

Book Reviews

A Plea for Reform

The Grand Jury: An Institution on Trial. By Marvin E. Frankel and Gary P. Naftalis. New York: Hill and Wang, 1977. Pp. 148. \$8.95.

Reviewed by Norval Morris†

The Grand Jury: An Institution on Trial by Marvin E. Frankel and Gary P. Naftalis is effective and timely in that it rides the crest of a wave of grand jury reform. It is certain to be influential in reshaping state and federal pretrial procedures. Like Judge Frankel's *Criminal Sentences: Law without Order*,¹ it is a concise, vigorous, gracefully phrased monograph. Unlike that earlier book, it does not reflect an impassioned reformist perspective. Paradoxically, prosecutorial discretion, exercised over and through the grand jury, may prove more resistant to control than judicial sentencing discretion, because prosecutors may have a greater investment in the inefficiencies and injustices of American criminal procedure than judges.

In their Introduction, Frankel and Naftalis promise to examine the history and functions of the grand jury, the problems and practices that have made it a subject of controversy, and major proposals for reform now pending in Congress.² They further engage to present their own views on "some debatable questions."³ The authors keep these promises with style and precision, but in brief compass. One crucial issue and two lesser issues are finessed. The critical question whether the grand jury should be abolished rather than reformed is set aside with too great haste;⁴ the proper scope of immunity (use or transactional)⁵ and the scope of judicial power over leaks from and

† Dean, University of Chicago Law School.

1. M. FRANKEL, *CRIMINAL SENTENCES: LAW WITHOUT ORDER* (1973).

2. M. FRANKEL & G. NAFTALIS, *THE GRAND JURY: AN INSTITUTION ON TRIAL* 5 (1977) [hereinafter cited by page number only].

3. *Id.*

4. Pp. 117-21.

5. Pp. 76-81, 127-28.

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publicity about grand jury proceedings are also treated in summary fashion.⁶ The latter two issues are arguably collateral to grand jury reform, and enough has been written about them for Frankel and Naftalis's incorporation of them by reference and summation to suffice.

In the abolition or reform debate, Frankel and Naftalis side with the reformers and against both the abolitionists and those (mostly United States Attorneys) who see the grand jury as a necessary weapon against crime that does not require substantial reform. The authors propose a comprehensive list of reforms. Among them are more effective judicial instructions to the grand jury, stricter accountability of prosecutors to the courts, a full transcript of proceedings before the grand jury, right to counsel for grand jury witnesses, adequate notice prior to compelled appearance before a grand jury, reduction of the powers of the grand jury over recalcitrant witnesses, advice to the witness that he is a prospective defendant if and when he is, presentation by a witness of exculpatory evidence or testimony, limitation on repeated efforts to indict before successive grand juries, and better protections against injurious leaks of grand jury testimony.⁷

The length and scope of the list of proposed changes makes one fear that in the effort to bring a larger measure of fairness to the grand jury we may further protract appalling delays in the prosecution of ordinary felony cases and move yet further towards a negotiative rather than an adversarial system. I am no perfervid champion of the adversary system; there is, in my view, much to be said for the inquisitorial pretrial procedures of the Western European democracies. But it would be sad indeed if we wound up with the worst of both worlds.

The tension between those who would reform and those who would preserve without change the grand jury was illustrated recently by a debate over the issue of a grand jury witness's right to counsel. At its last meeting, the House of Delegates of the American Bar Association, not a radical body, voted 186 to 93 to recommend that grand jury witnesses be afforded that right.⁸ Spokesmen for the Department of Justice vigorously opposed the reform as a serious obstacle to prosecution of drug-related, white-collar, and organized crime.⁹

But in spite of widespread opposition from prosecutors, abolition or substantial reform of the grand jury seems imminent. In the words of Frankel and Naftalis:

6. Pp. 85-89, 132-35, 137.

7. Pp. 121-37.

8. *Chicago Sun Times*, August 10, 1977, at 41, col. 5.

9. *Id.*

There are widespread charges, and not a little proof, of abuses. The grand jury has served too often . . . to harass the unorthodox and the unpopular. Its large and secret powers have proved too frequently to be terrifying weapons in the hands of righteous or cynical prosecutors. There have been too many cases in which witnesses have been badgered, trapped, subjected to harsh, sudden, and wearing appearances in distant places, defamed by leaks not necessarily accidental, or otherwise scarred by gratuitously high-handed or perverse employment of the grand jury's great authority.¹⁰

Frankel and Naftalis argue that abolition of the grand jury is neither feasible nor desirable. It is true that given the entrenchment of the grand jury in the Bill of Rights there is little likelihood of abolition in federal practice. But in the states the grand jury is already frequently by-passed in routine felony cases. In the Circuit Court of Cook County, for example, the grand jury is something that is hurried through upstairs subsequent to negotiation and decision respecting what charge will be prosecuted. States' attorneys compete with each other in testing how few questions and answers replete with hearsay will trigger a true bill. In most crowded city courts the grand jury is merely one possible step in the leisurely round of negotiations and pretrial motions en route to a plea. It is certainly no shield of liberty as it was in the minds of the framers of the Fifth Amendment, no protection against abuse of state power. In most states the prosecutor can, in fact, avoid the grand jury entirely if he is so minded and proceed instead by information or similar processes.

The reform or abolition question thus differs between federal practice and state and local practice since, as Frankel and Naftalis rightly argue, amending the Bill of Rights is no light or inconsequential task.¹¹ But in rejecting abolition of the grand jury as an alternative to reform, they turn their case more than elsewhere and more than is justifiable on federal practice where the constitutional barrier to abolition is so formidable.

Frankel and Naftalis also offer two policy justifications for reforming rather than abolishing the grand jury. First, they suggest that "[t]he grand jury as a roving ombudsman has a fairly long and frequently honorable record."¹² It is certainly true that in regard to its investigation of political crime, its uncovering of bribery and corruption in government, and its fight against organized and white-

10. P. 117.

11. Pp. 118-19.

12. P. 91.

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collar crime, prosecutorial affection for the grand jury is understandable and commendable. But the very efficiency of the grand jury as investigator and the great power that it gives the determined prosecutor have not infrequently led to its abuse by overzealous prosecutors as a weapon against the unorthodox and unpopular. Judge Hufstedtler has perceived the sad paradox: "It would be a cruel twist of history to allow the institution of the grand jury that was designed at least partially to protect political dissent to become an instrument of political suppression."¹³ Reform of the grand jury in federal practice thus faces the formidable challenge of improving the grand jury's investigative function, in terms of fairness and efficiency, without imposing further delays on already dilatory pretrial processes. In the states the task is easier since there is little to be said for retaining the "probable cause" role of the grand jury.

Many countries have shaped preliminary inquiry procedures that, without using the grand jury, strike a decent balance between the needs for conviction of the guilty and for avoidance of trials of those of whom probable cause of guilt is lacking.¹⁴ A preliminary hearing before a judicial officer, in which the prosecution must make a prima facie case and in which the defense, represented by counsel, may at its election offer evidence, is a simple procedure to find probable cause that does not raise difficulty elsewhere in the common law world nor in those jurisdictions where it has been adopted in the United States. It does not, of course, function as an investigative procedure, but the framers of the Bill of Rights did not have that function in mind when they built the grand jury into the Fifth Amendment. The availability of such alternatives for finding probable cause places a crucial burden on those who would reform rather than abolish the grand jury to improve the investigative role of the grand jury without adding further delays and inefficiencies to the prosecution of ordinary crime.

Second, Frankel and Naftalis commend the grand jury as "a vehicle for citizen participation in government."¹⁵ This appears, in fact, to be their bottom-line argument against abolition, since they recognize that investigation could be accomplished without the grand jury. They suggest that the interposition of lay jurors at the pretrial stage contributes to the protection of individuals, the flexibility and respon-

13. *Burse v. United States*, 466 F.2d 1059, 1089 (9th Cir. 1972).

14. For a recent far-reaching proposal for the creation of an investigative magistracy that would render the grand jury's investigative function otiose, see L. WEINREB, *DENIAL OF JUSTICE: CRIMINAL PROCESS IN THE UNITED STATES* (1977).

15. P. 120.

siveness of the law, and the legitimacy of the criminal process. The argument is appealing, but it has all too frequently been used to avoid the issue of whether lay participation in fact accomplishes those ends. That is the larger issue behind the debate over abolition of the grand jury that Frankel and Naftalis never quite address.

Lurking behind any discussion of grand jury reform is the problem of that "over-mighty subject" of the criminal law, the prosecutor. Powerfully armed to compel testimony by subpoena and grant of immunity, unfettered in the selection of what crimes to pursue, the prosecutor is a towering inquisitorial figure in the otherwise largely adversarial landscape of criminal justice. One wonders, at the end of Frankel and Naftalis's excellent study, whether reforms of grand jury practices will much affect the potential for and the occasional reality of abuse of the prosecutor's formidable powers. As Frankel and Naftalis put it:

The general problem of selecting, and better regulating, prosecutors plainly transcends, though it directly affects, the subject of the present book. But such matters are separable only in the sense that finite amounts of reading and writing are about all we can manage in any allotted time period. The interconnections are worth mentioning, if only not to lose sight of them.¹⁶

This balance of insight and modesty characterizes the entire work. *The Grand Jury: An Institution on Trial* merits the attention of all concerned with justice and efficiency in the investigation and prosecution of crime.

16. P. 138.

In Search of Corporate Soul

The Structure of the Corporation: By Melvin Aron Eisenberg. Boston: Little, Brown & Co., 1976. Pp. xvi, 320. \$16.50.

Reviewed by Donald E. Schwartz†

This is the corporation's season in the sun. Next to government, the large corporation is probably the dominant economic and social institution in our society. The extensive examination to which it is now being subjected is welcome and overdue.¹ To this examination, Professor Melvin Eisenberg has made a readable, important, and provocative contribution. Although *The Structure of the Corporation* neither raises all the questions nor furnishes all the answers, it moves us significantly toward a prescription of sound policy for corporate law.

Fear of the "soulless" corporation is not new. The metaphor recurs constantly in nineteenth century debates on corporations.² Yet corporate reform has largely concerned the corporation's external relationships, especially the protection of customers, creditors, and investors. To ignore relationships within the corporation is paradoxical since the corporation's acts result from the decisions of individuals proceeding in accordance with norms prescribed by law. This corporate "constitutional law," as Professor Eisenberg terms it,³ can surely also channel the economic and social influence of "soulless" corporations.

Professor Eisenberg's earlier publications have played important roles in causing other scholars and critics to look more closely within the corporation.⁴ *The Structure of the Corporation*, a synthesis of

† Professor of Law, Georgetown University Law Center.

1. E.g., Securities Exchange Act Rel. No. 13482 (Apr. 28, 1977), FED. SEC. L. REP. (CCH) ¶ 81,130; Securities Exchange Act Rel. No. 13901 (Aug. 29, 1977), FED. SEC. L. REP. (CCH) ¶ 81,296; *Corporate Rights and Responsibilities: Hearings Before the Senate Comm. on Commerce*, 94th Cong., 2d Sess. (1976); *The Role of the Shareholder in the Corporate World: Hearings Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Senate Judiciary Comm.*, 95th Cong., 1st Sess. (1977).

2. See L. FRIEDMAN, *A HISTORY OF AMERICAN LAW* 171-72 (1973).

3. M. EISENBERG, *THE STRUCTURE OF THE CORPORATION* 1 (1976) [hereinafter cited by page number only].

4. See Eisenberg, *Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants*, 63 CALIF. L. REV. 375 (1975); Eisenberg, *Mega-subidiaries: The Effect of Corporate Structure on Corporate Control*, 84 HARV. L. REV. 1577 (1971); Eisenberg, *Access to the Corporate Proxy Machinery*, 83 HARV. L. REV. 1489 (1970); Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1 (1969).

these articles, seeks to analyze and develop "new and more highly articulated models of corporate structure."⁵

Eisenberg's most important chapters treat the role of management in corporate structure. Corporate critics have devoted much attention to defining the role of the board and prescribing cures for its deficiencies. Eisenberg contrasts the received legal model, under which the board makes policy and manages the business, with the working model, under which the executives exercise those functions. He is disturbed by the discrepancy between myth and reality:

[M]any legal rules have been shaped on the premise that the board manages the corporation's business in fact as well as in law. For example, by proceeding from the assumption that officers play a subordinate role to the board, the rules governing the authority of officers frequently embody an unrealistically restrictive view of an officer's power of position. Standards of care, by the same token, often seem to be pitched to the outside director rather than the executive, as if the former were really running the business. . . . In a wider context, the skew between belief and reality has led to what might be called the quack-cure problem—the danger that belief in the validity of the received legal model will forestall meaningful regulation by lulling shareholders, legislators, and the public into the illusion (which often seems deliberately conjured-up) that a disinterested board is supervising the corporation's affairs.⁶

Professor Eisenberg suggests his own model. He finds the principal function of the board to be monitoring management, not giving advice, approving major transactions, or exercising control. The prime requirements of his model are independent directors and an adequate flow of information to the board. His definition of independent directors excludes the corporation's counsel, investment bankers, important suppliers and customers, and management's relatives.⁷ Control of the corporate proxy machinery is vested exclusively in the independent directors.⁸ Adequate flow of information depends heavily on the selection and role of independent accountants. Eisenberg argues that too much discretion is allowed to management in selecting accountants and accounting conventions.⁹ The choice of "generally

5. P. 6.

6. P. 148 (footnotes omitted).

7. Pp. 175-76.

8. P. 176. I assume that this means "exclusively" with respect to the board's own access to the proxy statement and is subject to the shareholders' right to have access, an idea that Eisenberg favors.

9. The SEC has limited management's discretion in this area somewhat by requiring

accepted accounting principles” that “present fairly” the financial condition of a company can “subvert legitimate expectations.”¹⁰ He would reassign these functions, giving independent accountants the choice of accounting principles and independent directors the choice of accountants. Eisenberg’s criticisms and proposals are of central importance to an understanding of corporate governance.

Eisenberg defines the role of stockholders in a publicly owned corporation largely by examining their voting rights.¹¹ He states that three schools of thought exist: “shareholder democracy,” which would strengthen the power of the shareholders; constituency representation, which would give a direct voice to various groups with a stake in corporate activity (for example, employees, customers, suppliers); and managerialism, which would increase the power of management to enable it to further the ends of enlightened social policy.

Eisenberg finds serious flaws in the last two models. Constituency representation is unworkable, and managerialism is dangerous because management’s interests may conflict with those of the stockholders. Eisenberg’s preference is to put “structural matters directly into the shareholders’ province.”¹² Whether a matter is structural depends not on whether it is “major,” “fundamental,” or “extraordinary,” but rather on whether it deals with the structure of the enterprise or relates to its control.¹³ All business decisions are left exclusively to management.¹⁴

disclosure of a change of accountants that is occasioned by a disagreement on a matter of accounting principles or practices or financial statement disclosure. Accounting Series Release No. 165, 40 F.R. 1010, FED. SEC. L. REP. (CCH) ¶ 72,187 (Dec. 20, 1974).

10. P. 194. Professor Eisenberg does not discuss the effect of the SEC requirement that whenever a company makes a change to an alternative accounting principle, the certifying accountants shall file a letter indicating whether or not the change is to an alternative principle that the accountant believes is preferable. Accounting Series Release No. 177, 40 F.R. 46107, FED. SEC. L. REP. (CCH) ¶ 72,199 (Sept. 10, 1975). The requirement doubtless allows less leeway to management in the selection of accounting principles, although it does not eliminate the need for the type of reform Professor Eisenberg proposes.

11. Unlike most statute writers, Professor Eisenberg deals separately with the closed corporation, which he approaches by comparison with partnership agreements.

12. P. 36. It is not clear whether putting structural matters “directly into the shareholders’ province” denies any role to the board of directors, or whether it gives shareholders only the final word. The former would be a major departure from state law and would greatly strengthen the shareholders’ power. I doubt, however, whether Professor Eisenberg means that. Most structural decisions—for example, whether to merge with another company, whether to make a partial liquidation of the company’s assets, whether to amend the certificate of incorporation to authorize additional shares—have to originate with management. It seems unlikely that Professor Eisenberg would want to submit such proposals directly to the shareholders without first obtaining a recommendation from the board of directors.

13. Pp. 15-16.

14. P. 68.

Some commentators have disagreed with Eisenberg's view on practical, not theoretical, grounds. These critics regard shareholders as powerless and indifferent.¹⁵ Eisenberg questions this view—"the AT&T myth"¹⁶—by noting that it mistakes the characteristics of a few mammoth corporations for those of the paradigm. Moreover, Eisenberg believes that, even in the largest companies, there are many institutional investors neither indifferent nor uninformed about structural matters, and in whose hands the vote is significant.¹⁷

Nevertheless, critics of shareholder participation contend further that the market offers a superior alternative to shareholder democracy. This approach is commonly referred to as the "Wall Street rule": unhappy stockholders express displeasure by selling their shares rather than by participating in corporate governance. The advocates of this "rule" argue that it is simple to apply, costs less than the mechanism required to implement the corporate political process necessitated by stockholder activism, and is effective. Its rationale is that if enough stockholders sell shares, the price of the corporation's stock would decline, making management vulnerable to outsiders seeking control of the company.

Although Professor Eisenberg recognizes the value of actual or potential control takeovers,¹⁸ he does not comment on the relationship of the Wall Street rule to the creation of a formal structure for stockholder participation. His sentiments are clearly against exclusive reliance on the market, however, and in this judgment I agree.

The Wall Street rule is not the delicate instrument for change that its supporters seem to believe. Advocates of the Wall Street rule often confuse it with other market devices that are used to punish inefficiency by departure or withholding patronage. Stockholders do not withhold patronage or depart the corporation when they sell their stock; only the identity of the stockholders changes. The message communicated by a sale of stock, matched by a purchase of stock, is ambiguous, as a series of random, uncoordinated decisions is bound to be.

In addition, it is questionable whether the rule does anything for the corporation. Large sales of the corporation's stock lower its price. A decline in the price of stock could injure the corporation and its

15. Manning, *Corporate Power and Individual Freedom: Some General Analysis and Particular Reservations*, 55 NW. L. REV. 38 (1960); Manning, Book Review, 67 YALE L.J. 1477 (1958).

16. Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 33 (1969).

17. P. 54.

18. See pp. 58-59.

shareholders by reducing the value of stock options and outstanding warrants and by raising the cost of capital in general. Finally, no data have been collected that establish a close relationship between the impact of the market and the stockholders' ability to effect a structural impact on control.

Eisenberg's belief in stockholder participation appears to be sound.¹⁹ As he recognizes, however, the difficulties in marshaling a fragmented army of small stockholders make significant stock ownership by large institutions a prerequisite to effective stockholder participation. Institutional owners have easy access to corporate management. This power stems not only from the ownership of many shares in the company, but also from the similar backgrounds and common viewpoints of corporate and institutional managers.²⁰ Fortunately, data show that even huge corporations have large concentrations of holdings in a few hands.²¹ Thus the suggestion for recognizing significant stockholder participation rights is not quixotic.

Professor Eisenberg might have gone farther in his analysis of shareholder participation. Beyond the mere availability of institutions to play an important role, it is desirable corporate policy that they should do so.²² Institutions formerly voted their shares as management recommended with great regularity.²³ With the increased occurrence of stockholder resolutions that raised issues of public policy, institutions ceased to cast an automatic vote for management.²⁴ Equally important, they frequently expressed their views to management on a variety of issues.²⁵ The result has often been a therapeutic airing of important social questions, such as corporate presence in South Africa, control of pollution, and increased opportunities for minorities. Such institutional activity is of benefit to all shareholders.

Vital to greater shareholder participation is the proxy machinery,

19. See A. HIRSCHMAN, *EXIT, VOICE AND LOYALTY* (1970) (suggesting that corporation's ability to recover from deterioration in quality depends on availability to shareholder of opportunity either to sell stock or to express dissatisfaction to management).

20. See Schwartz, *The Public Interest Proxy Contest: Reflections on Campaign GM*, 69 MICH. L. REV. 419, 494-511 (1971).

21. Pp. 47-49.

22. See A. CONARD, *CORPORATIONS IN PERSPECTIVE* 360 (1976).

23. 5 U.S. SEC. AND EXCH. COMM'N, *INSTITUTIONAL INVESTOR STUDY REPORT* 2760-63, 2846 (1971).

24. See generally B. LONGSTRETH & H. ROSENBLUM, *CORPORATE SOCIAL RESPONSIBILITY AND THE INSTITUTIONAL INVESTOR: A REPORT TO THE FORD FOUNDATION* (1973); J. SIMON, C. POWERS & J. GUNNEMAN, *THE ETHICAL INVESTOR* (1972); N.Y. Times, Dec. 14, 1972, at 71, col. 6.

25. See the Investor Responsibility Research Center's Survey entitled the 1977 Proxy Season: How the Institutions Voted on Shareholder Resolutions and Management Proposals 6 (1977).

which now enables management to perpetuate its incumbency. Professor Eisenberg finds basic principles to support the simple proposition that shareholders should have the same opportunity as management to gain access to the company's proxy statement for the purpose of nominating directors. State law gives the stockholders the exclusive right to elect directors, and a necessary corollary to that right is the right to make a timely nomination.

The difficulty, as Professor Eisenberg fully appreciates, is in devising an alternative that provides access without destroying the proxy machinery. In its recent hearings on corporate governance, the SEC questioned whether it has power to address the problem of access, whether a solution could be made practical, and, indeed, whether there should be such access.²⁶ I believe the answer to all three questions is affirmative.

The Commission's power stems from its mandate to achieve "fair corporate suffrage."²⁷ The Commission could reasonably conclude that a one-sided presentation of candidates for directorships is an unfair solicitation. It could condition the use of interstate facilities and the mails for the purpose of soliciting proxies upon furnishing nonmanagement shareholders an opportunity to nominate candidates through the corporate proxy machinery.²⁸

The key is to make access reasonable. Nominations are easy to make, and the process could be subject to frivolous use much more readily than the stockholder proposal process. Consequently, restrictions are necessary. Possible restrictions include requirements that the nominators own a minimum number of shares (either a percentage or a dollar amount, like \$100,000, depending on company size); that no petition could nominate more than one candidate or ten percent of the directors to be elected; that a stockholder be limited to signing one petition; that a full description of the candidate be given on a proper form; that the candidate consent; and that the nominators pay a fee that would be refundable only if the candidate received a minimum percentage of the vote.

The justification for shareholder access rests on more than notions of fairness. If Professor Eisenberg's proposals for change in the role of management are to work, independent board members must be

26. Securities Exchange Act Rel. No. 13482 (Apr. 28, 1977), FED. SEC. L. REP. (CCH) ¶ 81,130.

27. This was the stated objective of the House Interstate and Foreign Commerce Committee when it first considered legislation pertaining to proxy regulation. H.R. REP. No. 1383, 73d Cong., 2d Sess. 13-14 (1934).

28. Note, *A Proposal for the Designation of Shareholder Nominees for Director in the Corporate Proxy Statement*, 74 COLUM. L. REV. 1139 (1974).

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elected. Under the prevailing system, however, most directors owe their selection to the chief executive officer, who dominates the nomination process. And management has little incentive to nominate candidates of unquestioned ability because its candidates do not have to face the rigors of a real election. Given the current realities of the election process, the selection of directors will continue to constitute an annual coronation ritual.

Invigorating stockholder participation in the nomination process is unlikely to deprive management of its power to perpetuate itself in office—except in the rare, but important, case when a proxy contest occurs. Nor does equal access to the proxy machinery assure that the outside candidate will win. It might operate, however, so as to make the victorious candidates less beholden to management for their selection. Further, it might have a healthy effect on management's selection process and encourage the nomination of candidates who can survive the scrutiny of a contest.

Eisenberg also examines several significant corporate transactions to see how the law limits the shareholder role in structural situations. He finds that statutory and common law rules provide for unjustifiably inconsistent stockholder roles in corporate combinations that differ in legal form, but not economic substance. Thus he argues for broader application of the *de facto* merger doctrine.²⁹

This section is adapted from the earliest of the Eisenberg articles,³⁰ and despite its updating, significant developments affecting combinations have occurred that are not discussed. These issues are crucial to analysis of the structural rules governing combinations.

First, the most common form of corporate combination is now the triangular merger.³¹ Its effect and purpose are to deny voting and appraisal rights to everybody. Although Eisenberg does not discuss the triangular merger, his examination of subsidiaries suggests that the existence of the subsidiary should be ignored.

Second, instead of engaging in a formal merger, corporations often acquire specific assets and assume specific liabilities. The economic implications of such a transaction are broader than the impact on stockholders. When the assets are acquired, the acquiring company's stock distributed to the acquired company's shareholders, and provision made for known liabilities, nothing remains to satisfy claims that may subsequently arise. Products liability claims are the most likely to be

29. See generally *Farris v. Glen Alden Corp.*, 393 Pa. 427, 143 A.2d 25 (1958).

30. Eisenberg, *supra* note 16, at 33.

31. See J. FREUND, *ANATOMY OF A MERGER: STRATEGIES AND TECHNIQUES FOR NEGOTIATING CORPORATE ACQUISITIONS* 79, 106-08 (1975).

asserted. Escape from subsequent liabilities is the result that the parties seek when they structure the transaction as a sale of assets. Because the social consequences of that result may be intolerable, some recent cases have ignored the form of the transaction and have dealt with liabilities as if a merger had occurred.³²

Third, the courts have encountered the argument that minority stockholders of a subsidiary are entitled to their share of the synergistic gains resulting from a merger with a parent, and not merely to the pre-merger value of what they surrendered.³³ This is a fundamental issue of fairness affecting the efficacy of the appraisal laws; the contention has not met with success.³⁴

Fourth, appraisal statutes have been cut back to apply in fewer situations as greater reliance has been placed on the market option for dissatisfied stockholders. At the same time, Delaware has eased the procedural obstacles in appraisal statutes.³⁵ The impact of these developments needs fresh assessment.

Fifth, courts have wrestled with the problem of whether a merger requires a valid corporate purpose, or whether a merger justifies itself.³⁶ The argument that some mergers are improper is increasingly made about mergers designed to eliminate minority ownership.³⁷ The Supreme Court's recent rejection of the applicability of federal law to such questions increases the importance of state corporation law.³⁸

Finally, Eisenberg considers the impact on the power distribution model of complex corporate organizations. He notes the recent trend to create "megasubsidiaries"—massive subsidiaries that own most of the assets of the parent and whose stock is owned principally or wholly by the parent. The distribution of voting power to the stockholders

32. Courts, in recent cases, have placed less emphasis on the form of the transaction and more on the policy served by products liability in determining whether the acquiring corporation will be liable for the previously unasserted claims against the acquired corporation. *E.g.*, *Knapp v. North American Rockwell Corp.*, 506 F.2d 361 (3d Cir.), *cert. denied*, 421 U.S. 965 (1974); *Cyr v. B. Offen & Co.*, 501 F.2d 1145 (1st Cir. 1974); *Ray v. Alad Corp.*, 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977); *Turner v. Bituminous Cas. Co.*, 397 Mich. 406, 244 N.W.2d 873 (1976).

33. See Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974).

34. *E.g.*, *Harriman v. E.I. DuPont de Nemours & Co.*, 411 F. Supp. 133, 154 (D. Del. 1975). *But see* *Mills v. Electric Auto-Lite Co.*, 552 F.2d 1239 (7th Cir. 1977).

35. Section 262(h) of the Delaware General Corporation Law, added in 1976, eased the cost burdens on a stockholder asserting appraisal rights. DEL. CODE tit. 8, § 262(h) (Supp. 1976).

36. *E.g.*, *Berkowitz v. Power/Mate Corp.*, 135 N.J. Super. 36, 342 A.2d 566 (1975).

37. See *Singer v. Magnavox Co.*, 422 SEC. REG. & L. REP. (BNA) E-1 (Del. 1977) and *Tanzer v. International Gen. Indus., Inc.*, 46 U.S.L.W. 2244 (Del. 1977), where the Delaware Supreme Court appeared to reach conflicting conclusions on this issue.

38. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977).

of the subsidiaries accomplishes nothing in restricting the power of management, since the manager of the parent casts the votes of the stockholders of the subsidiary.

To deal with the problem requires either a requirement that the parent's stockholders, instead of its board, decide how the parent votes its shares, or a pass through of the voting power from the subsidiary's stockholders to the parent's stockholders. Professor Eisenberg favors the pass through, at least in some cases—mergers, sale of assets, election of the subsidiary's board, and some amendments to the certificate of incorporation—in order to protect the interests of the minority stockholders of both the parent and the subsidiary. However, the case law Professor Eisenberg describes is not favorable to his position, and he advances a legislative solution to the problem.

As Eisenberg notes, the implementation of his model requires "significant statutory revision."³⁹ But by whom? He asserts that "it is still not too late to hope for action by the states,"⁴⁰ a hope that many do not share.⁴¹ And even Eisenberg does not dwell long on the prospects of state law reform. Instead, he points to possibilities of SEC rule-making, which would be confined to disclosures in, and access to, the proxy statement—a relatively small part of Eisenberg's normative package—and federal legislation. Although proposals have been made for federal minimum standards⁴² and federal chartering,⁴³ Eisenberg does not set out to solve the practical political problems that beset the implementation of his model. Strong criticism on this score, however, is probably unfair. His goal is not to present an alternative that is now politically feasible, but to set forth the model against which existing law and law reform should be measured.

The most significant omission in *The Structure of the Corporation* is suggested by Bayless Manning's description of corporation law:

[Corporation law is] hollow, empty, and largely devoid of policy content. It will not become again an area of significance and lose this hollowness until we reappraise in a very fundamental way what in the world it is we are trying to accomplish with it. I think we did more or less know what we were trying to do with cor-

39. P. 320.

40. *Id.*

41. Folk, *State Statutes: Their Role in Prescribing Norms of Responsible Management Conduct*, 31 BUS. LAW. 1031 (1976).

42. See, e.g., Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974).

43. See, e.g., R. NADER, M. GREEN & J. SELIGMAN, *CONSTITUTIONALIZING THE CORPORATION: THE CASE FOR THE FEDERAL CHARTERING OF GIANT CORPORATIONS* (1976); Schwartz, *A Case for Federal Chartering of Corporations*, 31 BUS. LAW. 1125 (1976).

poration law about 1840. It may not have been a very sensible thing we sought to do at that time, but we at least had a target and a philosophy. Since then, as far as I can see, it has all been downhill.⁴⁴

This continuing failure to give corporate law a policy content is serious, for as Professor Conard has observed, “[n]otwithstanding the pervasive intrusion of external government, corporation boards and executives still make most of the decisions which affect the welfare of consumers, employees, and the national economy.”⁴⁵

The Eisenberg model apparently proceeds on the premise that the law should protect stockholder interests by giving them greater power in some respects, by providing them with more effective watchdogs, and, of course, by utilizing fiduciary principles. But surely one major difference between close corporations and large corporations is the broad public impact of the latter’s activities, not only on investors but also on many others. To contend that corporation law ought to ignore the relationship of the corporate decisionmaking process to society and to rely solely on the market or direct government regulation to protect the public is to continue the insignificance of corporation law that Manning described.

Professor Eisenberg probably does not intend to present a model of corporate structure premised on a policy that corporation law should be concerned only with the private interests of investors. He acknowledges that his model must take into account the corporation’s relationship to society, but he fails to expand upon the effect that corporate structure can have on that relationship.

Professor Eisenberg’s policy premises are too muted. Clearly he is in favor of constraining the power of managers, but it is less clear whose interests he seeks to advance. He may be saying that all interests concerned with corporate behavior will be served if we are able to make managers less powerful and that this requires a convenient mechanism to make them accountable to someone else. The mechanism he uses is countervailing shareholder power. This would render shareholders symbolically powerful in order to protect their own interests and to act as surrogates for others. If this is his thesis, it needs amplification and analysis. If it is not, and if corporation law is to escape the opprobrium of Manning’s observation, some new theme must be developed.

44. ECONOMIC POLICY AND THE REGULATION OF CORPORATE SECURITIES 81 (H. Manne ed. 1969) (comment by Prof. Manning).

45. A. CONARD, *supra* note 22, at 318.

In Search of Corporate Soul

Legal analysis does not carry us far enough. The development of a policy for corporation law requires the utilization of other disciplines. History tells us that the corporation has been the vehicle for implementing changing economic and social goals.⁴⁶ The heart of any statement of policy must be that the legitimacy of the modern corporation rests both on its utility and its responsibility.⁴⁷ The question then remains whether the law can define the corporate structure to foster agreed social and economic policies.

The work of some social scientists suggests a strong relationship between the structure of the organization and the goals it seeks.⁴⁸ A special concern expressed by some of the social scientists is that the existing patterns of corporate behavior frustrate society's goals. Robin Marris writes that "unless we can develop a type of business organization whose stated and legitimate purpose is to create social benefit for society, while in the process creating a just income for its members . . . we shall suffer a conflict between national aims and business ethics."⁴⁹

A plan for structure, then, should begin with an understanding of what the lawmakers want to accomplish. The task is to develop strategies calculated to bring the social impact of the corporation within the internal control of the corporation. The still developing work of the social scientists illuminates for us, perhaps even more than the work of legal analysis, how corporate organizations function and consequently what legal models can achieve.⁵⁰ Only with an interdisciplinary approach can we channel the activities of the "soulless" corporation.

46. See, e.g., O. HANDLIN & M. HANDLIN, *COMMONWEALTH: A STUDY OF THE ROLE OF GOVERNMENT IN THE AMERICAN ECONOMY: MASSACHUSETTS, 1774-1861* (rev. ed. 1969).

47. See J. HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970* (1970).

48. K. ARROW, *THE LIMITS OF ORGANIZATION* (1974); O. WILLIAMSON, *CORPORATE CONTROL AND BUSINESS BEHAVIOR: AN INQUIRY INTO THE EFFECTS OF ORGANIZATION FORM ON ENTERPRISE BEHAVIOR* (1970). One legal writer who has displayed a firm grasp of the significance of organization is Professor Christopher Stone in his book *WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR* (1975). A forthcoming work by Professor John Coffee, *Beyond the Shut Eye-Sentry: Toward a Theoretical View of Corporate Misconduct and a Relevant Legal Response*, 64 VA. L. REV. (November 1977) (forthcoming), makes an important contribution.

49. Marris, *Conclusion*, in *THE CORPORATE SOCIETY* 392 (R. Marris ed. 1974).

50. E.g., Note, *Decisionmaking Models and the Control of Corporate Crime*, 85 YALE L.J. 1091 (1976).

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