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OVERVIEW

An Introduction to The American Law Institute's Corporate Governance Project

Melvin Aron Eisenberg*

The American Law Institute's Corporate Governance Project was formally initiated in 1978. Its background was described somewhat later by the President of the Institute, Roswell B. Perkins, in the Institute's news letter:

Questions have been asked, perhaps inferentially more than explicitly, as to why the ALI undertook this project and why at this time. . . . The most fundamental reason why the ALI undertook this Project is that the Institute tends to take very seriously the mission stated in its charter, namely:

. . . to promote the clarification and simplification of the law and its better adaptation to social needs. . . .

If one takes the mandate seriously, the question becomes: how could the ALI *fail* to undertake a project in the area of law governing those institutions on which our entire system of production of goods and services depends? A commitment to the health and vigor of the free enterprise system requires that the law as to governance of business associations be fully as efficient and effective as, for example, the law of contracts and the law relating to commercial transactions.

As to a rationale for the timing of this project, the answer is perhaps fourfold:

- (1) The project has a long history, and the timing of the emer-

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gence publicly of the first tentative draft has, in fact, no special significance.

(2) There can be no doubt that there has been in the last decade an extraordinary ferment of activity in the field of corporate governance, including, for example: (a) a degree of involvement of the Securities and Exchange Commission and of federal courts acting under the federal securities laws in issues of fiduciary duty which challenges the supremacy of state corporate law; (b) intense criticism of certain aspects of the governance of large corporations by those who would seek radical change, such as federalization of corporate law; (c) regulation by Congress of certain internal corporate matters, as exemplified by the accounting provisions of the Foreign Corrupt Practices Act of 1977; and (d) new developments in the business world involving control of corporations, such as the proliferation of hostile takeovers and the efforts of majority stockholders to eliminate minority interests. Accompanying the ferment, there has been a degree of uncertainty and inconsistency in the law which cries out for rational, dispassionate analysis and the development of guiding principles.

(3) The timing of a project which seeks to strengthen the institutional framework of our free enterprise system (including preservation of the fundamentally non-governmental methods of policing the internal workings of the system) should not be dictated by crisis. To those who do not perceive immediate threats to the system whereby corporations have traditionally been governed, one can safely say that the next crisis will not wait for objective study projects. The arguably hasty reaction of Congress manifested in some aspects of the Foreign Corrupt Practices Act surely demonstrates the need for challenging ourselves to address important problems with a continuity of concern rather than with a barometer-like reaction to the heightening or reduction of public pressures.

(4) Many other groups have been motivated to undertake partial statements of guiding principles, as is reflected, for example, in the Business Roundtable's statement entitled *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation* (January 1978); *Corporate Governance in America*, the final report of the 54th American Assembly (Arden House, April 1978); the publication of the *Corporate Director's Guidebook* by the Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association (1978); and the *Statement on Corporate Responsibility* recently issued by the Business Roundtable (October 1981). The same factors which stimulated these documents, to say nothing of an enormous tide of law review articles and legal symposia, are among the factors which gave rise to the ultimate launching of the ALI project. In brief, the ALI project is scarcely an isolated response; it is part of a virtual sea in motion.

I have referred to the long history of the project. William Draper Lewis, the first Director of the ALI, was extremely interested in corporation law. In 1923 there was a great debate within the Council of the Institute as to whether corporation

law should be an early subject for an ALI Restatement. General Wickersham took the view that it was impossible to write a Restatement for a subject that was so largely statutory. Judge Learned Hand said that, on the contrary, there were principles to statutes as well as to decisions and that such a project was entirely possible. The debate continued, and experimental drafts were presented for consideration, but World War II arrived without the successful development of a project. Dr. Lewis sought to revive the effort in the immediate post-War years. In 1945 he characterized (not artfully, but pungently) the field of law relating to business associations as "the most important almost entirely omitted field" so far as the coverage of the Restatements was concerned. The post-War revival of the project was never funded, however, and the launching of the current work became, in a sense, the third initiative of the Institute in the field.

The current effort began with a growing belief on the part of our present Director, Herbert Wechsler, in the course of the late 70's, that the time had come for a major effort in the field of corporate structure and governance and that such an undertaking would be a natural sequel to the ALI's work on the Federal Securities Code. In 1977 a committee designated by the President under the authority of the Executive Committee considered and supported the proposal for a project in this area. Then, in the years 1977 and 1978, four regional invitational conferences were convened throughout the country jointly by the ALI, by the Section of Corporation, Banking and Business Law of the ABA, and by the ALI-ABA Committee on Continuing Professional Education. The net result of these conferences was a strong consensus that the Institute should undertake a project in this field. Further impetus to the project was provided by a national invitational conference held in Williamsburg in March of 1980, which was cosponsored additionally by the New York Stock Exchange and attended by many of the nation's business leaders. Two ALI-ABA publications resulted from the conferences: *Commentaries on Corporate Structure and Governance* (1979) and *National Conference on Corporate Governance and Accountability in the 1980's* (1981). . . .

The project is, accordingly, not a reaction to any particular event, but rather a product very long in the gestation period. It is hoped that it will not be perceived by lay leaders in the corporate world as an effort in any sense hostile to the fundamental tenets of private ownership and operation of our business institutions. While trite, it is worth repeating that the best antidote to governmental regulation is effective voluntary regulation, and, further, that enhancing certainty in any area of the law tends to reduce costly litigation. Advice and counsel from all quarters of the business world will be most welcome to our Reporters, Consultants and Advisers. The ALI's capacity to pro-

vide intensive and objective analysis of a field, through an amalgam of the intellect, experience, and judgment of judges, professors, and practicing lawyers, should help to assure a worthy result.¹

From the outset, it was clear that the Corporate Governance Project would differ from most other ALI projects in its selectivity. Although most ALI projects cover a fairly well-defined subject in its entirety, the Corporate Governance Project was intended to cover only those aspects of corporation law that relate to corporate governance, or, to put it perhaps more accurately, only the most important aspects of corporate governance. To this end, the Project was divided into seven Parts: Definitions; Objective and Conduct of the Business Corporation; Structure of the Corporation; Duty of Care and the Business Judgment Rule; Duty of Loyalty; Transactions in Control; and Remedies.

It soon became apparent that the Corporate Governance Project would also differ from most ALI projects in the mixture of its formulations. Most ALI projects have been either addressed wholly to courts (Restatements) or wholly to legislatures (Model Codes). Corporation law, however, is peculiarly a mixture of statute, case law, and corporate practice — practice, not only in the sense of customary ways of doing things, but also in the sense of rules, such as certificate or by-law provisions, or resolutions, governing important aspects of corporate structure that are adopted voluntarily, through a process in which lawyers often figure heavily. The Corporate Governance Project had to include all three types of provisions if it was to address corporation law seriously. Accordingly, although most of its provisions are addressed to courts, principally in their role as adjudicators, but occasionally in their role as framers of judicial rules of procedure, some provisions are directed to legislatures, and a very few provisions, segregated into a separate subchapter and not set in traditional black letter, are addressed to corporations themselves, for voluntary adoption.

In December 1981, the Council of the Institute approved *Tentative Draft No. 1* of the Corporate Governance Project for submission to the 1982 Annual Meeting of the membership. *Tentative Draft No. 1* included most of Part I (Definitions), all of Part II (The Objective and Conduct of the Corporation), and much of Parts III (Structure of the Corporation), IV (Duty of Care and Business Judgment Rule), and VII (Remedies).

Institute projects are usually funded by outside sources — normally, foundations. When the Corporate Governance Project was funded, the Institute contemplated that it would be completed within three years, and the funding was granted in that context. Against that background, every effort was made to progress expeditiously. Many persons legitimately felt that progress had been too swift — more particularly, that there had not been adequate

1. Perkins, *The President's Letter*, 4 A.L.I. REPORTER 1 (1982).

consultation with groups outside the Institute — and objected to a vote on *Tentative Draft No. 1* for that reason. Some objected, for other reasons, to the whole idea that the Institute should have a Corporate Governance Project. In response to concerns that the issues raised by *Tentative Draft No. 1* were too important to put to membership votes without the opportunity for more more extensive comment, a decision was made to submit *Tentative Draft No. 1* to the 1982 Annual Meeting for discussion only.

Based on that discussion, together with extensive consultation that occurred after the 1982 Annual Meeting within and without the Institute, much of the material in *Tentative Draft No. 1* was extensively reformulated. In 1984, two new tentative drafts were issued. *Tentative Draft No. 2*, consisting of Part I (Definitions), Part II (The Objective and Conduct of the Business Corporation), and Part III, Chapter 1 (Structure of the Corporation — Administrative Organs, Senior Executives, and Directors), was approved by the Council for submission to the 1984 Annual Meeting. The Council also ordered that Part IV (Duty of Care and the Business Judgment Rule) and most of Part V (Duty of Loyalty) be published as *Tentative Draft No. 3* with the legend, “The Council’s consideration of Parts IV and V has not been completed pending further comments, and the Council, therefore, does not propose that there be action by votes on these Parts at the 1984 Annual Meeting.” Although the new tentative drafts did not wholly overlap *Tentative Draft No. 1*, in practice they superseded that draft.

Parts II and III of *Tentative Draft No. 2*, together with the related definitions in Part I, were submitted to the ALI membership on May 18, 1984. The President opened consideration of the draft by stating that, in order to be sure the membership would have an opportunity to revisit Parts II and III, the Council would bring those Parts back to the membership at some point during the course of the next three annual meetings. He added that the Council hoped that on resubmission the focus would be on points that: (i) had emerged as a result of the interplay between Parts II and III and subsequent Parts of the Project; (ii) had emerged from new statutes, judicial decisions, probing legal or empirical factual analyses, or other developments that might be deemed significant to the Institute’s deliberations concerning evolving legal principles; or (iii) could be classified as matters that had been overlooked or misapprehended.

During the one day allotted to consideration of *Tentative Draft No. 2*, the membership was able to consider only section 2.01 (which comprises all of Part II), and sections 3.01 and 3.02. All three sections were overwhelmingly approved on the tentative basis customary for Institute projects, subject to certain changes ac-

cepted by the Reporter on the floor, to the Reporter's consideration of other comments made on the floor, and to the revisit promised by the President at the outset of the meeting.

The Reporters' present hope is that the balance of Part III, as well as Part IV, will be brought to a tentative vote at the Institute's 1985 annual meeting, and the remaining Parts will be considered over the following two to three years. Under this schedule, the Project would be completed by 1987 or 1988.