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## The Role of Financial Journalists in Corporate Governance

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## The Role of Financial Journalists in Corporate Governance

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# THE ROLE OF FINANCIAL JOURNALISTS IN CORPORATE GOVERNANCE

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## INTRODUCTION

Recent corporate scandals have caused many corporate law scholars to re-evaluate a great deal of corporate law orthodoxy. In a recent essay, Michael Klausner highlighted the limits of corporate law in promoting good corporate governance and called for scholars to devote greater attention to extralegal enforcement mechanisms.<sup>1</sup> A great many scholars have already taken up that effort. Some have pursued the insights offered by behavioral economics to aid their rethinking of the last quarter century's corporate law jurisprudence and commentary.<sup>2</sup> Many have focused their attention on the functioning of the securities markets and the various players who comprise it.<sup>3</sup> Jill Fisch, Hillary Sale, and John Coffee, among others, have emphasized the role of gatekeepers such as securities analysts, securities lawyers, and auditors.<sup>4</sup> A great deal of this work has focused on the conflicts of interest afflicting various actors and ways to deal with these conflicts.<sup>5</sup> An article by Bernard Black emphasizes the importance of accurate, honest

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1. Michael Klausner, *The Limits of Corporate Law in Promoting Good Corporate Governance*, in RESTORING TRUST IN AMERICAN BUSINESS 91, 97-8 (Jay W. Lorsch, Leslie Berlowitz & Andy Zelleke eds., 2005). Klausner explains the shortcomings of corporate law and calls for attention to be paid to extra-legal influences on governance. He notes that professional norms are "fostered by the financial press every time they write a story that exposes bad board behavior . . ." *Id.*

2. See generally Stephen J. Choi & A.C. Pritchard, *Behavioral Economics and the SEC*, 56 STAN. L. REV. 1, 14 (2003); Ronald J. Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias*, 28 J. CORP. L. 715 (2003); Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135 (2002); Robert Prentice, *Whither Securities Regulation? Some Behavioral Observations Regarding Proposals for its Future*, 51 DUKE L.J. 1397 (2002); A. Michelle Dickerson, *A Behavioral Approach to Analyzing Corporate Failures*, 38 WAKE FOREST L. REV. 1 (2003).

3. See generally Robert J. Thompson & Hillary A. Sale, *Securities Regulation as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859 (2003).

4. See Jill E. Fisch & Hillary A. Sale, *The Securities Analyst As Agent: Rethinking the Regulation of Analysts*, 88 IOWA L. REV. 1035, 1040-56 (2003); see generally John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301 (hereinafter Coffee, *Gatekeeper Failure*); John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid,"* 57 BUS. L.J. 1403 (2002) (hereinafter Coffee, *Understanding Enron*).

5. See Coffee, *Gatekeeper Failure*, *supra* note 4, at 301; Coffee, *Understanding Enron*, *supra* note 4, at 1403; Fisch & Sale, *supra* note 4, at 1035.

disclosure and how to ensure its quality.<sup>6</sup> Indeed, disclosure goes to the very heart of any market-based extralegal enforcement apparatus in corporate governance.

This Article pursues the important theme of disclosure, but focuses on a feature that has remained almost entirely overlooked by corporate and securities law scholars: the role of financial journalists in corporate governance.<sup>7</sup> This omission is perhaps due to the fact that journalists do not fit easily into a legal discussion because they are largely unregulated. They are, in a sense, not legal actors, and, therefore do not comfortably become the subject of a legal prescription. Nevertheless, journalists contribute in many ways to the legal system at large and the system of corporate governance in particular.

This Article uses case studies to highlight the importance of financial journalists in our scheme of corporate law by identifying and illustrating several distinct ways that journalists contribute to our system of corporate governance. It is beyond the scope of this Article to fully explain the mechanisms whereby journalistic reporting affects attitudes and actions, whether on the part of the public at large, legislators, judges, prosecutors or corporate directors and officers.<sup>8</sup> Nonetheless, the case studies suggest causal links between the reporting described and the consequences for corporate governance that follow. Rather than attempting to undertake a thoroughgoing empirical exploration of the

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6. See Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781 (2001).

7. Despite ubiquitous references to media reports throughout corporate law scholarship, no one has written a thorough account of the role of the media in corporate law. Scholars have, however, paid some attention to the media in other areas of law. See, e.g., Melissa B. Jacoby, *Negotiating Bankruptcy Legislation Through the Media*, 41 HOUS. L. REV. 1091 (2004) (discussing the media's role in the legislative process that ultimately led to the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005); M. ETHAN KATSH, *LAW IN A DIGITAL WORLD* 9 (1995) "Scholars seem to view the powerful realms of law and media as distinct and independent, each having an impact on behavior and attitudes, but having little influence on each other." (pointing out that books about communication and society rarely focus on law, while books about law focus on speech regulation and free expression, but little else); KATHLEEN HALL JAMIESON & PAUL WALDMAN, *THE PRESS EFFECT: POLITICIANS, JOURNALISTS AND THE STORIES THAT SHAPE THE POLITICAL WORLD* 95-97 (2003) (explaining the ways that the press shapes events in the political sphere).

8. See Daniel M. Filler, *From Law to Content in the New Media Marketplace*, 90 CAL. L. REV. 1739, 1756 n.80 (2002) (noting that "there has been a remarkable paucity of scholarship on the links between media coverage and the law"). *Id.*

track record of financial journalists' contributions to corporate governance, this Article presents an overview that surveys the terrain, setting out markers for future empirical, theoretical, and doctrinal inquiry. In so doing, this Article creates a research agenda for scholars who wish to pursue the issues explored herein more rigorously, in order to deepen our understanding of the way journalists affect corporate governance.

Part I reviews the structure of corporate law in order to demonstrate where journalists fit in. Part II contextualizes the role of journalists in corporate law by addressing several preliminary issues: the sorts of roles they are *not* well suited to fill, the incentives under which they operate, how they get their information and the relationship between shaming and my view of journalistic enforcement. Part III explores the numerous roles that journalists can and do fill in the corporate governance system.<sup>9</sup> Among these are uncovering and deterring fraud, and acting as an informational intermediary that catalyzes and informs legal action by Congress, the SEC, the courts, shareholders, or private litigants.<sup>10</sup> Along the way I will highlight the conflicts of interest that afflict virtually every actor in the system of corporate governance, and argue that financial journalists enjoy a convergence of their public and self-interests, and thus can help to bring these other actors' conflicting interests into alignment.

One possible objection to a theory of journalistic enforcement of corporate law is that securities analysts are in a better position than journalists to ferret out financial fraud. In Part IV, I consider the role of analysts—their competencies and conflicts—and compare them to those of journalists. This comparison does not yield an easy answer as to which set of professionals serve as the better enforcer. Rather, the comparison serves as a basis for reflecting on the ways journalists and analysts might interact to improve the overall efficiency of the corporate system.

In its brief discussion of gatekeepers, this Article will limit its focus to securities analysts: the gatekeepers whose function most closely

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9. *See infra* Part III.

10. In addition to performing these roles vis-à-vis corporate managers, they can do the same for the gatekeepers of corporate America—those professionals relied on by corporate and securities law to monitor and advise corporate actors. Corporate and securities law scholars have paid considerable attention to the role of gatekeepers in recent years. *See Black supra* note 6, at 781. Nevertheless, a thorough analysis of the ways that financial journalists report on gatekeepers is beyond the scope of this Article.

overlaps with that of journalists. Journalists can cover gatekeepers in either an adversarial role, by reporting wrongdoing,<sup>11</sup> or in a cooperative dynamic, by complementing the research conducted by securities analysts, who may choose not to publicize the wrongdoing they uncover because of their own conflicts.<sup>12</sup>

I. FILLING A GAP IN CORPORATE LAW: WHERE DO JOURNALISTS FIT INTO OUR SCHEME OF CORPORATE GOVERNANCE?

A. How Corporate Law Works.

The central task of corporate law is to reduce the loss in shareholder wealth that inevitably results from the central feature of the modern American corporation—the separation of ownership and management.<sup>13</sup> Shareholders (the principals) own the company, but managers and directors (their agents) are responsible for directing its affairs. A necessary result of this separation of ownership and control is that managers' interests are different from those of shareholders. While shareholders want the firm to be as profitable as possible, managers want to be well compensated, and avoid working too hard while retaining their lucrative, prestigious and powerful positions.

Corporate directors and officers are conflicted. They are duty-bound to act in the interest of shareholders, but have personal interests as well. Their fiduciary duty requires them to work diligently and loyalty on behalf of the shareholders, but as human beings they face the imperative of satisfying their own interests. Sometimes they do not work hard enough; sometimes they are not honest enough. They appropriate corporate assets to themselves; they falsify financial disclosures. Sometimes they harm shareholders by engaging in wrongful market conduct. Corporate law seeks to align their interests with those of the shareholders. It succeeds to a greater or lesser extent.

Corporate law has developed several mechanisms to minimize the

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11. See, e.g., Gretchen Morgenson, *How Did They Value Stocks? Count the Absurd Ways*, N.Y. TIMES, Mar. 18, 2001 at C1. Gretchen Morgenson of the New York Times received a Pulitzer Prize in 2002 for her coverage of the conflicts of interest that led analysts to continue to publicly hype stocks while privately deriding them as “junk” or worse.

12. See *infra* Part IV.B.

13. See generally ADOLPH BERLE & GARDINER MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).



agency costs that arise as a result of the separation of ownership and control. First, if managers do a poor job, shareholders may use the franchise to remove directors from office. Second, they may sue the directors to rectify wrongful behavior. These are the two primary legal tools available to shareholders. For reasons that have been ably explained by many others, these legal restraints are relatively weak.<sup>14</sup>

Beyond the mainly ineffectual derivative actions and electoral mechanisms, two other constraints intimately related to capital markets are believed to exert a more meaningful form of constraint on managers. The disclosure regime imposed by federal securities law, and the market for corporate control, have functioned as more effective disciplinary structures.<sup>15</sup> The market for corporate control improves managerial honesty and diligence because it plays on directors' and managers' interest in keeping their jobs and maintaining control of their corporations. Lastly, federal securities laws require the detailed disclosure that is the lifeblood of our capital markets, and is the informational predicate that the market for corporate control relies on to signal management underperformance. Accurate, timely disclosure of company financial information is vital to the operation of both mechanisms, and it is notable that the most infamous scandals of recent years have involved the falsifying of financial disclosure.

These four basic mechanisms of managerial discipline form the backbone of the American corporate governance system. But they are not the only explanations for the relative efficiency of our corporate system. Even with these legal and market mechanisms in place, there remains ample opportunity for corporate managers to appropriate shareholder wealth to themselves, either through excessive compensation in cash or perquisites, improper loans and other self-dealing, or by otherwise underperforming and shirking. Individual managers stand to reap enormous personal financial rewards through fraud or other misbehavior that poses little threat of discovery. The standard legal and market constraints represent a rational and largely

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14. See, e.g., LUCIAN ARYE BEBCHUK & JESSE M. FRIED, PAY WITHOUT PERFORMANCE, 207-210, (2004) (explaining the weaknesses in the system of shareholder voting, its negligible frequency and SEC proposals to strengthen it); *Id.* at 45-48 (explaining both the procedural hurdles and substantive rules of law that inhibit shareholders from successfully pursuing claims against managers and directors in derivative actions); Klausner, *supra* note 1, at 92-93 (explaining the general weakness of shareholder voting and derivative actions as disciplinary mechanisms).

15. See Thompson & Sale, *supra* note 3, at 859.

effective response to this problem, but deterrence is imperfect and temptation is enormous. Corporate law is thus faced with a chronic problem of enforcement: how to make managers follow the rules furnished by our legal system?

Recently, American corporations have been the scene of some shockingly bald examples of corporate managers acting primarily in their own self interest, to the great financial detriment of their shareholders. It seems as though the disciplinary effect of state corporate law, federal securities law, and extra-legal enforcement mechanisms, has failed to fully align management's interests with those of shareholders.

In an attempt to impose further discipline on corporate leaders, Congress passed the Sarbanes-Oxley Act in 2002.<sup>16</sup> The Act imposed numerous duties on various corporate actors; not only on directors and officers,<sup>17</sup> but also on the professional gatekeepers who lend their expertise to the corporate endeavor: auditors who bear the responsibility of assuring that corporations provide fair and accurate financial information to the public that fairly and accurately reflects the reality of the corporation's financial status,<sup>18</sup> attorneys who advise corporations on their transactions and securities issuances,<sup>19</sup> and securities analysts who serve the dual role of informational intermediary and marketing cheerleader.<sup>20</sup>

While many have criticized the wisdom of several provisions of Sarbanes-Oxley on their merits,<sup>21</sup> the Act suffers from another frailty

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16. Officially titled the "Public Company Accounting Reform and Investor Protection Act of 2002." Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11 U.S.C., 15 U.S.C., 18 U.S.C., and 28 U.S.C.) [hereinafter the "Sarbanes-Oxley Act," "Sarbanes-Oxley," or the "Act"].

17. 15 U.S.C. § 7241 (2002) (requiring CEOs and CFOs to certify the "appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial conditions of the issuer").

18. Title I of the Act establishes the Public Company Accounting Oversight Board. 15 U.S.C. § 7211 (2002).

19. Section 307 directs the SEC to establish rules governing the professional responsibility of attorneys advising public corporations. 15 U.S.C. § 7245 (2002)

20. Section 501 directs the SEC to establish rules governing securities analysts. 15 U.S.C. 780-86 (2002).

21. See, e.g., Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. J. 1521 (2005); Larry Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of*

common to all areas of corporate law, and, indeed to all legal regulation: the aforementioned problem of enforcement. Even if all were to agree that the rules and standards contained in the Act were perfectly conceived and drafted, the problem will remain: how to get corporate managers to obey the rules, and adhere to these standards.

Several potential solutions to this problem suggest themselves. We might simply hope that those individuals charged with duties and responsibilities under the Act, and corporate law generally, will faithfully discharge them because it is the right thing to do, but such a posture is clearly naïve. We might believe that traditional enforcement will be enough to ensure compliance with legal norms. We might hope that Congress, having charged the Securities and Exchange Commission with responsibility for enforcing the rules, will provide sufficient funding to vigorously police corporate managers and enforce the law.

Another possibility is that internal pressure, i.e., a corporate culture of adherence to the law, might make all corporate employees into the enforcing arm of these various regulatory schemes. Under such a view, well-intentioned corporate employees, privy to corporate activities but typically reluctant to make waves, will be relied on to smoke out malfeasance and do something about it.

This approach, like all corporate law, is impeded by the problem of interest. Corporations are made up of individuals, each with his or her own conflict of interest. Perhaps it is not too naïve to proceed from the premise that most people are basically virtuous, and wish to do the right thing,<sup>22</sup> but are just conflicted. These individuals have both self-interest and a public-minded interest. They wish to be good, law-abiding citizens, and probably want to call attention to the wrongdoing they see around them. However, they also have a self-interest, albeit benign, in keeping their jobs. Imagine a scenario in which a mid-level manager, or even someone further down the corporate hierarchy, becomes aware of financial wrongdoing at the highest level. That person might want to alert upper management to the illicit behavior of their supervisors. Obviously this poses a problem. No good deed goes unpunished: they

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2002, 28 IOWA J. CORP. L. 1 (2002).

22. For a notable adherent to this viewpoint, see ADAM SMITH, *The Theory of Moral Sentiments* in THE ESSENTIAL ADAM SMITH 65 (R. L. Heilbroner ed., W. W. Norton & Co. 1986). “How selfish soever men may be supposed, there are evidently some principles in his nature which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeking it.” *Id.*

may lose their job as thanks for their efforts. So these individuals suffer from a conflict of interest—one that reduces the overall efficacy of enforcement efforts.<sup>23</sup>

*B. Reputational Constraints.*

Beyond Sarbanes-Oxley and the four legal mechanisms described above, what else accounts for the fact that by and large directors and officers do a pretty good job? One strand of corporate theory propounds the view that reputational concerns account for this generally good behavior.<sup>24</sup> While recognizing that the mechanisms of corporate law only loosely constrain the opportunistic behavior of management, this theory holds that directors refrain from appropriating corporate assets because they know that if they overreach, share prices will fall, they may be sued or challenged in a proxy fight, and thereby lose their stature among peers. This is not a mere dignitary threat; more importantly, their services will suffer in the market. They will be unable to secure other board or executive positions.

Some corporate law scholars thus point to the desire of managers and directors to reap the rewards of self-esteem, and positive reputation, as a meaningful constraining force.<sup>25</sup> Indeed one commentator has asserted, with perhaps a degree of hyperbole, that “corporate directors are the ‘most reputationally sensitive people in the world.’”<sup>26</sup> Some have explained this concern by reference to the reality that corporate managers suffer from a lack of diversification, both in wealth and personal labor.<sup>27</sup> That is, in contrast to shareholders who spread their

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23. Whistleblower statutes are one way that the law has responded to this problem of interest. The law affords certain protections to those who seek to redress wrongs done in the workplace, but these laws, while well-intentioned, are relatively ineffective and significantly restricted in design and scope. *See infra* Part II.E.1.

24. *See* Lucian Arye Bebchuk, Jesse M. Fried & David I. Walker, *Management and Control of the Modern Business Corporation: Executive Compensation and Takeovers: Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751 (2001); Ribstein, *supra* note 21; David Skeel, *Norms and Corporate Law: Shaming in Corporate Law*, 149 U. PA. L. REV. 1811 (2001).

25. *See* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1012-14 (1997).

26. Skeel, *supra* note 24, at 1859 (quoting shareholder activist David Monks).

27. *See* Coffee, *Gatekeeper Failure*, *supra* note 4, at 301 (noting that “[m]anagers generally make large, firm-specific human capital investments in their firms.”); Jeffrey N. Gordon, *What Enron Means for the Management and Control of Modern Business*

wealth throughout a diversified investment portfolio, an outsized proportion of the personal wealth of executives of large public corporations is invested in the company they run.<sup>28</sup> By the same token, in contrast to the labor portfolios of gatekeepers such as accountants, lawyers and analysts—who work for many different clients—corporate executives are totally undiversified, investing all of their labor in the corporation they run.<sup>29</sup> Executives thus have a great incentive to maintain a reputation for honesty, diligence, competence and success. But at the same time, they also have full access to the assets of their corporation, and an enormous temptation to enrich themselves in inappropriate ways.

In light of the view that reputational interests are an effective constraint on management, we might begin with the following suppositions. First, despite their concern for their reputations, managers are evidently unwilling to forgo wrongful personal gain, where that gain is the result of behavior shielded from public view, and thus unlikely to be discovered and punished. Indeed, as the recent corporate scandals have made clear, many managers will steal furtively. Focusing then on opportunistic wrongdoers, we can assume that if managers are willing to forgo wrongful gains if the likelihood of discovery is high, then publicity in the form of journalistic reporting is key to pushing them further still toward an ideal of managerial behavior. These premises underlie the claim of this Article: that journalistic reporting can serve to improve corporate governance.

### C. Gatekeepers As a Constraint on Management.

Before discussing the ways that journalists go about their work, I wish to note that a check on managerial opportunism can be found, to some degree, in the system of gatekeepers our capital markets and corporate governance scheme relies on.<sup>30</sup> Gatekeepers include

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*Corporations: Some Initial Reflections*, 69 U. CHI. L. REV. 1253, 1245.

28. Stock ownership by managers is generally viewed as a good thing for corporate governance. Share ownership by managers helps align their interests with those of the public shareholders and increases their incentive to run their company profitably. See BEBCHUK & FRIED, *supra* note 14, at 2-4.

29. See Gordon *supra* note 27, at 1245.

30. See generally Coffee, *Gatekeeper Failure*, *supra* note 4; Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53 (1986).

professionals such as securities lawyers, securities analysts, auditors and debt rating agencies, professionals who play an important role in the financial life of any corporation that seeks to avail itself of the capital markets. These market intermediaries assist issuers in the preparation of their public disclosures and the marketing of their securities to the public. They also advise on the viability, profitability and legality of many business decisions. In so doing, they serve to enhance managerial effectiveness.

But gatekeepers also function to keep managers honest. As previously mentioned, the temptation for corporate managers to misrepresent material facts in SEC disclosure filings and elsewhere may be enormous because of the large gains they stand to reap from such malfeasance. One theoretical view of the incentive structure underlying the effectiveness of the gatekeeper system can be understood by reference to managers' lack of labor and wealth diversification.<sup>31</sup> Whereas corporate executives invest all of their labor capital and significant proportions of their financial capital in their company, gatekeepers are well-diversified: they work for many different issuers and gain only a small percentage of their income from any given client.<sup>32</sup> Moreover, gatekeepers have a significant investment in their own reputation for honesty and care. Since gatekeepers would receive comparatively little benefit from condoning or committing fraud in connection with any given client, the risk of impairing their reputation and thus their ability to earn income from other clients is not worth taking.<sup>33</sup> This view suggests that gatekeepers play a vital role in the corporate governance system. Yet, as recent experience has demonstrated, this role has proven problematic; for reasons to be explained later in this Article, gatekeepers are not completely effective at preventing managers from engaging in inappropriate self-serving conduct.<sup>34</sup> Part IV will briefly explore the failures of gatekeepers, analysts in particular, and the conflicts of interest that have made such failures nearly inevitable.

The next Part addresses several preliminary questions that will provide some background necessary to understand Part III's detailed description of the particular roles financial journalists play in corporate

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31. See Gordon, *supra* note 27, at 1245.

32. See generally Coffee, *Understanding Enron*, *supra* note 4.

33. *Id.*

34. See *infra* Part IV.

governance. Among these questions is what kinds of wrongdoings can journalists be counted on to uncover? How does this Article's account of journalistic enforcement of corporate law intersect with the theory of shaming? How do journalists gather their information? Why should journalists bother?

## II. WHAT CAN WE EXPECT OF JOURNALISTS AND WHY?

### A. Journalists Are Best Suited to Uncovering Affirmative Wrongdoing.

One key question to be answered in fashioning an account of journalists' role in corporate governance is: what kinds of transgressions are financial journalists most likely to reveal? It is not realistic to suppose that financial journalists will play an effective, leading edge role in uncovering merely inefficient management. That role is best carried out by analysts and institutional investors, and is reflected in share price. But that is not to say that financial journalists do not report on such matters. In fact, a great deal of financial journalism addresses management and the daily performance of corporations in the marketplace. But I place this sort of reporting outside the ambit of this Article because it seems only loosely or diffusely connected to governance.<sup>35</sup> Moreover, because of its ubiquity, uneven quality, and frequent reliance on analysts for company talking points, I consider it to be less consequential than other kinds of reporting, not to mention altogether more difficult to measure. Rather, I will focus on journalistic coverage of more active species of wrongdoing that are not the result of laziness, poor decision-making or incompetence. This kind of behavior often manifests itself as deceptive accounting practices, including the exquisitely complex sort of special purpose entity financing employed by Enron,<sup>36</sup> blatant falsification of accounting records, failures to implement adequate internal controls,<sup>37</sup> intentionally misleading

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35. This is not to minimize the importance of quotidian reporting on company performance, management, strategy, finance and the like. By bringing to the investing public such information about companies, financial journalism takes its rightful place among the mechanisms of market efficiency. Indeed, such a role is recognized by the law. *See, e.g., SEC v. Texas Gulf Sulfur Co.*, 401 F.2d 833 (2d Cir. 1986) (requiring, under the disclose or abstain rule, insiders to disseminate their material nonpublic information through the financial media).

36. *See infra* Part III.A.

37. *See infra* Part III.C.

forecasts of earnings, and criminal or otherwise wrongful market conduct.<sup>38</sup>

Beyond investigating and reporting on managerial malfeasance, journalists also contribute to corporate governance through their coverage of legislative initiatives affecting corporate governance and securities regulation. This role has become more pronounced in the wake of the federal government's recently enlarged role since the enactment of The Sarbanes-Oxley Act. Thus I will also explore the ways in which journalists can contribute to the efficacy of federal legislative and regulatory law in corporate governance.<sup>39</sup> This role involves maintaining public awareness of corporate wrongdoing, and also apprising the public of Congressional support of the SEC—the body charged with enforcement of Sarbanes-Oxley. The public awareness engendered by effective reporting on the intersection of corporate scandal and the legislative process in turn increases political pressure on Congress to legislate for the common weal, rather than on behalf of special interests.

### B. Journalism Or Shaming?

In recent years, several corporate law scholars have turned their attention to shaming and social norms. David Skeel has explained the ways that enforcers such as judges,<sup>40</sup> institutional investors,<sup>41</sup> and so-called “shaming entrepreneurs”<sup>42</sup> have attempted to deter corporate

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38. See *infra* Part III.B.

39. See *infra* Part III.D.

40. See Skeel, *supra* note 24, at 1823-26, 1852 n.163 (noting that the U.S. Federal Sentencing Guidelines authorize judges to “order [a corporate defendant], at its expense . . . to publicize the nature of the offense committed, the fact of conviction, the nature of the punishment imposed, and the steps that will be taken to prevent the recurrence of similar offenses”); see also Jeffrey S. Parker, *Rules Without . . . : Some Critical Reflections on the Federal Corporate Sentencing Guidelines*, 71 WASH. U. L.Q. 397, 430 (1993) (discussing the “punitive publicity” policy of the Federal Sentencing Guidelines).

41. See Skeel, *supra* note 24, at 1836-42. For example, the California Public Employees' Retirement System (CalPERS), a major institutional investor, annually publishes a list of underperforming companies. The list outlines the managerial missteps that have caused CalPERS to highlight the firm. The publicity and embarrassment caused by a spot on the list has apparently been effective in inducing positive changes in the targeted companies.

42. *Id.* at 1823. The most prominent example of shaming entrepreneurs is Robert Monks and Nell Minow, two shareholder activists who have taken it upon themselves to



malfesance by invoking shaming sanctions. The financial press has also engaged in shaming. Business Week and Fortune have in recent years published articles listing the worst performing corporate boards.<sup>43</sup> In discussing the role of journalists as enforcers of corporate governance norms, I address the distinctions and areas of convergence between my account and the theory of shaming put forward by Skeel and others.<sup>44</sup> There is a great degree of overlap between the two approaches, but significant differences remain.

The most important distinction is that in shaming theory, shaming is the enforcement. Except in the case of judicial shaming, the sanction is purely extralegal. However, in my account of journalistic enforcement, the role of the press is not necessarily to impose the ultimate sanction, although I acknowledge the vitality of such a role. Rather, I will focus primarily on the press as playing an intermediate role, somewhere between the wrongdoers and institutional enforcement actors such as the courts, plaintiffs' firms, the SEC, Congress, and the capital markets. By calling attention to the misdeeds of corporate directors and officers, the press can initiate various sorts of corrective responses, whether judicial, legislative, administrative, or market-imposed.

This is not to say that the theories are mutually exclusive or independent of one another. For example, both theories depend on the sensitivity of the transgressor to reputational concerns. This is an important point because one of the functions of the press in enforcement is its role as an alternative or supplement to legal enforcement. To a degree, journalistic revelation of corporate malfesance will in itself reduce the incidence of wrongdoing. This is accomplished in two ways. First, press coverage that brings to light a given instance of wrongdoing may actually put a stop to it. Second, in an environment of heightened

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take out full-page advertisements in national publications like the Wall Street Journal to shame the directors of large, publicly-held corporations. One such advertisement consisted of a full-page silhouette purporting to represent the directors of Sears Roebuck along with the following text: "The Non-Performing Assets of Sears." For more discussion of the role of shaming entrepreneurs, *see id.* at 1823-26.

43. *See* John A. Byrne & Richard Melcher, *The Best and Worst Boards*, BUSINESS WEEK, Nov. 25, 1996, at 82; Geoffrey Colvin, *America's Worst Boards*, FORTUNE, Apr. 17, 2000, at 241.

44. *See, e.g.*, Jayne W. Barnard, *Reintegrative Shaming in Corporate Sentencing*, 72 S. CAL. L. REV. 959 (1999); Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253 (1999); Dan M. Kahan & Eric A. Posner, *Shaming White-Collar Criminals: A Proposal for Reform of the Federal Sentencing Guidelines*, 42 J. L. & ECON. 365 (1999).

and effective press coverage of fraud, would-be fraudsters will be deterred by a heightened likelihood of discovery of their actual or potential wrongdoing.

Another point of overlap is the sensitivity of each approach to the type and degree of wrongdoing. Skeel makes clear that the virtues of shaming are minimized in cases of mismanagement and maximized in cases of affirmative wrongdoing or illegality.<sup>45</sup> Skeel has pointed out that shaming is inappropriate in cases of mismanagement because it over-deters risk-taking by imposing excessive costs for managers whose wealth is not diversified.<sup>46</sup> The market for corporate control better addresses the problem of ineffective management. Similarly, as Part III demonstrates, financial journalists can contribute most to corporate governance by reporting on affirmative wrongdoing, rather than simply poor decision making.

### C. Careerist Self-Interest As an Incentive for Energetic Reporting

Enlightened self-interest gives us reason to believe that financial journalists can play an important role in improving corporate governance. Whereas bad corporate governance can properly be seen as stemming from the divergence of management's self-interest and shareholders' interests, financial journalists actually enjoy a convergence of their self-interest in career gains and the public's interest in managerial integrity and shareholder wealth maximization. Indeed, journalists have more incentive than ever to perform this function.

A confluence of societal developments in the last twenty years has made the media environment more fertile than ever for high profile financial journalism. First, more Americans are investors in the stock market than ever before.<sup>47</sup> As a result, Americans are paying more attention to the goings-on in America's boardrooms. Also, since the advent of round-the-clock cable news, particularly the spectacular rise in the popularity of cable financial news, media outlets are devoting more resources to their coverage of corporate affairs. Moreover, due to the

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45. See Skeel, *supra* note 24, at 1832-33.

46. *Id.*

47. See James A. Fanto, *We're All Capitalists Now: The Importance, Nature, Provision and Regulation of Investor Education*, 49 CASE W. RES. L. REV. 105 (1998); Michael J. Borden, *PSLRA, SLUSA, and Variable Annuities: Overlooked Side Effects of a Potent Legislative Medicine*, 55 MERCER L. REV. 681, 714 (2004).

recent rise of what might be termed an American “equity culture,”<sup>48</sup> the most popular cable television coverage of corporate news has taken on a decidedly financial cast. Many of the most-watched financial news personalities either have backgrounds as traders or analysts, or pose as having such expertise. These changes have led to a significant increase in public awareness of, and focus upon, the financial details of corporate activity, as opposed to the marketing, employment or product market coverage that had previously received primary attention.

In addition, while news consumption used to be limited primarily to the morning paper and the six o’clock television news, the modern 24-hour news cycle has changed patterns of news-watching behavior. The resulting expansion of air time, and greater pot of money to be earned by media professionals, has created a new careerism in journalism and a culture of celebrity journalists. There is thus an unprecedented potential for material and professional gain to be achieved by journalists who cover important corporate news.

Corporate scandals have grown to such a level that they compete with politics and sports for the attention of the popular mind. In this environment, financial journalists have a heightened incentive to investigate and publicize corporate wrongdoings. For example, Bethany McLean, a reporter at Fortune, spent two years working on the Enron story and finally reaped the reward of the notoriety that went along with her reportorial accomplishment. Ms. McLean and her co-author signed a publishing deal worth \$1.4 million<sup>49</sup> for her book on Enron,<sup>50</sup> and the book was then adapted into a successful documentary film. In addition, she now frequently finds herself a commentator on national television.<sup>51</sup> Indeed in the current environment of media saturation, widespread equity ownership, and rampant corporate fraud, financial journalists can in fact do well by doing good.

#### D. Contrast with Political Journalists

This portrayal of financial journalists presents an interesting

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48. Peter Nobel, *Social Responsibility of Corporations*, 84 CORNELL L. REV. 1255, 1255 (1999).

49. Eric Celeste, *The Claim Game*, DALLAS OBSERVER, Apr. 4, 2002.

50. BETHANY MCLEAN & PETER ELKIND, *THE SMARTEST GUYS IN THE ROOM* 320 (2005).

51. McLean has appeared numerous times on *The News Hour with Jim Lehrer*, on Court TV and elsewhere.

contrast with political reporters who cover the President. Reporters who cover the President are in a very vulnerable position. They are the elites of the media, doing some of the most important, visible and remunerative work of all journalists. But in order to fulfill their public mission, they must ingratiate themselves with those who control access to the highest governmental actors and information. If they are unable to obtain such access, they will not only fail in their public duties, but will also find their careers stalled. A shrewd administration can exploit this conflict of interest by denying access to those reporters who publish politically damaging stories. The result is the impoverishment of public discourse on the actions of government.

Traditionally, administrations have been relatively inefficient in guarding information and sealing the lips of top officials who have access to it. But the George W. Bush administration has been extraordinarily well disciplined in controlling information and access to top officials. The Bush administration has been notably parsimonious in its voluntary disclosure of information. Indeed one observer with a front row seat to the press relations of the Bush II White House has recently noted that it is “one of the most secretive White Houses ever.”<sup>52</sup> Furthermore, both the President and his two primary spokesmen, Ari Fleischer (in the first G.W. Bush administration) and Scott McClelland (in the second), have been draconian in their exploitation of political reporters’ central conflict of interest. They have punished those who have written damaging stories by denying them the access they need to succeed professionally. This behavior began even before Bush took office when, Bush commented at a campaign rally to Richard Cheney that the New York Times’ Adam Clymer was “a major league [expletive].”<sup>53</sup> The result of this antagonism has been to neuter the White House press corps and impair the public’s understanding of crucial policy decisions.

But this strategy of exploiting reporters’ dependence on information works in the White House only because of a key structural feature of that governmental institution. With strictly enforced codes of silence, the White House has, for all intents and purposes, one sole gatekeeper of information. The White House press secretary decides which reporters

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52. Elisabeth Bumiller, *The White House Without a Filter*, N.Y. TIMES, June 4, 2006 at D3. The observations about information control in the Bush White House pertain most accurately to the period from January 2001 to July 2006.

53. Adam Clymer, *A Bush League Aside Vaults an Onlooker into the Campaign’s Glare*, N.Y. TIMES, Sept. 10, 2000, at D1.

will get their questions answered, or which will get interviews and other access.<sup>54</sup> The gatekeeping function at the White House is extraordinarily focused and efficient.

While reporting on the national political beat has no doubt been diluted by the President's media apparatus, this structural impediment to the dissemination of information does not exist in the realm of financial reporting. Whereas there is a single gatekeeper guarding the oval office, Corporate America does not enjoy the same sort of fortress. Because corporations are so numerous, and because any given major corporation is spread out geographically, has numerous decision makers, and many supporting actors with access to inside information, corporate information has many points of egress. There is no gatekeeper in a large corporation because there are so many employees and so little ability to control their communication. Nor does the sense of missionary zeal exist in a corporation as it does in the hallowed corridors of government. Moreover, since the career aspirations of financial journalists are not dependent on their ability to gain boardroom access, they are free of the kinds of conflicts of interest that political reporters face.

Despite the existence of a fertile environment in which to ply their trade, journalists cannot make stories happen on their own. Journalists, in order to yoke their careerist self-interest to their public mission, must rely on various techniques for developing information that is often difficult to come by. The next Part briefly explores some of these techniques.

### *E. How Do Financial Journalists Get Their Information?*

#### *1. Whistleblowers*

A corporation may have scores of employees aware of its misdoings and who are potential sources for news stories. But these employees also suffer a conflict of interest. Frequently, they would like to do the right thing, but are aware that in so doing they may lose their jobs or their prospects for advancement. Other disincentives to report wrongdoing are the personal stress that might result from reprisals, the potential duty to serve as a witness in court, a sense that they are

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54. Bob Edwards, *The Press and Freedom: A Radio Journalist Spots Disturbing Trends in How the White House Press Corps Reports on the Bush Administration*, NIEMAN REPORTS, Summer 2003, p. 81.

betraying their colleagues, and perhaps uncertainty caused by incomplete knowledge of the wrongdoing, particularly if the fraud is well orchestrated and technically complex, as was the case in Enron.<sup>55</sup> While this conflict may constrain many corporate employees from walking into the head office and demanding that wrongs be righted, those employees may face much less risk by tipping off financial reporters to the objectionable behavior of their superiors. Because they are able to inform the media with a great deal of confidence in their anonymity, these employees are able to act in the public interest without harming their private interest in retaining their jobs.

While whistleblowers can perform a socially useful function, they enjoy little protection from the law. Whistleblower protection statutes take various forms and exist at both the state and federal level.<sup>56</sup> These statutes mainly require disclosure to governmental authorities, rather than journalists.<sup>57</sup> Moreover, the protection typically afforded is of dubious benefit, because it tends to only redress retaliatory firings that are not easy to prove.<sup>58</sup> Sarbanes-Oxley carries forth the legislative concern for whistleblowers in a number of ways. First, it requires whistleblowing by lawyers who observe fraudulent actions taken by the corporations that employ them.<sup>59</sup> Second, it provides protection for employee-whistleblowers, but only if they provide information to appropriate governmental authorities.<sup>60</sup> Thus this legal protection is not a significant aid to would-be whistleblowers wishing to convey

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55. See Elletta Sangrey Callahan & Terry Morehead Dworkin, *Who Blows the Whistle to the Media, and Why: Organizational Characteristics of Media Whistleblowers*, 32 AM. BUS. L.J. 151 (1994) (discussing attempts to “kill the messenger”); TERANCE D. MIETHE, WHISTLEBLOWING AT WORK 73-78 (1999). Carleen Hawn, *The Women of Enron: Corporate Cassandra*, FASTCOMPANY, Sept. 2003, at 80 (pointing out how Margaret Ceconi, one of two prominent whistleblowing Enron employees, has lost friends as well as her job as a result of going to the SEC with allegations of fraud in the accounting of profits from “bundled” energy contracts at Enron Energy Services).

56. For a full discussion of legislative protections for whistleblowers at both the state and federal level, see generally Elletta Sangrey Callahan & Terry Morehead Dworkin, *Employee Disclosures to the Media: When is a “Source” a “Sourcerer”?*, 15 HASTINGS COMM. & ENT. L.J. 357 (1993).

57. See generally *id.*

58. See generally *id.*

59. 15 U.S.C. § 7245 (2002).

60. 18 U.S.C. § 1514(A) (2002). Whistleblowing to journalists is not protected under Sarbanes-Oxley.

information to journalists.

Nevertheless, the actual and potential role of whistleblowers must not be minimized, particularly in the context of financial journalists' enforcement efforts. Viewed in this context, whistleblowers face fairly minimal risk because they are able to notify journalists confidentially about wrongdoing, and where to look to ferret it out. Particularly in large corporations, with many employees, the risk of unwanted discovery of the whistleblowers' identity should be small.<sup>61</sup> In spite of these concerns, whistleblowers can play an important role in funneling journalists toward appropriate targets of investigation.

## 2. Other Journalistic Techniques

While whistleblowers represent one way for corporate information to land in the hands of journalists, old-fashioned reporting stands as another. Not only can insiders seek access to journalists, but journalists are trained to infiltrate organizations by developing sources. They make themselves known to people around a corporation by establishing a physical presence. They may frequent local eateries, or other hangouts like bars and fitness clubs, to make their presence known. Through patient development of relationships and persistent questioning, they establish channels of communication that ultimately lead to revelation by piecing together disparate bits of information.

But where does a journalist start? How does a journalist know where to focus her efforts? How does she distinguish the honest companies from the ones where the wrongdoing is going on?

One answer comes from the recent corporate mega-scandals. There are several ways a journalist might find his or her way to a story. By focusing on an industry, and observing the general practices, competitive strategies, and successes and failures of various industry players, a journalist can come to more sensitively understand the actions of a given corporation that seem to not fit its competitors' patterns.<sup>62</sup>

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61. Of course one can imagine carefully managed frauds in which access to information about the wrongdoing is narrowly confined and carefully monitored. In such a situation, perpetrators could deduce the source of the information once it becomes public, but it seems reasonable to believe that many frauds are not so fastidiously managed.

62. This method was useful to Jonathan Weil in his investigation of Enron. By understanding the difficulties Enron's competitors were having in the telecommunications field, Weil developed a skepticism about certain of Enron's claims

Another crucial component of a financial journalist's legwork involves carefully reading SEC disclosure filings. Auditor's footnotes are of particular interest to anyone interested in understanding the true financial condition of a reporting company, as they often provide clues to creative, aggressive or fraudulent accounting practices.

A skillful journalist thus has many tools at his or her disposal to develop information that can be used to track down information about corporate wrongdoing. The next Part describes several ways that journalists can affect corporate governance by reporting what they have learned.

### III. ROLES JOURNALISTS PLAY.

Financial journalists can play several distinct roles in corporate governance. First, in their capacity as investigative watchdog, they can discover and report financial fraud, and instigate a market-based response that, in combination with governmental investigations, will put an end to the fraud.<sup>63</sup> Second, their reporting can uncover wrongful corporate market conduct and thereby alert traditional players in the legal system and set them into action to correct it. In this respect, they are stalking hounds for regulatory enforcement officials and plaintiffs' attorneys. Regulatory investigators will get the scent of the hunt from journalists then use their subpoena power to further root out misbehavior and bring appropriate judicial or administrative proceedings.<sup>64</sup>

Third, financial journalists can play an important role in corporate compliance litigation, under both state and federal law. By reporting on illegal corporate market conduct, journalists can create a sort of external monitoring and reporting system, against which courts can measure the efficacy of internal compliance programs required under state and federal law. Although the Delaware courts currently embrace a management-friendly standard for evaluating the sufficiency of corporate compliance programs, that deferential standard may evolve into something more demanding if journalists consistently display an ability to outperform those compliance programs.<sup>65</sup>

The fourth function of financial journalists—helping ensure

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of profitability. *See infra* Part III.A.

63. *See infra* Part III.A.

64. *See infra* Part III.B. The same can be said for plaintiffs' attorneys, with discovery as a stand-in for the subpoena.

65. *See infra* Part III.C.



enforcement of the Sarbanes-Oxley Act—is somewhat more indirect, but nevertheless significant. I am referring to the political influence that high profile financial reporting can exert on Congress. Since the SEC has primary responsibility for the enforcement of Sarbanes-Oxley, and Congress controls the SEC’s budget, there is a significant capacity for Congress to undercut the efficacy of the new federal corporate governance norms by limiting SEC funding. In the absence of effective investigative reporting by financial journalists, it is less likely that corporate scandals will receive popular national attention. In such an atmosphere of quiet on the corporate scandal front, Congress will be able to scale back enforcement funding for the SEC without any public outcry. If, by contrast, corporate scandals remain present in the popular mind, political pressure on Congress to do something about the matter will accumulate, and self-interested legislators will want to be able to demonstrate to constituents that they have done something about the problem. In this way, the fourth function of financial journalists can be achieved.<sup>66</sup>

Under such conditions, the problems of divergence of interests can be harmonized on all fronts: the journalists have done their job of promoting the public welfare by bringing misbehavior to light and having it corrected or addressed by the appropriate authorities. In so doing, they have enhanced their reputations and careers, and have earned their pay. The legislators have, though with some arm twisting, legislated in the public interest rather, than acting in the sole interests of K Street lobbyists and their corporate benefactors. Finally, and most importantly for corporate law, corporate managers and directors will, as a result of heightened enforcement corporate law norms, conform their behavior to their proper role of maximizers of shareholder wealth.

The importance of journalists to corporate law is not merely an academic observation. Both state and federal law explicitly acknowledge the utility of journalism as part of the system of shareholder litigation, both under Rule 10b-5, and state fiduciary law. The procedural hurdles that confront shareholders seeking to bring a derivative action effectively mandate reliance on journalistic reports of company activity. When a shareholder brings a derivative action, the first obstacle is the requirement that the shareholder either make demand upon the board of directors to bring the action itself (a certain path to oblivion for the action), or demonstrate to the court that demand would

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66. See *infra* Part III.D.

be futile and ought to be excused. This latter option, the only viable course of action, is further impeded by the requirement that the plaintiff must plead particularized facts that raise a reasonable doubt that the board is capable of making “an independent decision about whether to assert the claim if demand were made.”<sup>67</sup> This pleading requirement is made all the more difficult by a rule forbidding discovery to acquire the facts needed to be alleged.<sup>68</sup> Instead of discovery, the Delaware courts instruct plaintiffs that they are relegated to the “tools at hand,” judicial jargon for SEC disclosure materials, minute books, and, most significantly for our purposes, news reports.<sup>69</sup> Thus, Delaware corporate law expressly recognizes the importance of financial journalism, and it is relied on as an integral component of the corporate litigation system.<sup>70</sup>

Federal securities law imposes similar informational obstacles to litigants seeking to sue under Rule 10b-5. In 1996, Congress, having formed the impression that meritless securities litigation was flooding the federal courts,<sup>71</sup> amended the Securities Exchange Act of 1934 to impose significant procedural hurdles upon plaintiffs in securities fraud class actions. The heightened pleading requirements of the Private Securities Litigation Reform Act of 1995 (PSLRA)<sup>72</sup> similarly require the pleading of particularized facts sufficient to support a claim of fraud.<sup>73</sup> As in Delaware, PSLRA combines heightened pleading with a more dramatic deviation from prior securities fraud law: plaintiffs do not have access to discovery until they have survived the motion to dismiss.<sup>74</sup> So how are 10b-5 plaintiffs to survive a motion to dismiss

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67. Grimes v. Donald, 673 A.2d 1207, 1216-19 (Del. 1996)

68. DEL. CT. C.P.R. 23.1.

69. See, e.g., Brehm v. Eisner, 746 A.2d 244 (Del. Sup. Ct. 2000) (en banc); Rales v. Blasband, 634 A.2d 927, 934 n.10 (Del. 1993); White v. Panic, 793 A.2d 356 (Del. Ch. 2000) *aff'd*, 783 A.2d 543 (Del. 2001) (stating that a shareholder may “rely on the truthfulness of reports published by reputable media . . .”) *Id.* at 364,

70. For a thorough discussion of litigants’ use of the “tools at hand,” see Stephen A. Radin, *The New Stage of Corporate Governance Litigation: Section 220 Demands*, 26 CARDOZO L. REV. 1595 (2002).

71. See Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1 (1998) (expressing skepticism about the perceived excesses of federal securities litigation).

72. PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995, Pub. L. No. 104-69, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 U.S.C.).

73. 15 U.S.C. § 78u-4(b) (2000).

74. 15 U.S.C. §§ 77z-1(b), 78u-4(b)(3)(B) (2000). See also Borden, *supra* note 47 at 685-94 (discussing PSLRA’s provisions and the legislative process that led to its

without access to discovery? By using the same litany of information sources available under state law, with journalistic reporting playing an often crucial role.

Another point of intersection between corporate law and journalism is found in Regulation FD (“Reg FD”), promulgated by the SEC in 2001. Reg FD, which prohibits selective disclosure to analysts and other market professionals, impacts journalism in a somewhat indirect fashion. As will be discussed in Part IV, by putting journalists on something of an even footing with analysts, Reg FD creates interesting ways for journalists to affect corporate governance.

*A. Investigative Journalists Can Uncover a Deep Fraud and Initiate a Market-Based Response: The Case of Enron.*

The house of cards that was Enron persisted for years right under the noses of every analyst and journalist in the country, not to mention the SEC. But one enterprising journalist was able to begin to penetrate the dense enigma that Enron’s financial reporting had become.

Jonathan Weil, a young reporter for the Wall Street Journal’s Texas regional edition, received a call from a source who told him, “[y]ou really ought to take a look at . . . Enron.”<sup>75</sup> Spurred by this rather nondescript suggestion, Weil embarked on a two month investigation. After steeping himself in the subtleties of accounting for energy derivatives, consulting with accounting and derivatives experts, and interviewing executives at Enron and its competitors, he looked carefully at Enron’s SEC filings.<sup>76</sup> Applying his skeptical eye to the financial disclosure, Weil concluded that Enron’s stated earnings might be substantially inflated. He reported that Enron’s “gain on sale” accounting methods, a method that treated certain unrealized gains from long-term energy related contracts and other derivatives as current profits, were allowing the company to apply undisclosed assumptions about future market conditions to those transactions, thereby booking highly suspect current profits to sustain its share price.<sup>77</sup>

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enactment).

75. Scott Sherman, *ENRON: Gimme an E: Uncovering the Covered Story*, COLUM. JOURNALISM REV., Mar.-Apr. 2002, at 22. available at <http://www.cjr.org/issues/2002/2/enron-sherman.asp>.

76. See *id.*

77. Jonathan Weil, *Energy Traders Cite Gains, But Some Math Is Missing*, WALL. ST. J. (Texas Journal regional insert), Sept. 20, 2000 at T1.

Weil's article, for which he was eventually widely credited in journalistic circles as being the first journalist to break the Enron story, did not cause a splash when it was written. The article, published on September 20, 2000 in an insert in the Texas regional edition of the Wall Street Journal, was not picked up in the national edition. Nor did Weil follow up his story with more reporting.

Nevertheless, the article began a cascade of events that led to the company's unraveling. The article was read by James Chanos, an astute hedge fund manager who used Weil's analysis as a starting point for his own research.<sup>78</sup> Digging through Enron's SEC filings with a skeptical eye, Chanos became convinced that Enron was not being forthright in its disclosures. Chanos pieced together bits of publicly available information about the company to confirm his hunch: that Enron had poor return on invested capital; its executives were selling shares regularly; and its debt was rising. He also tried, and failed, to make sense of a three-paragraph disclosure in a 2000 10-Q about Enron's dealings with a related party.<sup>79</sup> He found it entirely incomprehensible. After discussing it with numerous securities lawyers, derivative specialists and other experts who found it equally impenetrable, Chanos concluded that the company was trying to hide something significant. Finally, Chanos used what he knew about the telecommunications industry to cast doubt upon Enron's claims that its broadband business was a cash cow.<sup>80</sup> Having started with Weil's article, Chanos ultimately convinced himself that Enron was in trouble. Within weeks of the publication of Weil's article, Chanos was taking a large short position on Enron's stock, betting that its price would fall.<sup>81</sup>

Fortune Magazine's Bethany Mclean had been in contact with Chanos in early 2001 and he told her that his firm was skeptical of Enron.<sup>82</sup> He gave her a few reasons why, and she set out to write an exposé on Enron seeking to get to the bottom of the question of how

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78. MCLEAN & ELKIND, *supra* note 50, at 320.

79. *Lessons Learned from Enron's Collapse: Auditing the Accounting Industry: Hearing before the H. Comm. on Energy and Commerce*, 107th Cong. 71-86 (2002) (statement of James Chanos, Kynikos Associates, Ltd.) (explaining how Weil's article highlighting Enron's use of "gain on sale" accounting piqued Chanos' interest in taking a closer look at Enron).

80. *See id.*

81. MCLEAN & ELKIND, *supra* note 50, at 320-21.

82. McLean stated that she "would never have thought of looking at Enron if [Chanos] hadn't tipped [her] off." Sherman, *supra* note 75.

Enron makes its money. The result of McLean's careful research and analysis was a cover story published on February 19, 2001, entitled "Is Enron Overpriced?"<sup>83</sup> McLean's article was the first nationally prominent analysis of the house of cards that Enron was ultimately revealed to be. Not surprisingly, her reporting caused quite a furor at Enron. While Mclean was interviewing company president Jeffrey Skilling, he became enraged at her penetrating questioning and hung up on her.<sup>84</sup>

Sensing that the Fortune article could be seriously damaging, Enron sent a delegation including CFO Andrew Fastow, PR chief Mark Palmer and Mark Koenig, the company's head of investor relations, to Fortune's New York office at dawn the very next morning.<sup>85</sup> Meeting for two hours with McLean and two of her editors, the executives tried to cast the company's financial position in the best possible light, but left without convincing the journalists that McLean's account ought to be changed. In one last desperate ploy, Enron Chairman Kenneth Lay called Fortune's managing editor and suggested he spike the piece.<sup>86</sup> Rik Kirkland refused, and by February 28, Enron's stock price had dropped from \$82 in early January to \$68.50. This fall in Enron's stock price continued over the summer, as more and more investors ceased the willing suspension of disbelief that had buoyed the shares through the previous several years.

The downward momentum in Enron's share price was fueled by a series of news articles written by an ever-widening circle of journalists who followed Weil and McLean's trail. On May 9, 2001, TheStreet.com published a story raising questions about Enron's related party transactions. Then, in August 2001, Jeffrey Skilling resigned after only six months as CEO, a development that led the Wall Street Journal's duo of Rebecca Smith and John Emshwiller to begin an extensive investigation of the company that produced several prominent stories.<sup>87</sup> Their highly damaging revelations detailing Enron's special

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83. Bethany McLean, *Is Enron Overpriced?*, FORTUNE, Mar. 5, 2001, at 122.

84. MCLEAN AND ELKIND, *supra* note 50, at 322.

85. *Id.*

86. *See* Sherman, *supra* note 75.

87. *See, e.g.*, Rebecca Smith and John R. Emshwiller, Enron Prepares to Become Easier to Read, WALL ST. J., Aug. 28, 2001 at C1; Rebecca Smith and John R. Emshwiller, Enron Jolt: Investments, Assets Generate Big Loss—Part of Charges Tied to 2 Partnerships Interests Wall Street, WALL ST. J., Oct. 17, 2001 at C1; Rebecca Smith and John R. Emshwiller, Partnership Spurs Enron Equity Cut—Vehicle is Connected to

purpose entity financing led to the company's implosion.

So what can the story of Weil, Chanos, McLean and others tell us about the role of journalists in the scheme of corporate governance? Enron was an enormous fraud that endured several years before any analyst or journalist noted even a scent of trouble. It was a failure of corporate governance on almost every level. Enron's SEC disclosure was fraudulent, and the SEC never knew until it was far too late. For years, the market rewarded Enron's chicanery. Gatekeepers, from document-shredding accountants, to opinion-letter-writing lawyers, to stock-hyping securities analysts, either passively acquiesced, or actively participated in the wrongdoing.

But through a combination of skepticism, hard work, ability to analyze accounting reports, and cooperation with analysts and other experts, a couple of journalists got the story right and brought the fraud into the light. Weil got the ball up in the air where it was taken up by Chanos, who tipped McLean. Little by little, the story came out and the market responded. Once Enron's share price began its decline, more and more journalists took up the cause. Finally, the SEC got involved and the legal process was underway.

Many have criticized the press for being asleep at the switch during Enron's high-flying days, and no single journalist can be credited fully with bringing the perpetrators of the Enron fraud to justice. But the Enron debacle was years in the making, and journalists played a major part in its undoing.

We can expect that the notoriety and acclaim McLean and others garnered will not go unnoticed by others in their profession. If notoriety and acclaim are not enough, surely some will notice the \$1.4 million dollar advance McLean shared with her co-author, Peter Elkind, for writing *The Smartest Guys in the Room*.<sup>88</sup> Weil went from being a

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Financial Officer, WALL ST. J., Oct. 18, 2001 at C1; Rebecca Smith and John R. Emshwiller, Enron CFO's Partnership Had Millions in Profit, WALL ST. J., Oct. 19, 2001 at C1; John R. Emshwiller, Enron Transaction Raises New Questions—A Company Executive Ran Entity that Received \$35 Million in March, WALL ST. J., Nov. 5, 2001 at A3; Rebecca Smith and John R. Emshwiller, Trading Places: Fancy Finances Were Key to Enron's Success, and Now to Its Distress—Impenetrable Deals Have Put Firm in Position Where it May Lose Independence—Talks with Rival Dynegy, WALL ST. J., Nov. 8, 2001 at A1; Rebecca Smith and John R. Emshwiller, Running on Empty—Enron Faces Collapse As Credit, Stock Dive, and Dynegy Bolt—Energy-Trading Giant's Fate Could Reshape Industry, Bring Tighter Regulation—Price Quotes Suddenly Gone, WALL ST. J., Nov. 29, 2001 at A1.

88. Eric Celeste, *The Claim Game*, DALLAS OBSERVER, Apr. 4, 2002.

reporter for the Texas Journal to being named national accounting correspondent for the Wall Street Journal.<sup>89</sup> All of this suggests that financial journalists have much to gain from effective reporting. There is every reason to believe that more journalists will hone their skills and focus their energies on uncovering frauds with such significant professional rewards to be gained for doing their job well. In so doing, they will advance their self interest and fill an important role in our scheme of corporate governance.

B. Financial Journalists as Catalysts of Judicial and Regulatory  
Process: The Recent Annuities Litigation.

Another role for the financial press is akin to the one played by journalists in the Enron affair. In the Enron story, Weil *et al.* served the system by using their investigative and analytical skills to uncover a very deep fraud. Their reporting catalyzed a market response to the wrongdoing, and led to the end of the fraud, and ultimately to criminal and civil sanctions for the transgressors. The next example illustrates a slightly different role: the press as catalysts of legal process absent significant market ramifications of the type that followed the Enron revelations.

This example involves inappropriate market conduct on the part of large financial services firms engaged in sales of variable annuities. The reporting done by financial journalists brought the wrongdoing to the attention of plaintiffs' attorneys who filed industry-wide class actions that ultimately led the SEC and the National Association of Securities Dealers to address the wrongful conduct. Although this example does not involve the kind of impact on shareholder welfare as the sort of corporate fraud carried out by Enron's leaders, it is nevertheless important because it implicates a very tricky question in corporate law. How are shareholders to view wrongful or illegal conduct by managers that is profitable, even in light of criminal or civil fines that may be imposed *ex-post*? This is essentially a question about corporate compliance, an area that has received renewed attention since *In re Caremark Inc. Derivative Litigation*,<sup>90</sup> and one that affects shareholders differently than does financial fraud. In compliance cases, wrongful

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89. Weil has since left journalism for a lucrative position as Managing Director of Glass, Lewis & Co. LLC, an independent investment research and proxy management firm.

90. 698 A.2d 959 (Del. Ch. 1996). See *infra* Part III.C.

market conduct, when detected, often causes significant losses in shareholder wealth because of heavy fines imposed by regulatory authorities, as well as costly settlements in private litigation.

Beginning in 1997, financial journalists began paying significant attention to a little known, but far-reaching and costly bit of consumer abuse perpetrated by insurance and financial services companies. Insurance companies were making money hand over fist by making unsuitable sales of variable annuities, a tax-deferred retirement investment product, to investors who purchased these instruments with moneys from their IRAs, 401(k)s and other tax deferred investment accounts (so-called “qualified plans”).<sup>91</sup> The problem with such sales is that a consumer buying an investment with tax deferred dollars has no need for the most valuable feature of a variable annuity (tax deferral), and would get the same benefits by buying a mutual fund and annuitizing it at retirement. But commissions earned by salespersons and fees charged by the corporations who peddled variable annuities were much higher for variable annuities than for mutual funds. Salespersons, induced by large commissions, inappropriately sold tens of billions of dollars of variable annuities into qualified plans. As a result, investors lost tens of millions of dollars of retirement funds by paying outsized fees and commissions. This abusive sales practice had persisted industry-wide for over a decade, with no notice from any of the regulatory agencies.<sup>92</sup>

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91. A variable annuity is a two-part investment product. During the first phase, the “accumulation phase,” a variable annuity works like a mutual fund. The investor chooses from a menu of investment options reflecting his risk and return preferences and the shares in the fund grow, tax deferred, for a period of years. This tax-deferral is of considerable value, because gains from mutual funds sold independently of annuities are taxed annually. Over time, the savings are considerable. During the second phase, the annuitization phase, the money in the fund is annuitized, and the investor receives a guaranteed monthly or quarterly payment for as long as she lives. In this way, a variable annuity can be a meaningful hedge against the risk of outliving one’s assets. The problem is that the excessive commissions, management fees and other charges assessed by the purveyors of mutual funds eat much of the tax savings, leaving the investor at the end of the accumulation phase with a much smaller pot of money to annuitize and thus a smaller annuity for life. By contrast, had the investor placed the money from her 401(k) or IRA in a mutual fund, she would have received the same tax-deferred growth without the excessive charges. Upon retirement she could have placed the accumulated wealth in an annuity or disposed of it otherwise, as she saw fit. *See Borden, supra* note 47, at 702-07.

92. For a more complete discussion of the unsuitable sales of variable annuities and the litigation and regulatory action that followed, see Borden, *supra* note 47, at 702-07.



However, the June 1996 cover of Fortune magazine screamed in huge typeface: “The Great Annuities Rip-Off.” Soon, a flood of articles in major publications featured headlines decrying this scandal.<sup>93</sup> By early 1998, the prominent plaintiffs’ firm Milberg, Weiss, Bershad, Hynes & Lerach had taken up the cause and had sued virtually all major purveyors of variable annuities.<sup>94</sup>

It turns out that the media coverage that brought national attention to these inappropriate sales had attracted some attention among plaintiffs’ attorneys. In fact, Ron Uitz, a Washington attorney who had become aware of the problem arranged a meeting with partners at Milberg Weiss in an attempt to induce the powerful firm to initiate litigation against several insurance companies. The class action specialists initially declined to pursue the matter, but within days of this first meeting, another article on unsuitable sales of variable annuities appeared in the Wall Street Journal.<sup>95</sup> After discussing this article, the partners at Milberg Weiss called Uitz and asked him for another meeting, during which they decided that the matter deserved their attention.<sup>96</sup> The attorneys soon filed class action complaints against over twenty major insurance companies. The litigation that followed generated significant settlements as well as regulatory action, not to mention substantial amounts of billable hours put in by this writer and countless other attorneys.

Not only did the reports in the financial media bring the

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93. See, e.g., Ellen E. Schultz & Bridget O’Brian, *Annuity Buyers May Be Overdosing on Tax Deferral*, WALL ST. J., July 28, 1997 at C1; David Franecki, *Caution Is Urged on Annuities and IRAs*, WALL ST. J., July 20, 1998 at C1.

94. Ron Panko, *Can Annuities Pass Muster? Attorneys take Insurance Companies to Court*, BEST’S REV., July 1, 2000, at 103; Deborah Lohse & Bridget O’Brian, *Lawyers Seek Class Action Against Insurers over Annuities*, WALL ST. J., Nov. 9, 1999, at C1. In 2003, Milberg Weiss Bershad Hynes & Lerach LLP was separated into two groups. Milberg Weiss Bershad & Schulman LLP served as the continuing firm. On January 1, 2007, Milberg Weiss & Bershad LLP became the name of the firm.

95. See Schultz & O’Brian, *supra* note 93, at C1.

96. The account of how the Wall Street Journal article instigated the litigation was provided in an e-mail from Ronald Uitz. E-mail from Ronald Uitz, (Aug. 14, 2006) (on file with the author). The lead attorney in the variable annuities litigation reports that “[w]e . . . were looking at a number of possible theories, advanced by various specialized lawyers . . . , for claims against annuity issuers at the time. [Uitz’s] idea came to the forefront because it seemed the most persuasive theory, applied against the most flagrant abuse—and the article may have had some effect in helping us realize that.” E-mail from Michael Spencer, Milberg Weiss (Feb. 13, 2007) (on file with author).

wrongdoing to the attention of plaintiffs' lawyers, but they also provided a substantial amount of information that ended up in the class action complaints served in the cases. As a young attorney working for a firm that represented a number of the annuities defendants, I recall a binder filled with news stories about annuities that was distributed to each attorney working on the cases. Before responding to discovery requests and interviewing our clients, we schooled ourselves on the details of variable annuities by studying the articles in the binder. Armed with this background, we were sufficiently expert to begin our document production and interviewing work.

Later in 1998, and repeatedly through the years, the SEC, NASD and state insurance regulators, prodded to action by the large quantities of litigation in the courts, began to investigate the matter<sup>97</sup> and published investor alerts warning unwary consumers of the duplicative and costly impact of placing a variable annuity in a qualified plan.<sup>98</sup> Much of the litigation ultimately settled at considerable cost to the various corporations, with the NASD fining American Express Financial Advisors the relatively modest sum of \$350,000, and levying fines on several other sellers totaling over \$250,000.<sup>99</sup> Dwarfing the NASD fine was the \$215 million settlement paid to plaintiffs by American Express Financial Advisors' parent company.<sup>100</sup>

If we take the \$215 million settlement paid by American Express Financial Advisors, a subsidiary of the American Express Corporation,

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97. *NASDR Focuses on Internal Supervision*, INS. REGULATOR, July 7, 1997, at 1 (reporting that Roger B. Sherman, vice president of NASD Regulation, Inc., announced the NASDR's investigation of the matter to a conference sponsored by the National Association for Variable Annuities and conveyed to attendees his concerns about sales of variable annuities into qualified plans).

98. See NASD, *Notice to Members 99-35, The NASD Reminds Members of Their Responsibilities Regarding the Sales of Variable Annuities*, 231 (May 1999) (instructing sellers to "disclose to the customer that the tax deferred accrual feature is provided by the tax-qualified retirement plan and that the tax deferred accrual feature of the variable annuity is unnecessary."); SEC *Investor Alert—Variable Annuities: What You Should Know*, available at <http://www.sec.gov/investor/pubs/varanntty.htm> (last visited Feb. 15, 2007).

99. See Jeffrey S. Poretz & Nicole Griffin, *NASD Turning up the Pressure on VA Suitability*, NAT'L UNDERWRITER LIFE & HEALTH - FIN. SERVICES EDITION, Apr. 7, 2003, at 36; Jeff Benjamin & Rick Miller, *Short Interests: AmEx Fined for Suitability Infractions*, INVESTMENT NEWS, Dec. 9, 2002, at 2.

100. Panko, *supra* note 94, at 103. Settlement figures for other defendants were not disclosed.

as an example, we might ask whether the media actually played a role beneficial to shareholders. Perhaps it can be argued that shareholders would have been better off if no one knew about the affair. When a company is sued for wrongful conduct in the marketplace, the suit is brought on behalf of a constituency to which the directors do not owe a fiduciary duty. But that is not to say the corporation does not owe its customers a duty of care. Such a duty comes from various sources: common law contract doctrine, state insurance law, and state law governing the relationship between “financial advisors” and their clients.<sup>101</sup> The concurrent duties owed to both shareholders and the public creates a tension between the quest for profit and appropriate behavior in the marketplace. Ultimately, it is the role of the courts, legislatures and regulatory authorities to create penalties calibrated to deter wrongful market conduct for the protection of consumers. When corporations seek higher profits by taking advantage of informational asymmetries between themselves and consumers, they risk harming their shareholders by exposing the corporation to fines, civil judgments and settlements. The annuities litigation demonstrates the ability of journalists to catalyze legal process benefitting both consumers and shareholders.<sup>102</sup>

C. Journalists Can Influence Standards of Review in Compliance  
Litigation

The two preceding examples of the roles journalists can play have focused on journalists digging up information about corporate malfeasance and serving it to different kinds of users. In the Enron story, the proximate users of the information were market players—investors and analysts. In the annuities story, the users were players in the judicial realm—plaintiffs attorneys and ultimately regulatory bodies. The next example will illustrate a role more intrinsically legal. I will

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101. For a discussion of various theories of duty applicable in the sale of variable annuities, see Borden, *supra* note 47, at 722-29.

102. Interestingly, the litigation and regulatory process instigated by journalistic reporting on variable annuities seems to have benefited neither shareholders nor the public. On the one hand, American Express had to dole out \$215 million, a settlement that no doubt displeased its shareholders. On the other hand, it turns out that in the years that followed the variable annuities litigation, the percentage of sales of variable annuities that were bought by consumers with moneys from their qualified plans actually *increased*. Thus this particular body of litigation may have had minimal social value. See *id.* at 733-36 (emphasis added).

demonstrate that in corporate compliance litigation, journalistic revelations, beyond serving as a source of information for pleading and directing discovery, can serve as a benchmark for evaluating both corporate compliance programs and ultimately the legal standards under which the adequacy of those programs are adjudicated.

Journalists can play an important role in corporate compliance, governed by the landmark Delaware case, *In re Caremark Derivative Litigation*.<sup>103</sup> The *Caremark* decision provides a legal framework for dealing with one of the problems caused by the multi-layered management structure in large corporations. When criminal or otherwise unlawful actions cause harm in the form of settlements, criminal and civil fines or other charges, shareholders suffer.<sup>104</sup> Yet managers and directors may be immune from personal liability in such situations because corporation law permits firms to indemnify managers and directors for the costs imposed in civil, criminal or regulatory actions under many circumstances.<sup>105</sup> Moreover, in large corporations, the many layers of management responsibilities make it very unlikely that top management and directors will be aware of wrongdoing by their subordinates. Under such a scheme of informational insulation and legal indemnification, there is little incentive upon managers and directors to prevent such activities and the harm they cause to shareholder welfare. What is more, the unlawful actions involved in *Caremark*, *Allis-Chalmers*, and similar compliance cases frequently involve profitable activities that enrich shareholders, at least to the extent that they do not come to the attention of legal authorities.

Revisiting a 1963 Delaware Supreme Court ruling viewed as highly deferential to management,<sup>106</sup> the recent *Caremark* case suggests, in dicta, that in order to avoid liability for breach of the duty of care, management must establish a rationally devised internal monitoring and supervision structure, commonly known as a compliance program, to ensure that wrongdoing be detected and rectified. Whereas the older *Graham v. Allis-Chalmers* case has been likened to the one-bite rule for dog owners,<sup>107</sup> the *Caremark* decision clarified that managers and

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103. 698 A.2d 959 (Del. Ch. 1996).

104. For example, in *Caremark*, a government investigation of criminal activities by employees of Caremark and its predecessor resulted in fines and settlements totaling more than \$250 million. *Id.* at 970.

105. DEL. CODE ANN. tit. 8 § 145 (2006).

106. See *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963).

107. Kellye Y. Testy, *Adding Value(s) to Corporate Law: An Agenda for Reform*, 34

directors are not immune from liability for wrongful acts by subordinates unless a rationally designed compliance system is in place.

Yet *Caremark* has been criticized as a paper tiger, both because it provides management with a significant safe harbor from liability, and because legally adequate compliance programs are insufficiently rigorous to detect much wrongdoing.<sup>108</sup> The lack of rigor stems from the deferential legal standard used to adjudicate liability for managers' failure to monitor. An outgrowth of the business judgment rule, the *Caremark* standard only requires good faith in designing the monitoring and reporting system. As Chancellor Allen wrote:

The level of detail that is appropriate for [the required] information system is a question of business judgment. And obviously too, no rationally designed information and reporting system will remove the possibility that the corporation will violate laws or regulations, or that senior officers or directors may nevertheless sometimes be misled or otherwise fail reasonably to detect acts material to the corporation's compliance with the law. But it is important that the board exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibility.<sup>109</sup>

The *Caremark* case is important for our purposes because compliance presents another role for journalists in corporate law. As things currently go, journalists already play a role in the *Caremark* scheme. Litigants commonly rely on news reports in the preliminary phases of derivative actions alleging breaches of the duty to monitor.<sup>110</sup> Plaintiffs frequently rely on newspaper stories to formulate the allegations in their complaints. Indeed this reliance is inevitable, given

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GA. L. REV. 1025, 1040 (2000).

108. See Charles M. Elson & Christopher J. Gyves, *In Re Caremark: Good Intentions, Unintended Consequences*, 39 WAKE FOREST L. REV. 691 (2004).

109. *Caremark*, 698 A.2d at 971.

110. See, e.g., *Landy v. D'Alessandro*, 316 F. Supp. 2d 49, 60 (Dist. Mass. 2004) (complaint alleging that Wall Street Journal reports put defendants on notice of wrongdoing); *Salsitz v. Nasser*, 208 F.R.D. 589, 594 (E.D. Mich. 2002) (complaint relying on New York Times article showing that, despite contrary claims to regulators, company officials were aware of safety hazard that led to tort liability). *But see Saito v. McCall*, 2004 Del. Ch. LEXIS 205 at 33 (commending allegations in complaint that went "beyond articles in trade magazines and newspapers").

the lack of access to discovery in the early stages of a derivative action, and Delaware's mandate to rely on the "tools at hand,"<sup>111</sup> including news media reports. Journalistic reporting can thus serve the procedural function of aiding a litigant in getting past a motion to dismiss. Beyond this initial stage, once a complaint survives the motion to dismiss, the factual premises relayed by journalists can serve as a starting point for a more in-depth investigative process once discovery begins. This use of journalistic reports is essentially the one described in the context of the annuities litigation.<sup>112</sup>

But on a deeper level, journalistic reporting can serve a more intrinsic legal function in *Caremark* litigation. Journalists' work might come to be used as a benchmark for judging the efficacy of a compliance system. Management defendants frequently argue, with success,<sup>113</sup> that despite the existence of their compliance program, they were nevertheless unaware of the wrongdoing alleged.<sup>114</sup> In so arguing, they rely on the director-friendly standard (rationally designed in good faith) announced in *Caremark*. If plaintiffs are routinely able to defend on the basis of a minimally functional monitoring and reporting system, then the situation arises in which we can imagine a competition between journalistic reporting and the internal reporting of a compliance program. What will courts make of the fact that plaintiffs are consistently able to allege factual matters made public by newspapers, but allegedly unknown to corporate managers with the aid of a compliance system? Perhaps this portends some instability in *Caremark* jurisprudence.

Take, for example, the facts of *Caremark* itself. Shareholders sued Caremark after the company settled regulatory enforcement actions for over \$250 million for making illegal payments to doctors for referrals, transactions that were carried out by mid-level functionaries.<sup>115</sup> At the time of the governmental investigations that led to the settlement, Caremark had a compliance system in place. Evidently it did not work.<sup>116</sup> Yet it is not hard to imagine journalists easily uncovering

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111. See, e.g., *Brehm v. Eisner*, 746 A.2d 244, 248 (Del. 2000).

112. See *supra* Part III.B.

113. See, e.g., *In re Abbot Labs: Derivative Shareholders Litig.*, 325 F.3d 795, 809 (7th Cir. 2003).

114. See *Ash v. McKesson HBOC*, 2000 Del. Ch. LEXIS 144 (Del. Ch. 2000).

115. See *In re Caremark Derivative Litigation*, 698 A.2d 959, 961 (Del. Ch. 1996).

116. As is typical with shareholder derivative suits, the *Caremark* case settled, so the court did not rule on the adequacy of Caremark's compliance system. Nevertheless, the

details about the illegal activities. Recall that journalists often find information about a company from sources outside the company, not by asking insiders. By talking to Caremark's competitors, and the physicians with whom it did business (and others with whom it did not), a reporter could, without much trouble, have found out about the illegal payments at issue in the case.

With reporters discovering and publishing information that compliance systems might miss, the excessive generosity to defendants of the *Caremark* standard comes into vivid focus. But it is unclear whether such a development will cause the Delaware courts to reconsider this deferential standard. That does not necessarily mean that reporting on compliance issues will be ineffectual. Rather, it is fully possible that a series of compliance cases finding managers not liable, but found to have been scooped by reporters about wrongdoing going on under their noses, may still have a positive effect on governance. One possibility is that even while escaping liability, the directors might suffer such embarrassment, or damage to their reputation, that they generally will begin to take compliance more seriously. Another possibility is that judges, bound by *Caremark* to absolve culpable behavior, will take the opportunity to shame the managers in question in the way that David Skeel has suggested.<sup>117</sup> Given the awkwardness of cases continually involving publicly reported illegality that escapes the attention of a rationally devised compliance system, judges applying *Caremark* might feel a need to impose the only sanction they have at their disposal: expressions of opprobrium.

Alternatively, and more optimistically, the judicial understanding of what comprises a rationally devised compliance system could change to reflect the reality that internal monitoring ought, as a legal matter, to be able to detect wrongdoing that curious journalists are able to detect. Such a reform, however, seems fairly unlikely. One reason for such pessimism is that the incongruence I have suggested between what compliance systems detect and what journalists detect is based upon aggregate experience; litigation under *Caremark*, and the business judgment rule, only embrace the facts of the case before the court, and the experience of the compliance system in question. Where the legal rule asks only that the defendants act in good faith and in a rational

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ease with which the standard is satisfied has been clearly announced by the Delaware courts.

117. See Skeel, *supra* note 24 at 1823-26.

manner, the cumulative experience of other companies, other illegal acts, and other journalists is not relevant to the judicial inquiry under *Caremark*.

It is possible, however, that Delaware *Caremark* jurisprudence post-Enron may come to embrace a more demanding standard. In a 2003 law review article, then-Chief Justice of the Delaware Supreme Court Norman Veasey discussed the tension between the deference of the business judgment rule and the “evolving expectations of the standards of conduct of directors and others,”<sup>118</sup> particularly in the context of the duty of good faith. While being careful not to commit to a change in the court’s approach, Veasey noted:

[A]s a matter of prudent counseling, boards should be told that it is arguable—but not settled—that the issue of good faith may be measured not only by the evolving expectations of directors in the context of Delaware common law fiduciary duty, but also against the backdrop of Sarbanes-Oxley and the SRO requirements . . . .<sup>119</sup>

In Veasey’s reference to Sarbanes-Oxley, we see an example of the intersection of state and federal corporate law—in this case federal criminal enforcement against corporations. Federal criminal prosecutions of corporations are governed by guidelines set out in a memorandum from the Deputy Attorney General entitled “Principles of Federal Prosecution of Business Organizations”<sup>120</sup> (the “Thompson Memo”). Under these guidelines, prosecutors are to consider various factors in making the decision to charge a corporation. One factor to be taken into account is the existence of a corporate compliance program. The Thompson Memo cites *Caremark* but goes beyond the case’s lenient approach, advising prosecutors to ask “is the corporation’s program well designed? . . . [d]oes the corporation’s compliance program work?”<sup>121</sup> The memo advises prosecutors to determine whether the compliance program is “merely a ‘paper program,’ or whether it was designed and implemented in an effective manner.”<sup>122</sup> Compared with

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118. E. Norman Veasey, *Policy and Legal Overview of Best Corporate Governance Principles*, 56 SMU L. REV. 2535, 2539 (2003).

119. *Id.* at 2144.

120. Memorandum from Larry D. Thompson, Deputy Attorney General to Heads of Department Components, United States Attorneys, January 20, 2003. *available at* [http://www.usdoj.gov/dag/cftf/corporate\\_guidelines.htm](http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm) (last visited Feb. 15, 2007).

121. *Id.* at 9.

122. *Id.* at 9-10.



Delaware's standard of a "rationally designed" compliance program, it appears that the Department of Justice will take a more aggressive position in evaluating corporate compliance when pursuing criminal actions against corporations under Sarbanes-Oxley and other federal criminal statutes.

Indeed, the idea of using journalistic revelations as a benchmark for evaluating internal corporate monitoring has a particular application under Sarbanes-Oxley. Section 404 of the Act requires managers of issuing companies to report annually on the effectiveness of their company's financial reporting internal controls.<sup>123</sup> It is as yet unclear how aggressively the SEC will enforce this provision, and how much latitude it will grant issuers whose internal controls fail to adequately obstruct would-be falsifiers. It will be interesting to see whether the federal courts adopt a more searching standard than the *Caremark* standard. In any event, if journalists routinely display an ability to detect wrongdoing that a corporation's internal controls are unable to prevent or identify, plaintiffs and prosecutors will have a strong argument that the controls were inadequate.

Perhaps Veasey was referring to the Federal Sentencing Guidelines and looming litigation when invoking "evolving expectations . . . against the backdrop of Sarbanes-Oxley." If so, then the scholarly debate about state-federal competition in corporate law, and the fear of a race to the bottom,<sup>124</sup> takes on a more optimistic cast. Delaware courts may be

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123. 15 U.S.C. § 7262 (2002).

124. See William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 668 (1974) (contending that state corporate law competition results in a race to the bottom); Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 IOWA J. CORP. L. 625, 630 (2004). For a discussion of the race-to-the-top argument see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW*, 212-27 (1991); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporate Law*, 76 NW. U. L. REV. 913, 919-20 (1982); ROBERTA ROMANO, *GENIUS OF AMERICAN CORPORATE LAW*, 2-12 (1993); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 258 (1977). In the context of securities regulation, several commentators have argued for greater regulatory competition. See Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998); Alan R. Palmiter, *Toward Disclosure Choice in Securities Offerings*, 1999 COLUM. BUS. L. REV. 1; Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998). For a discussion of the race-to-the-bottom hypothesis, see Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV.

faced with a dilemma if federal prosecution decisions, and the prosecutors themselves, rely on journalistic accounts, as a benchmark for evaluating the efficacy of compliance programs under the heightened standard the Thompson Memo suggests. In such a scenario, Delaware may find itself with cases in which journalists outperform compliance programs deemed legally sufficient under state law, but criminally actionable under federal law. Under such conditions, Delaware's courts might be expected to ratchet up the standard for what constitutes a legally sufficient compliance program.

The foregoing analysis of the role of journalists in compliance cases suggests that they are able to serve as more than information feeders to markets and litigants. If journalists are able to outperform a corporate compliance program in a particular case, whether under *Caremark* or Section 404 of Sarbanes-Oxley, they present an argument that the compliance program in question is inadequate. Although that argument is not likely to succeed under the current *Caremark* standard, there are signs that Delaware's standard of good faith may evolve into something more rigorous. Thus, beyond their utility in individual cases, journalists may ultimately serve as a kind of Greek chorus, reminding the Delaware courts of the inadequacy of the standard for corporate compliance programs under *Caremark*.

*D. Financial Journalists Can Impact the Legislative Process.*

Another important recent change in the world of corporate law has been the federalization of corporate governance. Corporate law has long been a state matter, with Delaware leading the states in competence and impact. In fact, the Delaware courts have arguably been the most important governmental actors in corporate governance matters. But in 2002, Congress made its first significant modern encroachment on the primacy of state corporate law.

The Sarbanes-Oxley Act of 2002 imposed several new duties on various corporate actors and gatekeepers aimed at reducing corporate fraud. These provisions have been ably explained elsewhere and have generated substantial commentary, both positive and negative.<sup>125</sup>

Sarbanes-Oxley has met with decidedly mixed reactions from corporate law scholars. Some believe it is a useful initial step in

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L. REV. 1435, 1455-56 (1992).

125. See, e.g., Ribstein, *supra* note 21.

improving corporate governance. Others believe its mandates are entirely too onerous, and will create substantial friction in the economy while bringing little in the way of benefits.<sup>126</sup> This Article is not concerned with evaluating the merits of the Act; rather this Part will consider the ways in which it has been, or will be affected by financial journalists.

The federalization of corporate law implicates journalists in two important respects. As I will briefly discuss in this Part, the federalization of corporate law can be viewed, to some degree, as the result of journalistic attention to the scandals of Enron, WorldCom and others. But another, equally important aspect of Sarbanes-Oxley is the continuing role the financial press will play in its ongoing vitality and vigor.

1. The Role of Journalists in Bringing Sarbanes-Oxley into Existence.

In the early years of this decade, with headlines screaming about various mega-scandals, it became impossible for the President and Congress to ignore the crisis in corporate governance, and the resulting impact on investor confidence and capital markets. One could scarcely glance at a newspaper without being reminded of the constant revelations of hideous corporate wrongdoing. In such an atmosphere, the President and Congress had no choice but to confront the problem and attempt to make strong reforms. Despite the Bush administration's strong pro-business bent and the President's own personal relationship with Kenneth Lay, the media outcry became so insistent that the President conspicuously denounced Enron and others while proudly trumpeting reform efforts.<sup>127</sup> With strong backing from the White House, and despite opposition from corporate lobbyists used to having their way in Washington, Congress bit the bullet and enacted Sarbanes-Oxley.<sup>128</sup>

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126. See, e.g., Michael Schroeder, *Critics Say Sarbanes-Oxley Hobbles Stocks, Chills Risk Taking, But Upshot Is Far Less Dramatic*, WALL ST. J., July 22, 2003 at C1.

127. President Bush, surrounded by smiling lawmakers, announced at the signing ceremony that "[t]he era of low standards and false profits is over . . . . No boardroom in America is above or beyond the law." Elisabeth Bumiller, *Corporate Conduct: The President; Bush Signs Bill Aimed at Fraud in Corporations*, N.Y. TIMES, July 31, 2002, at A1.

128. Congressional sensitivity to the public's awareness and comprehension of the corporate scandals was nicely expressed by Senator Jon Corzine. "The politics will be

Although it seems intuitively obvious that media attention forced Congress to act, it may be difficult to prove. Legislators, like many of the actors discussed in this paper, are riven by conflicts of interest. Although they ostensibly serve in order to legislate in the public interest, their self-interest in retaining their seats sometimes conflicts with that public calling. With money as the lifeblood of electoral success, and special interests providing the bulk of that money, legislators do all they can to appease their benefactors, even when that means failing to appropriately address important matters of public policy.<sup>129</sup> Only when policy issues become important and visible enough to the electorate will politicians take action that displeases their corporate benefactors.<sup>130</sup> With scandal after scandal dominating the news in 2001 and 2002, it became impossible for Congress to avoid action.<sup>131</sup>

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determined by the circumstances . . . if we continue to see an erosion of the stock market and more cases like Adelphia and Tyco, then it will be significant. If we see less, then it may have less of an impact, because these can become issues that are hard for people like my mom to understand.” Stephen Labaton & Richard A. Oppel Jr., *Enthusiasm Waning in Congress for Tougher Post-Enron Controls*, N.Y. TIMES, June 10, 2002 at A16.

129. See Stephen Labaton, *Enron’s Collapse: Regulation; Audit Changes Are Facing Major Hurdles*, N.Y. TIMES, Jan. 24, 2002, at C7. “Congress appears reluctant to impose stricter standards on the accounting profession, an industry that is among its largest political patrons . . .” *Id.* This initial legislative foot dragging was overcome as more and more scandals hit the front pages. According to one story,

The legislation has enjoyed extraordinary momentum in the last three weeks, but its outlook had been cloudy until mid-June. While Mr. Sarbanes had managed to get the bill out of his committee on a bipartisan vote, lobbyists and some leading Republicans had pledged to rewrite it when it got to conference committee.

That changed, however, as the scandals at Tyco, Adelphia and WorldCom, and the perception that the fall in the stock market stemmed from a loss of investor confidence, made it increasingly risky for any politician to object to the measure.

Richard A. Oppel Jr., *Negotiators Agree on Broad Changes in Business Laws*, N.Y. TIMES, July 25, 2002 at A1.

130. See Labaton & Oppel *supra* note 128, at A16; see also Bumiller, *supra* note 127, at A1.

131. See Bumiller, *supra* note 127; see also Patricia A. McCoy, *Crisis in Confidence: Corporate Governance and Professional Ethics Post-Enron: Realignment Auditors’ Incentives*, 35 CONN. L. REV. 989, 999 (2003) (asserting that

By July 23, 2002, in the month following WorldCom’s revelation that it had overstated its cash flow by \$ 3.9 billion, the S&P 500 had dropped twenty percent and public furor over the accounting scandals had exploded. Under intense public pressure, Congress stopped its bickering and rushed through passage of the Sarbanes-Oxley Act of 2002.

*Id.*

2. Exerting Political Pressure to Ensure Adequate SEC Funding.

But the impact of media attention on the legislative process leading to the enactment of Sarbanes-Oxley is only part of the picture. What may prove more important is the media's ongoing role in ensuring the efficacy of SEC enforcement efforts pursuant to Sarbanes-Oxley. Perhaps it can be said that passing Sarbanes-Oxley was the easy part. Implementation and enforcement of its provisions do not follow automatically. The nature of federal regulatory law involves an empowering statute, and a directive from Congress to the agency in question authorizing the promulgation of rules and regulations pursuant to a broad legislative mandate. Moreover, in order for the SEC to implement and enforce the provisions of Sarbanes-Oxley, Congress must appropriate sufficient funds to make the Act more than a paper tiger.

An important factor to be weighed when considering the good to be accomplished by an active financial press is Congress' relative lack of sophistication regarding corporate governance and securities issues.<sup>132</sup> As one commentator noted in the 1990s, "the ultimate provisions adopted by Congress . . . reflect a deficient understanding of the American system of corporate structuring, particularly the separation of corporate ownership and control."<sup>133</sup> Viewing Congress in this light, it is possible to appreciate a potentially unwanted effect of a robust press. Some commentators have argued that Sarbanes-Oxley was a hasty, ill-advised, and misguided legislative stampede motivated by a desire to respond to political pressure caused by a public demand for reform fueled by journalistic accounts of corporate fraud.<sup>134</sup>

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132. See Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 CONN. L. REV. 915, 986 (2003) (asserting that "Congress may know almost nothing about corporate law."); Wells M. Engledow, *Handicapping the Corporate Law Race*, 28 IOWA J. CORP. L. 143, 170 (2002) (noting that "Congress may not understand efficient regulation of corporate matters.").

133. Kurt Hartmann, Comment, *The Market for Corporate Confusion: Federal Attempts to Regulate the Market for Corporate Control through the Federal Tax Code*, 6 DEPAUL BUS. L.J. 159, 178 (1994).

134. See Romano, *supra*, note 21.

The debate over the nonaudit services prohibition was, therefore, in large part a replay of a battle over the regulation of the accounting industry fought two years earlier when Levitt was SEC chair. But the environment this time was markedly different. There was a media frenzy, heightened by a sharply declining stock market and high-profile accounting frauds and business failures, in the middle of an election year. For example, the major network evening news coverage between January and July 2002

Even assuming that these critics are correct on the merits, this may be a case of blaming the messenger, for surely it is more accurate to say that Sarbanes-Oxley was an ill-advised stampede instigated by the egregious wrongdoings of corporate executives. In any event, knowing what we know about how politicians respond to headlines importuning crises, it is not farfetched to predict that a continuing drumbeat of press reports highlighting financial fraud might lead to more legislative forays that may prove to be more or less misguided. In light of Congressional incompetence in this area of law, it is necessary to briefly consider the institutional structure of federal regulation of corporate governance under Sarbanes-Oxley.

While many of the substantive legal changes brought about by Sarbanes-Oxley are in the form of legislative mandates aimed at private actors,<sup>135</sup> others are directives aimed at the SEC, to implement and enforce the policies and norms outlined by Congress in the Act. The Act requires the SEC to promulgate rules in areas Congress identified as needing regulation,<sup>136</sup> to more regularly review the filings of reporting companies,<sup>137</sup> and to generate reports on various matters of concern.<sup>138</sup> This power sharing arrangement between Congress and the SEC shifts the burden of oversight and regulation from a less-technically competent

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contained 613 stories on business, of which 471 (77%) were about corporate scandals; of those stories, 195 connected corporations to Congress (individual members or the institution itself), while 188 connected corporations to the Bush Administration. These figures compare to a total of 489 business stories, of which only 52 (11%) were about scandals, in the same period the prior year. Moreover, more than 80% of the scandal-related stories looked to government action to address the problem. In this charged atmosphere, Levitt's earlier reform proposals now seemed prescient (at least to the Democrats for whom Levitt was a source of expertise), and the accounting industry had lost its public credibility with the audit failures.

*Id.* at 1590.

135. For example, Section 403 of the Act directly requires large shareholders, directors, and officers of issuers to file statements of their stock holdings in the issuer. 15 U.S.C. § 78p (2002).

136. For example, Section 307 of the Act, requires the SEC to promulgate rules "setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers . . ." 15 U.S.C. § 7245 (2002).

137. Section 408 of the Act, requires the SEC to review the periodic disclosures of each reporting company no less frequently than once every three years. 15 U.S.C. § 7266 (2002).

138. Section 702 of the Act requires the SEC to study and report on credit rating agencies. 15 U.S.C. § 7202 (2002). Section 703 of the Act requires the SEC to study and report on recent enforcement actions. 15 U.S.C. § 7203 (2002).

body to one that is much more expert. In view of the strong influence exerted by corporate lobbyists upon Congress, there is some reason to be optimistic that future responses to corporate crises will be channeled through the SEC—a much more technocratic institution.<sup>139</sup>

If journalistic activity, and the resulting political pressure that it may instigate, pose some hazard of misguided legislation, they also have the potential to produce something more beneficial: pressure upon Congress to adequately fund the SEC's enforcement efforts. In Enron's wake, the passage of Sarbanes-Oxley represented a significant shift in the locus of corporate governance regulation from the states to Congress. As mentioned, the SEC is charged with enforcement and implementation of the new federal regulation. But regulatory oversight requires money, and Congress must be continually prodded to appropriate funds to ensure adequate enforcement.

There are two reasons to suspect that sufficient funding is unlikely to materialize without public pressure. First, in an era of budgetary deficits and significant anti-regulatory ideology, Congress will always be looking to scale back line item appropriations in the budgeting process. Second, as a result of special interest lobbying by powerful corporate constituencies, legislators have conflicts of interest that inhibit them from making responsible budgeting decisions. This conflict further reduces the likelihood of adequate funding for the SEC.

Even in the immediate aftermath of Enron, when Congress seemed to be implementing badly needed reforms by enacting Sarbanes-Oxley, it continued to demonstrate the limitations in its commitment to real corporate reform. As Professor Joel Seligman has pointed out, in July 2002 "Congress 'authorized' but did not then appropriate, a 66% increase in the Commission's budget."<sup>140</sup> Only three months after the President signed the Sarbanes-Oxley Act, which included among its provisions an increase in the Commission's budget from \$438 million to \$776 million, the White House requested that Congress appropriate only \$568 million for the SEC.<sup>141</sup> Although Bush had specifically touted the

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139. The SEC's rule-making process is marked by an active period of public input, with corporate lawyers and other corporate interests taking full advantage of their opportunity to comment on proposed rules.

140. See Joel Seligman, *Self-Funding for the Securities and Exchange Commission*, 28 NOVA L. REV. 233, 254 (2004) (arguing that the SEC's chronic under-funding problem could be solved by permitting it to fund itself with the fees it collects through its normal operations).

141. See Stephen Labaton, *Bush Tries to Shrink S.E.C. Raise Intended for Corporate*

heightened appropriations during the signing ceremony for the Act in the summer of 2002, by October the political calculus had apparently changed. By renegeing on the budgeting provision, Bush apparently believed that the public would either not pick up on the change, or that the clamor over the scandals had become sufficiently muted that it was safe to hold back on appropriations.<sup>142</sup>

Ultimately, despite the White House's attempts to roll back funding, the SEC got most of what Congress authorized.<sup>143</sup> In fact, SEC appropriations have remained strong in the years since the passage of Sarbanes-Oxley. But the continued vitality of SEC enforcement efforts remains subject to the vicissitudes of the political horse-trading that marks the budgeting process, and indeed the entire legislative process. In order to ensure sufficient financial support for the enforcement apparatus designed to prevent more Enrons, journalists must continue to report on the legislative process in order to bring the actions of politicians into line with their rhetoric.<sup>144</sup> The federalization of corporate law thus presents new possibilities for journalists to inform a broader swath of the public about corporate regulation.

This Part has explained various ways in which journalists contribute to our system of corporate governance. The Enron story demonstrated how journalists may uncover deep frauds and thus instigate market responses to corporate fraud. The annuities story showed how journalists' reporting can spur legal process in the courts, by alerting plaintiffs' attorneys to wrongdoing in the marketplace. This legal process can in turn alert regulators to culpable conduct that can serve as the basis for regulatory actions, fines, and investor education. The *Caremark* litigation showed how journalists can affect the way a case is litigated, and more significantly, might, in time, contribute to a change in the judicial standards that govern corporate conduct. I also described

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*Cleanup*, N.Y. TIMES, Oct. 19, 2002, at C14.

142. *Id.* "Democrats said that the White House position reflected the calculation that the corporate scandals have moved to the back burner, and therefore the White House does not need to honor the provision in the legislation that calls for the higher financing."

143. Congress appropriated \$716.4 million for the SEC for fiscal year 2003. See William H. Donaldson, *Testimony Concerning Appropriations for Fiscal 2004*, Apr. 8, 2003, available at <http://sec.gov/news/testimony/040803tswhd.htm>.

144. I do not suggest that the evidence presents a particular causal link between reporting on the budgeting process and the White House's relenting on the size of the increase. Instead, I suggest that continued vigilance is crucial and that journalists are an indispensable part of that vigilance.



how journalists might affect the legislative branch's efforts to regulate corporate governance, both in the passage of legislation, and in the appropriations process that is a strong determinant of SEC effectiveness.

But in many instances, particularly in the case of accounting fraud, one wonders whether the financial press is the right place to look for an effective watchdog of corporate wrongdoing. Perhaps, in some contexts, the role is better played by securities analysts, for they have superior resources to devote to the task, and most likely have a deeper expertise in analyzing financial data. Thus the next Part briefly explores the role of analysts and compares their capacities and shortcomings with those of journalists.

#### IV. JOURNALISTS AND ANALYSTS.

While financial journalists in various contexts have demonstrated their ability to contribute to our scheme of corporate governance, a thorough account of their contribution must take stock of their weaknesses. Some might argue that, Enron notwithstanding, securities analysts are better equipped than journalists to play the watchdog role, particularly when detecting accounting fraud and signaling that a company's financial disclosures are flawed. In this Part, I will both briefly describe some phenomena that hamper the effectiveness of financial journalists and consider the role of securities analysts. I will present an example of the interplay of journalists and analysts that suggests a way that their roles might intersect. This Part will conclude with some observations about Regulation FD that will form the basis for future research on the intersection of journalists' and analysts' roles.

##### *A. Weaknesses of Journalists*

Although both theory and evidence suggest that journalists have an important role to play in enforcement of corporate law, there are several reasons to be skeptical of their utility, especially when compared with securities analysts. First, journalists, like analysts, suffer from certain conflicts that can reduce their efficacy. Second, financial journalists may not have the same expertise in the techniques necessary to conduct the kind of analysis required to root out more complicated frauds.

Analysts' advanced training in quantitative methods is their stock in trade, their most important skill. By contrast, the educational background of many journalists leads one to suspect that they are unable

to competently carry out the sort of analysis needed to critically evaluate complicated financial data, or understand the anecdotal reports they may receive from various tipsters or whistleblowers. But there is a dearth of empirical evidence available to confirm this suspicion. The most comprehensive report available is substantially out of date. In 1987, the Ford Foundation published a report concluding that only 6% of journalists had even an undergraduate degree in economics or business.<sup>145</sup> That evidence, however, is misleading. Coming as it did before the advent of cable financial news and the equity boom of the 1990s, the Ford Foundation study cannot be taken as a reliable measure of financial journalists' competence today. Moreover, the study focused on journalists as a whole, without specifically focusing on financial journalists. No study of the educational backgrounds of financial journalists has been performed to date.

But the educational background of the vast majority of journalists is mainly irrelevant to this article. Of greater interest is the educational background of business and financial journalists from leading national publications, particularly those that focus on business. I have publications like the Wall Street Journal, Barons, the New York Times, the Washington Post, Forbes, Business Week, Fortune and the like in mind.<sup>146</sup> Not only are these outlets able to hire the most qualified reporters available,<sup>147</sup> but they also are able, as a function of both resources and editorial mission, to support their reporters in various ways, such as permitting them sufficient time to develop a story, hiring experts to help sort through particularly complicated accounting and financial material, and providing training to shore up their expertise.<sup>148</sup>

Another impediment to financial journalists relates to the political and ideological bent of the publishers and editors for whom a journalist may work. For example, a publication that strongly espouses free

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145. Mark Donald Ludwig, *Business Journalists Need Specialized Finance Training*, NEWSPAPER RES. J., Spring 2002, at 129.

146. There are doubtless other publications that can make important contributions, but the publications listed represent the type of publications that have the greatest concentration of top flight reporters with significant technical backgrounds to do the kind of in-depth financial analysis that I envision.

147. For example, the Wall Street Journal's managing editor, Paul Steiger, a graduate of Yale University with a degree in economics, has asserted that the qualifications that got him hired in 1966 would be insufficient to get a job at the Journal today. Lewis M. Simons, *Follow the Money*, AM. JOURNALISM REV., Nov. 1999, at 54.

148. *Id.*

market ideology may discourage its reporters from pursuing a lead premised on an idea antithetical to the viewpoint of the publication. Moreover, media concentration has engendered corporate conflicts of interest that affect financial journalists. A journalist working for a diversified media conglomerate may find his or her efforts to investigate fraud hamstrung by the corporate concerns of her employer if his or her reporting leads to the discovery of information damaging to a member of the employer's corporate family.

Journalists also face legal threats to their effectiveness. As the New York Times' Judith Miller painfully discovered during the recent CIA leak investigation,<sup>149</sup> journalists can wind up in jail for doing their jobs. While this example of incarceration was no doubt exceptional, it may have only been the beginning of a trend of legal jeopardy for journalists. In February 2006, staff lawyers from the SEC issued subpoenas to two Dow Jones journalists. According to Herb Greenberg, one of the two, who reports for MarketWatch.com, the subpoena sought "all unpublished 'communications,' including emails and phone records, between me and people and organizations I've quoted—and at least one I've never quoted—regarding five stocks."<sup>150</sup>

These subpoenas caused a furor among media professionals, particularly coming as they did on the heels of the Plame investigation. To the relief of financial journalists, Christopher Cox, Chairman of the SEC, promptly signaled that the subpoenas were the handiwork of "renegade" staff lawyers in the enforcement division of the SEC.<sup>151</sup> Cox notified the public that neither he, nor the Commission's Office of General Counsel, had been aware of the decision to issue the subpoenas.<sup>152</sup> To further calm the situation several weeks later, the SEC announced a new policy containing stringent guidelines for the issuance of subpoenas to journalists by Commission staff.<sup>153</sup>

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149. *Judith Miller Goes to Jail*, N.Y. Times, July 7, 2005, at A22.

150. Herb Greenberg, *About My Subpoena*, Marketwatch.com, Feb. 24, 2006, available at <http://www.marketwatch.com/News/Story/Story.aspx?guid=%7B6800D8C7-E199-4CE6-915A7A9D29DEE685%7D&siteid=mktw&print=true&dist=print> Bottom.

151. Stephen Labaton, *S.E.C. Leader Issues Rebuke Over Journalist Subpoenas*, N.Y. TIMES, Feb. 28, 2006, at C3. Apparently, the subpoenas were issued without the knowledge and approval of the head of the SEC's enforcement division.

152. *Id.*

153. See Policy Statement of the Securities and Exchange Commission Concerning Subpoenas to Members of the News Media, Release No. 34-53638, Apr. 20, 2006, available at <http://www.sec.gov/news/press/2006/2006-55.htm>.

Governmental legal action is not the only source of interference with journalists' investigative efforts. In October 2006, Patricia C. Dunn, chairwoman of Hewlett Packard, another director, and officers of the corporation were accused of illegally gathering the phone records of journalists in an attempt to discover who leaked information from a board meeting.<sup>154</sup> Dunn hired investigators and provided them with confidential personal information about board members.<sup>155</sup> The investigators then posed as those board members in order to obtain their personal telephone records.<sup>156</sup> Armed with this information, the investigators were able to ascertain the identity of the leakers and collect information about their phone conversations with journalists.<sup>157</sup>

The HP case demonstrates one method by which a corporation can thwart journalists' efforts to gather information. The effect of such an action is twofold. Not only might such espionage be effective in ending a particular investigation, but it might also have a chilling effect on journalists who are concerned about the invasion of privacy wrought by techniques such as those practiced by HP.

A different kind of legal threat also lurks around financial journalists attempting to investigate fraud. A corporation engaged in conduct of questionable legality may threaten to sue for libel if a publication runs a story containing damaging allegations. Faced with such a threat, publishers are likely to suppress a story, even if the allegations are responsibly reported and documented. *SEC v. Dirks*,<sup>158</sup> discussed below in Part IV.C, involved such a threat and a decision not to run a story about a flagrant fraud.

Another problem with some financial journalists is self-imposed. Over the years, journalists have occasionally engaged in opportunistic trading in shares of the companies they've covered. For example, in 1993, R. Foster Winans, a *Wall Street Journal* reporter who co-wrote the influential "Heard on the Street" column, revealed the contents of soon-to-be published columns to a stockbroker.<sup>159</sup> The broker traded in advance of the column's appearance and earned profits of nearly

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154. See Damon Darlin, *Ex-Chairwoman Among 5 Charged in Hewlett Case*, N.Y. Times, Oct. 5, 2006, at A1.

155. *Id.*

156. *Id.*

157. *Id.*

158. *Dirks v. SEC*, 463 U.S. 646 (1983).

159. David A. Wilson, Note & Comment, *Outsider Trading—Morality and the Law of Securities Fraud*, 77 GEO L. J. 181 (1988).

\$700,000, paying Winans \$30,000 for the tip.<sup>160</sup> Both men were ultimately convicted of securities fraud.<sup>161</sup> This kind of abuse can undermine the public's confidence in financial journalism, leading to the view of journalists as wolves guarding the henhouse.

Although journalistic reporting on corporate matters suffers from certain imperfections, it is nonetheless a significant part of our corporate governance. But one still might ask, isn't at least some of this role played more effectively by financial analysts? After all, financial analysts have the training, resources and access to top management that journalists lack. They are paid well to scrutinize public and non-public data in order to assess the value of corporations. This observation is no doubt true. But the limitations of financial analysts are just as clear as their strengths. Next I will explain what securities analysts do, whom they work for, and review the most notable problem with securities analysts—their conflicts of interest. Then I will briefly sketch the ways in which the roles of both analysts and journalists intersect.

#### *B. The Role and Conflicts of Securities Analysts.*

Securities analysts are a cornerstone of the capital markets, contributing significantly to market efficiency by collecting and analyzing company information from numerous sources and channeling that information into the market.<sup>162</sup> Securities analysts cover a company or a handful of companies within a given industry, meticulously researching the company's performance, market environment, internal operations and micro and macro-economic environment in order to arrive at earnings estimates. These estimates ultimately provide the basis for the analyst's recommendations to buy, hold, or sell the company's securities. Estimates and recommendations are consumed by both the analyst's employer and, depending on the type of institution employing the analyst, the investing public.<sup>163</sup>

Analysts work for a variety of institutions. So-called "buy-side analysts" work for institutional money managers like mutual funds,

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160. *Id.*

161. *United States v. Winans*, 612 F. Supp 827, 832 (S.D.N.Y. 1985), *aff'd sub. nom.*, *United States v. Carpenter*, 791 F.2d 1024 (2d Cir. 1986), *aff'd*, 484 U.S. 19 (1987).

162. For a thorough explanation of the roles and conflicts of securities analysts, see Fisch & Sale, *supra* note 4, at 1040-56.

163. *Id.*

hedge funds, and pension funds. These organizations rely on analysts' work product to formulate investment strategies.<sup>164</sup>

"Sell-side" analysts work for full-service broker-dealers and make recommendations on the securities they cover. Many influential sell-side analysts work for prominent brokerage firms that also provide investment banking services for corporate clients, including companies whose securities are covered by the analysts. Independent analysts are typically not associated with firms that underwrite the securities they cover. They often sell their research reports on a subscription or other basis. Some firms, having discontinued their investment banking operations, now market themselves as more independent than multi-service firms, touting the enhanced quality of their research their freedom from conflicts of interest engenders.<sup>165</sup>

Although they are more adept at analyzing financial data than financial journalists, analysts use their expertise and the data for different purposes. Whereas the information developed by journalists is published for the express purpose of informing the public, analysts have a strong proprietary interest in their information. Furthermore, unlike public accountants, whose job it is to verify the accuracy of company financial data in order to enhance the confidence and safety of public investors, analysts do not have a public interest role. They are in the business of making money.

There are positives and negatives associated with analysts' self-interest. On one hand, they might use the information as part of a process identifying undervalued companies for the purpose of targeting them for a tender offer.<sup>166</sup> In this way, although they are not going to publicize the information they gather, they may ultimately use the information as part of the market for corporate control, an important director constraint mechanism in corporate law.

On the other hand, analysts and their institutional employers might sell stock that they alone know is overvalued. The discrepancy in value may be the result of an accounting sleight-of-hand transparent to an

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164. SEC Investor Alert, *Analyzing Analyst Recommendations*, Apr. 20, 2005, available at <http://sec.gov/investor/pubs/analysts.htm>.

165. *Id.*

166. See Marcel Kahan & Michael Klausner, *Lockups and the Market for Corporate Control*, 48 STAN. L. REV. 1539 (1996) (explaining the benefit to the securities markets of the informational investment made by various actors who search for undervalued companies in order to target them for a hostile takeover).

expert, but not to small investors;<sup>167</sup> or it might be overvalued simply because of changes in market conditions that had not been publicized, but analysts know because of their position. Whatever the reason for a company's shares to be temporarily mispriced, analysts' informational advantage can position them, and their employers, to earn profits by engaging in market transactions with public investors. The potential for insider trading gains can affect the objectivity of analyst reports and recommendations. Analysts who displease issuers by aggressively discovering and publicizing bad news risk losing access to insiders that generates some of those trading profits.

This type of insider trading is perhaps a relatively unimportant example of a current issue dominating scholarly discussion of analysts: their conflicts of interest.<sup>168</sup> Analysts encounter a variety of conflicts of interest that can decrease their vigor for pursuing and providing as much objective information as possible to the markets. These conflicts stem from various sources, including investment banking relationships, brokerage commissions, analyst compensation, and analysts owning and trading in company securities, as described above.<sup>169</sup>

Not only do the potential benefits from insider trading on material nonpublic information represent a conflict of interest for analysts, the same can be said of the revenues that analysts bring to their employers through lucrative investment banking engagements.<sup>170</sup> Sell-side analysts have a strong disincentive to issue unfavorable recommendations because of the risk that such actions will cause issuers to choose other institutions to underwrite their future issuances of securities. These underwriting engagements are extremely profitable for the investment bank, and there is a great deal of evidence that analysts inflate their recommendations on companies for whom the analysts' firm serves as,

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167. The moral and legal valence of this type of insider trading is a matter of intense debate. For a discussion of insider trading, compare Stephen M. Bainbridge, Note, *A Critique of the Insider Trading Sanctions Act of 1984*, 71 VA. L. REV. 455 (1985) (arguing that the present federal prohibitions against insider trading do not achieve a substantial deterrent effect) with Roberta S. Karmel, *The Relationship Between Mandatory Disclosure and Prohibitions Against Insider Trading: Why a Property Rights Theory of Inside Information Is Untenable*, 59 BROOK. L. REV. 149 (1993) (arguing that prohibitions against insider trading are necessary to ensure that confidentiality is not abused).

168. See Coffee, *Understanding Enron*, *supra* note 4; Fisch & Sale, *supra* note 4.

169. See Fisch & Sale, *supra* note 4, at 1043-56.

170. *Id.* at 1047. "In today's world . . . the analyst is the 'star of the show' in a typical investment banking bake-off, or client competition."

or wish to serve as, an underwriter.<sup>171</sup> Such inflation seems almost inevitable, in view of the fact that analyst compensation is frequently linked to the number of investment banking deals the analyst generates, or the overall profitability of the firm's investment banking division.<sup>172</sup>

In addition, their access to top management leaves them, to some degree, captive to that management. Since they possess the key to the front door, they may suffer from what we might call an insider's bias. This bias can lead analysts to rely excessively on management's account of a company's performance, neglecting the legwork necessary to fully appreciate the reality of a corporation's financial condition.<sup>173</sup>

Nevertheless, it may be plausible to maintain that problems like fraudulent financial disclosure are best dealt with by securities analysts. When it comes to scrutinizing labyrinthine accounting structures, analysts are often better suited than financial journalists to comprehend both the big picture as well as the details. But as Enron demonstrated, when corporate insiders are determined to maintain a significant level of opacity in accounting, even the best trained quantitative analysts may be overmatched, particularly where their conflicts of interest inhibit any skepticism about the company's story.<sup>174</sup> In such cases, journalists may prove more effective, as was the case with Enron. Because it is likely that someone on the inside of the company is going to know about the fraud, the training, skeptical perspective, and methodology of a financially savvy reporter can be the most important tool for unlocking the fraud. Thus reporters are the antidote to the front door approach employed by analysts.

### C. The Intersection of Journalists and Analysts.

An example of the interplay between journalists and analysts can be

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171. See, e.g., Coffee, *Understanding Enron*, *supra* note 4, at 1047 (noting that "ratio of 'buy' to 'sell' recommendations increased from 6:1 in 1991 to 100:1 by 2000"); Fisch & Sale, *supra* note 4, at 1052-55 (reviewing the evidence of ratings bias and noting that "as the Internet market collapsed from spring 1999 to fall 2001, and Merrill analysts internally described covered stock as 'junk,' Merrill publicly continued to issue buy and strong buy ratings for these securities").

172. Fisch & Sale, *supra* note 4, at 1052-55.

173. See *id.* at 1054-56.

174. See ELKIND & MCLEAN, *supra* note 50, at 235 (describing the credulity of analysts who continually accepted Enron management's increasingly dubious claims about its finances).



found in *Dirks v. SEC*,<sup>175</sup> a celebrated insider trading case. *Dirks* stands as an interesting example of many of the issues discussed in this Article. Raymond Dirks was a securities analyst who covered Equity Funding, a company engaged in a massive fraud.<sup>176</sup> Ronald Secrist, an executive at Equity funding, was distressed about the fraud, and frustrated that the SEC and other regulatory agencies were unwilling to act, despite being notified.<sup>177</sup> Secrist informed Dirks of the wrongdoing, and suggested that he investigate the matter.<sup>178</sup> Dirks did just that, using the access that his position as an analyst covering the company afforded him.<sup>179</sup> What Dirks found was indeed a massive and audacious fraud.<sup>180</sup>

One of the first things Dirks did was contact William Blundell, the Los Angeles bureau chief of the Wall Street Journal, and urge him to write a story about the fraud, hoping to instigate SEC action.<sup>181</sup> The Journal, out of a rational fear of being sued for libel, refused to move on the story.<sup>182</sup>

With neither the Journal nor regulators willing to act on the information, Dirks moved to protect his clients, and advised several large institutional investors to sell.<sup>183</sup> They did so and the company's stock price dropped precipitously. This fall ultimately led the NYSE to suspend trading in Equity Funding shares, and the SEC initiated its investigation thereafter.<sup>184</sup>

So what does *Dirks* tell us about journalists, analysts, and enforcement of corporate governance norms? It makes a couple of things clear. First, and perhaps most powerfully, it illustrates the fact that extralegal enforcement mechanisms are a vital part of the corporate governance system. The SEC is incapable of effectively monitoring all corporate activity for fraud. Indeed, as the case demonstrates, it does not always act even when made aware of fraud. Our system relies on analysts and journalists to bring fraud to the attention of both markets and legal institutions.

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175. 463 U.S. 646 (1983).

176. *Id.* at 648.

177. *Id.* at 649.

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.* at 649-50.

183. *Id.* at 650.

184. *Id.* This also led the SEC to bring an insider trading action against Dirks. *Id.*

Second, this case illustrates one reason to question the reliability of journalistic enforcement: media outlets' fear of legal retribution reduces the likelihood of publicizing information that can lead to enforcement. Retribution can come in various forms. In *Dirks*, the fear was of a libel suit. Publishers may also fear retribution from companies refusing to place advertisements, or withholding access to important information, while revealing it to other journalistic outlets.

Yet upon reflection, *Dirks* represents a more hopeful view of journalistic enforcement. Ignore for the moment the fact that Blundell refused to run with *Dirks*' information. Focus instead on the opportunity that *Dirks* presented the Journal. This sort of cooperation between analysts and journalists is precisely what we might imagine as the ideal of a cooperative dynamic between journalists and analysts. The analyst makes use of his enhanced access and familiarity with a company and attempts to convey news of wrongdoing to both regulatory authorities and the financial press.

*D. Regulation FD: Preliminary Thoughts for Future Research*

Analysts have long held a privileged position in corporate boardrooms, frequently obtaining significant amounts of nonpublic information directly from top executives. Analysts in turn use this information to formulate their estimates and recommendation. While this access is valuable to analysts when generating their estimates, it also carries a significant public benefit. Accurate estimates preceding quarterly public disclosures of earnings help assure efficient market pricing of securities.<sup>185</sup> Rather than waiting for quarterly earnings announcements from issuers themselves, the market is able to price securities with substantial accuracy with the help of earnings estimates, more often than the four times per year when companies announce their earnings.<sup>186</sup>

Yet the access to inside information that analysts enjoy has enabled them to engage in profitable stock trading with public investors knowing less about the reality of a company's financial position than the analyst, his employer, and its clients.<sup>187</sup> Concerned with this informational

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185. See Fisch & Sale, *supra* note 4, at 1067.

186. See *id.* at 1067-68.

187. See Stephen J. Choi, *A Framework for the Regulation of Securities Market Intermediaries*, 1 BERKELEY BUS. L.J. 45, 58 (2004) (characterizing selective disclosure as a "mechanism for firms to subsidize analysts").

asymmetry, and the belief that the public was losing confidence in the fairness of the securities markets, the SEC passed Regulation FD (for fair disclosure) in 2000.<sup>188</sup> Reg FD prohibits selective disclosure of material nonpublic information, mandating that when issuers disclose such information to an analyst (or other covered persons) they must also disseminate the information broadly.<sup>189</sup>

While Reg FD has had many varied effects, and has been both praised and criticized from various quarters, it has a particular significance for the topic of this paper. Selective disclosures to analysts have, as previously mentioned, served an important function in enhancing market efficiency. But the opportunity for profits gained through privileged inside access created a conflict of interest for analysts that contributed to their poor performance.<sup>190</sup> This conflict is related to one that has plagued national political journalists. In order to do their jobs effectively, analysts depend on access. But if their reports include truthful assessments damaging to the corporation, they risk losing the access that permits the insider trading profits.<sup>191</sup> By ending selective disclosure, Reg FD may quiet our concern about insider trading conflicts, as well as conflicts related to access.

One interesting question raised by Reg FD is whether its mandates will level the playing field between journalists and analysts. In other words, it is possible that journalists who carefully monitor a company will now be privy to just as much information as analysts. However, it is also quite possible that the overall amount of information available to both has decreased as a result of Reg FD. To be sure, many critics of Reg FD forecast that decreased disclosure will be the primary result of the new rule, with opponents dubbing the regulation FD for Fewer Disclosures.<sup>192</sup>

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188. 17 C.F.R. § 243.100(b) (2002).

189. *Id.*

190. *See* Choi, *supra* note 187, at 59.

191. *See* Fisch & Sale, *supra* note 4, at 1054-56. "Indeed, analysts who exercise independent judgment are often frozen out of future access. Corporate officials may refuse to take analysts' phone calls, prohibit employees from speaking with them, avoid their questions in conference calls, and refuse to attend analyst-organized conferences." *Id.* at 1054.

192. Whether the rule will live up to its nickname is a complicated empirical matter, but preliminary evidence suggests that the quantity of disclosure has not fallen off significantly. *See* Fisch & Sale, *supra* note 4, at 1066-67 (reviewing the nascent body of empirical evidence generated in the first years after the implementation of Reg FD). In any event, it is not clear that this line of inquiry is really relevant to the key questions

Soon after Reg FD became effective, many analysts began to complain that the new rule forced them to work harder for information that had once been spoon-fed to them in the form of earnings guidance.<sup>193</sup> While this deprivation has no doubt proven inconvenient for many analysts, it has also created a new opportunity. In order to perform at a high level of competence, and with the reliability the market demands, analysts now have to do more legwork to arrive at an accurate estimate of corporate earnings.

Not only does this provide an opportunity and incentive for analysts to distinguish themselves in the market for securities research, but it also liberates them, to some extent, from the negative market effects of their symbiotic relationship with issuers. Since the prohibition of selective disclosures to analysts (and analysts' concomitant loss of inside trading profits), issuer executives have lost some of the leverage they once had over analysts—losing inside access is now less of a threat. Thus analysts should, post-Reg FD, be free from their debt to issuers to provide a *quid pro quo* in the form of flattering ratings for access.

To be sure, this effect does not resolve other conflicts, but it does create the possibility of more vigorous research that may uncover wrongdoing. Analysts' other conflicts, particularly the need to generate investment banking revenues, remain problematic and may constrain analysts from directly disclosing any unflattering information they discover. But this incentive to research more aggressively may nevertheless redound to the benefit of investors, if analysts were to discreetly share such information with journalists.<sup>194</sup> In this way, highly trained specialists, who have substantial access to company data and employees, can channel useful information to the public without harming their institutional interests in maintaining positive client relations.

The *Dirks* story, and my conjectures about Reg FD, suggest that there is more to be studied about the interrelation between financial

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addressed by this article; the kinds of information voluntarily disclosed by issuers are not likely to include information that will reveal frauds.

193. *Id.* at 1066.

194. Of course an analyst would be taking a risk that divulging unflattering information to a journalist would lead to recriminations by the issuer. But, recall that Jonathan Weil was tipped discreetly by a source who told him "you really ought to take a look at . . . Enron." See Sherman, *supra* note 75. Concerns about retaliation and confidentiality could be minimized by tactful indications of where to look for wrongdoing.

journalists and securities analysts. As more time passes since the enactment of Reg FD, observers will be able to determine whether they can in fact work together to provide timely, objective information about issuers, in a way that supports the investing public's interests, while leaving analysts' legitimate financial interests intact.

#### CONCLUSION

This Article has furnished an account of how financial journalists fit into our system of corporate governance. By detailing the ways in which journalists contribute to that system, I have demonstrated their utility in multiple contexts: judicial, legislative, administrative, and market-oriented. Journalists can catalyze both legal process and market responses to corporate wrongdoing. Beyond contributing to the legal system as it exists, journalists may be able to affect the evolution of corporate compliance jurisprudence by proving the inadequacy of legally sufficient corporate compliance programs. In the future, lawyers may be able to draw on the work of journalists to argue that judges must heighten the legal standards for evaluating such programs.

I have also demonstrated that financial journalists, while operating in a system driven by conflicts of interests at every turn, actually benefit personally while also benefiting shareholders. Thus, in contrast to corporate directors and officers, journalists experience a convergence of their self-interest and shareholders' interests.

I have also indicated some shortcomings of financial journalists, while comparing them to securities analysts. While I have not endeavored to reach a conclusion as to which group of professionals can do more to detect and disclose fraud, I have illustrated ways, both actual and hypothetical, in which they can cooperate to improve corporate governance.