelity; it also included an acknowledgment of the Norman king's claim to sovereignty over everything within his realm.[11] To an important degree, the oath taken at Salisbury established a reciprocal relationship between the modern central secular ruler and the ruled. In seeking the oath, William I was effectively acknowledging the reality that his rule depended on the deference and cooperation of his subjects, many of whom could (and sometimes did) operate as autonomous "free men".[12] As de facto autonomous agents pledging fealty to the king, the subjects accepted the responsibility granted by the crown for those parts of the realm with which they had been entrusted and, in turn, obligated themselves to giving an account of those holdings when called upon to do so. They became what Maitland (following Gierke) termed "right-and-duty-bearing" subjects,[13] and the acceptance by autonomous agents of responsibility and obligation to the governing principal marked the birth of accountable governance.

That unique approach carried over into the extended issuance of charters, a practice that became increasingly common throughout medieval Europe, especially in regards to the legal creation of urban centers as pockets of "liberties" within feudal realms (Berman, 1983, 363-390). Among the examples cited by Berman, the Anglo-Norman charters initiated by William I and his successors stood out for the explicit connection to the crown, and this approach characterized charters granted to individuals (Douglas, 1927), gilds (O'Donnell, 1952) and other collectivities. Accountability to the crown was thus a pervasive characteristic of the English charters that formed the instrumental foundation for the modern corporate form.

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[11] On the nature and use of oaths in late medieval and early modern times, see Spurr, 2001.

[12] The evidence to support this is found in this history of royal charters granted to markets and gilds which indicates quite clearly that the chartering process did not *create* those entities but rather acknowledged and gave them protection and support as ongoing enterprises that could not be ordered into or out of existence nor controlled by royal edict or oversight. Markets and other collective activities thrived in England and elsewhere despite the attempts of local lords to control them, and they would thrive underground or aboveground despite any actions by the even powerful monarchs. Chartering was therefore a means for co-opting and gaining some degree of control over autonomous agents that would otherwise operate outside the law and pose constant threats to emerging regimes. Supporting this view is the fact that early charters were given to ongoing enterprises and more often than not contained provisions that were facilitating nurturing rather than controlling and restrictive (Britnell, 1978, Richardson, 2004).

[13] The phrase is cited in Dewey, 1926, p. 565 and throughout.

This connection between the birth of accountable governance and the embryonic corporate form found in those charters is critical to understanding the "purpose" that forms our standard for assessing policies and laws related to corporate governance. The corporation is more than a mere artificial person or an association of shareholders. In the Anglo-Norman tradition it exists as an "accountable" institution in the sense of being an autonomous agent defined by its responsibilities and obligations to the sovereign entity that is its principal.[14]

Clarifying the standard:

Viewing the creation of the corporate form in this way – that is as an accountable institution -- adds a core, defining dimension to the traditional definition of the modern business corporation and establishes a perspectively useful standard of purpose for the assessment of corporate governance reform. Typically characterized for analytic purposes as *an artificial or fictional legal entity* (reflecting the ecclesiastic roots) *comprised of shareholding owners* (the Genoan tradition) and *committed to some collective goal* (in the English tradition of making a profit for its owners, providing public conveyance for its constituents/customers, etc.), we can now add its inherent condition as an *accountable* (rights-and-duties-bearing) institution.

Put in direct terms, by granting a corporate charter to an enterprise, the state has effectively determined (or at least declared) that the entity is "fit to be held responsible" (e.g., to be called to account) for its actions and activities.[15] The "purpose" of corporate governance, therefore, is to maintain and sustain that fitness for accountability, and it is credible to regard the purpose of corporate governance reform – what we regard as "assessable" for the present task – to be the protection and enhancement that fitness.

Seen in this light, we are able to demarcate and differentiate the view of corporate governance that emerges from the English "accountability" tradition and those of its

[14] This view of accountable governance is further developed in Dubnick, 2007.
[15] See Pettit, 2001 for the philosophical basis of my approach.

historical alternatives. For present purposes we will label those alternatives the "stakeholder" and "fiduciary" models.

The stakeholder model: Today's consensus view of corporate governance in the business and finance literature (especially in the US) takes its cue from the narrow conceptualization of "principals" derived from the Genoan joint-stock company tradition, and has been expressed by one source as the "ways in which suppliers of finance to corporations assure themselves of getting a return on their investment" (Shleifer and Vishny, 1997, p. 737). The problem of corporate governance, in this view, is how owners and others who provide capital for the corporate entity shape, direct, regulate, etc. the operations of the agency or firm to enhance the probability that they will receive some value from their financial effort (Hart, 1995). It is governance by investors and financiers and for investors and financiers.

At the heart of many discussions of corporate governance based on the stakeholder model was the controversy initiated in 1932 with the publication of Berle and Means' *The Modern Corporation and Private Property* (Berle and Means, 1991). Observing a growing problem of distance between ownership and management, their analysis helped define the central issues of corporate governance in terms of how to get the management/ agents to follow the wishes of the owner/principals (cf. La Porta et al., 1999a). One result is a myopic approach to corporate governance that has turned into conventional wisdom among students of business enterprises.[16]

That this myopia afflicts the model's critics as well is evident in the many reform efforts that seek to make the corporation more "responsible" by either broadening the definition of relevant stakeholders or modifying corporate decision rules to include socially responsible actions (Carroll, 1999, Carroll, 1991, Klonoski, 1991).

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[16] The book led a charmed and influential life for nearly half a century, with only scattered and intermittent studies to counter its major claims and dominance. However that changed with publication of a special symposium on the book published in 1983; see, for example, Hessen, 1983, North, 1983, Stigler and Friedland, 1983.

<u>The fiduciary model:</u> For those following the canonical law tradition, the focus shifts from stakeholders (narrowly defined by their financial stake) to the corporate entity itself. Governance in this model is driven by fiduciary responsibilities for the current and future well being of the artificial entity that has legal status as a corporate person. In contrast to governance *by* and *for* financial stakeholders, those who govern in this model are required to put aside personal interests and concerns – those of the shareholders as well as their own --in order to act on behalf of the well being of the collectivity (the "oneness") itself (cf. Iwai, 2002).

The importance of this distinction from the financial stakeholder model is exemplified in the case of the proposed "Hershey Company" sale in 2002 where the fiduciary obligations of the corporate entity that held controlling interest in the firm (the Hershey School Trust, a charitable enterprise established by the founder of the Company) required it (or at least those making decisions for the Trust) to offer its 30+% stake in the Company for sale. In response to severe criticism from other Company shareholders and other stakeholders, the Trust's managers held that despite their own personal sympathies and views, their hands were effectively tied by the legal (fiduciary) responsibility; they had to do what was best for the Trust itself. Only the successful issuance of a legal injunction requested by the State of Pennsylvania halted the sale, but episode highlighted the difference between the governance models derived from the two traditions.[17]

<u>The accountability model:</u> Corporate governance in the accountability tradition of the English model stands simultaneously separate and "above" (in the inclusive sense) those of the stakeholder and fiduciary forms. It is distinct from the joint-stock company form in putting the interests of stakeholders (financial and otherwise) in a secondary (albeit, not unimportant) position to that of a "higher principal" (e.g., the sovereign, public interest, public good). What distinguishes it from the legalistic canonical (fiduciary) model is the status it gives the corporate entity as an *active* "rights-and-duty-bearing" (albeit artificial)

[17] For details, see Komoroski, 2004; another interesting case – also involving a Pennsylvania trust – involves the Barnes Foundation; see Eisenstein, 2003.

person.[18] The English model corporation, in other words, has more than passive legal standing; it possesses a "franchise" to take action in the classic sense of that term as:

> a right, privilege, or power, of public concern, which cannot be exercised by private individuals at their will, but must be secured by grant, in some form, from the sovereign power of the territory in which it is to be exercised. It carries with it an assurance of right of user, similar in character to grants of other rights and things, and there is a reciprocal agreement on the part of the grantee to use it in accord with public policy. (Needham, 1915, p. 98)

The often cited James Kent *Commentaries* on law is even more explicit on the obligation of the incorporated franchisee to actively pursue its authorized tasks. The grant of a franchise in the form of corporate standing contains "an implied covenant on the part of the government not to invade the rights vested, and on the part of the grantees to execute the conditions and duties prescribed in the grant" (quoted in Needham, 1915, p. 98).

The governance of such a franchise requires at minimum a process that assures the entity's ongoing commitment to chartered functions and tasks as well as the capacity to give an account to those among it principals who seek such. From this view, concerns for stakeholder interests and/or fiduciary responsibilities to the collective well-being can be added, but *in its most fundamental form corporate governance must meet the standard of accountability.*

It follows that any effort at corporate governance reform should be assessed in light of the accountability-purpose standard, if for no other reason than to determine how far the corporate form has become distanced from its historical purpose. No doubt, most contemporary attempts to regulate or change corporate governance reflect an indifference to the accountability standard. The preoccupation with shareholder and stakeholder rights and control, for example, has driven much of the intermittent reform focused on corporate management practices in the US and elsewhere (La Porta et al., 1999b, La Porta et al., 2000, La Porta et al., 2002). A concern with traditional fiduciary

[18] The French term for such a corporate entity – *personne morale* – captures, or at least implies, the core sense of the model.

responsibility (that is, to the interests of the corporate entity itself rather than its "owners" or creditors) had faded somewhat with the elevation of shareholders to sole role of principal (Scott, 1949, Mitchell, 1990, Mitchell, 1993), but it has made a comeback in recent years in calls for a shift away from shareholder value and toward increasing corporate value (Smith, 1999) and enhancing corporate trust and integrity (Farber, 2005, Roberts, 2001). While these reform efforts and proposals can be assessed on their own terms, what we are seeking here is to apply the accountability standard.

When assessing pre-SOx reform efforts, therefore, the issues could be put retrospectively in positive or negative terms. In a positive sense, the question to be asked is whether (and how) the reform efforts enhance or strengthen the accountability aspect of governance; in the negative, the assessment would focus on whether and how the reform efforts weakens accountability.

SOx, however, offers a distinct opportunity to assess corporate governance reforms that were intended to enhance the reputation of corporate enterprises as accountable institutions in the historical sense. The crises that emerged from the scandals at Enron and other enterprises required some action – symbolic or otherwise (Conrad, 2003, O'Brien, 2006a) – to counter their delegitimizing impact. But the circumstances surrounding this flurry of corporate difficulties called for more than readjustments in how firms would handle stakeholder or fiduciary issues. For the first time since at least the Great Depression it was the *accountable nature of the corporate form* that was at issue. How well did SOx measure up to that challenge?

<u>Assessing accountable governance: a framework:</u>

Despite its popular association with performance measures, there is no known metric for accountable governance.[19] Nevertheless, it is possible to identify various forms of

[19] There have been efforts to assess the quality of performance measures and measurement systems (e.g., Poole et al., 2000) and some attempts to establish indicators for types of accountability mechanisms (e.g., Page, 2004), but these fall short of measures of accountability per se. Part of the problem is the lack of a clear conceptualization or theory of accountability; see Dubnick, 2007, Dubnick, 2005, Dubnick, 2002.

accountability-relevant relationships that can provide the basis for comparison and assessment of governance mechanisms and proposals for reform. To accomplish this I apply a framework developed in an earlier paper (Dubnick, 2006) that allows us to categorize policies and their implementation into four types or relationships involving account giving. The four types range from those impacting directly on the behavior of account giver to those that operate at the level of moral suasion. They are presented here as four distinct "orders" of accountability.

First order ("performative") accountability entails a situation requiring explicit and direct acts of account giving. Such "speech acts"[20] typically require at least two parties – an account giver who is *doing* the account giving and an account receiver who is the intended target of that act. The fact that account giving is an action unto itself – not merely a statement about something, but a "doing" per se – makes it what linguists and philosophers call a performative act (Searle, 1989, Austin, 1975) – thus the appellation *performative accountability.* To designate it as such does not imply that it is a meaningless or vacuous act – to the contrary, as is the case with other performatives such as "I promise" or "I bid" or "I bet", the awkward "I account for" has some force and meaning within a given context.

At its most basic and informal, performative account giving can overlap with the social act of "reason giving" recently highlighted in the work of Charles Tilly. Humans are reason seeking/giving animals, Tilly asserts, and we engage in various forms of reason-giving in a range of social relationships from the most mundane (e.g., practices of etiquette) to the unfathomable (e.g. attempting to comprehend the events of 9/11 as they occurred) (Tilly, 2006, Tilly, 2004). But despite a fundamental similarity in form as well as a degree of overlap, the defining line between reason-giving and account-giving is crossed where the account-giver is assumed/perceived to be "responsible" to the account-receiver for the condition, action, or event that is the focus on the relationship.

[20] On the social nature of speech acts, see Austin, 1975, Searle, 1962, Strawson, 1964, Searle, 1969.

In most scholarly examinations of first order account-giving, stress is placed on its role as a functional and appropriate reaction to some error or faux pas, and thus most analyses concentrate on the social conventions for making excuses or offering justifications (Scott and Lyman, 1968). Although such mitigatory and explanatory first order acts of account giving are common place, they often overshadow equally important purposes for engaging in them, as found in information-generating (monitoring, surveilling) forms such as bookkeeping, reporting, responding to audits, subjecting oneself to inspection, etc. (Kaufman, 1967, Kaufman, 1973).

In all these instances, the acts of account-giving – whether in the form of publishing an annual or quarterly report, issuing a press release, giving testimony at a trial or before a legislative committee, offering a public apology, providing a written elaboration of reasons for taking actions, releasing or posting of transcripts -- are responses to a direct (although sometimes implied or perceived) solicitation from real or potential account receivers. The solicitation can take the form of a speeding ticket issued by a police officer, a reporter's microphone place in front of one's mouth, a demand by an auditor to see one's books, a phone call from one's supervisor seeking an explanation for some action, a public accusation, etc. In each case the effort is to generate a performative response from the account giver.

But not all accountability is performative. Most forms of accountability in fact occur in anticipation (sometimes anxious anticipation) of the need or requirement to engage in performative accountability. They relate, in other words, to a "presumptive account giver".

Second order ("regulatory") accountability, for example, does not involve direct and explicit account giving, but is instead manifest in following the guidance, rules and operating standards of the presumptive account giver's task environment. This is *regulatory accountability* and it makes use of the potential "threat" of being called to performative account to establish and maintain restrictive and directive control over the account giver.

In a widely discussed work on the nature of cyberspace, Lessig takes note of four major mechanisms that society relies on to constrain or limit behavior, including law, social norms, the marketplace and the "architecture" of the operating environment (Lessig, 1999). Of those four,[21] law and architecture generate second order accountability by creating operating environments in which the possibility of some form performative account giving plays a significant role in shaping and directing the behavior of agents.

The use of law as a basis for regulatory accountability is well documented both historically (von Dornum, 1997) and in contemporary analyses of requirements related to rule of law standards (Rosenbloom, 2003, Sanders et al., 1998, Stinchcombe, 2001). Lessig's major contribution has been to highlight the role of task environment "architecture" in the regulatory endeavor. This architecture – which Lessig notes is manifest in the "code" of everything from computer programs to constitutions – determines such things as access and the range of discretion/autonomy an individual has while operating in the constructed environment. It obviously places various checks on the range of choices or decisions that an accountable individual can make, but it also functions as a rationale for constrained or directed behavior. Thus, if called upon to provide an account for his or her behavior (that is, to engage in first order accountability), the person who operates within the architecture would refer to its rules, parameters, SOPs, etc. (see also the discussion of codes in reason-giving in chapter 4 of Tilly, 2006). Underlying all this is the belief that first order, performative accountability would be triggered if an individual was found to be challenging or violating the code.

In contrast, rather than focusing on the control of conduct, **third order ("managerial") accountability** relies on account giving as a means to elicit purposive behavior. Accountability in this sense is intended to be motivational rather than regulatory, and in

[21] Challenges or violations to social norms would more likely call for reliance on what Tilly calls "reason giving" (Tilly, 2006), and the price mechanisms of the marketplace operate within the context of law to deal with any problems. On the latter point, it is relevant that Lessig did not include the marketplace in his first examination of such mechanisms; see Lessig, 1998-2000.

that sense the term *managerial accountability*[22] seems most appropriate (Dixon et al., 1998, Fowles, 1993, Lyons, 1998, Meyer, 2002, Page, 2006). The logic is simple: the measure or assessment of an action or condition for which the account giver is assumed "responsible" is, *under the right conditions*, regarded as an effective means for motivating that individual to improve that action or condition in the future. Under third order accountability, the focus is on designing task environment conditions (again, architectures) that facilitate those motivations rather than control or constrain them. Thus, we see the extensive use of incentives and sanctions in third order accountability.[23]

While second-order (regulatory) and third-order (managerial) accountability operates primarily through the architecture and machinations of task environments, **fourth order ("embedded") accountability** operates through the norms and values of the account giver – through what Foucauldian's designate as "governmentality" (see Foucault, 1991, Rose and Miller, 1992, Rose, 1999, Rose, 2000). We will use the label *embedded accountability* to stress the internalization of the sense of "moral responsibility" characteristic of this form, and take special note at this point of its association with professionalism and high levels of commitment to living up to perceived expectations.

Assessing SOx:

Fourth order accountability stands as both foundational and aspirational in the present situation. On the one hand, once in place as the values and norms of corporate governance – that is, once embedded in the corporate culture of a firm – it can shape and direct the use of performative, regulatory and managerial accountabilities. On the other hand, establishing an embedded fourth order accountability is an extremely challenging task, perhaps on par with Plato's strategy for creating his Republic. Optimistically, one can imagine policies that reward corporations for developing and fostering corporate

[22] Not long ago the concept of "managerial accountability" would have been more closely associated with regulation and control; see Mason 1958; Preston and Post 1974.
[23] Third order accountability is central to what I have called the "promises of accountability" is other papers (e.g., Dubnick, 2003, Dubnick, 2005). These promises relate to a number of socially desirable ends, ranging from justice and democracy to ethical behavior and enhanced performance in the production of goods and service. Despite its simple logic, however, the value and validity of managerial accountability remains an empirical question.

cultures that give priority to accountable governance standards (e.g., Stone, 1975). But others would argue that the effort would require not merely changes in policies related to corporate governance, but a wholesale (and unlikely) transformation of legal ontology under which the Anglo-American system operates.[24]

As it happens, the agendas for most corporate governance reform efforts are aimed at lower aspirations than creating corporate forms that are in sync with the accountability model. Requiring automobile manufacturers to meet set standards for average fuel economy on their vehicles reflects a first order (performative) solution to the problem of having those firms act responsibly. Often reform policies aim as improving performance by modifying the regulatory regime in which they have to operate. Deregulation of the airlines, buses and other forms of interstate public transportation can be regarded as shifting the second order accountability (regulatory) regime toward the open market, with the unfettered firms having to deal with a different set of account-giving relationships. Modifications in policies regarding the taxation and reporting of executive compensation and benefits can and have had impacts on third order (managerial) accountability decisions. In each of these cases, the different orders of accountability have modified some aspect of corporate decision making.

But in the wake of the corporate scandals at Enron, WorldCom, etc., the agenda for corporate reform expanded and rose to the level of the goals implied in the accountable governance model. Short of a miraculous transformation in the legal ontology of Anglo-American corporate operations through fourth order reforms that alter the existing "governmentality", however, reforms would have to come through policies based on the lower order approaches. In that sense, there is a need for a SOx-like initiative that contains provisions that at least push in that direction. The immediate question is whether SOx is such an initiative.

The answer is clearly no.

[24] See the interesting analysis offered in Kitagawa, 1960. Japan's experience with modern corporate law speaks to many of the issues now raised about globalization and its impact, particularly in light of the hegemony of the Anglo-American legal cultures.

<u>The performative provisions:</u> The Sarbanes-Oxley Act contains 69 sections, with about two-thirds having some provisions that relate to a type of accountability relationship. Due to the necessary formalisms required of such a statute, some sections were definitional, others were redundant in regard to the substance of their accountability provisions (e.g., Title XI sections contained authorizations for actions to enforce previous sections), and still others contained provisions that were not related to our task.

Of what remained, there were 17 provisions for what can be termed first order accountability mandates; that is, they detailed an action (e.g., a filing of a disclosure, the development of an ethics code) that had to be taken by some actor. Of those, nine were aimed at external actors whose activities impacted (directly or indirectly) on the corporation. Of those, seven related to accounting firms hired to serve as auditors of the company. The other two required actions by outside attorneys and the security analysis industry.

The remaining eight first order provision involved mostly disclosure and reporting requirements. Two of the disclosure requirements were general in nature, requiring complete (section 401) and quick (409) reporting. An additional two were targeted at specific officers, with section 302 requiring CEO and CFO certification of annual financial reports and section 1001 (which was a sense of the Senate provision) strongly suggesting that the CEO sign the corporate income tax filings.

Four additional disclosure provisions were actually indirect mandates that would clearly have third order effects. Section 407, for example, requires a report that confirms that at least one member of the audit committee is a financial expert, with the obvious implication for recruiting such an individual. Section 406 requires a similar disclosure about a corporate code of ethics for financial offices, again impacting on managerial operations. Section 403, seeking disclosure of personal financial transactions by corporate officers and major shareholders, would require the development of relevant tracking and reporting mechanisms.

But perhaps the most significant provisions with secondary consequences among the disclosure requirement are found in section 404 which mandates reports on the operations and effectiveness of the firm's "internal control structure and procedures for . . . financial reporting." The development and operations of such mechanisms (if they did not already exist) have recently been noted as the most costly and problematic of the SOx requirements (Tackett et al., 2006, Carney, 2006).

Regarding these various first order provisions, there seems only the faintest relationship between them and objective of reestablishing accountable governance. Implied in some provisions (e.g., the CEO/CFO signoffs; the code of ethics for financial managers; the development of effective internal control systems) is the assumption that such *legal* requirements will make it clear to the effected officials that they have *moral* obligations that go beyond their own self-interest or even those of the firm's shareholders and stakeholders. Whether there are connections between these requirements and fourth order (embedded accountability) effects involves empirical questions that might prove difficult to answer in the short term.

<u>The regulatory provisions:</u> SOx also contains 21 provisions that can be categorized as second order accountability actions. Six are found in Title I of the Act which relates to the establishment and authority of the Public Company Accounting Oversight Board, a non-profit entity that deals directly with the outside accounting firms the serve the audit needs of the corporations. In addition, three other sections (201, 202, 906) contain regulatory provisions related to the outside auditors. In fact, in Title II of the Act, only section 206 relates directly to the firm by prohibiting the hiring of officers who had worked for those outside auditors during the previous year.

The remaining 11 second order provisions are scattered among the other Titles and range from determining the composition of corporate audit committees (section 301) to prohibiting the extension of credit to firm officers or directs (402) to protections for whistle blowers and informants (806 and 1007). Among the most important of these second order accountability provisions are those that extend and enhance the criminalization of malfeasant behavior of corporate officers (e.g., see sections 807, 906).

Once again we are confronted with questions about the assumed link between these second order provisions and the objective of developing an embedded sense of moral obligation among corporate agents. Given the details of these sections, the desire for retribution and restoration may have taken priority over any intent to change the moral commitments and behavior of corporate officials. But assuming that long-term moral and behavioral change was part of the design, there seems little in the law that addresses the potential for the hazards (moral and cognitive) associated with regulatory actions (Klick and Mitchell, 2006).

<u>Managerial and the absence of fourth order provisions:</u> In addition to the third order actions implied in the disclosure provisions of sections 404, 406 and 407 (noted above), SOx contains only one accountability-relevant provision that is somewhat managerial. According to section 304, if the firm's reports to the SEC are determined to be noncompliant, the firm's major officers (CEO, CFO) must forfeit bonuses and other compensation rewards.

It should be noted at various points in the deliberative process, members of Congress offered a number of management-relevant ideas for consideration. But opposition to overly intrusive policies won the day, and only section 304 remained as an explicit managerial provision when SOx was finally passed.

The irony is that, short of some fourth-order expression of substantive standards to guide corporate decisions, third-order managerial provisions might have enhanced the Act's promise as a stimulant for accountable governance. As it is, the section 404 requirements for reporting on the design and effectiveness of internal control of financial records has drawn the most reaction from corporations who complain about the ambiguities and costs associated with its implementation.

Finally and most notably, there is no single provision in the legislation that can be classified as a fourth order accountability action. There is nothing in SOx to deal *directly* with the assumed objective of establishing or improving the corporation's purpose as an accountable ("rights-and-duties-bearing") institution.

Conclusion:

Of the many efforts at corporate governance reforms that have emerged in recent decades (Rockness and Rockness, 2005), Sarbanes-Oxley stands out as a watershed event in several respects. It has clearly been a force in both the nationalization of US regulation of corporate governance (see Alva, 1990, Cary, 1974, Roe, 2003) and the Americanization of global regulatory regimes (Gates, 2003, Vagts, 2003, Hollister, 2005). And its impact on the daily relationships within business environment have certainly been notable, as anyone who works in the accounting or securities field can attest to.

But as drawn up in haste, SOx can be seen as a missed opportunity in one important respect. It is probably the case that the political circumstances of the moment generated as good an effort as might have otherwise been expected in a political system that seems addicted to a policymaking-by-crisis mode, but a more thoughtful and informed debate might have led to considerations about the nature of corporate accountability that have been off the reform agenda for at least a century in the US.[25]
As it now stands, the provisions of SOx and their enforcement have generated their own problematics (O'Brien, 2006b, O'Brien, 2007), and the long postponed debate over the role of corporate entities as accountable institutions is likely to be extended.

[25] However, additional time and deliberation might not have made a difference. In the United Kingdom the consideration of corporate governance issues has been taking place for at least a decade, with the 1992 Cadbury Report often cited as the start of an ongoing debate that has generated a number of reports over the past 15 years. Despite this extended debate, the focus remains on stakeholder reform, transparency and oversight; see Solomon and Solomon, 2004, chapter 1.

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