Dodd-Frank and Board Governance: New Political-Legal Risks to Monetary Policy and Business Judgments?[†]

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Abstract

While Dodd-Frank promises to better govern U.S. financial markets, it also creates new political-legal risks. We consider a particular set of risks here, and their implications for legal, financial, and business strategy.

1. By weakening the voice of inflation-averse commercial bankers in nominating Federal Reserve District Bank presidents, Dodd-Frank risks shifting the center-of-gravity in monetary policy meetings toward a more accommodative stance.

2. Through theoretically related channels, the Act's weakening of "director primacy" in corporate governance may favor shareholders at the *expense* of other stakeholders, shrinking corporate wealth to benefit one interest over others (rather than reducing agency costs to improve business performance more generally).

In short, increased accountability risks tipping policy toward stakeholders who benefit more from negative-sum redistributions than increased productivity. Appreciating how this common risk can impact seemingly unrelated dimensions of governance should, we think, help professionals in organizational planning, risk management, and proxy advising more consistently succeed in the new institutional setting that Dodd-Frank created, as well as others that will likely evolve from administrative and case law developments.

Keywords: Dodd-Frank, financial regulation, director accountability, Federal Reserve, corporate governance, political-legal risk, non-market strategy

Signed into law by President Obama on July 21, 2010, the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (H.R. 4173)[1] has been characterized as the most sweeping change to financial services regulation since the Great Depression.[2] It promises to significantly strengthen financial market performance by:[3]

1. Improving accountability and transparency;
2. Protecting taxpayers from paying for bailouts; and
3. Protecting consumers from abusive practices.

Working toward these promises, however, the Act includes almost 1,000 pages,[4] and is thus almost certain to create risks (intended or not) of weakening economic performance on important margins. Dodd-Frank's reform of board-governance in both the Federal

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[1] Following the President's signing of enrolled bill (H.R. 4173), which passed the House and Senate, the Dodd-Frank Wall Street Reform and Consumer Protect Act [hereinafter Dodd-Frank Act] became Pub. L. 111-203, 124 Stat. 1376 (2010).

[2] A prominent law firm's summary, for example, argues that "The Act marks the greatest legislative change to financial supervision since the 1930s." Davis Polk & Wardell, *Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, DAVISPOLK.COM, July 21, 2010 (last visited July 22, 2010). Reporters from the *Wall Street Journal* similarly characterize the Act as "the biggest expansion of government power over banking and markets since the Depression." Damian Paletta & Aaron Lucchetti, *Law Remakes U.S. Financial Landscape*, WALL STREET JOURNAL, July 16, 2010, http://online.wsj.com/article/SB10001424052748704682604575369030061839958.html (last visited Sept. 27, 2010).

[3] The Act promises "To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, [and] to protect consumers from abusive financial services practices." Dodd-Frank Act, Preface.

[4] The enrolled bill (H.R. 4137) contains 848 pages. However, popular reports characterize the Act as containing over 2,000 pages. In addition to arguing that Dodd-Frank "affects almost every aspect of the U.S. financial services industry," for example, William Sweet observed that the Act "spans over 2,300 pages". Posting of William Sweet The Harvard Law School Forum on Corporate Governance and Financial Regulation to http://blogs.law.harvard.edu/corpgov/2010/07/21/dodd-frank-act-becomes-law/ (July 21, 2010, 11:49 AM). Paletta and Lucchetti, among others, have also cited the Act's large number of pages, which may effectively grow from numerous administrative rules that will likely be created under Dodd-Frank. Paletta & Lucchetti, *supra* note 2.

Reserve System and public corporations, for example, seemingly works toward the goal of "improving accountability and transparency", but *risks institutionalizing more inflationary monetary policy and less productive business judgments*. Our article attempts to explain the nature of these risks in an accessible but scientifically sound manner, and considers implications for professionals in organizational planning, risk management, and proxy advising.

We argue from the academic literature that, by weakening the voice of inflation-averse commercial bankers in nominating the Fed's District Bank presidents, Dodd-Frank risks shifting the center-of-gravity in monetary policy meetings toward a more accommodative stance.[5] And through qualitatively similar channels, also examined in the literature, the Act's weakening of "director primacy"[6] in corporate governance may favor shareholders at the expense of other stakeholders (e.g., bond holders) rather than reduce managerial agency costs in a way that improves business performance more generally. Finally, while Dodd-Frank's enactment may be too recent for these hypothesized risks to have been

[5] One channel through which pivotal votes in monetary policy meetings may shift is Reserve Bank-requests to increase the "discount rate" – i.e., interest that the Fed charges for loans to member commercial banks. "If a relatively large number of Reserve Banks request an increase in the discount rate, this would suggest potential support among those presidents for an increase in the federal funds rate at the upcoming FOMC [monetary policy] meeting. This hint of wider support for a tightening, in turn, can give leverage during the pre-FOMC discussions to a governor . . . who preferred to tighten". LAURENCE H. MEYER, A TERM AT THE FED: AN INSIDER'S VIEW 52 (HarperCollins Publishers 2004). By shifting the franchise for electing District Bank presidents away from inflation-averse commercial bankers, Dodd-Frank may reduce (holding other considerations constant) the number of Reserve Banks requesting an increase in the discount rate, and thus institutionally weaken pressure to "tighten" the Fed Funds rate. Consistent with such channels being empirically important, there is evidence that District Bank presidents prefer significantly tighter monetary policy than do Federal Reserve Board governors. Dino Falaschetti, *Does Partisan Heritage Matter? The Case of the Federal Reserve*, J.L. ECON. & ORG. 488–510 (2002).

[6] Stephen Bainbridge (2002) coined the term "director primacy" to refer to the deference that U.S. corporate law has historically given the business judgments of boards. STEPHEN M. BRAINBRIDGE, CORPORATION LAW AND ECONOMIC 192-240 (Foundation Press 2002).

realized, evidence from historically comparable political-legal arrangements suggests that our concerns are more than academic. Professionals in law, finance, and business may thus benefit from starting now to gauge exposures to these new non-market risks and develop strategies to succeed in a rapidly evolving institutional environment.

The remainder of our article offers a more thorough consideration of how Dodd-Frank creates these risks, as well as principles for productively addressing them. It begins by highlighting organizational features of the Fed that have tended to create a low-inflation business environment. It then reviews evidence that this stability, rather than being constant, is sensitive to the ability of politicians (both Democrat and Republican) to influence monetary policy for short-term electoral advantage. Here, we see a Federal Reserve System that historically offered District Bank presidents relatively thick insulation from these pressures,[7] as well as evidence that presidents pushed harder against inflationary policies than did their more politically exposed colleagues on the Federal Reserve Board of Governors.[8] Finally, we highlight how, by lowering this organizational firewall between District presidents and political pressures to which Fed Governors have been more immediately exposed, Dodd-Frank may institutionally increase the U.S. monetary authority's inflation-bias.

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[7] Former Governor of the Federal Reserve Board, Laurence Meyer, argues that this historical "structure is designed to protect the independence of the [monetary policy committee] by balancing the politically appointed governors and the Reserve Bank presidents selected outside of the political process." MEYER, *supra* note 5, at xiii.

[8] Former FRB Governor Meyer offers an interesting anecdote consistent with this more rigorous evidence, noting how willing several District Bank presidents (from Richmond, San Francisco, Chicago, Boston, and Kansas City) were to disagree on the record with then Chairman Greenspan's more accommodative policy view – "I was surprised to see the Reserve Bank presidents so openly laying their cards on the table. They were not afraid to challenge the Chairman." *Id.* at 39.

We then turn to similar changes in how corporate boards will be governed under Dodd-Frank. In addition to altering who has a voice in managing the Fed, the Act strengthens the ability of shareholders in public corporations to propose strategic, operational, and managerial changes, and even gives shareholders a more direct say on certain management decisions. Popular characterizations of this part of the Act point to the benefits of tightening constraints on runaway managers. But rather than increasing accountability so that business performance *generally* improves, arrangements like these have sometimes allowed shareholders to take a larger piece of a shrinking corporate pie – i.e., benefit themselves at the *expense* of other stakeholders (e.g., employees, bondholders) rather than in a mutually beneficial manner.

While these risks may appear different on their surfaces, they emerge from the common insight that *increasing accountability cannot offer a free lunch* – rather, doing so necessarily risks tipping the scales toward stakeholders who can benefit more from negative-sum redistributions than increased productivity. Understanding the general nature of this risk can equip legal, financial, and business professionals to more consistently succeed in the new institutional setting that Dodd-Frank created, as well as others that will emerge from follow-on developments in administrative and case law.

Can Dodd-Frank Institutionalize Increased Inflation?

Presidents of the Federal Reserve's District Banks have played a peculiar role in the making of U.S. *public* policy – i.e., they have historically been nominated by *private* sector bankers to represent the interests of fellow bankers in monetary and other policy decisions. Pointing to this unusually direct role for private interests, lawmakers have long criticized District presidents as lacking the necessary accountability to make good public policy.[9]

Dodd-Frank decisively addresses this criticism. Under the Act, District presidents will be nominated by their Class B directors (who are, in turn, elected by a Districts' member banks to represent the public) and Class C directors (who are, in turn, appointed by the Board of Governors to represent the public).[10] Class A directors, who are nominated by member banks to represent member banks, will no longer vote for District presidents.[11]

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[9] James L. Pierce, *A Case For Monetary Reform*, AMER. ECON. REV. 246–50 (May 1979) offers illustrative examples of this type of criticism.

[10] Under Title XI (Federal Reserve System Provisions), Section 1107 (Federal Reserve Act Amendments on Federal Reserve Bank Governance), Dodd-Frank amends the Federal Reserve Act of 1913 so that "The [District Bank] president shall be the chief executive officer of the bank and shall be appointed by the Class B and Class C directors of the bank, with the approval of the Board of Governors of the Federal Reserve System, for a term of 5 years; and all other executive officers and all employees of the bank shall be directly responsible to the president." *See* Dodd-Frank Act §1107. In addition, under Section 1109 (GAO Audit of the Federal Reserve Facilities; Publication of Board Actions), Sub-section (b) (Audit of Federal Reserve Bank Governance) requires as part of this Title's audit of the Fed an examination of whether "the current system of appointing Federal reserve bank directors effectively represents 'the public, without discrimination on the basis of race, creed, color, sex or national origin, and with due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor, and consumers' in the selection of bank directors, as such requirement is set forth under section 4 of the Federal Reserve Act". *See* 12 U.S.C. § 302 (2006).

[11] "The Act removes the authority of member banks' representatives (Class A directors) to vote for the President of the Federal Reserve Banks." Paletta & Lucchetti, *supra* note 2.

But by changing who can vote for District presidents, Dodd-Frank may lower a historically important firewall against inflationary pressures. Commercial bankers are interested in low inflation – after all, their assets are loans, the value of which decreases with the prospect of being paid back with a weaker currency. Moreover, formal institutions already hold other members of the Fed's monetary policy committee (i.e., FRB Governors) more "accountable",[12] and these members have historically favored significantly looser monetary policy than have District presidents.[13] In light of this firmly grounded theory and considerable evidence, Dodd-Frank's reform of how District Bank presidents are nominated appears to risk an increase the (political) equilibrium level of U.S. inflation.

The Fed's Historical Organizational Structure Offered District Presidents Considerable Insulation from Political Pressures for Inflation

To appreciate this risk more fully, it is instructive to understand a widely held proposition in economic science – i.e., a central bank's independence (CBI) strengthens price stability. Surveying the literature on how this political independence relates to economic performance, for example, Allan Drazen (2000) finds considerable agreement that (1) CBI consistently shares a negative correlation with inflation (i.e., more independence is associated with less inflation, and this association is evident across both time and

[12] Indeed, proponents of increasing District president accountability have long argued that the appointment process should look more like that of Federal Reserve Board Governors. *E.g., see,* Pierce *supra* note 9.
[13] *See* Falaschetti, *supra* note 5 at 488–510; DINO FALASCHETTI, DEMOCRATIC GOVERNANCE AND ECONOMIC PERFORMANCE: HOW ACCOUNTABILITY CAN GO TOO FAR IN POLITICS LAW AND BUSINESS 52-60 (Springer-Verlag (2009); DINO FALASCHETTI & MICHAEL J. ORLANDO, MONEY, FINANCIAL INTERMEDIATION, AND GOVERNANCE 109-11 (Edward Elgar Publishing 2008).

countries), and (2) this source of price stability does not appear to increase the volatility of business cycles.[14]

But why should it be possible for an "unaccountable" central banker to make more productive monetary policy, and what do good answers to this question imply for expected inflation following Dodd-Frank? To address the first question, consider the politics of paying for public goods and services. To the extent this decision mimics that of households, a politician is constrained to collecting taxes or asking for loans – i.e., paying cash or using credit cards. Either alternative, however, is likely to impose considerable costs on voters, or become infeasible if the goods or services being considered show little promise of increasing productivity.[15] But unlike households, "publics" can also print money, which can be a politically attractive alternative if, for example, voters tend to be borrowers rather than lenders. And through distributive channels like these, pressures appear to regularly exist for "accountable" central banks to reject policies that would efficiently foster price stability and instead adopt inflationary policies that distribute enough of a shrinking economic pie to pivotal constituents.

This type of argument has led economists to believe that monetary policy tends to improve when, paradoxically, political institutions insulate central bankers from

[14] *See* ALLAN DRAZEN, POLITICAL ECONOMY IN MACROECONOMICS ch.5 (Princeton University Press 2000).
[15] *See* Dino Falaschetti, *When Deficits Make Sense*, HOOVER DIGEST 72–75 (2008).

democratic pressures.[16] In a series of influential papers, for example, Kenneth Rogoff showed how delegating monetary authority to a 'conservative' banker (and institutionally cementing that delegation) fulfills this prescription in principle.[17] And by giving inflation-averse commercial bankers a relatively strong voice in monetary policy, the historical organization of the Federal Reserve System may have incorporated this democratically unpopular (but perhaps economically efficient) prescription into practice. Indeed, consistent with this theory, District Bank presidents have exhibited a significantly stronger preference in monetary policy meetings for low-inflation policies than have Governors of the Federal Reserve Board (who are nominated by the President of the United States rather than commercial bankers).[18]

Dodd-Frank weakens inflation-hawks in nominating the Fed's District Presidents

By formally disenfranchising Class A directors, Dodd-Frank may succeed in making District Bank presidents "more accountable", but at the expense of weakening the voice of traditional inflation-hawks in U.S. monetary policy. And while this implication draws from a relatively well-understood institutional risk to economic performance, the political

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[16] *But see* Adam Posen, *Why Central Bank Independence Does Not Cause Low Inflations: There Is No Institutional Fix for Politics*, 7 FINANCE AND THE INT'L ECON. 40–65 (Richard Brian ed., Oxford University Press 1993); Adam Posen, *Declarations Are Not Enough: Financial Sector Services of Central Bank Independence*, NBER MACROECONOMICS 253–74 (Ben Bernacke and Julio Rotemberg eds., Cambridge: MIT Press 1995); Adam Posen, *Do Better Institutions Make Better Policy?*, INT'L FINANCE 173–205 (1998). Adam Posen argues that CBI may simply reflect deeper societal forces (e.g., those associated with the distributional consequences of inflation). *See id.*

[17] "Society can sometimes make itself better off by appointing a central banker who does not share the social objective function." Kenneth Rogoff, *The Optimal Degree or Commitment to an Intermediate Monetary Target*, Q. J. OF ECON. 1169–1189 (1985); Kenneth Rogoff, *Reputational Constraints on Monetary Policy*, CARNEGIE-ROCHESTER CONFERENCE SERIES ON PUBLIC POLICY 141–181 (Karl Brunner & Allan Meltzer eds., North-Holland Publishing Company 1987).

[18] *See* citations accompanying *supra* note 13.

attractiveness of such proposals exhibits a remarkable durability. Proceedings from the 1979 meeting of the *American Economic Association*, for example, observe that "many proposals have been made over the years" to put more distance between private-sector directors of the District Banks and District presidents who formally participate in the making of public monetary policy.[19]

Throughout its development, important parts of Dodd-Frank appear to have received a strong push to act on such enduring calls. Senator Christopher Dodd (D-CT), for example, proposed making the New York District president a de facto eighth Governor of the Federal Reserve Board and, moreover, silence the formal voice of *anyone* supervised (presently or previously) by the Fed in nominating District Bank presidents.[20]

But while such changes can appear to address reasonable calls for increased accountability, the research cited above suggests they also risk institutionalizing an increase in the Fed's inflation-bias. Because commercial banks lend money, the purchasing power of which fluctuates with monetary policy, they have a pecuniary interest in low-inflation. The Federal Reserve Act, in turn, long gave these banks'

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[19] Pierce, *supra* note 9, at 247. Those proceedings also describe Senator William Proxmire's letter, introduced to the Senate Banking Committee in 1978, which argues that "The accountability of the Reserve Bank presidents should be established if they are to continue to have a say in monetary policy." *Id.* at 246. And to put this principle into law, the proceedings further argue that "The stock of the Reserve Banks should be retired (purchased from member banks) and the boards of directors eliminated. *Reserve Banks should become purely governmental entities*." *Id.* at 250 (emphasis added).

[20] "As part of a new bill aimed at revamping financial regulation after the worst banking crisis since the 1930s, Senator Christopher Dodd's plan gives the president [of the United States] the power to name the head of the most important regional Fed bank… Dodd's proposal would [also] ban any past or current officer, director or employee of a firm supervised by the Fed from sitting on any of the regional Fed bank

management a strong say in the presidency of District Banks. Weakening the voice of commercial banks in this process, and transferring it to the President of the United States, would have traded a set of inflation-hawks from the nominating process for elected politicians that theory and evidence agree are less averse to inflation.[21] And by closing a direct channel through which commercial bankers have historically influenced the nomination of District presidents, Dodd-Frank's final version can similarly increase inflation risks.

Will Dodd-Frank Productively Constrain Managerial Agency Costs, or Inefficiently Facilitate Shareholder Opportunism?

In addition to addressing board-governance in the Federal Reserve System, Dodd-Frank also reforms the governance of directors in public corporations.[22] Of particular interest for our purposes is the Securities and Exchange Commission's (SEC) authorization under the Act to (i) ease shareholder access to corporate proxies,[23] and (ii) require corporations to give shareholders a non-binding "say-on-pay".

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boards." Kristina Cooke, *Presidents Would Tap NY Fed Chief Under Dodd Bill*, REUTERS.COM, Mar. 15, 2010, http://www.reuters.com/article/idUSTRE62E51H20100315 (last visited Sept. 27, 2010).

[21] *See* citations accompanying *supra* note 13.

[22] *See, e.g.*, Kara Scannell, *SEC Set To Open Up Proxy Process*, THE WALL STREET JOURNAL.COM, Aug. 5, 2010 (2010), http://online.wsj.com/article/SB10001424052748704741904575409680246527908.html (last visited Sept. 27, 2010).

[23] While diffusing the ownership of corporations can ease access to financial capital, it can also encourage shareholders to shirk in monitoring management, since any particular (diffuse) shareholder's monitoring is unlikely to be pivotal. In other words, a "collective action problem" (and perhaps more) can discourage diffuse shareholders from productively governing corporate management. To the extent that other stakeholders benefit from corporate policy, they might thus attempt to organize shareholders by formally requesting permission to cast votes as a "proxy". Dodd-Frank reforms how the Securities Act of 1934 and

Proxy Access

Under Dodd-Frank's Subtitle G (Strengthening Corporate Governance), Section 971 (Proxy Access) authorizes the SEC to require management of registered companies to include shareholder-nominated directors on any "ballot" presented to shareholders via proxies or related solicitations.[24] In addition, Dodd-Frank authorizes the SEC to require registered corporations to pay for expenses associated with letting outside shareholders access the corporate proxy, an authorization upon which the SEC promptly acted.[25]

Executive Compensation

Dodd-Frank also enfranchises shareholders to directly cast a (formally) non-binding vote on whether their management's compensation program is agreeable. In particular, Section 951 ("Shareholder Vote on Executive Compensation Disclosures") amends the Securities Exchange Act of 1934 by, among other things, inserting after Section 14 of the Exchange Act a requirement that shareholders "vote to approve the compensation of executives" at least once every three years,[26] and to vote on the frequency of this 'say-on-pay' at least once every six years.[27] Similarly, Section 951 (b) gives shareholders a non-binding say on executive compensation when fundamental transactions (i.e., transactions

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associated administrative rules have heretofore governed this solicitation, strengthening the ability of non-management (dissident) shareholders to proxy for others in shareholder-votes.

[24] *See* Dodd-Frank Act, § 971(a)(2).

[25] On August 25, 2010, about a month after Dodd-Frank became law, the SEC approved a rule that "would require companies to print the names of shareholder board nominees directly on corporate ballots if certain conditions are met." Jessica Holzer & Fawn Johnson, *SEC Makes Ousting Board Members Easier*, THE WALL STREET JOURNAL.COM, Aug. 26, 2010, http://online.wsj.com/article/SB10001424052748703632304575451572616571774.html (last visited Sept. 27, 2010).

[26] *See* Dodd-Frank Act § 951(a)(1).

[27] *See* Dodd-Frank Act § 951(a)(2).

that change control of the corporation or sell a substantial portion of the corporation's assets) require shareholder approval.[28]

Does Dodd-Frank Risk Pushing Shareholder-Democracy too Far?

Here, again, we find new political-legal risks emerging from provisions that, at least on their face, appear to simply enable principal-stakeholders (shareholders in this case) to more productively monitor managerial agents. A better story, we think, is that accountability can go too far at any level of organizational governance - e.g., the federal and corporation levels.[29] Indeed, rather than promising to address agency problems in a productive manner, Dodd-Frank may simply relocate those problems in a manner that benefits politically attractive constituencies.[30] And appreciating the nature of this dynamic may become increasingly important for legal, business, and financial professionals as Dodd-Frank's immediate institutional changes evolve through the Act's numerous opportunities to develop administrative rules.

As our introductory comments note, making agents more accountable to their principals hardly offers a free lunch. Doing so in a corporate setting, for example, risks changing distributional pressures on revenues, and thus altering other stakeholders' incentives.

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[28] Notice that this de jure non-binding "say on pay" can turn into a de facto binding say. Management's dismissal of shareholders' "say" could, for example, weaken shareholders' requirement to demand a remedy from the board before bringing a derivative suit, and thus considerably lower an important procedural hurdle to shareholder suits. Faced with an increased probability of such suits, the willingness of directors to accept even non-binding shareholder votes may thus increase. Even more, any pressure to accept formally precatory proposals could discourage the search for and acceptance of efficient control transactions in the first place.

[29] *See* FALASCHETTI, DEMOCRATIC GOVERNANCE, *supra* note 13 (offering a book-length examination of this hypothesis).

Bond market participants, for example, may demand higher interest rates to compensate for an increased likelihood of corporations pursuing projects that favor equity-holders over debt-holders. And those who are asked to instead supply human capital, such as individuals offering managerial talent, may demand insurance-like measures to offset an increased risk of having their firm-specific investments expropriated.

Through channels like these, legislating, regulating, or litigating an increase in accountability to shareholders can weaken corporate performance. And like our principled concern about compromising central bank independence (CBI), our concern about weakening director primacy also receives considerable empirical support. Evidence exists, for example, that *authoritative* shareholders tend to award golden parachutes. This pattern appears more consistent with shareholder democracies ultimately threatening other stakeholders than with managers indulging their own preferences when diffuse shareholders cannot productively govern the firm. Similar patterns appear in data on bond prices, as well as anti-takeover protections in initial public offerings (IPOs) – i.e., strong shareholders, not weak ones, tend to offer protections that are oftentimes characterized as evidence of opportunistic managers.[31]

In this light, shareholders appear to willingly tie their hands when doing so productively insulates other important stakeholders from opportunistic redistributions. Diffusing the

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[30] Public pension plans or unions, for example, can own considerable stakes in corporations.
[31] For evidence of such effects, *see* Dino Falaschetti, *Golden Parachutes: Credible Commitments or Evidence of Shirking?*, J. OF CORP. FIN. 159–78 (2002); For a review of this evidence, *see* Falaschetti,

firm's ownership, symmetrically, appears to be a capable substitute for such commitment devices – i.e., it raises the cost of 'owner' opportunism, and can thus elicit productive effort from stakeholders (under certain conditions) at a lower cost than would formal hand-tying arrangements.[32] By *mandating* a stronger voice from shareholders, Dodd-Frank could take this choice away from those who are both closer to relevant information and perhaps more productively motivated, and thus risk the stability and productivity of the corporate business form, as well as the economic performance to which that form has historically contributed.

Conclusion

The newly enacted Dodd-Frank Act promises to better govern U.S. financial markets in the wake of 2008's financial panic. But while this law may ultimately succeed on certain dimensions, it also appears to create considerable political-legal risks. Our article investigates a general source of such risks – that is, how increasing the "accountability" of boards in corporations and the Federal Reserve System may compromise business judgments and monetary policy – and reviews considerable evidence that, while governance reforms like Dodd-Frank often promise increased productivity, their implementation can empower one set of interests (e.g., shareholders, borrowers) to gain from others' losses (e.g., bondholders, lenders).

Shareholder Democracy and Corporate Governance, REV. OF BANKING AND FINANCIAL LAW (BOSTON UNIVERSITY SCHOOL OF LAW) 553-80 (2009).

[32] Falaschetti, *supra* note 31, for example, finds evidence that corporations who lack a strong shareholder are significantly *less* likely to award golden parachutes to their executives, an empirical pattern that is more

Understanding the principle drivers of such inefficiencies is important for developing organizational, operational, and transactional strategies that can consistently succeed in a rapidly evolving regulatory environment. Organizational planners, for example, may benefit from explicitly considering the non-market risks that Dodd-Frank creates in deciding to go public, as well as structuring corporate charters and bylaws to mitigate the potential for and consequences of realizing such risks.

Risk managers in legal, operational, and transactional roles can also benefit from such an understanding. Our analysis, for example, implies that expected benefits from inflation hedges may have increased (e.g., developing currency strategies, contracting over floating versus fixed nominal values, and carefully measuring the relative "stickiness" of input and output prices). It also highlights opportunities for covenants to create value by protecting bondholders from proposal-initiated changes to corporate strategy that could benefit residual claimants at the expense of others.

In addition, our analysis highlights the potential for new litigation risks. What if, for example, shareholders say "no" to an executive compensation arrangement and board members ignore this "advice" – could board decisions under these new circumstances weaken deference under the 'business judgment rule' or statutorily imposed fiduciary

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consistent with golden parachutes insuring firm-specific human capital against opportunistic changes in control than with managerial agents exploiting slack in their relationship with relatively weak shareholders.

duty considerations, and increase scrutiny under a 'duty of loyalty' standard?[33] On the other hand, new opportunities may emerge to safe-harbor potentially conflicted transactions. If shareholders say "yes" to a compensation arrangement, for example, moving the standard for judicial review from the (deferential-to-management) duty of care to that of loyalty could be more difficult.

Finally, proxy advisors might benefit from considering related possibilities. How might Dodd-Frank's easing of proxy access, for example, affect the distribution of interests that a board must effectively represent? And what opportunities or risks might the above noted implications of "Say on Pay" and proxy access create if they turn de jure non-binding votes into de facto binding votes? On the other hand, advisors may also want to consider risks to shareholders whose voice the Act attempts to strengthen – corporate law doctrines that create fiduciary duties for controlling shareholders could, for example, eventually extend to those who access corporate proxies under Dodd-Frank and "succeed" in having their voices heard in corporate policy.[34]

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[33] To be sure, § 951 (c) of Dodd-Frank explicitly acknowledges that shareholder votes on executive compensation neither substitute for the decisions of management, § 951 (c)(1), nor change existing or create new fiduciary duties for management. Dodd-Frank Act § 951 (c)(2)–(3). Our observation here, rather, is that shareholders' 'say on pay' can inform judicial review of whether existing duties have indeed been satisfied. For example, while the Act does not formally change management's duty of loyalty, showing that managers acted in a disloyal manner may become harder for transactions that shareholders approved.

[34] Dissident shareholders that "succeed" under Dodd-Frank may be close to fitting the description of controlling shareholders to whom fiduciary duties extend. Consider, for example, Alan R. Palmiter's introduction to his chapter on "Duties of Controlling Shareholders" – "Corporate fiduciary duties extend to those who control the corporate governance mechanisms…With the power to select the board and approve fundamental changes, a controlling shareholder can act to the detriment of minority shareholders. For this reason, courts impose fiduciary duties on controlling shareholders that generally parallel those of directors." ALAN R. PALMITER, CORPORATIONS 329 (6th ed., Aspen Publishers 2009).

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