Stakeholder Inclusion and Shareholder Protection: New Governance and the Changing Landscape of American Securities Regulation

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STAKEHOLDER INCLUSION AND SHAREHOLDER PROTECTION: NEW GOVERNANCE AND THE CHANGING LANDSCAPE OF AMERICAN SECURITIES REGULATION

Paul Curran Kingsbery*

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INTRODUCTION

According to regulation experts, the United States securities regulation system is due for a complete overhaul.\(^1\) Although the regulatory scheme is not the sole source of recent economic turmoil, Americans watching their investments decline in value may blame those regulators who have assumed the mantle of investor protection.\(^2\) The precise level of reform that is to come is still uncertain and sweeping new legislative programs could have unexpected consequences going forward. Simultaneous with calls for reform of the securities laws and regulations, there is growing attention among scholars of administrative law towards a school of thought called “New Governance.”\(^3\) This Note analyzes a few potential avenues for change in United States securities regulation in light of the descriptive and normative claims of New Governance theory.\(^4\)

This Note analyzes the implications of New Governance theory as it relates to a group of proposals to reform U.S. securities regulation. New Governance does not have one definition, and alternate terms such as “reflexive law, soft law, collaborative governance, democratic experimentalism, responsive regulation, outsourcing regulation . . . [and] meta-regulation”\(^5\) are used to describe similar phenomena. Unless specifically used in the context of Securities and Exchange Commission policy determinations, “securities regulation” in this Note is intended to indicate the aggregate of all legal protections of the interests of securities holders, under federal and state laws and regulations, as well as case law and emerging international norms. The only way to apply and evaluate New Governance theory is to contextualize the rules governing securities issuance and exchange in light of all stakeholders and policymakers.

Part I of this Note describes New Governance theory in both descriptive and normative terms and gives an account of how New Governance solutions are already integrated into the U.S. securities regulation regime. Part II of this Note describes reform proposals in two important securities regu-

\(^1\) See Harvey Pitt, Bringing Financial Services Regulation into the Twenty-First Century, 25 YALE J. ON REG. 315, 319 (2008) (“The system cries out for serious change, which begs the question: Where do we go from here?”).
lution areas: executive compensation and financial reporting. Part III of
this Note analyzes the extent to which the discussed reforms incorporate
New Governance principles, weighs these reforms against traditional legal
and policy values, and advocates, in particular, for expanded application of
New Governance in the field of financial reporting.

I. BACKGROUND ON NEW GOVERNANCE THEORY AND U.S. SECURITIES
REGULATION

Part I of this Note explores the common core of a group of theories col-
lectively referred to as New Governance. These theories are united in
questioning "the false dilemma between centralized regulation and deregu-
latory devolution." Part I.A proposes that these theories are best under-
stood in the most general terms, applying to novel non- and quasi-
governmental organizations, federal and state governments, and the stake-
holders themselves. Part I.B argues that New Governance is best under-
stood as a general theory of norm formation by giving examples of how the
so-called command-and-control regulatory systems that comprise U.S. se-
curities regulation already incorporate New Governance principles.

A. Defining and Understanding New Governance

As a still-nascent theory of administrative law, New Governance evades
a single definition. Definitions of New Governance fit into two categories:
some focus on differences between New Governance and traditional forms
of government, while others focus on the increasing role that non- and
pseudo-state actors play in policy formation. The "New Governance
model" proposed by Orly Lobel is illustrative of the first category, as Lobel
defines New Governance mainly by what it is not. For Lobel, New Gov-
ernance "supports the replacement of the New Deal's hierarchy and control
with a more participatory and collaborative model." Robert Ahdieh takes
the second approach. Rather than defining a theoretical movement in op-
position to current administrative institutions, Ahdieh's treatment of New
Governance begins with an examination of the problems stemming from
"cross-jurisdictional interaction among regulatory entities," and develops
an explanation of how these interactions can "[offer] an effective mecha-

6. Id. at 343.
7. Id. at 344.
8. Ahdieh, supra note 4, at 863.
The distinction between the two strategies for defining New Governance is important because it has consequences for policy determinations ancillary to the implementation of a New Governance administrative scheme. The proper role of traditional sovereign states in a New Governance scheme depends on whether New Governance is a new process of norm formulation, or if it is merely a new strategy for the formulation and implementation of the policy objectives of the State.

The distinction between the Lobel and Ahdieh definitions should not be overemphasized. Lobel recognizes that her "Renew Deal" vision is an amalgamation of "scholarly theories including . . . reflexive law, soft law, collaborative governance, democratic experimentalism, responsive regulation, outsourcing regulation, . . . [and] meta-regulation . . . ." Although Lobel makes certain debatable claims about New Deal regulation, broadly characterizing it as command-and-control regulation, Lobel recognizes that a "statutory mandate may be a first step in the constitution of a governance model." Thus, even when New Governance is understood as a "third way between state-based, top-down regulation and a single-minded reliance on market-based norms," rather than a "proceduralization" of existing, but opaque, influence on policy formation, there are no precise boundaries between the old and the new.

The line of distinction between old and new governance—and thus an understanding of the essence of New Governance—is further complicated by scholarship recognizing the importance of traditional nation-states to the orderly formation and operation of the New Governance solutions. The fact that old and new may coexist does not, however, imply that the new is subsumed within the old. Even in recognition of the importance of their centralized organizations, New Governance institutions are distinct from their command-and-control counterparts.

9. Id. at 896.
10. Lobel, supra note 5, at 346 (internal citations omitted).
11. See id. at 369.
12. Id. at 451.
13. Id. at 443.
15. This is particularly true in the case of "transnational" governance structures, and international governance structures, as in the Tuna/Dolphin Case described in Richard W. Parker, The Use and Abuse of Trade Leverage to Protect the Global Commons: What We Can Learn from the Tuna-Dolphin Conflict, 12 GEO. INT'L ENVTL. L. REV. 1 (1999).
The regulation of securities provides a unique opportunity for administrative law scholars to test the boundaries of new and old institutions for two reasons: first, securities regulation is aided by an abundance of market data that is constantly generated and scrutinized by market participants; and second, command-and-control was arguably never the dominant mode of norm generation in the field of securities regulation. The history of securities trading gives ample examples, however, where more information did not yield better information, and consequently did not give rise to better regulatory policy. Where such market failures occurred, the rules were not self-sustaining, and therefore required changes. New Governance regulation strategies grant market feedback about the success of a rule a visible place in discussions leading to policy formation.

In "proceduralizing" the role of market feedback, New Governance can be seen as expanding the role of the government into the private sector. A critic may argue that New Governance is a mere cover for deregulatory policy cloaked in a false mantle of government, but this criticism, aside from relying on empirical data about the intentions of New Governance proponents that are impossible to obtain, assumes that government involvement in problem-solving is an end in itself, rather than a means for the prevention of failure in private ordering. The most effective criticism of New Governance focuses on its efficacy. Regulation is necessary precisely because private ordering does have an impact on persons outside of individual transactions; a strong argument in favor of regulation is that the distinction between private and public ordering is artificial. A corollary of the assertion that there is no purely private realm is that there is no purely public realm either. Just as agency costs arise in the context of executive compensation, when policymakers make rules that benefit a narrow but influential area of society for personal gain, governments introduce agency costs on those whom they govern. Thus, although the term "market failure" generally applies in the context of private ordering, New Govern-

17. See infra Part I.B.
19. See generally Lobel, supra note 5.
21. Donna M. Nagy, The SEC at 70: Playing Peekaboo with Constitutional Law: The PCAOB and its Public/Private Status, 80 NOTRE DAME L. REV. 975, 1030 (2005) ("[T]here is a growing consensus that expanded privatization has served to blur the distinction between the spheres of public and private. The blurriness has prompted Professor Jody Freeman and others to argue that there is 'no purely private realm and no purely public one . . . [only] the set of negotiated relationships between the public and the private.'") (quoting Jody Freeman, The Private Role in Public Governance, 75 N.Y.U. L. REV. 543, 548 (2000)).
ance permits more transparent and open procedure to prevent misaligned incentives between the government and the governed.\textsuperscript{22}

This Note focuses on the implications of New Governance theory for a sampling of proposals for change in U.S. securities regulation, rather than a criticism of particular theories, and adopts the most inclusive definition that still maintains the requisite level of clarity. Such a definition of New Governance appears in Kenneth Abbott and Duncan Snidal's \textit{Strengthening International Regulation Through Transnational New Governance: Overcoming the Orchestration Deficit}. The definition has four factors:

1) decentralization of "actors and institutions, public and private, into the regulatory system";

2) reliance on decentralized actors for regulatory expertise;

3) "orchestration . . . rather than direct promulgation and enforcement of rules"; and

4) use of "soft law" over "hard law."\textsuperscript{23}

An important aspect of the Abbott/Snidal definition is that it defines New Governance techniques in terms of implementation by the state.\textsuperscript{24} Though some scholars prefer to characterize New Governance in opposition to the old and centralized government,\textsuperscript{25} one can also achieve the same result—or arguably, a better result—by maintaining sovereignty of the government over matters that New Governance seeks to address, and by restricting the role of the government to enforcing primarily procedural rules. This view of New Governance is focused on the perspectives of regulated entities and the people, rather than the perspectives of those involved only in policy formation. For a regulated entity, the aggregate impact of rules on the entity's freedom of action is the central focus, regardless of whether the rules are derived from statutes, regulations, New Governance soft law, or customary practice in a given industry. The government, however much it claims to abstain from involving itself in private ordering, whether in the context of market interactions or compliance with regulations, will ultimately insinuate itself in private ordering when political circumstances

\textsuperscript{22} Because New Governance requires expanded stakeholder input, New Governance theory assumes that, through a bargaining process, incentives can be aligned. A failure of a "solution space" in a New Governance-style negotiation could lead to a breakdown in the New Governance institution. For an example of the failure of New Governance due to an impossibility of incentive alignment, see Douglas NeJaime, \textit{When New Governance Fails}, 70 Ohio St. L.J. 323, 373-84 (describing the failure of the Montgomery County, Maryland Citizens Advisory Committee due to substantial disagreement between gay-rights advocates and Christian public interest law firm Liberty Counsel).

\textsuperscript{23} Abbott & Snidal, supra note 14, at 5.

\textsuperscript{24} Id. at 4.

\textsuperscript{25} See Lobel, supra note 5, at 379-80.
make doing so feasible and politically advantageous.\textsuperscript{26} In the short-term, it makes little difference from the perspective of a regulated entity what the government’s legal justification for such insinuation is, but in the long-term, the government may be called to account for infringing on the private sphere when the political conditions that inspired the government to act dissipate.

The aspiration to improve regulation through New Governance, even among those who advocate New Governance, is not necessarily as idealistic as Lobel’s or even Ahdieh’s definition might imply. Some argue that an important aspect of New Governance is that it delays regulatory decision-making. Under this view, “strik[ing] when the iron is cold” is necessary in order to prevent cognitive distortions in the assessment of risk.\textsuperscript{27} There are others who view New Governance as merely an excuse not to act at all.\textsuperscript{28} Whether the effect of implementing New Governance is to materially improve policy decisions, to merely delay decisions to facilitate deliberation outside of a New Governance system, or to prevent regulation at all is an empirical question that requires extensive study. Before such systems can be studied, however, they must actually be implemented on some scale. In the absence of well-developed empirical data, this Note attempts to make just the first step in the experiment, by presenting potential methods of implementation. The final step, that of presenting a verdict on the long-term viability of New Governance regulatory strategies, is currently beyond the competence of theoretical analysis.

B. Aspects of New Governance in Current U.S. Securities Regulation

Lobel asserts that the “regulatory model promotes adversarial relations, mutual distrust, and conflict.”\textsuperscript{29} By contrast, in the Renew Deal’s “cooperative regime, the role of government changes from regulator and controller to facilitator, and law becomes a shared problem-solving process rather than an ordering activity.”\textsuperscript{30} In order to properly understand the (potential for) influence of New Governance on the reform of the U.S. securities

\textsuperscript{26} See infra Part II.A.2.
\textsuperscript{28} See Paul M. Secunda & Jeffrey M. Hirsch, Debate, Workplace Federalism, 157 U. PA. L. REV. PENNUMBRA 28, 34 (2008), http://www.pennumbra.com/debates/debate.php?did=17 (Professor Secunda expresses his concern that the “practical result of this increased call for decentralization, flexibility, and soft law approaches to the workplace will be the further aggrandizement of employer power at the expense of employees.”).
\textsuperscript{29} Lobel, supra note 5, at 377.
\textsuperscript{30} Id.
regulation regime, however, the extent to which the status quo diverges from Lobel's vision of rigid command-and-control regulation is crucial. The engine of the Securities Act of 1933 (the "'33 Act") is section five of that act ("section five"), in that many criminal and civil penalties that arise under the '33 Act stem from violations of the filing requirement found in section five.\textsuperscript{31} Although there are numerous exemptions and qualifications, which have grown with the passage of time, the basic command of the '33 Act is that information must be made available to the government before securities are sold.\textsuperscript{32} Although other securities laws and regulations, such as the Investment Company Act of 1940 and the Securities Exchange Act of 1934 ("the '34 Act") create some substantive restrictions on the business activities of firms engaged in securities trading,\textsuperscript{33} the '33 Act sought to prevent fraud by information dissemination. In terms of enforcement, the '33 Act allows a federal agency to act within its sphere of competence; determining when a given "prospectus" has been filed is a straightforward bureaucratic issue that requires minimal fact-finding. Although other ancillary considerations, such as whether the information contained in filed materials is true, or whether a given exemption applies, section five of the '33 Act is a regulatory enhancement that encourages corporations to implement the types of procedures that Abbott and Snidal envision in their discussion of the application of New Governance techniques by the Federal government. Given the broad spectrum of rules that could be applied (and that are applied in the investment company context), no government involvement in the securities trade could be further from Lobel's characterization of the New Deal as a set of rigid and centralized norms.\textsuperscript{34} To the extent that section five allows an investor to make an informed investment choice by forcing the issuing company to give certain financial information, it arguably reflects Lobel's characterization of New Governance systems as those which broaden "the decision-making playing field by involving more actors in the various stages of the legal process."\textsuperscript{35} Section five allows market participants to judge the value of particular enterprises in an informed

\begin{itemize}
  \item \textsuperscript{32} See 15 U.S.C. § 77e(a) (2000).
  \item \textsuperscript{33} See The Investment Company Act of 1940, 15 U.S.C. § 80 (1940); 17 C.F.R. § 240.15c 3-1.
  \item \textsuperscript{34} See Lobel, supra note 5, at 377.
  \item \textsuperscript{35} Id. at 373.
\end{itemize}
manner, rather than forcing all allocations of capital to be approved by the government itself.

The '33 Act certainly does not act in isolation. Enforcement of the Act's goals involves broad participation but does not ensure that the regulatory scheme as a whole will be decentralized. In practice, even the stricter regulatory requirements of other securities laws and regulations harness broad, participatory methods of private enforcement. Though judicially constructed, the right to private action under Rule 10b-5 is nonetheless firmly entrenched within the regulatory regime. Broad participation alone does not define New Governance, but it does reveal a potential avenue for the further implementation of New Governance-style reforms. Courts of law, as they decide particular "cases" and "controversies", can be understood as New Governance institutions despite their old government origins. An instructive example is the case of Basic v. Levinson, which enabled the Efficient Markets Hypothesis as a powerful tool for enforcing Rule 10b-5 claims in the class-action context. Although federal "market regulation" construed narrowly has its origins in the problems faced in the twentieth century, the fraudulent sale of securities has always been illegal. The perceived problem leading to the adoption of more specific regulations in the run-up to the '33 Act was based on: 1) inability of the states to enforce cross-jurisdictional fraud; and 2) lack of expertise of the courts in dealing with complicated fraud. Markets have always been "regulated" in the broad sense that both laws and social norms always impact market participants' actions, or at a minimum, market participants' assessments of risk attached with potential actions. Basic signals a return to the common law experimental application, in which courts interpret the law in light of the policy consequences that have attended previous applications. To the extent that these policy decisions are made by unelected judges in a diffuse judicial system rather than elected officials in a central legislature, Lobel's characterization of the status quo as highly centralized is open for debate.

39. See SELIGMAN, supra note 18, at 1-38.
40. See generally LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION ch. 1 (2d ed. 1988).
41. SELIGMAN, supra note 18, at 42-43 (Seligman describes "lax state corporation laws" and, in describing courts' inability to deal with corporate fraud, writes that "the ability of the judiciary to protect non-controlling shareholders from management self-favoritism had been outrun by a series of statutory innovations that allowed corporate insiders to achieve profits from securities distributions without risking a fraud suit.").
In addition to the New Deal and post-New Deal regulatory expansions in securities regulation that embody New Governance principles in a non-obvious fashion, there are examples in the U.S. securities regulation regime of self-consciously New Governance-style arrangements. The potential for development and adoption of International Financial Reporting Standards by the SEC will be explored in Part II, but the SEC already has in place the Multijurisdictional Disclosure System with Canada, which "permits Canadian issuers meeting eligibility criteria to satisfy certain securities registration and reporting requirements . . . by providing disclosure documents prepared in accordance with the requirements of Canadian securities regulatory authorities." Additionally, the role of credit-rating agencies in shaping investment decisions and regulatory capital requirements provides another example of the quasi-governmental ordering characteristic of New Governance theory persisting in the current securities regulatory regime.

II. AVENUES FOR CHANGE

The origin of the United States Securities and Exchange Commission was a Senate Banking and Currency Committee investigation referred to as the "Pecora Hearings." These hearings focused on the causes of the "enormous decline in security prices," which is commonly known as the Stock Market Crash of 1929. Eighty years later, the country faces a similar process of introspection about the apparent lack of proper functioning of the U.S. securities markets. In the summer of 2009, the United States Department of the Treasury released its reform proposal, Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation. Although the white paper announced several important guiding principles, and specific proposals such as the creation of a new agency dedicated to consumer protection, the precise direction of regulatory change is still uncertain. Regardless of the responses to the current "financial crisis," as long as the public perceives regulation as playing a role in these failures, the regulations will be subject to change. There are, however, a few procedural and substantive issues that any modern regulatory

43. See, e.g., David Oakley, Moody's Shakes Up Its Triple A Ratings, FIN. TIMES, Feb. 11, 2009 at 24.
44. SELIGMAN, supra note 18, at 1.
45. Id.
47. See Pitt, supra note 1.
scheme must address, and principles of good government that apply under any economic conditions. Part II analyzes two (important) examples of these unavoidable issues: executive compensation and financial reporting.

A. Executive Compensation Regulation

Executive compensation is an emerging area of concern for securities regulators. In the 110th Congress, Congressman Barney Frank, Chairman of the House Financial Services Committee and then-Senator Barack Obama, proposed the Shareholder Vote on Executive Compensation Act\(^48\) (the “Frank-Obama Bill”), a bill that would have given the shareholders of public corporations a non-binding advisory vote on executive compensation.\(^49\) More recently, changing economic conditions and an increasingly close relationship between the federal government and financial institutions led the House to pass H.R. 1586 in March of 2009.\(^50\) If passed by the Senate, H.R. 1586 would impose a 90% tax on certain employees’ compensation where their employer has received more than five billion dollars under the Troubled Asset Relief Program (“TARP”).\(^51\) More extreme measures, such as the “Pay for Performance Act of 2009,”\(^52\) could allow federal regulation of the bonus compensation of all employees of companies that receive TARP funds.\(^53\)

The emergence of executive compensation as a securities regulation issue is understandable because it is superficially straightforward—comparing the executive’s total compensation with either the average employee’s compensation or the company’s bottom-line gives a clean statistic that can easily be reported on television with simple charts and graphs. By comparison, questions about the efficiency of capital markets or the risks attached with running a large corporation, and their implications for executive compensation and insider-trading regulation,\(^54\) are far more complex and thus inspire less impassioned debate. New Governance theory can be helpful by facilitating a democratic process that both acknowledges the importance of shareholders as stakeholders and focuses the regulatory power

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\(^{49}\) See id.

\(^{50}\) An Act to Impose an Additional Tax on Bonuses Received by Certain TARP Recipients, H.R. 1586, 111th Cong. (2009).

\(^{51}\) Id. § 1(a).


\(^{53}\) See id. § 1(b) (“[A]n entity subject to subsection (e) may not . . . pay a bonus . . . without regard to when the arrangement to pay such a bonus was entered into.”).

of the government on difficult issues as opposed to populist rhetoric that could, in practice, violate public trust in government by destroying shareholder wealth.

1. Shareholder Voting Rights

New Governance regulatory schemes focus on procedural mechanisms for ensuring the fair implementation of substantive rules. Unlike pure democratic political processes, minority views cannot be forced out by artificially restricting the proportion of representation, but unlike command and control regulation, New Governance does not require those forming regulations to be entirely impartial and technocratic. Given the goals of stakeholder inclusion and protection of minority interests, a strategy of giving shareholders a direct vote on upper-level executive compensation would be a powerful method of implementing New Governance theory in the U.S. securities regulation system. As noted above, there has already been significant political support for a move to shareholder votes on executive compensation.

Although shareholder vote on executive compensation ("say on pay") legislation is a departure from traditional norms of corporate governance, it is an incremental change rather than a revolutionary one. Limitations in the U.S. tax code and procedural requirements after the Sarbanes-Oxley Act of 2002 already effectively restrain how public companies may compensate their executives, and state laws imposing duties of loyalty, care, and good faith on the boards of directors of companies restrict executive compensation, as described below. Because say on pay votes are generally advisory (i.e., non-binding), none of the enforcement mechanisms of current executive compensation limitations would be strengthened merely by passing say on pay legislation or by a company’s voluntary adoption of such measures. Several companies, either because they independently see the value in giving shareholders a vote on executive compensation or because they see the passage of such legislation as inevitable, have already implemented shareholder votes on executive compensation. For example, when Intel announced in January 2009 that it would provide shareholders with an advisory vote on executive compensation, fifteen other companies had already made similar plans and several more companies were considering do-

55. 1.R.C. § 162(m) (2006) (disallowing the deduction of "[c]ertain excessive employee remuneration").
56. See discussion of executive compensation infra Part II.A.2.
There is certainly no clear consensus among companies that advisory votes are the best method of regulating executive compensation, and some have argued that executive compensation is too complicated for shareholders to make an informed choice. A possible response to the criticism that say on pay legislation provides for votes that are merely advisory is that Boards are unlikely to ignore the results.

The particular approach taken by the Frank-Obama Bill demonstrates that a New Governance solution can seamlessly integrate into traditional regulatory schemes. The four-page bill would have added a new subsection (i) to Section 14 of the '34 Act. Under it, section 14, which governs the content of proxy materials, would have required any board of directors to include in its proxy materials for the annual shareholder meeting a "separate shareholder vote to approve the compensation of executives as disclosed pursuant to the Commission's compensation disclosure rules." Another provision of the Frank-Obama Bill would have required a similar vote to be included in proxy materials for "an annual meeting of the shareholders (or a special meeting in lieu of the annual meeting) . . . that concerns an acquisition, merger, consolidation, or proposed sale or other disposition of substantially all the assets of an issuer" disclosing the contents of executive compensation related to a specified triggering event. Both the annual and event-driven shareholder votes are limited by similar language that makes them non-binding on the board of directors, and explicitly avoids creating "any additional fiduciary duty by such board." These limitations demonstrate that in addition to the policy decision to allow shareholders to vote on executive compensation, the Frank-Obama Bill is concerned with avoiding significant disruptions to the surrounding old government regulatory system. As noted above, this concern about how a New

58. Id. Apple, Inc., now has shifted its position after an options backdating scandal and an affirmative shareholder vote that they be given an advisory vote on executive compensation. See Apple, Inc., Definitive Proxy Statement (Form 14A), at 46 (Jan. 7, 2009); see also Apple "Say on Pay" Motion Approved by Shareholders, REUTERS, Apr. 27, 2009, http://www.reuters.com/article/technologyNews/idUSTRE53Q2HN20090427.
59. See Dvorak & Lublin, supra note 57.
60. See discussion supra Part I.
63. Id.
64. Id.
Governance solution interacts with traditional government structures is common in New Governance literature.\footnote{65}{See generally Nagy, supra note 21.}

The Frank-Obama Bill would have also required the SEC to "issue any final rules and regulations required by the amendments made by" the bill within one year.\footnote{66}{H.R. 1257, 110th Cong. § 2(b) (2008).} The involvement of the SEC would be crucial in any shareholder vote on executive compensation because of the sometimes conflicting demands of the securities laws—although they primarily emphasize the truthful disclosure of information about securities issuers to the public, the securities laws also prohibit disclosure of certain information about the issuance of securities without SEC approval.\footnote{67}{See, e.g., Securities Act of 1933 § 5, 15 U.S.C. § 77e (2000).} The disclosure requirements of the Frank-Obama Bill would have permitted the SEC to govern what specific material would have been released to the public. As the SEC has primary responsibility for managing the competing values of full disclosure and controlled dissemination of information about the issuance of securities, these limiting provisions in the bill would have utilized the regulatory expertise that already exists rather than reinventing the wheel.

Although the Frank-Obama Bill never passed the Senate, there has been continued discussion about similar legislation and as noted above, there are various efforts by companies, activist shareholders, and legislators to enact similar provisions.\footnote{68}{See Carl Icahn, Capitalism Should Return to its Roots, WALL. ST. J., Feb. 7, 2009, at A11, available at http://online.wsj.com/article/SB123396742337359087.html.} The simplicity of the Frank-Obama Bill’s mandate demonstrates the tendency for New Governance-inspired structures to focus on procedural mechanisms rather than substantive regulation, but this is not the only form of regulation proposed in the field of executive compensation.

2. Direct Federal Control under the "Reasonability" Test

In time, say on pay legislation may come to be seen as much as a tool of the board of directors in assessing its own performance and realizing the attitudes of shareholders as it is a tool of central regulators in making administrative determinations about executive compensation. In contrast to the say on pay reforms through legislation or adoption by public corporations, a very different group of legislative proposals would empower the government to make substantive inquiries into the acceptability of executive compensation. Far from embodying New Governance theory of ruling by stakeholder consensus, proposals such as H.R. 1586, "An Act to impose
an additional tax on bonuses received from certain TARP recipients,"69 and
H.R. 1664, "An Act to amend the executive compensation provisions of the
Emergency Economic Stabilization Act of 2008 to prohibit unreasonable
and excessive compensation and compensation not based on performance
standards"70 each represent a trend distinctly in opposition to say on pay
legislation. Under these laws, politicians rather than shareholders would
make decisions about how managers of public corporations are compen-
sated.

According to legislators in the House debates about H.R. 1586, the com-
pensation of executives of corporations receiving TARP funds was "uncon-
scionable"71 and as a result, the federal government’s taxation power
should be used to reabsorb government "largesse."72 For employees of
TARP recipients, section l(a) of H.R. 1586 would have imposed an addi-
tional tax liability of ninety percent of the TARP bonus received by the
taxpayer. Section 1(b) of H.R. 1586 defined the TARP bonus as the lesser
of either the value of retention payments or adjusted gross income exceed-
ing $250,000. While utilizing the tax power to avoid constitutional re-
straints on the legislature,73 the high rate of the tax imposed by H.R. 1586
would have effectively limited the level of compensation that certain public
corporations (TARP recipients) could pay their employees.

Supporters of H.R. 1586 generally characterized the bill as an extraordi-
nary measure, targeted specifically at certain companies that, in a sense, owed the government after receipt of TARP funds, and yet were "wasting"
taxpayer money.74 Though the members of Congress who supported H.R.
1586 may have had numerous reasons for doing so, including meeting the
demands of their constituents or avoiding moral hazards that attend undes-
served compensation,75 the bill must be understood in the broader context
of efforts to regulate executive compensation. Currently, the bill has not
passed the Senate and may never become a law, but other proposed legisla-
tion reflects a similar commitment to the establishment of substantive lim-

69. An Act to Impose an Additional Tax on Bonuses Received by Certain TARP Re-
72. Id.
73. U.S. CONST. amend. IX.
tovil).
Dingell).
its on executive pay. For example, H.R. 1664 proposes to prohibit executive compensation that is "unreasonable or excessive, as defined in standards established by the Secretary [of the Treasury]" or is a bonus "not directly based on performance-based measures set forth in standards established by the Secretary [of the Treasury]."76 The bill also creates a Commission on Executive Compensation to conduct studies about executive compensation and report its findings to the President and the Congress.77 While the creation of such a commission is consistent with New Governance theory because it serves an information-gathering function, the delegation of the authority to determine substantive standards of executive compensation would permit stakeholders to give input only to the extent the Secretary of the Treasury voluntarily solicits inputs, or the Administrative Procedure Act and the Constitution require. The bill on its face does not create substantive standards and it is possible that the Secretary of the Treasury could implement flexible standards, but the bill does guide the Secretary’s decision by imposing an affirmative “reasonability” requirement and by retaining Congressional power to shape the Treasury’s proposed standards.78 The regulation of executive compensation by centralized administrative organizations like the United States Treasury applies only, under current legislation, to those who have received TARP funds, but the possibility of wider substantive regulation of all publicly traded corporations in the future is suggested by provisions in the tax code79 and by much of the rhetoric surrounding efforts to pass “fair” compensation legislation.80 One motive of reasonable compensation legislation is the need to protect taxpayer investment.81 Where rhetoric, however, is dominated by “fairness” arguments concerning equality of compensation (as opposed to protection of assets), there is no real distinction between regulating compensation in a public corporation that receives TARP funds and one that does not.

3. New Governance and the Shift from State to Federal Regulation

Although distinguishable based on their support of the New Governance theoretical model, both say on pay and reasonable compensation legislation

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77. Id. § 2.
78. Id. § 1.
79. See Easterbrook & Fischel, supra note 54.
are examples of a growing trend towards a federal law of corporate governance, which is only formally distinguishable from securities regulation. The federal securities laws generally focus on the dissemination of information,\textsuperscript{82} and rules governing secondary trading,\textsuperscript{83} with the ultimate intent to "substitute . . . full disclosure for the policy of "caveat emptor."\textsuperscript{84} The regulation of executive compensation is part of a trend that purports to protect investors by increasing federal level involvement in corporate affairs.\textsuperscript{85} Traditionally, state law governed the permissibility of certain business decisions. On the state level, the decisions of boards of directors have been granted wide latitude under the Business Judgment Rule,\textsuperscript{86} and cases have interpreted the Delaware General Corporate Law, which imposes a duty of loyalty and a duty of care on managers and the boards of directors of corporations, to require good faith implementation of that rule.\textsuperscript{87} A decision by Congress to further restrict the ability of a board of directors to determine appropriate management compensation would imply that Congress believes the state law remedies are not functioning properly. State law solutions to executive compensation problems have been decided by courts experienced in corporate governance matters, such as the Delaware Court of Chancery, and have focused narrowly on resolving agency costs leading to the misalignment of incentives between the manager and equity-holders.\textsuperscript{88} The Congressional Record, however, reveals a much broader area of inquiry, including such factors as executive/lower-level employee comparability,\textsuperscript{89} fairness to taxpayers,\textsuperscript{90} and concerns about manager "greed."\textsuperscript{91}

\begin{footnotesize}
\begin{itemize}
\item[82.] Securities Act of 1933 \textsection 5, 15 U.S.C. \textsection 77e (2000).
\item[83.] Securities Exchange Act of 1934, 15 U.S.C. \textsection 78 (2000); 17 C.F.R. \textsection 230.144; 17 C.F.R. \textsection 230.144A.
\item[84.] See Thel, \textit{supra} note 36, at 1183.
\item[86.] See Shlensky v. Wrigley, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968) (holding that the decision of the board of directors will stand where "the decision is one properly before directors and the motives alleged in the amended complaint [show] no fraud, illegality or conflict of interest in their making of that decision").
\item[88.] See \textit{generally} In re Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006); In re Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005); In re Walt Disney Co. Derivative Litig., 825 A.2d 275 (Del. Ch. 2003); Easterbrook & Fischel, \textit{supra} note 54.
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Under state law, the problem of management compensation is primarily viewed through the prism of the complex principal-agent relationship between the board of directors and company management on the one hand, and shareholders on the other. Even under the requirement of good faith as a separate cause of action for shareholders, the focus of the good faith requirement is still fixed firmly on the relationship between shareholders and management. The protections afforded by state law were reduced in 1996, however, under the National Securities Market Improvement Act ("NSMIA"), which restricted the ability for state securities regulators to conduct "merit review" for many securities. Shareholders already have many tools at their disposal for protecting their interests under the federal securities laws and state corporate law, including: voting rights, derivative suits, SEC regulation, and exchange rules. Still, as mentioned above, the call for more regulation strongly suggest that these existing methods are not adequate to meet the political demand for investor protection.

A series of Delaware cases involving the compensation of Walt Disney, Inc. executive Michael Ovitz demonstrates the inherent limitations of current state law. The central issue in these cases was whether the Board of Directors of Disney violated its duty to act with due care and in good faith in shaping the compensation package granted to Michael Ovitz. The provisions that cover the responsibilities of the board of directors can be viewed as a compromise between the two competing roles of the board: to preserve shareholder assets (i.e., avoid waste) and to engage in profitable (necessarily risky) business transactions. The decision of how to compensate a particular executive can be analyzed in the same way any other project of a firm is analyzed, in terms of the likely return on the corporation’s investment. As any ex ante analysis of a given investment is necessarily an imprecise exercise, the mechanisms for judging such investment deci-
sions tend to be procedural, and focused on the decisional steps taken by the board of directors and their suitability in terms of conflicts of interest.

Although state regulatory regimes differ, Delaware’s corporate law is the dominant law governing large corporations that would be subject to the say on pay or reasonable compensation legislation discussed above. Under current case law, there are three categories of actions which shareholders may bring against a board that did not fulfill shareholder investment expectations: duty of loyalty, duty of care, and duty of good faith. In analyzing the development of compensation in the line of the Disney Cases, before the decision of the Delaware Supreme Court, Professor Sean Griffith described the law developing in the gaps between traditional duty of care and duty of loyalty analysis:

[T]he emerging duty of good faith is best understood as a rhetorical device rather than as a substantive standard. Good faith, in other words, is not now and is not likely ever to develop into a distinct doctrine of subrules and multipart tests. Instead, the pattern in the good faith cases is to raise issues under both the duty of care and the duty of loyalty but, rather than following either traditional analysis through to a conclusion, to blend the issues together and, in doing so, identify a basis for liability under the duty of good faith.

Though the statutory mandates of duty of care and duty of loyalty have been interpreted as chiefly procedural standards for business decisions (including in the context of executive compensation), the good faith standard opens the possibility of substantive regulation because full compliance with the statutory mandates for the development of an executive compensation package under state law could nonetheless trigger a violation of the judicially-crafted good faith standard. When a court will choose to find a violation of good faith will necessarily depend on the court’s assessment of the reasonability of compensation awarded to an executive. For example, if compensation of a particular executive is at or slightly below the average

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101. See, e.g., In re Walt Disney Co. Derivative Litig., 906 A.2d. 27 (Del. 2006); In re Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005); In re Walt Disney Co. Derivative Litig. 825 A.2d 275 (Del. Ch. 2003).
level of compensation for executives in the same industry, a court may be unlikely to find a violation of good faith regardless of the actual value of a given executive compensation arrangement to the shareholders. The implications of New Governance on this form of executive compensation regulation is not altogether clear, because while substantive regulation under the good faith standard would implicate reduced freedom of the boards of directors to experiment and exercise business judgment, it also implicates increased supervision by courts, which, as mentioned in Part I, can be viewed as generating policy in line with New Governance theory.  

B. Financial Reporting Regulation

A central policy outcome of the '33 Act and the '34 Act was to force those who traded securities to make disclosures to the public with supervision by federal regulators. This is reflected in the security registration requirement of section 5 of the '33 Act and the company registration requirement of section 12 of the '34 Act. Regardless of the intended legislative purpose behind implementing a regulatory system based on disclosure, which can be distinguished from merit review of securities offerings under state blue sky laws, at least one implication of the regulated disclosure system is that forcing disclosure aids investors. The requirements for form and content of disclosure are determined by a combination of statutory and regulatory provisions, but the standard is ultimately determined by the SEC, which has wide authority to determine what information companies disclose. As with executive compensation regulation, there are state regulatory regimes that govern disclosure of information, both as a matter of regulatory principles and prevention of fraud even through the use of half-truths. Since the NSMIA, however, the ability of state regulators

103. See supra Part I.B.
104. See supra note 31.
106. Id.; see also The Securities Act of 1933 § 10(a)(4) ("[T]here may be omitted from any prospectus any of the information required under this subsection (a) which the Commission may by rules or regulations designate as not being necessary or appropriate in the public interest or for the protection of investors."); The Security Act of 1933 § 28 ("The Commission, by rule or regulation, may conditionally or unconditionally exempt any person, security, or transaction, or any class of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation issued under this title, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.").
108. Uniform Securities Act of 2002 §§ 501(b), 505 ("It is unlawful for a person to make . . . a statement that, at the time and in the light of the circumstances under which it is made,
has diminished in the context of disclosure requirements, at least for large corporations which issue preempted "covered securities,"\textsuperscript{109} and although state fraud actions are a possible source of information disclosure policy, much of such law would be coterminous with federal regulatory policy, and the limited ability of state fraud acts to adequately protect investors was one of the motivating factors in the crafting of the federal securities regulations.\textsuperscript{110} Compliance with the federal disclosure system is therefore the primary concern for the vast majority of large issuers.

The Securities and Exchange Commission has generally delegated the power to form regulations about accounting principles to the Financial Accounting Standards Board ("FASB").\textsuperscript{111} The regulatory system consisting of SEC regulations and FASB standards, as well as other respected opinions, collectively form and define the United States generally accepted accounting principles ("U.S. GAAP") according to which auditors and executives certify public companies' financial statements are prepared.\textsuperscript{112} To the extent that U.S. GAAP is defined in a fluid manner by those with professional knowledge and by stakeholders, U.S. GAAP is arguably a paradigm case for implementation of New Governance principles, even if it was not consciously produced as such.\textsuperscript{113} Developments over time in the geographic reach and speed of dissemination of information securities markets have caused a system that was once relatively agile and responsive (compared to the legislative process or even the administrative process under the Administrative Procedure Act) to become less so. Two possible responses to changing geographical and technological realities could allow the federal securities regulations to become more in line with a theoretically perfect


\textsuperscript{110} See generally SELIGMAN, supra note 18.

\textsuperscript{111} See Nagy, supra note 21, at 986-87.

\textsuperscript{112} 17 C.F.R. § 240.13a-14 (2009) ("Certification of Disclosure in Annual and Quarterly Reports").

\textsuperscript{113} See Nagy, supra note 21, at 979 (discussing the PCAOB's "ambiguous status" as an accounting regulator). Although the PCAOB governs auditing standards rather than accounting principles and was specifically created by the Sarbanes-Oxley Act of 2002, there are "New Governance" features in common that stem from not operating as an agency of the government. Professor Nagy criticizes "negotiated rulemaking," but the issue of whether New Governance and related methods implement the best policy is secondary to determining the extent to which New Governance methods are implemented. See id. at 1030.
New Governance model, where stakeholder participation and dissemination of information are permitted to the maximum extent possible.

1. International Financial Reporting Standards

The implementation of multiple regulatory systems that serve one uniform function can be accurately described as wasteful to the extent that having additional systems impose regulatory costs without producing benefits in line with the added costs. Precisely to avoid such redundant costs (both for regulated entities and for government) without added benefit, the securities laws have been interpreted such that exemptions from certain administrative requirements are appropriate where there exists an alternative system of regulation. There are standards very different from U.S. GAAP on the global level, which are set by the International Accounting Standards Board ("IASB") and referred to as the International Financial Reporting Standards ("IFRS"). The primary focus of this Note is the administrative law and policy decisions which govern how substantive rules are created, rather than the substantive rules themselves. Unlike FASB which derives its authority from the SEC, the IASB is an outgrowth of a standards setting body called the International Accounting Standards Committee Foundation, which oversees the IASB and provides funding. A New Governance analysis of the IASB itself as a non- or quasi-governmental organization is beyond the scope of this Note; for purposes of analyzing the possible New Governance implications of permitting IFRS reporting by American securities issuers, it is sufficient to understand the IFRS as a system of norms that could redefine the disclosure responsibilities that securities issuers have to their investors and as a system not within the sole control of the U.S. government. Proposals to permit foreign bod-

114. Abbott & Snidal, supra note 14 (on multiplicity).
115. See Reves v. Ernst & Young, 494 U.S. 56, 67 (1990) ("[W]e examine whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary.") (citing Marine Bank v. Weaver, 455 U.S. 551, 557-59 (1982)). But see SEC v. Wallenbrock, 313 F.3d 532, 540 (9th Cir. 2002) ("[T]he existence of limited alternative regulatory enforcement mechanisms does not obviate the need for the protection of the Securities Acts ... [a]nd a patchwork of state regulation, which applies to most business entities in some fashion or another, cannot displace the federal regime.").
ies, regardless of how these bodies themselves shape policy, to shape U.S. financial disclosure policy represents a shift from a system of political accountability to a system of stakeholder accountability that may be best understood from a New Governance perspective.\textsuperscript{118}

The SEC has, in the past, taken measures to accommodate foreign issuers of securities. Regulations issued by the SEC have exempted foreign issuers from certain registration requirements that apply to U.S. issuers,\textsuperscript{119} and the SEC established an Office of International Affairs "[c]harged to promote investor protection in the global capital market by advancing international regulatory and enforcement cooperation."\textsuperscript{120} As noted above, the securities laws of the U.S. have generally been understood as providing an exemption for situations where there is an alternative regulatory scheme, especially where such an alternative system is more targeted to a particular regulatory problem.\textsuperscript{121}

A very different kind of proposal is embodied in the SEC Proposed Rule, "Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers."\textsuperscript{122} The proposed rule establishes a fairly long-term and gradual transition to permitting the use of IFRS by U.S. companies,\textsuperscript{123} and a major stated policy motivation for allowing U.S. issuers to use IFRS is that "[a]s trading and investment become more global, investors face an increasing need for full, fair and reliable disclosure that enables comparison of financial information across investment alternatives that cross national boundaries."\textsuperscript{124} In addition to this investor-protection rationale, the SEC also states that "capital formation . . . would be enhanced if the world's major capital markets

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\textsuperscript{118} See Roadmap, supra note 117, at 70,827 ("A change to commit U.S. reporting to following IFRS would include a change in the relationship of the U.S. capital markets to the accounting standard setting process. The IASB and its related organizations include members from a number of countries. The IASB is expected to be responsible to broad, worldwide constituencies of investors . . . . These constituencies can be expected to represent a wide range of interests, reflecting varying economic, social, and political environments.").

\textsuperscript{119} See, e.g., 17 C.F.R. § 240.3a12-3 (2009) ("Exemption from Sections 14(a), 14(b), 14(c), 14(f), and 15 for Securities for Certain Foreign Issuers").

\textsuperscript{120} Ahdieh, supra note 4, at 879 (citations omitted).

\textsuperscript{121} See generally United Hous. Found. Inc. v. Forman, 421 U.S. 837 (1975) (finding that the sale of units in a public housing development were not securities despite some expectation of future benefit to the purchaser).

\textsuperscript{122} Roadmap, supra note 117.

\textsuperscript{123} Id.

\textsuperscript{124} Id. at 70,818; see also Christopher Cox, Chairman, SEC, Chairman's Address to the SEC Roundtable on International Financial Reporting Standards (Mar. 6, 2007), http://sec.gov/news/speech/2007/spch030607cc.htm.
all operated under a single set of high-quality accounting standards.” The proposed rule strongly implies that the SEC views achieving one as not mutually exclusive of achieving the other, a feature that is conducive to New Governance solutions.

The proposed rule details the history of interactions between the FASB and the IASB and the development and growth of the IASB as a “potential . . . set of accounting standards that [could] best provide a common platform on which companies can report and investors can compare financial information.” The rule’s central proposal is to “allow certain U.S. issuers that meet specific criteria to file financial statements in accordance with IFRS as issued by the IASB, rather than U.S. GAAP” to meet various requirements under the ’33 Act and the ’34 Act. There are two approaches contemplated in the proposed rule: Proposal A, under which a “U.S. issuer that elects to file IFRS financial statements would provide the reconciling information from U.S. GAAP to IFRS called for under IFRS 1,” and Proposal B, under which such issuers would also have to “disclose on an annual basis certain unaudited supplemental U.S. GAAP financial information covering a three-year period.” The central issue the SEC would face in deciding between these two different methods of implementation is the extent to which additional reconciliation would be useful for investors in the transition period. The resolution of this question depends on the extent to which investors rely on publicly disclosed reports in forming investment decisions. Regardless of whether or not individuals would be able to use the financial information in the short run, the proposed rule implicitly contemplates the long-term shift of all companies to using IFRS. This is demonstrated primarily through its advocacy of increased comparability between American securities issuers and those of other countries that utilize IFRS. The rule itself is limited to issuers that meet the eligibility requirements of the proposed rule, but overall comparability between American companies would be reduced in the long run if some used IFRS while others used U.S. GAAP. From an investor-protection standpoint, this proposed rule is only reasonable as part of a larger phase-in of IFRS, because investors are concerned with comparing investments against a full range of other investment opportunities, and not

125. Roadmap, supra note 117, at 70,818.
126. Id. at 70,818-20.
127. Id. at 70,828.
128. Id. at 70,832.
129. Id. at 70,833.
130. See id.
131. See id. at 70,828-30.
simply companies within one specific industry. Based on the qualifications under the proposed rule, "only a limited number of U.S. issuers would be eligible" to report using IFRS.132 Again, the proposed rule standing alone may enhance comparability with so-called "IFRS industries," but could also reduce comparability with other U.S. issuers in the long term unless the SEC institutes a more permanent shift in policy towards pervasive implementation of IFRS.

The proposed rule, though advocating increased usage of IFRS, does not uncritically adopt IFRS as it presently exists. On the contrary, the proposed rule notes that "IFRS is not as developed as U.S. GAAP in certain areas" and that "U.S. GAAP has been used longer and more extensively than IFRS."133 While these critiques are significantly mitigated by the SEC's assertion that this lack of development in prescriptive guidance is an asset in some respects, particularly in the need for accounting to reflect "underlying economics,"134 the administrative law concerns of determining the rights and responsibilities of U.S. citizens by a collection of committees that reflect foreign input, rather than domestic political decisions, are strengthened further by the SEC's admission that IFRS is not as mature as U.S. GAAP, despite the possible problems caused by incomparability of various company's securities under the current rules.

In The SEC's Global Accounting Vision, Lawrence Cunningham strongly criticizes the SEC's claims of the benefits of moving to IFRS.135 Just as legislative proposals favoring a reasonability standard serve as a counterweight to efforts to implement say on pay strategies in the field of executive compensation, Cunningham's critiques present an alternative to the views expressed in the SEC's proposed rule. While the central criticism of Cunningham's piece is that the SEC's financial reporting plan is "Quixotic," he makes four criticisms: 1) competing standards will not enhance comparability; 2) a single standard itself might not guarantee comparability; 3) U.S. adoption of IFRS will be costly and complicated; and 4) the transition to IFRS will not necessarily benefit investors.136 The New Governance model, as a descriptive matter, suggests that experimentalism in policy is preferential to ex ante determinations about regulatory efficiency. Cunningham's first three criticisms, while possibly well-grounded,
are of limited applicability when analyzing competing policy proposals in light of New Governance theory, and in any case, whether or not competition or moving to IFRS will enhance comparability in the long run is ultimately an empirical question that could not be resolved as a theoretical matter. Cunningham's fourth criticism, however, presents compelling arguments in favor of maintaining U.S. GAAP in order to maintain the traditional investor-protection principles of the U.S. securities regulatory system.

For Cunningham, whether the SEC's adoption of IFRS would be an advance for investors depends on whether the SEC takes the "endorsement" approach adopted by the European Union or the "deference" approach, which would make IASB pronouncements "binding" without formal adoption by a sovereign authority. The distinction is important because while the SEC and FASB have worked over the years to develop a system of policy formation in which FASB "avowed adherence to a model of public responsiveness," the "references to investor interests in IASB policy statements equivocate." Although the SEC's argument that the securities markets of the United States are increasingly intertwined with foreign markets may be factually accurate, Cunningham does not accept that the only logical policy decision is to move over to IFRS. Cunningham does not present a complete, alternative system and concludes that "[t]he most important concrete step is for the SEC to provide public evaluation of the challenges identified . . . to which it has currently given scant or no attention." In addition, he reveals a potential danger, particularly with regard to its concerns about the different importance of investor protection in the two accounting systems, that could stem from the total removal of a regulatory scheme from political accountability by implementing New Governance solutions.

2. The SEC's XBRL Initiative

Integral to the discussion of financial reporting are the regulations governing the presentation of the data, because the central goal is to get information to investors in a fashion that they can understand. The SEC has been moving consistently toward increased transparency in both its substantive standards and data format. In July 2005, a series of regulatory reforms altered the responsibilities of issuers and brokers to disseminate fi-

137. Id. at 58.
138. Id. at 62-63.
139. Id. at 80-81.
nancial information: the basic mantra was that "access equals delivery." Essentially replacing prior statutory mandates that issuers or brokers must deliver registration materials in the form of a "prospectus," these reforms allow the dissemination of information, typically a World Wide Web address, where such information can be obtained instead of the prospectus itself. As with all regulatory regimes, there are exceptions to this more permissive rule, but the import is to incentivize posting of filing information on the World Wide Web in addition to the EDGAR database maintained by the SEC that is publicly accessible. The SEC's new initiative to force usage of the eXtensible Business Reporting Language ("XBRL") is intended to further enhance the ability of investors to utilize financial information.

The SEC's final rule, "Interactive Data to Improve Financial Reporting" replaces the old EDGAR filing system with a new system, called the Interactive Data Electronic Applications ("IDEA") intended to "facilitate the use and analysis of information submitted to the Commission in interactive data format." Unlike such regulatory policies as executive compensation or accounting standards, the SEC's implementation of an interactive data filing scheme has little opportunity for altering substantive business decisions, but could expand the ability of investors to automate and thus refine evaluation of an issuer's SEC filings. In its final rule release, the SEC identifies one concrete and immediate benefit of mandatory XBRL implementation: those investors who currently pay others to perform data aggregation tasks now no longer need to incur such costs. More importantly, however, the XBRL-based system will apply both to those using the reporting requirements of U.S. GAAP and IFRS, and therefore could serve as an important tool during the transition period between the two accounting systems. The final rule contains a phase-in that mandates when particular filers must begin filing in the IDEA system based on the size of the filer.

140. Securities Offering Reform, Release 33-8591, 70 Fed. Reg. 44,722, 44,783 (Aug. 3, 2005) ("At this time, we believe that Internet usage has increased sufficiently to allow us to adopt a final prospectus delivery model for issuers and their intermediaries that relies on timely access to filed information and documents.").
143. See id.
144. See id. at 6,779; see also Roadmap, supra note 117, at 70,816.
III. WEIGHING THE COSTS AND BENEFITS OF NEW GOVERNANCE PROGRAMS

Part III of this Note assesses the extent to which each of the described policy changes demonstrates values accepted by New Governance scholars and then addresses the costs and benefits of New Governance in light of traditional legal principles, such as the rule of law and due process. Finally, Part III advances the position that while caution should be applied in the executive compensation and primary regulator context, application of New Governance principles is best suited at this time to the financial reporting context.

A. Applying a New Governance Framework

The extent to which the policy proposals discussed above reflect New Governance values varies. Although topics like executive compensation and financial reporting standards both implicate the rights of shareholders to make informed investment decisions, the proposed solutions do not all fully reflect the emerging values of New Governance theory. This Part will analyze all of these proposals in light of the four-factor New Governance definition put forth by Abbott and Snidal: 1) decentralization of “actors and institutions, public and private, into the regulatory system;” 2) reliance on decentralized actors for regulatory expertise; 3) “orchestration . . . rather than promulgation and enforcement of rules;” and 4) use of “soft law” over “hard law.”146 With the exception of the substantive regulation of executive wages under a reasonability standard, the policy proposals discussed generally represent the decentralization of actors and institutions.147 The substantive regulation of executive wages may be preferable to the shareholders in the short-term, but sets a dangerous precedent where their investment decisions as a shareholder group are limited in terms of their ability to seek talented management. From a New Governance perspective, allowing the federal government to set executive compensation would be unlikely to result in a temporary exercise of such power. Furthermore, the implementation of at least one legislative proposal, H.R. 1586, would implement a hard law tax regime as a means of enforcement, as opposed to the soft law advisory vote contemplated under the Frank-Obama bill.148

Viewing say on pay legislation and reasonable compensation legislation as two possible but mutually exclusive routes highlights the New Govern-

146. Abbot & Snidal, supra note 14, at 5.
147. See id.
148. See An Act to Impose an Additional Tax on Bonuses Received by Certain TARP Recipients, H.R. 1586, 111th Cong. (2009).
ance features that the Frank-Obama Bill possesses. The advantage of say on pay from a New Governance perspective is limited, however, by the fact that it still represents a federal government's incursion on the corporate governance sphere traditionally left to state law. The main difference—from a New Governance perspective—between state law good faith analysis of executive compensation and say on pay legislation, is that say on pay is more centralized and soft, while state law regulation has the potential to direct hard enforcement, albeit on the state level. Although both regulatory systems may work together, they could possibly be eclipsed by federal pre-emption of state law through substantive reasonable compensation legislation.

As opposed to executive compensation, financial reporting requirements present a stronger case for adding New Governance principles into the securities regulation framework. Despite Cunningham's protests that the SEC may be moving too quickly, it is undeniable that permitting a global constituency to help the SEC shape accounting principles will bring more people to the table overall; even Cunningham did not challenge the basic premise that the securities market has become global. In the context of implementing IFRS, the second element of the Abbott/Snidal definition of New Governance blends into the first, but the third and fourth factors are distinct. Unlike GAAP, IFRS generally embraces principles-based regulation, and in a 2007 speech, Chairman Cox discussed the mandate that Sarbanes-Oxley had given the SEC in taking the first steps towards implementing such principles-based regulations.149 These principles-based accounting standards will result in a movement towards orchestration and away from the rules-based accounting standards encompassed in U.S. GAAP. The implementation of XBRL presents the most straightforward New Governance solution because it is a technology with which the SEC has experimented, soliciting high levels of stakeholder (issuer and investor) feedback,150 and most importantly is entirely a soft law policy designed to help create a common data format that all investors can use in a more efficient manner. XBRL may lead to more informed investor decisions and help weed out poorly-performing companies or managers, thus potentially mitigating the extent to which politicization of executive compensation is necessary to ensure that compensation is actually taking place in a competitive market. Because the essence of the XBRL development is wide disclosure, it necessarily enlists a broader group of investors in the process of evaluating issuer information.

149. Cox, supra note 124.
B. External Costs/Costs to Legal Principles

The Constitutional and contract-law implications of executive compensation regulation are complicated. Due process jurisprudence gives the government significant leeway in the regulation of contract formation since the decision in *West Coast Hotel v. Parrish*, 151 which overturned the prior *Lochner v. New York* 152 decision creating a substantive due process-based contract right. For executives who take a job or sign a contract after substantive compensation legislation passes, the current case law would not weigh heavily on the side of finding a violation by Congress or the SEC. Shareholders are more likely to have sympathetic claims, especially where the federal government refuses to allow their particular executive to be paid a certain amount of money and they lose profits as a result. Although the Secretary of the Treasury or the Secretary’s designee would be unlikely to declare a given executive overpaid if there was compelling evidence that shareholders were not disturbed by the level of compensation offered, the problem with centralized regulatory techniques is that one particular government official may not have access to all available information or may make administrative decisions tainted by political influence.

XBRL and the enrichment of content has no impact on traditional legal values such as due process or fairness because the SEC’s initiative merely alters the content of submissions already required under the securities laws, and because there is unlikely to be an exorbitant increase in cost for issuers. 153 The delegation of responsibility for generating accounting standards to the IASB, however, could result in an alteration of the understanding of the SEC as an agency of the U.S. government intended to protect United States investors and regulated U.S. securities. This problem could be avoided to a large extent if the SEC chooses the endorsement adoption method, under which it would have to ratify standards, but such a path would diminish the primary policy argument in favor of IFRS reflected in the proposed rule: the establishment of a global accounting system. Assuming the endorsement model is not taken by the SEC, the problem could also be avoided if the procedures of the IASB were held to satisfy any due process rights that might arise from the issuance of rules governing U.S. citizens’ conduct by international non-governmental organizations that are not bound by the constraints and motivations underlying the federal securities laws.

152. 198 U.S. 45 (1905).
C. The Use of New Governance Strategies Is Crucial in the Financial Reporting Context

In describing the need for changes in securities law, former SEC Chairman Harvey Pitt described three “key components” of effectiveness as the primary reference of regulatory objectives: 1) transparency; 2) international comparability (prevention of regulatory arbitrage); and 3) global accommodations.\textsuperscript{154} Chairman Pitt’s description did not use the term New Governance, but his key components of a successful potential regulatory scheme have significant overlap with the goals of New Governance theory. While merely an incremental change rather than a complete overhaul of the regulatory system is advocated in documents like the Treasury’s “white paper,”\textsuperscript{155} the implementation of XBRL as a standard language for communicating financial data is likely to address the three key components when it becomes widely used and adopted. Although current laws require disclosure of financial information, this disclosure takes the form of long and complicated documents that do not reflect the state of the art in information technology. In permitting the tagging of financial information in filings, the SEC’s XBRL initiative will allow more rapid flow of information that was once effectively buried in the paper upon which it was written. This transparency is valuable not merely in that it will help American investors understand and compare the securities in which they invest, but it will also help bridge the gap between U.S. GAAP and IFRS accounting standards, if a total transition is indeed ahead. The ability to manipulate and focus on data that is made freely available with XBRL will allow fluid transition from one set of accounting principles to another (at least within the SEC’s phase-in window). Finally, by easing the transition to IFRS, XBRL facilitates global comparability, even though its implementation alone would not achieve this goal.

CONCLUSION

The defining characteristic of New Governance is that no regulation should be held sacred. A rule has the power to influence institutions and individuals only when it is based on consensus among a community with a shared interest in having certain conduct regulated. New Governance is not about enlarging or shrinking the government or any specific interest group; it is about expanding the notion of what the government can (help) accomplish by imposing procedural requirements on areas of interaction that were

\textsuperscript{154} Pitt, \textit{supra} note 1, at 319-20.
previously governed solely by custom or the market. New Governance is also valuable for what it tells us about old government institutions: the extent to which an old government institution can maintain consensus around certain laws will depend primarily on whether there is consensus behind both the conceptual norm and how the government implements it. By narrowly focusing the government’s regulatory activities on areas firmly inside its institutional competence (i.e., ensuring procedural rights, rather than substantive regulations) the government can harness the energy of the markets, rather than merely restraining them. Of all the regulatory proposals discussed in this paper, the reform in financial reporting through the development and use of XBRL as a data standard represents the most pure implementation of the openness and experimentalism to which much New Governance theory aspires.