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CORPORATE DISCLOSURE AND ITS IMPACT ON CORPORATE MORALITY/EFFICIENCY: AN INTRODUCTION

DISCLOSURE AND CORPORATE MORALITY: BEGINNING A DIALOGUE

*David A. Lipton**

It is difficult to engage a dialogue relating to the "The Impact of Corporate Disclosure on Corporate Morality" without inviting a lengthy interchange of contradictory opinions, much of which would typically be tediously well footnoted. The economists debate the presence or absence of any benefit to society from moral corporate behavior. Those scholars who view all societal relations as arising out of contract law seek to determine which corporate constituency bargained for the right to dictate corporate morality. And the ethicists simply ask "how is it that we are to define morality?" Collectively these well meaning and often thoughtful methods of analysis can effectively stifle the most gentle of inquiries into the desirability or effectiveness of using corporate disclosure to encourage corporate morality. Discussions on this topic run the risk of sounding similar to a commercial popular during the adolescent years of television which presented two individuals debating whether a flavored tablet placed in the mouth was a candy or a breath mint.

With full cognizance of these potential pitfalls, the Securities Program of The Catholic University of America, Columbus School of Law, in conjunction with the *Law Review*, chose to conduct a symposium, in honor of the Centennial of the Law School, to discuss disclosure and corporate morality. The task of those who participated in this Symposium was not simple. In essence, they had come to analyze "what has been, what is, what could be and, perhaps for the courageous, what ought to be the impact of corporate disclosure on corporate morality." Panelists for this program included[1] two former

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1. The Symposium was held on April 16, 1998 at the Columbus School of Law of The

SEC Directors of Enforcement, one of whom is now a sitting federal judge and one of whom has returned to private practice. Also on the panel was a former University President who is a Jesuit priest and a professor of management. Another panelist was the Principal of a socially conscious investor advisory group. There was also the vice-president of the only major American corporation that has designated a vice-president to be specifically responsible for corporate governance. In addition, there was a nationally recognized economist and author from one of Washington's largest think tanks and the general counsel of a publicly traded, cyberspace/technology-oriented corporation. A number of the panelists practice law in the Washington, D.C. area, in each instance with several years of prior experience working with the Securities and Exchange Commission. Finally, there was a well rounded assortment of professors and a dean, from law schools located in all regions of the country. Each of these academics had previously written or otherwise delved into some aspect of corporate disclosure and/or corporate morality. The author of this introduction was sufficiently vainglorious to serve as the moderator of this Symposium.

In introducing the several significant articles that were generated by the Symposium discussion, my goal will be to pose as few contentious propositions as possible and instead to assert a few simple observations upon which most readers could agree. This "neutral" introduction is designed to allow a variety of readers to feel comfortable exploring the discussions that grew out of the Symposium and to be able to digest these articles in a atmosphere that will lend support to a range of positions regarding the issues raised in the

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Catholic University of America. The full complement of panelists were: Dr. Margaret Blair, Senior Fellow, The Brookings Institution and Visiting Faculty, Georgetown University Law Center; Fr. William J. Byron, S.J., Rector, Georgetown Jesuit Community, Distinguished Professor of Management, Georgetown School of Business, and former President of The Catholic University of America; Eric A. Chiappinelli, Professor, Seattle University School of Law; James A. Fanto, Associate Professor of Law, Brooklyn Law School and Associate Director, Center for the Study of International Business Law, Brooklyn Law School; John M. Fedders, Attorney, securities and commodities law enforcement and litigation and former Director of the SEC's Division of Enforcement; Terrence J. Gallagher, Vice President - Corporate Governance, Pfizer, Inc. and former President of the National Board of the American Society of Corporate Secretaries; Donald C. Langevoort, Lee S. & Charles A. Speir Professor, Vanderbilt University School of Law; David A. Lipton, Professor, Columbus School of Law, The Catholic University of America; Nell Minow, Principal, LENS; Marleen A. O'Connor, Professor, Stetson College of Law; Beth-ann Roth, Attorney, Dechert Price & Rhoads and former Associate General Counsel, Calvert Group, Ltd.; Mark A. Sargent, Dean, Villanova University School of Law and former Professor and Associate Dean, University of Maryland School of Law; The Honorable Stanley Sporkin, United States District Judge for the District of Columbia, former Director, SEC's Division of Enforcement, and former General Counsel, Central Intelligence Agency; and Russell B. Stevenson, Jr., Senior Vice President, General Counsel and Secretary, CyberCash, Inc., former Professor, George Washington University National Law Center, and former Deputy General Counsel of the SEC. Steven M.H. Wallman, Senior Fellow, The Brookings Institution, and former SEC Commissioner, was instrumental in the development of this program.

Symposium. The distinguished participants in the Symposium were not exhorted to be "neutral" in the various arguments they developed. Instead what was hoped for and was indeed achieved was the development of a vocabulary, methodology and, perhaps, even differing ideologies by which the issues of the Symposium could be further analyzed. In essence, the Symposium was designed to initiate a discussion, not to conclude a discussion.

To set the stage for the Symposium in a manner consistent with the above stated goals, it may be asserted, without fear of reasonable contradiction, that the United States has one of the most highly developed and comprehensive corporate disclosure regulatory systems in effect amongst all the economies of the world. This disclosure system, with the attendant transparency that it has produced, is frequently credited as a significant factor in explaining the strength and efficiency of American securities markets. While many would debate precisely the motivation behind requiring the disclosure of certain corporate information, there can be little doubt that regardless of the motivation, required disclosure information frequently relates to the morality of the corporation's personnel and operations. Included within the category of information that relates to corporate morality would be disclosure regarding: director and officer business and familial conflicts of interest; liability for environmental and EEOC violations; foreign bribery disclosure under the Foreign Corrupt Practices Act; conviction of management for criminal offenses; judgments against management for securities law violations; and management salary in comparison to company performance, to name but a sampling. Undoubtedly, in each instance, one can identify an investor's financial concern as motivation for the required disclosure. But, in each instance, one can also identify a concern relating to societal values that motivates such disclosure requirements. Is it merely the financial concern factor that makes the American markets efficient and relatively reliable? Or is that efficiency and reliability a product of the fact that the disclosure relates to morality as well? Parties may debate that issue back and forth. At the end of that debate, many would conclude that the strength of our markets and the strength of our public corporations is derived both from financial concern disclosure as well as moral concern disclosure.

The contributors to this Symposium issue, as well as the other participants at the Symposium panel discussion itself, sought and are seeking to explore how, when and why disclosure of issues impacting on corporate morality should or should not be encouraged. Again, the goal was not so much to develop conclusions regarding these issues but to develop a methodology, to begin an analysis, and to encourage further, similar discussions.

Two of the contributors to this Symposium issue directly tackled the issue of disclosure and its relationship to the concept of materiality. Historically,

the determination as to when disclosure is required has turned on the question of whether the information is material. Both the contribution by former SEC Enforcement Director John Fedders as well as the article by Professor Donald Langevoort compel the readers to ask if indeed matters of morality are material to investors. Professor Langevoort suggests that the SEC should limit disclosure obligations to those matters which impact on investors, rather than those that impact upon other corporate stakeholders. This formulation of the role of disclosure would not seem to exclude the necessity of disclosing matters of moral significance when such disclosure advances the investor's ability to assess the value of the issuer's securities. Langevoort's analysis is further supported by his arguments relating to the necessity of preserving the reputation of the SEC as a premier administrative agency. This reputation, Langevoort believes, comes from a well-defined mission focusing on the protection of investors. To dilute this mission by introducing the goal of protecting competing non-investor interest might well threaten the integrity of this Agency.

Former Director Fedders traces the history of the Commission's and the judiciary's flirtation with a pure "qualitative" materiality disclosure policy. This author, who was largely responsible for the SEC's early 1980 iteration of its quantitative material disclosure policy, acknowledges that matters of societal morality are often required to be disclosed under the Commission's seemingly objective "quantitative" disclosure policy. In Fedders's 1982 speech on quantitative materiality, the then-Director of Enforcement reasoned that illegal behavior warrants disclosure whenever there is a "reasonable likelihood" that such behavior will have a "material effect on earnings, assets or liabilities." In the conclusion to his article, Fedders again states that "corporate morality will be driven by economic returns." Fedders's observations require the reader to once more ponder whether corporate morality can ever be divorced from the investor's universe of interests. In addition, this former official's commentary provides an invaluable insight into the inner workings of the political process by which the Commission hammered out its position on disclosure of corporate morality.

Dr. Margaret Blair chooses to approach the question of corporate morality from a different angle than that of some of the other authors. Dr. Blair, an author and economist at the Brookings Institution, does not specifically investigate the issue of whether corporate morality is of any relevance to those stakeholders who have made a financial investment in the corporation. Rather, Dr. Blair reasons that important contributions (such as intellectual capital) are made to the corporation by entities other than shareholders. Taking a page from the contractualists, Blair reasons that by contributing intellectual, organizational and other intangible assets to the corporation, non

financial-assets contributors create an implied contract with the corporation that requires the corporation to respond to the needs of these "investors." Implicit in this argument is the understanding that some of the "needs" of the nonfinancial asset-contributors would relate to matters that would typically be seen as matters of morality. The conclusion reached by Dr. Blair is consonant with her opening statement. In the introduction to her talk, Dr. Blair opined that corporations, as citizens of society, owe a duty to society to act morally. Dr. Blair does not stop with the conclusion that corporations have an obligation to consider and contribute to the interests of a variety of nonfinancial stakeholders. Instead, Dr. Blair provides three models to consider how the corporation might divide the "pie" between both financial asset and non-tangible asset contributors to the corporation. These models warrant further discussion as attorneys and economists further analyze the role of morality in corporate disclosure.

Professor James Fanto's article bypasses the debate as to what should be required of corporations in disclosure documents and instead focuses upon educating the investor as a means of encouraging corporate disclosure of matters relating to corporate morality. Instead of asking what disclosure government should require of corporations, Professor Fanto essentially inquires "how do we educate investors to understand issues of corporate morality?" The implied premise of Professor Fanto's inquiry is that the most efficient way to encourage disclosure relating to corporate morality is to enhance the investor's interest in such information. Central to this proposition is the conviction that it is credible to anticipate that investors, in determining how to respond to investment alternatives, can be encouraged to examine social as well as economic considerations. Fanto argues that "responsible" ownership in investments requires investors to consider more than the narrow concern of an "optimal portfolio." Owners must also consider the public role of a public corporation. Merely educating investors of their broader investment responsibilities would be only the start of Professor Fanto's approach. Professor Fanto reasons that investors would also need to be educated regarding: appropriate sources of information, the existence of a wide constellation of societal norms concerning moral behavior, and the range of individual and collective actions (beyond the "Wall Street walk") that can be engaged by investors in order to influence corporate behavior.

A final contribution to this Symposium issue deals with the matter of shareholder proposals. For more than six decades, SEC rules have fostered shareholder communication through the promulgation and interpretation of shareholder proxy proposal rules. While these rules were not specifically designed to promote shareholder input into matters of corporate morality, historically, the most widely debated shareholder proposals each dealt with

matters relating to corporate morality. Shareholder activists often have sought to employ the proposal rules as a mechanism to compel corporations to endorse a specific political, social or moral stance. Beth-ann Roth, an attorney in the Washington office of a large national law firm and formerly a lobbyist, counsel for an investment management firm, and SEC staff member, traces the history of the Commission's response to the activist use of shareholder proposals. This history is then placed within the context of the Commission's extensive reconfiguration of the shareholder proposal rules in 1998. Roth's significant contribution to this historical analysis is a new initiative which she proposes that the Commission undertake to enhance shareholder communication and input into the corporate governance process. Roth's contention is that the shareholder proposal rules that are currently in effect invite confrontation. Both the timing and the system employed to get the shareholder's proposal onto the proxy creates an adversarial atmosphere between management and the shareholder. Roth's proposal is that the Commission adopt rules which would mandate that corporations establish procedures which would invite shareholder input and allow corporations to discuss shareholder ideas before these ideas are formulated into formal shareholder proposals. Through these efforts and similar innovations, Roth anticipates that genuine shareholder communication would be increased and the "partnership" of governance between management and shareholders would be advanced.

Collectively, these authors, and the other commentators who participated in the Symposium discussions, have helped to create an arena in which the question of the desirability of utilizing mandated disclosure as a tool for promoting corporate morality can be further debated. The willingness of the Symposium participants to come together to discuss this issue of the Symposium, the production of the several commentaries which constitute this issue of the *Law Review*, and the diversity of approaches adopted in these articles reflect the genuine interest in this topic held by members of the academic, legal, and business communities. It is hoped that the ideas generated by this Symposium will motivate others to further investigate the issue of the impact of disclosure on corporate morality.