

FOX IN S-OX NORTH, A QUESTION OF FIT: THE ADOPTION OF UNITED STATES MARKET SOLUTIONS IN CANADA

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The connection between Dr. Seuss' rhyming stories¹ and the new initiatives by Canadian regulators and lawmakers to implement changes to Canada's securities law (S-Ox North) reproducing the Sarbanes-Oxley Act's changes in the United States' legal regime is not immediately obvious. However there may be one. It often seemed that Dr. Seuss put one word after the other because of its rhyming qualities rather than its contribution to the creation of a coherent story. In the case of S-Ox North, Canadian regulators seem to be more concerned with harmonizing Canada's securities markets rather than with addressing actual dangers facing market participants. One unanswered question is whether the S-Ox North changes address Canada's capital structure where, in contrast to the United States, the issuers are predominantly corporations in which a single shareholder or shareholder group has legal or factual control of the voting shares. Would it have made more sense to look at the recent corporate governance initiatives in the European Union, where the corporations' capital structure more closely resembles that of Canada? Thus, it remains to be seen whether putting the Canadian corporate fox in S-Ox North is an exercise in rhyming or a coherent change for the better.

This Article begins with an assumption that the aim of regulatory initiatives is to modify and constrain the problematic be-

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I would like to thank the participants at the American Society of Comparative Law Comparative Corporate Governance Symposium held October 16 and 17, 2003, at Stetson University College of Law, for their questions and comments concerning an earlier version of this Article and Janis Sarra, Assistant Dean and Associate Professor, University of British Columbia, for her invaluable comments and suggestions. I would also like to thank Yanyan Liu, Sara Jones, and Danielle Park for their research assistance and Lauren Berns for his editorial assistance. Any errors are the responsibility of the Author.

1. Dr. Seuss, *Fox in Socks* 19 (Random House 1965) ("Here's an easy game to play. Here's an easy thing to say New socks. Two socks. Whose socks? Sue's socks.").

havior or encourage and reward the nonproblematic behavior of those subject to the initiative. Utilizing this assumption as the basis for regulation, a regulator will have to perform a number of difficult tasks before initiating regulatory activity. The regulator must identify the behavior that it wishes to discourage or encourage; have a factual or theoretical understanding of what causes the identified behavior; and have a theory about how various policy options available to the regulator will affect that behavior in the desired manner. Thus, for regulation to be effective, it is desirable that regulators have a developed understanding of human behavior and the manner in which various social, political, economic, and environmental factors influence behavior.

However, as complex as this description of the regulatory process as applied to individual behavior may seem, there is an additional layer of complexity added when a regulator is trying to influence the behavior of an organization rather than an individual.² Studies in the social sciences have demonstrated that when individuals enter a collective decision-making process, the decisions that are made sometimes depart radically from the preferences expressed by the individual decisionmakers.³ Thus, regulators seeking to govern the behavior of corporations or, more precisely, the collective behavior of corporate management and boards of directors should have a theory of the corporation that explains why particular policies will work. For those beyond the borders of the United States, one question that springs to mind is whether the differences in our capital markets, corporate and securities law, and cultures are sufficiently large as to require regulators to take them into account in regulatory design. In other words, is path-dependence⁴ a legitimate theoretical inquiry in the

2. Alice Belcher, *Inside the Black Box: Corporate Laws and Theories*, 12 Soc. & Leg. Stud. 359 (2003) (suggesting that developments in United Kingdom and Australian corporate criminal responsibility and corporate responsibility indicate the contractarian conception of the corporation as a nexus of contracts is being replaced by the idea of the firm as a "behavioral entity").

3. These studies are reviewed in Erica Beecher-Monas, *Corporate Governance in the Wake of Enron: An Examination of the Audit Committee Solution to Corporate Fraud*, 55 Admin. L. Rev. 357, 361 (2003), and form part of the grounds for her conclusion that United States regulators chose an ineffective policy option when they chose internal controls.

4. "Path dependence" is a common idea in both economic and legal scholarship. It essentially means that, the events and choices of the past dictate the appropriate choices available in the present to some extent. See Stephen E. Margolis & S.J. Liebowitz, *Path*

regulatory decision-making model outlined above? Prior to the events at Enron and WorldCom, some scholars were of the view that corporate law was converging toward what they characterized as shareholder-centered corporate governance rules and that convergence was the only option for corporations wishing to raise capital in global capital markets.⁵ Other authors have been less sanguine about the prospects for convergence.⁶ It seems logical that if culture informs corporate behavior, then the convergence thesis is less compelling and may be restricted to those nations whose cultures are similar. The relevance of this discussion to this Article is that Canadian regulators' reaction to the passage of the Sarbanes-Oxley Act (S-Ox)⁷ has been primarily one that is consistent with the convergence thesis. The majority of Canadian securities regulators are proposing to impose most of the substantive provisions of S-Ox. However, the securities regulator in one Canadian jurisdiction has rejected the imposition of the S-Ox provisions on the grounds that they are inappropriate for the Canadian market.⁸ That regulator also rejected them as costly duplica-

Dependence in *The New Palgrave Dictionary of Economics and the Law* vol. 3, 17 (Peter Newman ed., Stockton Press 1998) (providing a brief explanation of the term, its uses, and its history).

5. This was the theme in Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 *Geo. L.J.* 439 (2001), in which they provide an exhaustive list of the factors leading to convergence. They concluded their article as follows:

We predict, therefore, that as equity markets evolve in Europe and throughout the developed world, the ideological and competitive attractions of the standard model will become indisputable, even among legal academics. And as the goal of shareholder primacy becomes second nature even to politicians, convergence in most aspects of the law and practice of corporate governance is sure to follow.

Id. at 468.

6. Douglas M. Branson, *The Very Uncertain Prospect of "Global" Convergence in Corporate Governance*, 34 *Cornell Intl. L.J.* 321, 325 (2001). Branson argues that the evidence for convergence is slim and unrepresentative, and that those promoting it are ignoring deeply embedded cultural norms that make the success of the universal corporate-governance model based on different norms unlikely. *Id.* at 326–327, 343–347. Furthermore, he believes that the model does not work with respect to the governance of multinational enterprises. *Id.* at 359–362. See also Janis Sarra, *Convergence versus Divergence, Global Corporate Governance at the Crossroads: Governance Norms, Capital Markets & OECD Principles for Corporate Governance*, 33 *Ottawa L. Rev.* 177 (2001–2002) (questioning both the existence and desirability of convergence); Janis Sarra & Masafumi Nakahigashi, *Balancing Social and Corporate Culture in the Global Economy: The Evolution of Japanese Corporate Structure and Norms*, 24 *L. & Policy* 299 (2002) (reporting that Japanese corporations have resisted convergence to Anglo-American governance models).

7. *Sarbanes-Oxley Act of 2002*, Pub. L. No. 107-204, 116 Stat. 745 (2002).

8. *Infra* nn. 150–153 (recounting the British Columbia Security Commission's objections to imposing S-Ox provisions).

tion of protection that is already in place in Canadian securities regulation.⁹

Whatever one may have thought about the debate concerning convergence prior to the events at Enron and WorldCom, these events led many scholars to question some of the assumptions about the functioning of the United States corporate-governance regime as one where shareholder primacy ruled. In particular, scholars are questioning the use of share prices as a measure of shareholder value and, therefore, the efficient capital markets hypothesis.¹⁰ But if, as a result of Enron, there is increasing doubt about the market as a policy option, then it is important to analyze the legislative reaction to Enron to determine whether the legislature's policy choices are appropriate. In addition, it is important to determine whether the relevant context for Canadian regulators is sufficiently similar to that of United States regulators to justify adoption of the same regulatory policy initiative.

The Article is structured in the following manner. Part I attempts to draw links between the facts of Enron and the types of human behavior and collective decision-making that the S-Ox legislators may have seen as problematic. Part II explains S-Ox and its component policy instruments. The Canadian S-Ox North initiative is also described, and relevant differences in its capital market are highlighted. Part III analyzes the policy choices in the context of the problematic behavior to attempt to describe the legislators' theory of the means by which corporate behavior is best regulated. Part IV provides a critique of the missed opportunities in Canada to address the legislators' theory in the context of the current corporate-law scholarship as a result of the decision to restrict the analysis of the costs and benefits of S-Ox North to the direct economic impact on share prices. It then sets out an agenda

9. *Id.*

10. See generally Lynn A. Stout, *Are Stock Markets Costly Casinos? Disagreement, Market Failure and Securities Regulation*, 81 Val. L. Rev. 611 (1995) (using the insights from information theory and a heterogeneous expectations model of stock trading in the presence of asymmetric, costly information to illustrate the inefficiency of a market based on the rational expectations of market participants); Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. Chi. L. Rev. 1233, 1235 (2002) (suggesting that Enron stock's behavior in the markets provided "another set of reasons to question the strength of the efficient market hypothesis" and noting that it raised questions about the appropriate use of the market as a policy option).

for further research that arises from the missed opportunity to conduct a broader analysis.

I. SARBANES-OXLEY

S-Ox was a legislative reaction to the events at Enron, where every institution of the shareholder-centered model of corporate governance failed. Two principle aspects of the model appear to have failed. The first is the breakdown of the mandatory-disclosure regime under securities regulation. The second is the monitoring role of Enron's board of directors.

A. The Crooked "E"¹¹

Enron was considered an innovative global company that used high technology to trade energy contracts like marketable commodities. The United States Senate Committee Report on the investigation into the role of the board of directors in Enron's collapse in July 2002 concluded that, as a result of Enron's strategy to utilize these contracts as marketable commodities, Enron was able to develop and run its online energy trading business outside of existing controls on investment companies and commodity brokers.¹² To meet its heavy financing needs that were required to settle energy contracts traded at the close of each business day and to enhance its credit rating, Enron developed increasingly complicated transactions.¹³ These included developing energy contracts called "prepays," in which Enron was paid large sums in advance to deliver energy products over a period of years; designing hedges to reduce risks inherent in long-term energy-delivery contracts; and pooling energy contracts and securitizing them through bonds or other financial instruments sold to investors.¹⁴ Enron's financing strategy also included making itself "asset light," by selling or syndicating its more traditional assets such as

11. This Section reproduces much of Professor Janis Sarra's article, *Rose-Colored Glasses, Opaque Financial Reporting, and Investor Blues: Enron as Con and the Vulnerability of Canadian Corporate Law*, 76 St. John's L. Rev. 715 (2002). With Professor Sarra's permission, the Author has borrowed freely from the summary of Enron's fall presented there and much of the language herein closely tracks Professor Sarra's.

12. Sen. Perm. Subcomm. on Investigations of the Comm. on Govtl. Affairs, *The Role of the Board of Directors in Enron's Collapse*, Sen. Comm. Print 107-70 (July 8, 2002) [hereinafter *The Role of Enron's Board*].

13. *Id.* at 8.

14. *Id.* at 7.

capital intensive power plants, either outright or selling interests in the assets to investors.¹⁵ The problem was that, rather than selling the interest to third parties willing to invest in Enron's assets or share the substantial risks associated with long-term energy production facilities and delivery contracts, Enron sold these interests to "unconsolidated affiliates" that were not included in its financial statements, but were closely associated with the corporation.¹⁶ Thus, the normal scrutiny that an independent third party would bring to the financial feasibility of this strategy was absent and the off-balance-sheet liabilities obscured both Enron's financial status and the level of risk involved in the energy contracts.

To accomplish its strategy, Enron relied increasingly on complicated transactions with convoluted financing and accounting structures, including multiple special purpose entities (SPEs), hedges, derivatives, swaps, prepaid contracts and other forms of structured finance.¹⁷ While some of these devices are currently utilized by corporations to assist in financing and risk diversification, they are typically made with independent third parties that are acquiring some portion of the business risk in exchange for the upside benefits of the corporation's economic activity. Enron's strategy increased immediate returns on its financial statement without disclosing to the investing public that it was essentially hedging its own risks, and without making clear the actual level of running liability that the corporation faced.¹⁸ Hence the "con." Enron's strategy of obscuring the true nature of the transactions also created conditions ripe for self-dealing transactions by managers.¹⁹

Enron's Board of Directors, while aware of these transactions, viewed them through "rose-colored glasses."²⁰ The Senate Committee Report documents numerous occasions in which warning signals were presented to the directors, who consistently failed to question the transactions or the accounting practices. The partial

15. *Id.*

16. *Id.* at 8. By October 2000, "Enron had a total of \$60 billion in assets, of which . . . nearly fifty percent [(\$27 billion)] were lodged with Enron's 'unconsolidated affiliates.'" *Id.*

17. *Id.*

18. Sarra, *supra* n. 11, at 720.

19. *Id.*

20. *Id.*

list summarized here gives the reader a sense of how heavily tinted those rose-colored lenses must have been. In 1999, the Board was advised that Enron was using accounting practices that “pushed the limits” and were “at the edge of acceptable practice,” yet it failed to question why this was necessary or prudent.²¹ The Board also failed to question why Enron’s gross revenues jumped from \$40 billion to \$100 billion from 1999 to 2000.²² The Board approved moving Whitewing, an affiliated company, off Enron’s books, while guaranteeing its debt with \$1.4 billion in Enron stock and helping it obtain funding for the purchase of Enron’s assets.²³ Board members also signed off, without question or objection, on Enron’s 10-K filings in 1999 and 2000 that recorded over 3,000 separate related entities, with over 800 organized in well-known offshore jurisdictions.²⁴

On three separate occasions in 1999–2000, the Board approved unprecedented arrangements allowing Enron’s Chief Financial Officer (CFO) to set up private equity funds, the LJM partnerships, to do business with Enron for the purpose of improving Enron’s financial statements.²⁵ The Board of Directors waived the company’s code of conduct prohibiting Enron employees from obtaining personal financial gain from a company doing business with Enron and thus allowed its CFO to establish and operate these off-the-books entities designed solely to transact business with Enron.²⁶ This was contrary to prohibitions on conflict of interest transactions. The Board’s subsequent failure to monitor these transactions resulted in the LJM partnerships realizing hundreds of millions of dollars of profit at Enron’s expense.²⁷ For example, the CFO advised the Enron Board in October 2001 that he had earned \$45 million on a \$5 million investment in the LJM partnerships in just two years.²⁸ The CFO was on both sides of the negotiating table in these transactions. Since the LJM partnerships transacted business essentially only with Enron, all these profits were at Enron’s expense. The LJM partnerships on

21. *The Role of Enron’s Board*, *supra* n. 12, at 15.

22. *Id.* at 22.

23. *Id.* at 12.

24. *Id.* at 22.

25. *Id.* at 24.

26. *Id.* at 24–25.

27. *Id.* at 24.

28. *Id.* at 37.

several occasions purchased Enron assets and then sold them back to Enron at a higher price.²⁹ LJM reaped a termination fee of \$35 million when Enron unwound the Raptor transactions, discussed in the next paragraph, even though the hedging arrangement should have resulted in LJM paying Enron.³⁰

In 2000, the Board approved several sets of complex transactions called the Raptors, despite questionable accounting and ongoing risk to the company.³¹ It was these transactions that likely led to Enron's collapse. The purpose of the Raptors was to "improve Enron's financial statements."³² The Raptor transactions involved setting up SPEs using highly questionable financing transactions through the LJM partnerships to allegedly meet the requirement of independent equity. The LJM partnerships contributed \$30 million to each Raptor, giving the appearance of separate equity investment in the SPEs, only to have that investment paid back out to the LJM partnerships with a \$10 million profit on each Raptor SPE six months later, leaving claims on Enron's stock as the Raptors' only asset.³³ The Raptor SPEs thus appeared to hedge millions of dollars in volatile investments, when essentially Enron was inappropriately hedging its own risk, unknown to its investors and creditors.³⁴ The result was that losses of almost \$1 billion were concealed from the market by creating an appearance that the investments were hedged by a third party, i.e. that the third party was obligated to pay Enron the amount of those losses, when in reality the third party was an

29. *Id.* at 24.

30. *Id.*

31. *Id.* at 37-38.

32. *Id.* at 47.

33. *Id.* at 43.

34. Each of the Raptor SPEs was funded with only two types of assets, \$30 million provided by LJM2, which was temporary and to be paid back as \$40 million within six months, and stock and stock contracts provided by Enron. In each case, LJM2 received its repayment and profit of \$10 million, leaving claims on Enron stock and stock contracts as the Raptors' only asset. Enron's liability for the Raptors was further increased in March 2001 by restructuring of transactions that committed further Enron shares, exacerbating the risk to Enron, because Enron was effectively required to provide as many Enron shares as necessary to satisfy the Raptor "hedges." The Senate Committee Investigation found ample evidence of Board knowledge of these transactions. *Id.* at 46-48; see also William C. Powers, Jr., Raymond S. Troubh & Herbert S. Winokur, Jr., *Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp* 97 (Feb. 1, 2002) [hereinafter *Powers Report*] (available at <http://www.enron.com/corp/por/pdfs/-PowersReport.pdf>).

entity in which the major stakeholder was Enron.³⁵ When the value of assets allegedly the object of the hedges began to fall, there was no economic substance (no assets or capital) in the Raptors to support the so-called hedges other than claims on Enron's own stock or stock contracts.³⁶ Further questionable transactions and accounting slights of hand created an unstoppable downward spiral in value.³⁷ Only at this point did Enron's outside auditor reverse its earlier opinion of the "proper accounting for the Raptors," deciding that the Raptor SPEs could not continue to "hedge" Enron's investment losses.³⁸ This resulted in a recorded \$720 million charge to earnings, investment losses that the Raptors no longer concealed.³⁹ It also resulted in a \$1.2 billion reduction in shareholder equity because of the auditor's changed opinion as to appropriate generally accepted accounting principles (GAAP) in accounting for the Raptor transactions.⁴⁰ In turn, investors reacted by selling shares, triggering a decline in stock price, lowered credit rating, and eventual bankruptcy.⁴¹ In April 2002, the United States Securities and Exchange Commission (SEC) concluded that Enron's financial statements were unreliable and the book value of assets would have to be written down as much as \$24 billion.⁴²

The above-cited examples of the failure of corporate directors to question or challenge these transactions are now well documented by the Enron Special Investigative Committee Report (the "Powers Report") and the Senate Committee Report.⁴³ While the reader is well advised to read the reports to acquire a full appreciation of what transpired, these examples starkly reveal the failure of the corporate-and-securities-law regime to safeguard investors. The abuses are almost inconceivable when tallied. While the language of Enron transactions is itself revealing, the Star Wars imagery of JEDI and the aggressive sentiment behind the "Rap-

35. *The Role of Enron's Board*, *supra* n. 12, at 44; *Powers Report*, *supra*, n. 34, at 4, 99, 133.

36. *Id.*

37. *The Role of Enron's Board*, *supra* n. 12, at 44.

38. *Id.* at 45.

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.* at 11.

43. *Id.*; *Powers Report*, *supra* n. 34.

tor” transactions, the seriousness of the accounting practices, and the colossal failure of board oversight are not the stuff of science fiction. On any measure of effective governance, the corporate directors failed.⁴⁴ The Senate Committee concluded that, while the evidence indicated that in some instances Enron Board members were misinformed, overall, the Board received substantial information about Enron’s plans and activities and explicitly authorized or allowed many of the questionable strategies, transactions, and high-risk accounting practices.⁴⁵ The Board failed to exercise any effective oversight that would have ensured the integrity of corporate transactions and appropriate disclosures to the investing public. The Board sanctioned the opaque accounting practices, failed to prevent the self-dealing transactions, and failed to monitor officers’ conduct. The end result was “Enron as con,” with devastating losses to tens of thousands of investors, creditors, employees, and pension beneficiaries.⁴⁶

B. The Failure of Disclosure

The system of regular, detailed financial disclosure of historical information about corporate operations that was also subject to an audit by a professional accounting firm collapsed completely at Enron.⁴⁷ This type of disclosure is at the heart of United States securities regulation. As one scholar has pointed out, the disclosure mandated by United States securities legislation is designed both to inform investors and to affect the behavior of corporate management by the exposure of their actions to public scrutiny.⁴⁸ There seem to have been two sources for the failure of disclosure:

44. The Powers Report came to the same conclusion. *Powers Report*, *supra* n. 34, at 22.

45. *The Role of Enron’s Board*, *supra* n. 12, at 13.

46. Sarra, *supra* n. 11, at 723.

47. Enron’s auditors, Arthur Andersen, eventually ceased to function as an accountancy firm after the disclosure of its role in the failure to report over \$4 billion in liabilities, although it was charged only with destruction of evidence for shredding its audit files on Enron. See William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 *Tulane L. Rev.* 1275, 1323, 1340–1342 (2002).

48. Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 *Harv. L. Rev.* 1197, 1209–1235 (1999) (reviewing the intellectual background and the legislation’s history to show that one purpose of requiring disclosure was to affect the governance of the corporation); see also Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 *U. Chi. L. Rev.* 1047 (1995) (arguing that control of agency problems between shareholders and managers, rather than accuracy enhancement, is the primary justification for the mandatory disclosure regime).

the sabotage of auditor independence and the perverse incentives created by executive compensation schemes.

One scholar argues that the facts surrounding Enron show a systemic failure, not in the corporate governance structure, but rather in the structure of “gatekeepers” on which depends much of the regulatory regime for publicly traded companies in the United States.⁴⁹ After documenting what he described as a pattern of “increased deference” to the audit client by auditors or a reduction of “independence and objectivity” by securities analysts, Professor John C. Coffee, Jr., offers some possible explanations for this systemic breakdown.⁵⁰ They include a combination of legal decisions and legislative changes during the 1990s that limited or eliminated certain liability risks, together with the growth in the sale of consultancy services for audit firms and investment banking services for securities analysts’ firms.⁵¹ The combined effect of these changes was to make it possible for corporate management to discipline the audit firm by denying it much more lucrative work as a consultant without firing it as an auditor (a move that might alarm investors or the regulator).⁵² Changes in the business structure of accountancy firms from general partnerships to limited liability partnerships also removed strong incentives for internal monitoring by each partner over his or her fellow partners’ audit procedures.⁵³

The lessening of these gatekeeper constraints was combined with the removal of the requirement that corporate management hold the stock it received in options for at least six months. This provided incentives for executives to engage in “earnings management,” rather than earnings generation.⁵⁴ The removal of the

49. John C. Coffee, Jr., *Understanding Enron: “It’s about the Gatekeepers, Stupid,”* 57 *Bus. Law.* 1403, 1404 (2002).

50. *Id.* at 1408–1416.

51. *Id.*; see also Jonathan Macey & Hillary A. Sale, *Observations on the Role of Commodification, Independence and Governance in the Accounting Industry*, 48 *Vill. L. Rev.* 1167, 1168–1169 (2003) (contrasting the present imbalance between consultancy and audit fee income with the situation the authors claim enhanced auditor professionalism, one in which the audit firm with a strong audit reputation commanded a fee premium and would reject noncompliant clients to protect that reputation).

52. Coffee, *supra* n. 49, at 1415.

53. Macey & Sale, *supra* n. 51, at 1170–1172 (pointing out that the limited liability partnership discourages taking an interest in another partner’s work, as that might result in loss of liability protection through being characterized as a supervision of the other partner).

54. Coffee, *supra* n. 49, at 1413–1414.

hold requirement meant that managers could now profit by increasing the short-term price of the stock through various financial manipulations which would inevitably erode its price over the long term, but well after the managers had cashed in their stock.⁵⁵ Thus gatekeepers were also subjected to increased pressure by corporate management to be aggressive in their accounting strategies to increase the managers' personal wealth.⁵⁶

However, the adoption of somewhat formalistic rules concerning the "independence" standard for auditors may have also created the impression that form ought to prevail over substance in the auditor-client relationship. Professors Jonathan Macey and Hilary A. Sale ascribe this effect to rules that permitted auditors to both act as the independent outside auditor and to perform internal audit work for a company.⁵⁷ The pre-S-Ox rules also did not treat the provision of nonaudit services to the audit client as grounds for questioning the audit firms' independence.⁵⁸ This led to the situation in which Arthur Andersen, acting as the outside auditor, was passing judgment on whether particularly aggressive

55. Coffee, *supra* n. 49, at 1414; see also Gordon, *supra* n. 10, at 1246-1247 (concerning the strong incentives created by options). Gordon wrote:

Stock options have value, of course, only if at exercise they are "in the money," meaning the stock price is above the exercise price. If option grants are very large and exercisable in the relatively near term, then a positive swing in the stock price can make the senior executives immediately very rich. Even if the stock price falls back, the well-timed executive option exercise is a life-changing experience. More formally, the Black-Scholes option pricing model instructs us that the value of the executive's stock option will be increasing both in the value of the underlying security and the variance (since stock options are issued "at the money"). Therefore, managers with a rich load of options have incentives to get the stock price high by any means necessary, fraud included. In particular, they have incentives to increase the riskiness of the firm, including projects that offer lower expected returns but higher variance. This will reduce the value of the firm for risk-neutral shareholders but has the potential to increase the value of managers' firm-related investments in cases where the gain in option holdings exceeds the loss to human capital. Managers become risk-preferring. Both pathologies, fraud and costly risk-taking, appear to have occurred in Enron. Enron became a hedge fund, taking leveraged bets in exotic markets that if successful would produce a huge, disproportionate bonanza for its executives. In particular, for a management team that had profited from previous option exercises, the downside seemed a problem only for the shareholders.

Id.

56. Coffee, *supra* n. 49, at 1412-1414; see also Bratton, *supra* n. 47, at 1348-1351 (describing the phenomenon of auditor "capture" at Enron).

57. Macey & Sale, *supra* n. 51, at 1175-1176 (highlighting the fact that former Rule 2-01 of Regulation S-X prohibited this dual service only if the value of the internal audit exceeded forty percent of the "independent" audit).

58. *Id.* at 1174.

income and expense recording strategies, on which it had provided advice for Enron, were acceptable under GAAP.⁵⁹ Thus, the accounting industry had lost the ability to require clients to comply with stricter standards for reporting financial information because the tables had turned. It was the client, wielding the “carrot and stick” of consulting fees that could discipline reluctant auditors by making further nonaudit fees contingent on cooperation. In addition, given the regulatory requirement that all publicly-traded companies have regular external audits of their financial statements, individual auditors faced only a small risk of lengthy unemployment given the fixed supply of, and steady demand for, qualified auditors. Thus, one gets a strong impression that the normative context of auditors had changed from wary, professional skepticism towards the client’s optimistic view of its financial reporting to that of eager creative partner in putting a positive spin on the client’s public financial image. The change appears to have been driven by changes in the market and regulatory requirements, including changes that have no direct impact on the auditor–client relationship.⁶⁰ Yet, the change in the corporate management–auditor relationship would not have had such a devastating impact if another aspect of the corporate governance

59. Bratton, *supra* n. 47, at 1349, 1351 (noting that Andersen received \$5.7 million in consulting fees with respect to the Chewco and LJM related transactions and also that regulators were not blind to the dangers from these situations, just unable to overcome the political lobby that opposed their regulatory initiatives). Bratton elaborated:

The dangers posed to audit quality by the conflict of interest bound up in ancillary consulting arrangements have been widely discussed. The Big Five firms marketed their advisory services very aggressively. They sold tax products having a record of going over the line of legality. They also marketed SPE arrangements. Significantly, the more aggressive the accounting implicated in the products, the more important it has been that the seller firm also be the auditor. The sales relationship imports a favorable audit. Alternatively, aggressive transactional “products” have been sold by investment bankers complete with opinion letters from Big Five firms opining conformity to GAAP. The letter serves to constrain later objections from an auditor.

Former SEC chair Arthur Levitt made audit quality and auditor independence a primary agenda item in an accounting-regulation initiative launched in the late 1990s. He did not achieve what he requested—a per se ban on consulting by auditors. Influence activity in Washington by the Big Five firms, led by Andersen, prevented that. Instead, amendments to the SEC accounting rules which became effective in 2001 prohibited subcategories of non-audit services—specifically, information-systems design and internal audit services. Additional proxy statement disclosures also were required. A glance at Enron’s 2001 proxy statement shows Enron and Andersen to have been in compliance.

Id. at 1351–1352.

60. *E.g.* *supra* n. 55 (discussing the change in the hold period for vested stock options).

model, the independent monitoring board of directors, had fulfilled its promise.

C. The Breakdown of the Monitoring Directors

Enron's Board of Directors was, in the words of one scholar, an exemplar of many of the "best practices" in corporate governance.⁶¹ It was composed almost entirely of outside directors, and had an accountancy professor as the chair of its audit committee. Yet the Board authorized Enron's Chief Financial Officer and other senior management to enter into lucrative deals with Enron in which their interests clearly conflicted with Enron's.⁶² It also authorized an opaque form of disclosure that kept its liabilities and risks out of the investing public's eye.⁶³ One of the most puzzling transactions was the decision to "hedge" Enron's risks in its investments in other companies' securities by covering the downside risk with the value of its own common stock. This was accomplished by having separate corporate entities created by Enron assume the risk in return for Enron's offering to guarantee any downside risk with its own stock.⁶⁴ When the value of Enron's securities portfolio and its own stock fell simultaneously, the "hedge" disappeared and Enron eventually had to recognize large losses and restate previously reported earnings downward by almost \$600 million.⁶⁵ As set out above, the United States Senate Committee concluded that the actions of the Board of Directors were not solely the result of misinformation and that it was aware of the opaque financial reporting and transactions involving management conflicts of interest.⁶⁶

The monitoring model of corporate governance has been promoted as an acceptable substitute for the alleged disciplinary effects of the market for corporate control. By the early 1990s some scholars characterized the model as "conventional wisdom."⁶⁷ The

61. Jeffrey N. Gordon, *Governance Failures of the Enron Board and the New Information Order of Sarbanes-Oxley*, 35 Conn. L. Rev. 1125, 1127 (2003).

62. Beecher-Monas, *supra* n. 3, at 359–360.

63. Bratton, *supra* n. 47, at 1310–1312; Gordon, *supra* n. 11, at 1133.

64. Powers Report, *supra* n. 34, at 13–15.

65. Bratton, *supra* n. 47, at 1316–1318.

66. *Supra* nn. 44–46.

67. Ronald J. Gilson and Reinier Kraakman make the following claim:

In the corporate governance debate, all arguments ultimately converge on the role of the board of directors in general, and on the role of outside directors in particular.

theory behind the use of outside or independent directors is that because they are not part of the management team, they will ally themselves with the shareholders' interests rather than those of management. Hamilton has documented the changes in corporate governance that have led to the dominance of the outside director in the United States.⁶⁸ Enron certainly presented its board of directors as an example of that conventional wisdom with its majority of outside directors and an audit committee composed solely of outside directors. Yet, as William Bratton points out, the results at Enron were extremely disappointing:

The monitoring model holds out an objective, process-based system. It importunes companies to put a majority of highly qualified outside directors on the board and to integrate the board into its decision-making structure as an active participant. At the level of mandate, however, it only requires that boards go through the motions of making considered business judgments respecting corporate transactions. It does not and cannot make the further subjective inquiry into the degree of attention and quality of judgment actually brought to bear. Corporate counsel are well-schooled in packaging documentation so that compliance is well evidenced. The system responds to breakdowns such as Enron's by adding layers of new proc-

Ever since Adolph Berle and Gardiner Means first analyzed the separation of ownership and management, commentators have searched for the corporate equivalent of the Holy Grail: a mechanism to bridge the separation by holding managers accountable for their performance. At this point in the quest, one solution to the accountability problem has attained the status of conventional wisdom. Whether one asks the Business Roundtable, the Conference Board, the American Bar Association or the American Law Institute, the answer to the question of who should monitor management is the same: independent outside directors elected by the shareholders. And it is important to understand how pervasive an institution the outside director has become. As of 1987, seventy-four percent of the directors of publicly held companies were not company employees.

Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 *Stan. L. Rev.* 863, 873 (1991) (footnotes omitted); see also Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 *J. Corp. L.* 1, 11–12 (2002) (arguing for market-based correctives to corporate fraud).

68. Robert W. Hamilton, *Corporate Governance in America 1950–2000: Major Changes But Uncertain Benefits*, 25 *J. Corp. L.* 349, 360–364 (2000) (documenting the transfer of formal control over a number of matters, such as audits, executive compensation, planning, etc., to committees of the board of directors made up of outside directors).

esses, each a ritualized enactment of the substance of the good governance.⁶⁹

Bratton's criticism of the monitoring model is not a new phenomenon. Scholars have criticized the use of independent directors as a substitute for regulation for a number of years.⁷⁰ Ronald Gilson and Reinier Kraakman examine this issue and conclude that the two reasons offered for effective monitoring are not sufficient to overcome the counterincentives that presently exist.⁷¹ The two reasons offered are *noblesse oblige* (arising from the good character that forms the basis on which they are chosen to serve in the first instance), and concerns about their reputations in a market for directors.⁷² There are at least three counter-incentives to *noblesse oblige*. First is the fact that a director's continued tenure on the board is dependent on renomination by management.⁷³ The second is that there are strong social and cultural ties between management and directors (who are often senior executives at their own corporations).⁷⁴ Third, there is an extreme imbalance between the financial compensation and the amount of work required to be diligent in discharging a director's duties.⁷⁵ As for the market for directors, Gilson and Kraakman point out that there is no evidence of the existence of such a market, let alone that it has the perfect information about directors' behavior needed to provide the appropriate incentives to be diligent.⁷⁶ After reviewing these counter-incentives, Gilson and Kraakman conclude:

This, then, is where the problem stands. On the one hand, the board of directors is the only existing device for monitoring managers. On the other, both more and less sympathetic observers of boards of directors have come to acknowledge what should have been obvious all along: The traditional cor-

69. Bratton, *supra* n. 47, at 1334.

70. See Victor Brudney, *The Independent Director—Heavenly City or Potemkin Village?* 95 Harv. L. Rev. 597, 638 (1982) (concluding in 1982 that a combination of judicial deference to directors' decisions under the business judgment rule, the absence of the requirement that management certify that its accounting and disclosure procedures comply with the legal standards for such procedures, and the lack of meaningful sanctions for poor performance by directors means there is no incentive for a director to be diligent).

71. Gilson & Kraakman, *supra* n. 67, at 874.

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.* at 875–876.

porate solution of introducing outside directors to bridge the separation between ownership and control has dramatic limitations.⁷⁷

Thus far, this Article has briefly reviewed the Enron story and highlighted two of the most salient failures of the existing corporate governance model—the capture of the gatekeepers by an imperial corporate management and the triumph of formalism in the boardroom. We can now review S-Ox and its northern counterpart, S-Ox North, to attempt to ascertain both the problems the legislators felt required their intervention and their view of the appropriate solutions.

II. S-OX AND S-OX NORTH: PROBLEMS AND SOLUTIONS

There are three features of S-Ox that require particular highlighting. Some scholars have seen the potential for fundamental changes in corporate governance in its provisions, while others have doubted whether most of the changes are fundamental.⁷⁸ The three features are the switch from reliance on professionalism to regulation in respect of accounting at public companies; the move to federal law as the dominant force in the regulation of internal corporate governance standards; and the continued willingness to rely on disclosure as the principle means of controlling corporate insiders' activity.

A. Accountants Are Now “Inside the (Corporate) Box”

S-Ox replaces the accounting profession's self-regulation over accounting industry standards and gives it to the Public Company Accounting Oversight Board (PCAOB) a majority of whose members are not accountants.⁷⁹ Audit firms that wish to continue to audit publicly traded companies must register with the PCAOB.⁸⁰ The PCAOB has the power to regulate accounting industry standards relating to auditing standards, quality control, and ethics for those firms registered with it.⁸¹ In addition, the PCAOB will

77. *Id.* at 876.

78. Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (and It Just Might Work)*, 35 Conn. L. Rev. 915 (2003) (providing an example of the latter reaction).

79. 116 Stat. at 750–751.

80. *Id.* at 753.

81. *Id.* at 755.

annually inspect the largest accounting firms' quality control and internal control procedures, and it has the power to impose penalties for deficiencies including the suspension and barring of firms and individuals from public firm auditing.⁸²

These provisions are a substantial change in a profession that, prior to S-Ox, was entirely self-governing. They clearly represent a repudiation of the classic understanding of the "independent" external auditor as a firm whose reputation for quality audits was the commodity being sold in the marketplace. With the loss of self-regulatory status, members of the accounting profession lost their claims to the status of an independent professional. Auditors of public companies are now seen as just another conflicted corporate agent, whose conflicts are to be controlled by the fear of loss of professional livelihood through being suspended or barred from practice in connection with publicly-traded companies. They have become yet another actor inside the corporate box regulated in the public interest just like the other actors—directors, officers, and shareholders.⁸³

S-Ox also takes aim at some of the conflict-creating incentives for the auditing firms by limiting the nonaudit compensation the firm can receive from its audit clients. It prohibits an audit firm from providing any of the nonaudit services expressly enumerated in S-Ox, as well as those that may later be added by SEC regulation.⁸⁴ It also makes provision of all other nonaudit services subject to pre-approval of the client corporation's audit committee, although pre-approval is not required when the nonaudit services are less than five percent of the annual total fees to an audit firm.⁸⁵ S-Ox further attempts to reduce auditor "capture" by the client's management by prohibiting the same audit partner from supervising the client's audit for more than five years in a row.⁸⁶ Finally, S-Ox requires that the auditors disclose discussions with

82. *Id.* at 757, 762. Among the grounds for suspending individuals and firms is failure to supervise those performing audits of public companies. *Id.* at 763.

83. Lawrence E. Mitchell, *The Sarbanes-Oxley Act and the Reinvention of Corporate Governance*, 48 *Villa. L. Rev.* 1189, 1198 (2003) (discussing the challenge for corporate-law scholarship following the inclusion of those gatekeepers, including auditors, "inside the corporate box," who had traditionally stood outside the corporation and offered professional opinion).

84. 116 *Stat.* at 771–772.

85. *Id.* at 772.

86. *Id.* at 773.

management concerning its critical accounting policies, alternatives to those policies and the impact of those alternative accounting treatments, and other material written information to the board of directors' audit committee.⁸⁷ This last provision is included to further the second principle in S-Ox: creating a federal duty of care for the board of directors and, in particular, its audit committee.

B. Federal Corporate Law

United States scholars have long recognized, and in some instances lamented, the failure to utilize the inchoate federal jurisdiction to regulate the internal corporate governance of publicly-traded corporations.⁸⁸ Although some earlier securities regulation may have incidentally affected that corporate governance (for example, the proxy solicitation rules), S-Ox represents a full-fledged takeover of corporate governance from state corporation law (albeit in a relatively narrow area in the corporate governance field).⁸⁹ S-Ox sets federal parameters for the design of internal board governance structures, the qualifications for service on a board committee, the responsibilities of that committee, and the committee's relationship with both the professionals retained by the corporation and the corporation's employees.⁹⁰ It also sets out duties and responsibilities of the board of directors in its supervisory capacity and of the corporation's executive officers with respect to the representations in the financial reports filed under securities regulation.⁹¹

S-Ox utilizes the power to prohibit stock exchanges from listing the stock of a noncompliant company as the means by which it will obtain compliance with its corporate governance requirements.⁹² To comply, a board's audit committee must assume responsibility for the appointment of the auditors, the supervision of the audit process, and directly receiving the auditor's reports.⁹³

87. *Id.*

88. Mitchell, *supra* n. 83, at 1189–1190; Cunningham, *supra* n. 78, at 918–920 (noting that S-Ox federalizes state laws, stock exchange practices, and corporate governance norms); Ribstein, *supra* n. 67, at 57–58.

89. *Id.*

90. 116 Stat. at 775–777.

91. *Id.* at 776–777.

92. *Id.* at 776.

93. *Id.*

In addition, S-Ox specifies that the audit committee must be composed of independent directors and provides a definition of independence that prohibits any financial compensation to the director from the corporation other than the normal directors' fees.⁹⁴ The audit committee must be provided with the power to engage independent advisors, and the corporation must provide the audit committee with sufficient funds to pay the audit firm and any advisors engaged by it.⁹⁵ Finally, the audit committee must establish procedures for dealing with complaints about accounting or audit matters and means by which corporate employees can contact it anonymously to complain about dubious accounting practices.⁹⁶

Corporate officers are also subject to certain federal corporate governance responsibilities. In addition to certifying that the financial statements comply with law and contain no material misstatements or omissions, they are responsible for ensuring that the corporation has a set of internal controls that will provide them with material information about the corporation and its subsidiaries and for verifying that the controls are effective—corporate officers must conduct this verification within ninety days of submitting a periodic report required under securities legislation.⁹⁷ They must also disclose to the corporation's auditors and the audit committee any weaknesses in the internal controls revealed by their verification testing, and any fraud they may have discovered. All changes to the controls must be disclosed in the report, as well as their expected impact on the accuracy of the information in the report.⁹⁸ Finally, in an attempt to minimize the perverse incentives generated by certain forms of executive compensation and minimize the rewards for managerial earnings management, S-Ox imposes an obligation on executives to forfeit bonus payments and profits from securities trading to the corporation if the corporation has to restate its financial statements

94. *Id.*

95. *Id.*

96. *Id.* S-Ox also establishes civil protections for whistleblowers who lose their jobs or are penalized for blowing the whistle with respect to federal securities-legislation violations. *Id.* at 802–804 (increasing the criminal penalties for retaliation against whistleblowers); *see also id.* at 810 (providing for up to ten years imprisonment for retaliation).

97. *Id.* at 777.

98. *Id.*

because of noncompliance with securities regulation and that noncompliance is the result of misconduct.⁹⁹

C. Enhancing Disclosure—Revealing Historical Information or Inducing Best Practices

The “Enhanced Disclosure” provisions in S-Ox appear to be aimed at two differing goals. The first is the elimination of technically compliant but opaque financial disclosure by corporations, and the second is the use of market discipline to increase the utilization of best practices by corporations by requiring disclosure and explanation if they are not utilized. Congress mandated that the SEC issue rules requiring disclosure of material information about all off-balance-sheet entities and required reconciliation of pro forma figures with the financial results of the corporation in accordance with GAAP in any information released by the corporation.¹⁰⁰ It also required the SEC to complete a study of the disclosures about off-balance-sheet entities following the rules’ implementation to determine if GAAP-based disclosure about these entities resulted in economically transparent information.¹⁰¹

Some examples of provisions aimed at the second goal are those that require disclosure of the management responsibility for maintaining an adequate system of internal controls for financial reporting and a yearly assessment by management of the effectiveness of its internal control structure and procedures.¹⁰² The corporation’s auditors must attest to and report on the management’s annual assessment.¹⁰³ Every corporation will be required to disclose the code of ethics for their its senior financial officers, and if it does not have one, why not.¹⁰⁴ The legislation provides detailed guidance as to the issues to be dealt with in such a code, including honest and ethical conduct, in particular involving conflicts of interest, full disclosure in any financial reports, and the need to comply with laws and regulations.¹⁰⁵ Any change to or waiver of the code must be disclosed immediately.¹⁰⁶ Corporations

99. *Id.* at 778.

100. *Id.* at 786.

101. *Id.*

102. *Id.* at 789.

103. *Id.*

104. *Id.*

105. *Id.* at 789–790.

106. *Id.*

must also disclose whether they have at least one “financial expert” on the audit committee as that term is defined in the legislation and by SEC regulations.¹⁰⁷

While these are not all of the areas in which the S-Ox legislates, they represent many of the main areas. We can now attempt to draw out from S-Ox and the commentary on its provisions the legislative diagnosis and prescription for corporate governance post-Enron.

D. The Diagnosis and Prescription

Clearly, given the drastic measures taken with respect to auditing of publicly-traded companies by audit firms, one of the ills diagnosed by Congress was that the accounting profession no longer brought any credibility as independent professionals to their audit of financial reports. Remedying the general loss of credibility in the financial markets was one of the primary goals of S-Ox.¹⁰⁸ Two main policy prescriptions were followed to restore this credibility. The first removed the power of self-regulation from the profession by the creation of the PCAOB and the requirement that all audit firms register with it and abide by its requirements in order to maintain their access to auditing of publicly traded companies.¹⁰⁹ It will set both procedural and substantive accounting standards, and verify adherence to these standards through its power to inspect the audit firms.¹¹⁰ Thus, insofar as the company audit branch of accounting is concerned, it has become a profession directly answerable to a federal regulatory body, rather than a professional servant dependent on the favor of an economically dominant client. The relationship has changed because the publicly-traded corporation is still legally required to have an external audit of its financial statements, but the auditor must conform to the regulator’s policies or face being banned from the audit practice. Of course, as with all regulators, there is the danger of capture by the regulated, although the danger in this

107. *Id.* at 790.

108. The subtitle of S-Ox is “An Act to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.” *Id.* at 745.

109. *Id.* at 750, 753.

110. *Id.* at 750–771.

case is more likely to come from capture by corporate financial officers, rather than the accounting profession.¹¹¹

The second initiative taken by Congress was to try to limit the amount of pressure that could be exerted on the audit firm and its partners through the “carrot and stick” of management’s control over the granting and withholding of nonaudit fees. Two prescriptions have been used to deal with the problem. First, absolute prohibitions have been placed on certain types of non-audit services.¹¹² Second, preperformance permission must be obtained from the corporation’s audit committee for any substantial non-audit work by the audit firm.¹¹³ In addition, the audit committee, not management, retains and supervises the audit firm, and the audit firm must report to the audit committee.¹¹⁴

The choice of supplanting market forces with strict regulatory control and the substitution of the audit committee for managers in the marketplace for audit services along with the prohibition of certain transactions in that marketplace does seem to indicate a rejection of market-based solutions to the problems of the accounting industry’s conflict of interest. Some scholars have expressed concern about this reversal of a lengthy trend among state regulators that relied on a competitive market for corporate-law rules as the guarantor of quality in corporate-governance regimes.¹¹⁵ However, in this area the choice has been made in favor

111. This danger would arise from the requirement that the PCAOB members have “an understanding of the responsibilities for and nature of the financial disclosures required of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosures,” contained in S-Ox. *Id.* at 751. This part of the criteria might most comfortably fit chief financial officers or corporate chief accountants. However, other criteria for board membership (e.g. demonstrated concern for investors) may counteract the danger.

112. *Id.* at 771–772.

113. *Id.* at 772–773.

114. *Id.* at 773, 776.

115. See Ribstein, *supra* n. 67, at 53–54 (arguing that insufficient consideration had been given to using market mechanisms to restore confidence rather than regulation, and in particular, allowing audit firms to use “signaling” to indicate quality). Ribstein states:

Auditors similarly can signal the objectivity and care of their services by, for example, clearly separating audit and nonaudit services or getting out of the nonaudit business. Alternatively, issuers can compete in the way they purchase audit and nonaudit services. The price firms pay for audit services may provide a signal to the extent that it reflects auditors’ liability risk and therefore the risk of auditing particular firms. Issuers can signal the markets about the honesty of their books by, for example, not buying nonaudit services from the same firms that audit their books and by periodically switching audit firms.

Id. at 54.

of regulatory, rather than market controls. The choice of policy instruments with respect to internal corporate governance is not as clear. There is one policy instrument that has clearly not been chosen, that is, a federal duty of care and loyalty for directors.¹¹⁶

One of the instruments that was chosen, the board of directors' audit committee, is a somewhat puzzling choice in light of the dismal performance of Enron's audit committee. It is almost as if Congress is saying: they should have done better, so all corporations should recreate the Enron board and try harder. However, as some scholars have noted, S-Ox contains little in the way of substantive standards and much in the form of procedural requirements in an attempt to perfect the monitoring model of corporate governance. But the model is no guarantee that anything of substance will be accomplished, as Bratton succinctly pointed out:

Enron, then, reminds us that the monitoring model assures us of little. It gives only a circumstantial guarantee of good governance because it only requires evidence of a "conscientious," well-informed business judgment. The conscientiousness itself is ill-suited to ex post verification. In the alternative, the substance of the business judgment could be reviewed. But we have avoided such strict scrutiny on the sound theory that ex post review of risk taking would have perverse deterrent effects. In the chasm separating the circumstantial guarantee from such an actual guarantee lie untold billions of lost investment dollars, and not only in respect of Enron. It is a cost of capitalism.¹¹⁷

If the monitoring audit committee provides no actual guarantee, what about the certification that the corporation's highest executive officers must sign and the reporting procedures they must create? Certification of the financial statements of the corporation has been a feature of securities regulation since it was introduced.¹¹⁸ The requirement to certify that adequate reporting mechanisms are in place and that the adequacy has been recently tested are new, and the coherence of having the same individual design and test a mechanism may suffer from the absence of an

116. Cunningham, *supra* n. 78, at 922.

117. Bratton, *supra* n. 47, at 1337-1338.

118. Cunningham, *supra* n. 78, at 942 (pointing out the requirement for certification extended to all members of the board of directors).

independent second check.¹¹⁹ Lawrence Mitchell speculates that these features in combination with others (such as the disclosure of codes of ethics) may create a federal duty of care with respect to financial reporting.¹²⁰ S-Ox certainly increases the potential penalties for misleading statements about the financial condition of the corporation by increasing civil and criminal penalties and by requiring corporate officers to disgorge any profits from stock trading or bonuses if misconduct was at the root of any restatement of financial information.¹²¹ Thus, S-Ox has also chosen the option of deterrence as well as procedural regulation as one of the prescriptions for the corporate governance ills disclosed by Enron. Of course, the effectiveness of increased penalties must depend on the degree to which these executives believe there is a realistic chance their misconduct will be exposed and successfully prosecuted.¹²²

The final strategy in S-Ox is that of requiring disclosure of information by corporate management and relying on the reaction to that disclosure as the governance tool.¹²³ The disclosure tool has been used by federal securities regulation in the United States since the 1930s and was preferred over the alternative “blue sky” merit regulation of corporate quality which had been one of the proposals for federal securities regulation at the time federal securities regulation was introduced.¹²⁴ Disclosure as a policy tool has a dual function. It can enhance efficiency in markets by allowing prices to reflect accurate information about the corporation. In addition, it can control corporate management through the discipline of the market and the exercise of shareholders’ corporate franchise with respect to disclosure of conflicts of interest and

119. *Id.* at 957.

120. Mitchell, *supra* n. 83, at 1201–1202.

121. 116 Stat. at 778.

122. Neil H. Aronson, *Preventing Future Enrons: Implementing the Sarbanes-Oxley Act of 2002*, 8 Stan. J. L. Bus. & Fin. 127, 140 (2002) (noting that deterrence does not deter wrongdoers who believe they will not likely be caught or those who believe they are merely fulfilling their duty to shareholders); *see also* Cunningham, *supra* n. 78, at 969 (suggesting that deterrence depends on whether one’s theory of criminality sees the individual as a rational wrongdoer, who is deterred when costs exceed the benefits).

123. 116 Stat. at 785–791.

124. Williams, *supra* n. 48, at 158 (reporting the drafting of an alternative bill introduced in both Houses of Congress that would have regulated corporations on the grounds of their operations being based on sound principles).

fiduciary obligations.¹²⁵ However, the former justification is dependent on the ability of stock markets to be efficient. Efficiency in that context usually refers to the relationship between the pricing of the stocks and information about the corporation. This type of efficiency takes a number of forms, from a claim that the price of the corporation's securities incorporates all information, both public and nonpublic, about the corporation, to a claim that the price incorporates all of the publicly available information, with the final, weakest claim being a claim that the price incorporates all historical information about price movements.¹²⁶ It is often asserted that the United States capital market meets the test for the latter two forms of efficiency, but not the first.¹²⁷ However, efficiency could also mean that there is a relationship between the price and the underlying value of the corporation, a claim that would bolster the normative power of those schemes of corporate governance that rely on the capital markets as the main source of discipline for corporate managers. A number of scholars have expressed serious reservations that this form of efficiency exists in our capital markets.¹²⁸ However, this does not mean that the disclosure tool will have no value as a means to control errant managers.

There is another aspect of disclosure as a governance tool. This aspect has been explored by Cynthia A. Williams who discusses the origins of the concepts used in United States securities legislation and the theory that the potential for public exposure of unsavory financial dealings would deter individual managers from such behavior.¹²⁹ The means or mechanisms by which managers would be deterred by such exposure appear to be a combination of market reaction and shame.¹³⁰ Doubtless, the utility of this

125. Mahoney, *supra* n. 48, at 1050–1054 (suggesting that, while the former is the generally accepted “efficiency” explanation for the use of disclosure in securities regulation, the latter is more consistent with the origins and use of disclosure as a regulatory tool in corporate law dealing with initial offerings and controlling the use of high-par-value stock prior to the enactment of securities regulation).

126. Ronald J Daniels & Jeffrey G. MacIntosh, *Toward a Distinctive Canadian Corporate Law Regime*, 29 Osgoode Hall L.J. 863, 873 (1991).

127. *Id.*

128. Maria O'Brien Hylton, “Socially Responsible” Investing: *Doing Good versus Doing Well in an Inefficient Market*, 42 Am. U. L. Rev. 1, 14 (1992); Stout, *supra* n. 10, at 616–617.

129. Williams, *supra* n. 48.

130. *Id.* at 1278–1281.

aspect of disclosure has been eroded by the divergence between market reaction and conduct that would otherwise be considered shameful that has resulted from the translation of the managerial fiduciary duty into a duty to maximize share prices. Managers appear able to overcome the dictates of their conscience by resorting to their supervening fiduciary duty to maximize shareholders' stock prices.¹³¹ It may require some means of rekindling the relationship between shame and fiduciary duty to restore the ability of disclosure to restrain corporate management's harmful activities.

E. Canada's Distinctive Regime

Canada is different from the United States. Its capital market structure is fundamentally different, as are its corporate and securities laws. Notwithstanding these differences, S-Ox will apply to Canadian corporations that sell their securities in United States markets and are listed on United States stock exchanges. It is important to appreciate that securities market regulation is targeted at specific kinds of problems arising from the capital market structure. For example, in the United States, the predominant corporate capital structure is that of a widely-held equity in which no individual or group has legal or effective control of the shareholder votes. This structure creates what has been described as the separation of ownership and control, or more realistically the inability of widely-dispersed shareholders to control a potentially opportunistic corporate management through the ordinary exercise of their rights to vote provided by corporate leg-

131. See e.g. *Varity Corp. v. Howe*, 516 U.S. 489 (1996) (reporting the misrepresentation to workers about the financial security of their benefits in a new subsidiary that the management of Varity Corp intended would be financially insolvent); Gordon L. Clark, *Pensions and Corporate Restructuring in American Industry: A Crisis in Regulation* (The Johns Hopkins U. Press 1993) (reporting the targeting for termination of older workers who were about to become eligible for enhanced pension benefits by Continental Can Co., Inc.); Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C.L. Rev. 283, 285-286 (1998) (detailing the misrepresentations by US Steel to its workers regarding its intention to keep its Youngstown steel plant open as long as it was profitable).

Scholars have suggested this is possible because the duty is owed to a one-dimensional abstraction that has no connection with the actual shareholders of the corporation. See e.g. Lawrence E. Mitchell, *Corporate Irresponsibility: America's Newest Export* (Yale U. Press 2001) and Daniel J.H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited*, 69 S. Cal. L. Rev. 1021, 1061 (1996) (both discussing the intellectual gymnastics that purify otherwise questionable activities).

isolation. Thus, the problems in the United States capital markets are those of controlling managers' ability to prefer their self-interest over the interests of shareholders, and perhaps other stakeholders as well.

The Canadian capital market is constructed differently. It consists of a majority of thinly-traded companies, with little or no institutional investment.¹³² Of those companies on the Toronto Stock Exchange (TSX) index, a majority have a single shareholder with legal control and more than three-quarters of them have either a single shareholder or a group of three or less shareholders with either legal control or effective control of the corporation.¹³³ There is a much higher proportion of corporations with restricted voting or nonvoting stock such that the owner of a minority of the equity owns the voting shares. There is also a high degree of corporate interconnection, with many of the one hundred most profitable corporations holding up to ten percent of the stock of the other companies on the list.¹³⁴ Directorships are interconnected as well, with a higher proportion of directors having multiple directorships.¹³⁵ For most publicly traded Canadian corporations, the problem is not the inability of widely dispersed shareholders to monitor managerial conduct, but rather that an alliance between the management and majority or controlling group of shareholders will conduct corporate affairs so as to disadvantage the minority shareholders or other corporate stakeholders.

F. Canada's Regulatory Regime

Canada is a federal country, as is the United States. Corporations may incorporate in any one of its provinces or territories pursuant to the corporate law of that jurisdiction, or they may incorporate under a federal corporate law statute. Securities regulation is also the subject of provincial, not federal legislation. Canada has had to develop a nonlegislative solution to the problem of securities transactions of an issuer being conducted in multiple jurisdictions. The various securities regulators have formed a national organization the Canadian Securities Administrators

132. Daniels & MacIntosh, *supra* n. 126, at 877.

133. *Id.* at 884.

134. *Id.*

135. *Id.* at 888.

(CSA) through which various “National Instruments” are developed and publicized. These regulatory instruments are then adopted and/or incorporated into the applicable regulatory regime by each of the regulators through the legislative mechanisms provided for doing so.

Enron, WorldCom, and similar scandals adversely affected Canadian investors, especially institutional investors who had significant investments in portfolios based on United States stock exchange indexes. However, none of the Enron scandals involved a Canadian corporation subject only to Canadian securities regulation. During and after the enactment of S-Ox, arguments were advanced that Canada’s capital markets and corporate governance regimes were so distinct that the wholesale adoption of United States regulatory measures would be an expensive and unnecessary step.¹³⁶

G. Distinct?

Canada’s capital market structure is different from that in the United States, with the biggest contrast in the shareholding structures of the two countries. Based on 1990 data, 85.7% of the publicly-traded companies on the TSE 300 Index had either a single controlling shareholder or a small group of shareholders (up to three) with sufficient shares to exercise effective control over the corporation.¹³⁷ Only fourteen percent of the companies on the TSE 300 Index were widely held, and of all publicly traded companies on Canada’s exchanges, only 5.4% are widely traded and have significant institutional shareholder holdings.¹³⁸ Interconnecting share ownership is widespread. Of the one hundred most profitable companies, forty-five percent held ten percent or more of the shares of another company on the list.¹³⁹ These companies also had a greater percentage of interlocking directorships than in the United States during the comparable period.¹⁴⁰ Relatively few Canadian companies are listed in United States stock exchanges,

136. See text accompanying nn. 153 and 156.

137. Daniels & MacIntosh, *supra* n. 126, at 884.

138. Of the remainder, 59.4% were infrequently traded and 35.3% were traded at a moderate frequency. Daniels & MacIntosh, *supra* n. 126, at 877.

139. See Daniels & MacIntosh, *supra* n. 126.

140. *Id.* at 888 (reporting the applicable figures were 28.9% of directors in Canada had two or more appointments as directors, while the comparable percentage in the United States was 18.2%).

and thus subject to S-Ox's requirements, although they are among the largest of Canada's corporations.¹⁴¹

III. THE SUBJECT OF REGULATION

Classic corporate law theory concentrates on the issues of the predominate form of corporate organization in the United States markets, the widely-held, widely-traded corporation. This theory further concentrates on what is viewed as the central conflict in such a corporation, the conflict between shareholders and managers. This conflict has been characterized as a conflict between ownership and control.¹⁴² It is also characterized as a problem of "agency costs" representing the costs of monitoring management in order to control managerial diversion, shirking, and empire building that reduce shareholder wealth.¹⁴³ At its root are the twin concerns that the benefits available to the individual small investor from monitoring management are very small in relationship to the costs of doing so and that, even if they wished to do so, widely-dispersed small investors cannot coordinate their efforts to actually exert any disciplinary pressure on management.

In contrast, the capital structure of most of Canada's publicly-traded corporations does not raise these concerns. Large blockholders can capture most of the gain from monitoring, and thus the disproportion between costs and benefits of monitoring is eliminated. In addition, since he or she will possess legal or de facto control over the directors' election, the controlling shareholder can impose discipline on errant managers. Thus, the conflict in the Canadian capital markets is not between managers and shareholders, but rather between controlling shareholders and noncontrolling shareholders over intrashareholder transfers of wealth or use of the corporation for the nonpecuniary ends of the majority shareholder.¹⁴⁴ While these differences do not lessen

141. Christopher C. Nicholls, *Canadian Response to Sarbanes-Oxley* 9 (Capital Mkts. Inst. 2003) (stating that only 177 of Canada's 4,000 publicly traded companies are interlisted on United States stock exchanges).

142. Adolph A. Berle, Jr. & Gardiner C. Means, *The Modern Corporation and Private Property* 120 (MacMillan Co., 1932).

143. Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance and Takeovers*, 76 Am. Econ. Rev. 323, 323 (1986); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305, 305 (1976).

144. Ronald J. Daniels & Paul Halpern, *Too Close for Comfort: The Role of the Closely*

the need for corporate governance tools to protect the legitimate interests of minority shareholders and securities regulation to protect market confidence and investors, they may dictate a greater emphasis on a different aspect of the corporate regime than is required in the United States

These differences were at the root of a debate about the type of regulatory reform required in Canada as a result of the Enron, WorldCom, and other scandals and the United States regulatory response. This debate first occurred between the heads of Canada's stock exchanges and the securities regulator in Canada's largest province, Ontario. It subsequently erupted again after proposed regulation was issued, this time with the dissenting voice being the securities regulator from British Columbia. The argument boils down to whether the substantial costs of S-Ox can be justified in Canada's capital markets. Those who favor harmonization of Canada's regulations with those of the United States have offered three main arguments in support. These are to deal with investor concerns about regulatory weaknesses, to remain competitive in terms of stringency, and to combat inappropriate incentives that, if left unchecked, might lead to future financial scandals in the Canadian market.¹⁴⁵ Those who opposed wholesale harmonization offer three arguments in opposition. These are that any Canadian regulatory initiatives are premature because United States implementing regulations must still be promulgated; there are problems of fit with Canada's different size/control structures; and a rules-based approach might undermine the efforts of Canadian regulators to create a "culture of compliance" in Canada's corporate governance and securities markets.¹⁴⁶

A. S-Ox North

Nevertheless, the CSA requested comment on three proposed Multilateral Instruments labeled as "investor confidence initia-

Held Public Corporation in the Canadian Economy and the Implications for Public Policy, 26 Can. Bus. L.J. 11 (1995); Daniels & MacIntosh, *supra* n. 126, at 885.

145. Nicholls, *supra* n. 141, at 11 (summarizing the views of the Chair of the Ontario Securities Commission, David Brown, expressed in a public letter to Canadian stock exchanges).

146. *Id.* at 12 (summarizing the views of Barbara Stymiest, Chief Executive Officer of the Toronto Stock Exchange, in response to the Brown letter).

tives” that contained key provisions of S-Ox.¹⁴⁷ They included the independent-director-audit-committee-membership requirements, audit committee responsibility for auditor retention and supervision, and the executive-officer certification of financial statements and internal reporting procedures. The Ontario Securities Commission commissioned a study of the economic costs and benefits of the requirement for independent directors on the audit committees. The study found that costs would be in the range of CAD \$37 million—\$142 million, while the estimated gains in Economic Value Added (EVA) were in the range of CAD \$1 billion—\$9.2 billion over a ten year period.¹⁴⁸ The study indicated that substantial losses could be avoided by having independent directors on the board of directors’ audit committee and that the costs of doing so were much less than the potential losses avoided.¹⁴⁹ When the proposals were issued for comment, the British Columbia Securities Commission (BCSC) issued its own notice setting out its rationale for refusing to adopt the CSA proposals on certification and audit committees.¹⁵⁰ It stated that it viewed the certification requirement as a nuisance filing because current regulation provided prohibitions on misleading statements of the corporation’s financial position with both directors and executive officers being liable for any such misrepresentation.¹⁵¹ It also had concerns about the ability of directors to evade their present responsibility

147. Canadian Securities Administrators, *Rules and Regulations Proposed and Final, Multilateral Instrument 52-108 Auditor Oversight*, http://www.osc.gov.on.ca/en/Regulation/Rulemaking/Rules/rule_52-108_20030627_multilateral-instrument.pdf (accessed Jan. 6, 2004); Canadian Securities Administrators, *Rules and Regulations Proposed and Final, Proposed Multilateral Instrument 52-110 Audit Committees*, http://www.osc.gov.on.ca/en/Regulation/Rulemaking/Rules/rule_52-110_20030627_multilateral-instrument.pdf (accessed Jan. 6, 2004); Canadian Securities Administrators, *Rules and Regulation Proposed and Final, Proposed Multilateral Instrument 52-109 Certification of Disclosure in Companies’ Annual and Interim Filings* http://www.osc.gov.on.ca/en/Regulation/Rulemaking/Rules/rule_52-109_20030627_multilateral-instrument.pdf (accessed Jan. 6, 2004).

148. The Office of the Chief Economist Ontario Securities Commn., *Hot Topics, Investor Confidence Initiatives: A Cost-Benefit Analysis of Proposed Multilateral Instrument 52-110 Audit Committees* 1, 2, http://www.osc.gov.on.ca/en/HotTopics/currentinfo/prom_inv_conf/pic_20030627_52-110_initiatives.pdf (accessed Jan. 6, 2004).

149. *Id.*

150. British Columbia Securities Commn., *BC Notices, BC Notice 2003/25 “Investor Confidence” Rules—The BCSC Approach*, <http://www.bsc.bc.ca:8080/comdoc.nsf/webpolicies/6dfc26ed07348df288256d52005d7ec2?OpenDocument> (accessed Jan. 6, 2004).

151. *Id.* at 2.

by claiming reliance on the officers' certification.¹⁵² With respect to the requirement for independent directors on audit committees, the BCSC said it preferred using a combination of positive general duties in the regulatory regime requiring a corporation to have an audit committee and to disclose material information about that committee's membership and their qualifications. The BCSC argued that these requirements, combined with market pressure would be the best policy tools to design an optimum governance regime for each corporation, rather than detailed prescriptions concerning membership, duties and qualifications.¹⁵³ However, the BCSC did note that the CSA request for comment on the proposed regulation did incorporate the cost-benefit analysis of the Ontario Securities Commission (OSC)¹⁵⁴ and that it would be carefully analyzing that document's claims.¹⁵⁵

Subsequently, the Chair of the BCSC responded to the OSC study by filing a comment with the OSC on the proposed audit committee requirements that enclosed a critique of that study by a professor from the New York University Stern School of Business.¹⁵⁶ This critique attacked the OSC study's methodology and assumptions pointing out that the links between the membership of an audit committee and EVA were fragile at best, and that a number of other studies had found little or no evidence of links between corporate governance changes and increased shareholder return.¹⁵⁷ The BCSC Chair concluded that in view of Professor Klein's critique, there was a genuine risk that the costs of the audit committee proposals would outweigh the benefits, measured in the increase in shareholder wealth generated by them and requested the CSA reconsider its proposals.¹⁵⁸

152. *Id.*

153. *Id.* at 3.

154. The Office of the Chief Economist Ontario Securities Commn., *supra* n. 148.

155. British Columbia Securities Commn., *supra* n. 150.

156. Douglas M. Hyndman, Comment Letter to CSA from BCSC Chair Hyndman, *Rules Proposed and Final, BCSC Comment Letter: Multilateral Instruments 52-108, 109, and 110*, http://www.osc.gov.on.ca/en/Regulation/Rulemaking/Rules/rule_52-110-20030924_com_hyndman.pdf (accessed Jan. 6, 2004).

157. April Klein, *A Critique of Investor Confidence Initiatives: A Cost-Benefit Analysis of Proposed Multilateral Instrument 52-110 Audit Committees*, http://www.osc.gov.on.ca/en/Regulation/Rulemaking/Rules/rule_52-110_20030924_com_hyndman.pdf (accessed Jan. 6, 2004) (included as an attachment to Hyndman, *supra* n. 156).

158. Hyndman, *supra* n. 156, at 4-5.

IV. WHAT IS THE GOAL OF REGULATION?

This account of the debate in Canada illustrates both a missed opportunity to examine the regulators' understanding of the causes of the behavior they wish to affect and the dangers of failing to specify the benefits of particular forms of regulation properly. The first missed opportunity is with respect to the concerns expressed by TSX Chief Executive Officer Stymiest about a departure from the goal of creating a "culture of compliance" in favour of a rules-based approach.¹⁵⁹ The second missed opportunity lies in the decision to use EVA as the measure of the benefits of changes to the audit committee membership, responsibilities, and qualifications requirements.

When Stymiest raised the issue of the culture of compliance goal, she created the opportunity to discuss the issue of how an artificial corporate entity can have a "culture," what factors create such a culture, and how the policy tools available to securities regulators can affect those factors so that compliance results. Such a discussion would be informed not only by scholarship regarding market incentives from economists, but also by cognitive psychology regarding the behavior of individuals and groups faced with uncertainty,¹⁶⁰ as well as sociological, anthropological, and economic discourse regarding the creation and maintenance of a corporate culture.¹⁶¹ Without such a discussion, one is left with another corporate black box in which regulations are promulgated on one side and corporate behavior emerges from the other. The link between the first and the second events occurs inside the box in an area in which collective decisionmaking and responsibility are the formal structure put in place by the regulatory regime.

However, instead of taking this opportunity, the OSC and other CSA members relied on a study that specified the benefits as shareholder wealth increases, rather than either changes in corporate behavior or increases in investor confidence in the informational aspects of securities markets. Christopher C. Nicholls points out the problems when regulators conflate investor confidence measured by increases in stock prices with investor confidence measured by increased trust in the fairness of the markets'

159. Nicholls, *supra* n. 141, at 11–12 (providing a summary of her comments).

160. As advocated by Beecher-Monas, see *supra* note 3.

161. See Belcher, *supra* n. 2 (suggesting as much).

operations.¹⁶² He points out that taking steps to increase the latter (trust) aspect is the only proper role for securities regulators. Increased share prices are not an inevitable result of increasing market fairness.¹⁶³ The results (share price levels) of fair market operation should reflect the underlying economics of the corporations concerned and will not necessarily increase with an increase in fairness or reductions in information asymmetry between corporate insiders and other market participants.¹⁶⁴ However, instead of trying to measure the effects of independent directors on the audit committees on some measure of the fairness of markets or the trust of investors in that fairness, the OSC chose to use EVA. EVA is one means of measuring the benefit to shareholders from a firm's economic activity. It is a measure of the residual income of a corporation (return on capital–cost of capital) in relation to the total capital invested in that corporation.¹⁶⁵ This means that the OSC study implicitly assumes that the benefits of the proposed regulation will inevitably be reflected in increased shareholder wealth, rather than in some direct measure of market fairness or trust in that fairness by investors.

These missed opportunities bring us back to the issues set out in the introduction to this Article concerning the need for an articulated theory of the factors that impact on the behavior of corporate directors, managers, and the corporate culture that shapes the responses of all of its employees. Some scholars have begun this project in corporate law by asking that corporate law be viewed as not merely enabling private parties to efficiently contract in the corporation as a nexus of contracts, but rather as a regulatory tool wielded to advance important public policy goals.¹⁶⁶ Other scholars have used developments in the understanding of human behavior to question the model of rational wealth maxi-

162. Nicholls, *supra* n. 141, at 2.

163. *Id.*

164. Nicholls, *supra* n. 141, at 5–7; see also Henry T.C. Hu, *Faith and Magic: Investor Beliefs and Government Neutrality*, 78 Tex. L. Rev. 777, 803 (2000) (discussing the same problem with respect to the SEC's passive attitude towards the promotion of diversified equity portfolios as investments with little or no risk of negative returns over a reasonable period of time).

165. The Office of the Chief Economist Ontario Securities Commn., *supra* n. 148, at 6.

166. Lawrence A. Cunningham, *Behavioral Finance and Investor Governance*, 59 Wash. & Lee L. Rev. 767, 788 (2002); Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as a Regulatory Tool*, 35 U. Cal. Davis L. Rev. 581, 581 (2002).

mizing behavior that lies at the foundation of economic theory.¹⁶⁷ This scholarship has the potential to make an important contribution to the development of appropriate regulatory tools, but before it can make this contribution, regulators must be willing to articulate and discuss the basis on which they believe a particular regulation will achieve the desired effect. In the Canadian context, the issues with which regulators must deal are broader than those in the United States, as our capital market includes both the widely-held corporation with liquid markets for its shares and the controlling shareholder model of a corporation with a thinly-traded market for its shares. One of the important questions for further investigation in this context is how one can regulate the internal governance of a corporation to minimize illegitimate inter-shareholder wealth transfers, while providing the controlling shareholder with the legitimate powers and rights that accompany control of the corporation. The other question is whether the importation of S-Ox regulatory requirements will adversely affect the corporate culture of Canada's corporations by encouraging the abandonment of a "culture of compliance" for a loophole conscious, rules-based culture. Answering both of these questions will require a scholarly sojourn inside the corporate decisionmaking black box, a sojourn that neither side in the current debate over the implementation of S-Ox appears to have seriously undertaken.

167. Stout, *supra* n. 10, at 616–617; Stephen M. Bainbridge, *A Behavioral Economic Analysis of Mandatory Disclosure: A Thought Experiment Turned Cautionary Tale*, http://papers.ssrn.com/s013/papers.cfm?abstract_id=204110 (accessed Jan. 9, 2004).