FOREWORD

Bringing Managers "To Book"

*Robert W. Hillman**

The year was 1967. Judicial expansion of federal securities laws was in an early stage. The Williams Act was still a year away from enactment. Insurance carriers competed to write policies protecting officers and directors. Lawyers were in short supply and generally unfamiliar with poison pills, shark repellents, and golden parachutes. Efficient markets meant prompt execution of buy and sell orders. The University of California, Davis School of Law had yet to graduate a class. And Dan Dykstra, a respected educator and member of the new law faculty at U.C. Davis, commented on derivative actions:

> Given the complex and sophisticated world in which corporations must operate, centralization [of decision-making] is understandable and necessary. Merely because centralization of decision making is understandable and necessary, however, does not mean that it can, or should, be ignored. How the decision-making power is used is important to each of us, and may well turn on the extent to which those who wield the power must account for its use.
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> It is in the context of such accountability that we must view the derivative suit. That management has largely escaped ownership control should not lessen its responsibility to shareholders, nor should it obviate the need to explain and justify its conduct. Rather, the contrary is true, *for as ownership's voice recedes, the need for vigilance increases, and accompanying that vigilance must be the means to bring "to book" those who misuse their power.*[1]

He concluded:

> It is unlikely that those who control corporate property and policy will ever again be permitted the freedom of an earlier era. It may be a mistake,

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[1] Dykstra, *The Revival of the Derivative Suit*, 116 U. PA. L. REV. 74, 81 (1967) (emphasis added).

> therefore, either to erect additional hurdles to the bringing of stockholders' suits or to fortify present ones. If such action is taken, alternative controls will certainly be created. Can anyone doubt that such alternative controls will take the form of federal government actions?[2]

The alternative controls in the form of federal regulation have certainly developed in the nearly twenty years since Dan Dykstra made these observations.[3] The change has been both dramatic and traumatic.[4] We can question, however, the effectiveness of federal and state controls in bringing managers who misuse power "to book." Directly or indirectly, most of the contributions to this symposium honoring Dan Dykstra raise just this issue.

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[2] *Id.* at 101.

[3] Regulatory "partnerships" between the federal and state governments troubled Dan in another context — the control of natural resources:

> [The history of the building of a Wisconsin railroad] clearly illustrates that a partnership between the state and federal governments for the control of natural resources cannot be created merely out of good intentions or pious talk. It reveals that a partnership by its nature is based on divided authority, and divided authority if not geared to common objectives and clearly defined methods means total ineffectiveness if not utter chaos. It further shows how easily the power and importance of special interest groups may be overlooked, purposely or otherwise, by governments engaged in petty jurisdictional disputes. It finally portrays how certain groups are ever alert to take advantage of conflicts in authority and how effective they are in playing one source of power against the other for their own advantage.

Dykstra, *Federal Government, State Governments and Natural Resources*, 37 MINN. L. REV. 569, 584-85 (1953).

[4] The judicial development of § 10(b) of the Securities Exchange Act of 1934 is best described as confused and inconsistent. This has not bothered Dan. With characteristic wisdom and patience, he offered the following comments in 1971:

> These opinions reflect that courts are increasingly cognizant that the reliance requirement, unless carefully used, can constitute an unreasonable hurdle to the effective application of section 10(b) and rule 10(b)-(5). Many will argue that this elastic approach contributes to the basic problem which now surrounds such actions — the inability to define the limits of liability. That such an argument has validity cannot be denied. The desire to articulate a limiting doctrine, however, should not entice the courts toward arbitrary solutions, nor must we settle for concepts whose only virtue is their ease of application. While it is my personal opinion that eventually the most effective area for line-drawing will be found on the basis of a scienter requirement, it is essential to remember that the battlegrounds on which 10(b) and 10(b)-(5) are being fought are complex and significant, and that for the moment wisdom may continue to lie in the case-by-case unfolding of these complexities.

Dykstra, *The Battle Grounds of 10(b)-(5)*, 1971 UTAH L. REV. 297, 306-07.

Alfred F. Conard, Henry M. Butzel Professor Emeritus at the University of Michigan, has contributed a great deal over the years to the debate on corporate reform. In "Theses for a Corporate Reformation," he offers a broad view of the subject and examines five "diseases that sap the efficiency of corporations as social instruments": (1) abuses of control by corporate managers; (2) directors' liability for negligence; (3) creditors' inability to penetrate the corporate entity; (4) state laws barring suits by unadmitted out-of-state corporations; and (5) the primacy of shareholder enrichment as the principal objective of business corporations.

Professor Conard's suggestions for reform are sweeping. He challenges reliance upon "disinterested" director approval of transactions in which managers have a conflict of interest, urges a more active role for institutional investors, reexamines director liability based upon negligence, questions use of corporate entities to defeat claims of creditors, proposes a national registry of corporations, and criticizes the primacy of shareholder wealth maximization as a corporate objective. As a means of implementing needed reform, Professor Conard proposes federal legislation to address the problems that escape effective state regulations.

Ted J. Fiflis, Professor of Law at the University of Colorado, explores further this issue of the relative roles of state and federal regulation. In "Of Lollipops and Law — A Proposal for a National Policy Concerning Tender Offer Defenses," Professor Fiflis considers the timely subject of tender offer defenses. He questions the assumption that states should establish national policy in the international securities markets and suggests the development of national policies to replace state regulation in this area. To implement this reform, Professor Fiflis proposes a relatively simple amendment to the Securities Exchange Act of 1934 that would provide the Securities and Exchange Commission with significant rulemaking authority.

William K.S. Wang, Professor of Law at the Hastings College of Law, challenges a critical assumption underlying the federal regulation of securities trading. In "Some Arguments That the Stock Market is Not Efficient," Professor Wang questions stock market efficiency from both "information-arbitrage" and "fundamental valuation" perspectives. Professor Wang provides numerous examples of mispricing. An inefficient market, Professor Wang observes, casts doubt on the thesis that takeovers benefit society and calls into question freezeouts at above-market prices. If, as Professor Wang suggests, markets do not provide efficient pricing mechanisms, regulatory policy is affected and widely held assumptions must be reexamined.

In "Meaning, Reference and Reification in the Concept of a Security," Williamson B.C. Chang, Professor of Law at the University of Hawaii, addresses one of the most important questions in the field of corporate law: the definition of a "security." It should try the patience of all, even Dan Dykstra, that fifty years after the passage of comprehensive federal securities regulation confusion remains about the circumstances under which the regulatory scheme applies. Professor Chang carefully evaluates the extensive and tangled case law on this subject. His suggested two-tier approach to defining a security helps clarify this murky area of the law.

As Dan observed in 1967, derivative actions are an important means of bringing managers "to book" for misusing power. In "Demand in Derivative Actions: Problems of Interpretation and Function," Deborah A. DeMott, Professor of Law at Duke University, explores some of the "problematic features" of demand requirements in derivative litigation. Professor DeMott criticizes courts for their inability or unwillingness to interpret correctly statutes and rules governing this prerequisite to derivative litigation. She outlines carefully the purpose of requiring demand on directors or shareholders and suggests the "unnecessary ambiguity in the development of the law of demand" is attributable to divergent judicial views of derivative litigation's desirability.

The theme of bringing managers "to book," expressed in many of the articles now published in Dan Dykstra's honor, is the principal issue of corporate law today. Dan's interests as a scholar and teacher, however, are not limited to this one aspect of corporate governance. He has made significant contributions to corporate law literature on the subjects of close corporations and reform of state law.[5] Through painstaking historical research, he has reminded us that corporations existed prior to the Securities Act of 1933 and that experiences of the last century may have meaning today.[6] Throughout these carefully developed articles, Dan displays the common sense and good judgment that make him a "scholar" in the finest sense of the word.

Dan is also a man of principle. Perhaps the best evidence of this is found in his article on "the right to be left alone."[7] Today's students

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[5] *See, e.g.*, Dykstra, *Gaps, Ambiguities and Pitfalls in the Utah Corporation Code*, 4 UTAH L. REV. 439 (1955); Dykstra, *Molding the Utah Corporation: Survey and Commentary*, 7 UTAH L. REV. 1 (1960).

[6] *See, e.g.*, Dykstra, *Corporations in the Day of the Special Charter*, 1949 WIS. L. REV. 310, 492; Dykstra, *The History of a Legislative Power Struggle*, 1966 WIS. L. REV. 402.

[7] *See* Dykstra, *The Right Most Valued by Civilized Man*, 6 UTAH L. REV. 305 (1959). The article was cited in Justice Douglas' concurring opinion in Gibson v. Flor-

cannot imagine the degree of popular support during the 1950's for loyalty oaths and investigations. As Dean of the Utah Law faculty, Dan took a firm and reasoned stand against government loyalty programs. Dan's article, which is often cited in opinions and commentary, displays his characteristic ability to apply lessons from the past to the present.

As all who know him will attest, Dan is valued for much more than his writing. He is one of the few people who is both universally liked and respected. He is revered as a leader, a teacher, a colleague, and a friend. We hope Dan will not take his retirement too seriously and will continue to play an active role in the Law School. His presence benefits all of us.

Dan's comments on uncertainty in the law serve as an apt transition to the articles now published in his honor:

> This brings me to my final observation, an observation already suggested, namely, that as of the present limits of a 10b-5 action are impossible to ascertain. There are factors of significance, to be sure — for example, materiality, reliance, scienter, and privity — but no precise rules or limits.
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> The lack of precision should not be a cause for undue alarm, particularly for lawyers trained in a common law system, a system geared to a case to case development, a system in which the limits are hammered out over a period of time. Our real concern should be to see that the hammering out proceeds in an orderly fashion, evidencing a high sense of judicial statesmanship and an appropriate regard for all elements in our economy.[8]

Let us now see if the managers can be brought "to book."

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ida Legislative Committee, 372 U.S. 539, 569 n.7 (1963).

[8] Dykstra, *Civil Liability Under Rule 10b-5*, 1967 UTAH L. REV. 207, 221.