

The Mess at Morgan: Risk, Incentives and Shareholder Empowerment

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I am grateful for the many helpful comments provided by participants at the University of Pennsylvania's Ad Hoc Faculty Seminar.

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Abstract

The financial crisis of 2008 focused increasing attention on corporate America and, in particular, the risk-taking behavior of large financial institutions. A growing appreciation of the “public” nature of the corporation resulted in a substantial number of high profile enforcement actions. In addition, demands for greater accountability led policymakers to attempt to harness the corporation’s internal decision-making structure, in the name of improved corporate governance, to further the interest of non-shareholder stakeholders. Dodd-Frank’s advisory vote on executive compensation is an example.

This essay argues that the effort to employ shareholders as agents of public values and, thereby, to inculcate corporate decisions with an increased public responsibility is misguided. The incorporation of publicness into corporate governance mistakenly assumes that shareholders’ interests are aligned with those of non-shareholder stakeholders. Because this alignment is imperfect, corporate governance is a poor tool for addressing the role of the corporation as a public actor.

The case of JP Morgan and the London whale offers an example. Although JP Morgan suffered a massive loss due to the whale’s risky trading decisions, JP Morgan shareholders benefited from this risk-taking. Accordingly, shareholders were poorly positioned to address the incentives that drove risky operational decisions. So-called “improved corporate governance” in the form of shareholder empowerment, rather than functioning as a solution, may have exacerbated the problem. In the end, the mess at Morgan demonstrates limitations on the value of shareholder empowerment in addressing the public impact of the corporation and suggests that, at least in some cases, regulatory approaches such as the Volcker rule may be warranted.

Keywords: Corporation law, corporations, securities regulation, risk management, investment banking, Dodd Frank Wall Street Reform and Consumer Protection Act, Volcker Rule, JP Morgan Chase, publicness, executive compensation, accountability, regulation, credit derivatives trading, corporate wrongdoing

JEL Classifications: G18, G23, G28, G32, G38, K22

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THE MESS AT MORGAN: RISK, INCENTIVES AND SHAREHOLDER EMPOWERMENT

*Jill E. Fisch**

The financial crisis of 2008 focused increasing attention on corporate America and, in particular, the risk-taking behavior of large financial institutions. A growing appreciation of the “public” nature of the corporation resulted in a substantial number of high profile enforcement actions. In addition, demands for greater accountability led policymakers to attempt to harness the corporation’s internal decision-making structure, in the name of improved corporate governance, to further the interest of non-shareholder stakeholders. Dodd-Frank’s advisory vote on executive compensation is an example.

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The case of JP Morgan and the London whale offers an example. Although JP Morgan suffered a massive loss due to the whale’s risky trading decisions, JP Morgan shareholders benefited from this risk-taking. Accordingly, shareholders were poorly positioned to address the incentives that drove risky operational decisions. So-called “improved corporate governance” in the form of shareholder empowerment, rather than functioning as a solution, may have exacerbated the problem. In the end, the mess at Morgan demonstrates limitations on the value of shareholder empowerment in addressing the public impact of the corporation and suggests that, at least in some cases, regulatory approaches such as the Volcker rule may be warranted.

I. INTRODUCTION

In April 2012, the financial media reported large derivatives trading by a JP Morgan Chase & Co. (JP Morgan) trader known as the London

* Perry Golkin Professor of Law, University of Pennsylvania Law School. I am grateful for the many helpful comments provided by participants at the University of Pennsylvania’s Ad Hoc Faculty Seminar.

whale.¹ JP Morgan eventually reported a \$6.2 billion loss stemming from the whale's proprietary trading in derivatives. Over the course of the next several months, JP Morgan's troubles multiplied such that the original whale began to seem more like a minnow. News reports revealed JP Morgan's involvement in wide-ranging misconduct—from unfair credit card billing practices to misrepresentations in the sale of mortgage-related products to investors.² Overall, in a two and a half year period from June of 2011 to January of 2014, JP Morgan paid almost \$34 billion in fines and penalties.³

The revelations were particularly notable in that, until early 2012, JP Morgan appeared to have escaped the widespread misfortunes associated with the financial crisis. Policymakers argued that the financial crisis was caused, in part, by excessive risk taking by Wall Street financial institutions.⁴ This risk-taking led to the collapse of many large banks including Bear Stearns, Lehman Brothers and Wachovia, and required an unprecedented government bailout. President Obama criticized the “fat cat bankers” for continuing to take large bonuses while the country and their stockholders suffered.⁵

Yet, at the same time, commentators praised JP Morgan for adhering to a conservative investment strategy that enabled it to weather the storm.⁶ JP Morgan was the only large financial institution to post a profit during the financial crisis. JP Morgan was also the first bank to repay the funds it received from the government through the Troubled Asset Relief Program.⁷

The reputational hit experienced by JP Morgan following the whale

1. See, e.g., Gregory Zuckerman & Katy Burne, 'London Whale' Rattles Debt Market, WALL ST. J. (Apr. 6, 2012, 1:19 PM), <http://online.wsj.com/articles/SB10001424052702303299604577326031119412436>.

2. To be fair, a substantial percentage of this wrongdoing was by Bear Stearns and Washington Mutual, two firms that JP Morgan purchased in 2008. See, e.g., Neil Irwin, *Everything You Need to Know About JPMorgan's \$13 Billion Settlement*, WASH. POST. WONKBLOG (Nov. 19, 2013), <http://www.washingtonpost.com/blogs/wonkblog/wp/2013/10/21/everything-you-need-to-know-about-jpmorgans-13-billion-settlement/> (although JP Morgan agreed to assume the liabilities incurred by those firms, it did not directly engage in the most of the misconduct); see also *id.* (stating that 70-80% of the activity leading to JP Morgan's \$13 billion settlement with the Justice Department regarding its mortgage-backed securities activities was by the acquired companies rather than JP Morgan itself – the Whale, in contrast, was all JP Morgan).

3. See Jared Cummins, *A Brief History of JP Morgan's Massive Fines*, DIVIDEND.COM (Feb. 17, 2014), <http://www.dividend.com/dividend-education/a-brief-history-of-jp-morgans-massive-fines-jpm/> (reporting fines paid by JP Morgan from June 2011 through January 2014).

4. See Elizabeth Williamson, *Obama Slams 'Fat Cat' Bankers*, WALL ST. J. (Dec. 14, 2009, 11:59 PM), <http://online.wsj.com/articles/SB126073152465089651> (quoting then White House economic advisor Larry Summers).

5. *Id.*

6. Pallavi Gogoi, *CEO Jamie Dimon Steers JPMorgan Chase Through Crisis*, USA TODAY (Jul. 27, 2009), <http://abcnews.go.com/Business/story?id=8179742&page=1&singlePage=true>.

7. *Id.*

and the subsequent revelations⁸ solidified the demand—sparked by the financial crisis—for the increased accountability of corporate managers. This demand led to demands for increased shareholder empowerment premised on the view that the failures at the large banks were, at least in part, governance failures.⁹ Shareholder empowerment was a substantial component of the regulatory strategy of the Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).¹⁰ One component of Dodd-Frank’s shareholder empowerment approach is its mandate that publicly-traded corporations provide shareholders with an advisory vote on executive compensation—Say on Pay.¹¹

The substantial impact that large public corporations have on a broad range of constituencies has long been recognized.¹² Recent commentators¹³ have termed this phenomenon “publicness,” by which they mean the actions of the corporation that affect the economy and society generally rather than just shareholder interests.¹⁴

One regulatory response to publicness is increased shareholder

8. See Hillary Sale, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 BROOK. L. REV. 1630 (2014) (stating that, “[i]ndeed, in the wake of the Whale, J.P. Morgan and its Chief Executive Officer, Jamie Dimon, went from being a post-financial crisis “poster child” and media darlings, to punching bags.”). See also Harry Bradford, *JPMorgan Chase’s Reputation Falls To Lowest Level On Record In Wake Of \$2B Loss*, HUFFINGTON POST (May 23, 2012), http://www.huffingtonpost.com/2012/05/23/jpmorgan-chases-consumer-reputation-yougov_n_1540582.html (reporting that Morgan’s reputation fell after the Whale to its lowest point on record). See also Steve Denning, *JPMorgan And The Death Of Corporate Reputation*, FORBES (May 3, 2013), <http://www.forbes.com/sites/stevedenning/2013/05/03/jpmorgan-and-the-death-of-corporate-reputation/> (questioning extent to which reputation still matters).

9. See Hamid Mehran, et al., *Corporate Governance and Banks: What Have We Learned from the Financial Crisis*, Fed. Res. Bank Staff Report No. 502 June 2011 (surveying literature).

10. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 7, 12, 15, and 31 U.S.C.). See Usha Rodrigues, *Corporate Governance in an Age of Separation of Ownership from Ownership*, 95 MINN. L. REV. 1822, 1838–39 (2011) (describing Dodd-Frank’s regulatory strategy of shareholder empowerment).

11. Dodd-Frank Wall Street Reform and Consumer Protection Act § 951, 15 U.S.C. § 78n-1.

12. The actions of corporations have, of course, always affected the public interest, which is what justifies their regulation under a wide range of laws from environmental to antitrust. See Part III, *infra*.

13. See, e.g., Donald C. Langevoort & Robert B. Thompson, “Publicness” in *Contemporary Securities Regulation After the JOBS Act*, 101 GEORGETOWN L.J. 337 (2013); see also Donald C. Langevoort & Robert B. Thompson, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1628 (2013); See, e.g., Joan Heminway, *Securities Regulation at the Public/Private Divide (If There Still is a Divide . . .)*, BUS. L. PROF. BLOG (Aug. 11, 2014), http://lawprofessors.typepad.com/business_law/2014/08/securities-regulation-at-the-publicprivate-divide-if-there-still-is-a-divide-.html; Jonathan Glater, *Private Offerings and Public Ends: Reconsidering the Regime for Classification of Investors under the Securities Act of 1933* (working paper 2015).

14. Hillary Sale, *Public Governance*, 81 WASH U. L. REV. 1012, 1013 (2013) [hereinafter Sale, *Public Governance*] (describing publicness as the actions of corporate actors that affect the economy and society generally, rather than just the shareholders).

empowerment. Claiming that the widespread misconduct of the financial crisis reflected a failure of corporate governance, policymakers have begun to seek to harness the corporation's internal decision-making structure to further the public interest.

This essay argues that such an approach is misguided in its efforts to employ shareholders as agents of public values and, thereby, to inculcate corporate decisions with an increased public responsibility through improved corporate governance. The incorporation of publicness into corporate governance mistakenly assumes that shareholders' interests are aligned with those of non-shareholder stakeholders such as customers, creditors and employees as well as society more generally. Because this alignment is imperfect, corporate governance is a poor tool for addressing the role of the corporation as a public actor.

The limitations of shareholder empowerment should not be surprising. The financial crisis followed a period in which large institutional shareholders had become increasingly active in monitoring management decisions and demanding greater accountability for those decisions. Despite this activism, large scandals appear to be more frequent than ever. The financial crisis itself offers reasons to question to the efficacy of shareholder empowerment.

This essay examines the effectiveness of shareholder empowerment by way of an example—the case of JP Morgan and the London whale. The whale illustrates the potential public consequences of excessive corporate risk-taking. That the whale was a public problem is demonstrated by the fact that its revelation spurred two congressional hearings, generated a 300-page Senate report and resulted in JP Morgan paying more than \$1 billion in fines to US and UK regulators. At the same time, the whale demonstrates why shareholders are poorly positioned to curb managerial risk-taking. Executives at JP Morgan were compensated in a manner that created powerful incentives for them to take substantial risks and, despite the potential problems that these incentives created from a public perspective, they were approved by JP Morgan shareholders.

Indeed, shareholder empowerment, rather than functioning as a solution to excessive risk-taking may be part of the problem. Because risk-taking is beneficial to shareholders, empowered shareholders may encourage corporate managers to make overly risky operational decisions. The problem is exacerbated by executive compensation reforms that place growing emphasis on the relationship between executive compensation and shareholder returns and that subject the resulting pay structures to increased shareholder oversight.¹⁵

15. Ira T. Kay, *The Unintended Consequences of Say on Pay Votes*, HARV. L. SCHOOL FORUM

Ultimately, increased accountability to address the potential for corporations to cause public harm may have to come from outside corporate law. The Volcker rule,¹⁶ which both limits bank participation in risky trading activities and which restructures the incentive structure of bank compensation programs, is an example of this approach. Although a detailed analysis of the Volcker rule is beyond the scope of this essay, the rule suggests that regulatory alternatives may be warranted to the extent that shareholder interests imperfectly reflect those of the general public. Toward that end, policymakers may have been justified in using the Volcker rule to address the problems reflected by the whale.

II. THE MESS AT MORGAN

A. *The Whale*

The trouble at JP Morgan started with media reports about the London whale.¹⁷ In April 2012, Bloomberg News reported that a JP Morgan trader was making large enough trades to move prices in the \$10 trillion bond market.¹⁸ The trader, deemed the “London Whale,” was Bruno Iksil, an employee in JP Morgan’s London Chief Investment Office (CIO).¹⁹ JP Morgan had spun off the CIO as a separate unit of the bank in 2005 to invest the bank’s excess deposits.²⁰ The CIO began trading synthetic credit derivatives in 2006.²¹ Employees in the CIO

ON CORP. GOV. & FIN. REG. (July 8, 2013 9:35 AM), <http://blogs.law.harvard.edu/corpgov/2013/07/08/the-unintended-consequences-of-say-on-pay-votes/> (“TSR is often replacing a broad portfolio of metrics including profitability, cash flow and capital returns, which are key metrics in the business strategy. This change may have negative consequences on executive motivation and possibly encourage excessive risk taking.”).

16. The Volcker Rule is section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, codified at 12 U.S.C. § 1851. The rules implementing section 619 are Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds, 17 CFR Part 255, Dec. 10, 2013, (Volcker Rule Adopting Release), available at www.sec.gov/rules/final/2013/bhca-1.pdf.

17. *JP Morgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses*, Staff Report, Permanent Subcommittee on Investigations, U.S. SENATE, Apr. 11, 2013, at 10, available at <http://www.hsgac.senate.gov/download/report-jpmorgan-chase-whale-trades-a-case-history-of-derivatives-risks-and-abuses-march-15-2013> [hereinafter Senate Report] (observing that the public first learned about the whale trades on April 6, 2012).

18. Stephanie Ruhle, Bradley Keoun, & Mary Childs, *JPMorgan Trader's Positions Said to Distort Credit Indexes*, BLOOMBERG (Apr. 6, 2012), <http://www.bloomberg.com/news/2012-04-05/jpmorgan-trader-iksil-s-heft-is-said-to-distort-credit-indexes.html>.

19. Gregory Zuckerman & Katy Burne, London Whale Rattles Debt Market, WALL ST. J., April 6, 2012, <http://www.wsj.com/articles/SB10001424052702303299604577326031119412436>

20. Senate Report, *supra* note 17 at 35.

21. *Id.* at 3.

termed this trading activity the Synthetic Credit Portfolio (SCP) in 2008.²² During the 2008 financial crisis, the bank received \$100 billion in new deposits from investors seeking safety.²³ These deposits had the effect of doubling the portfolio that the CIO was responsible for investing. By 2012, the CIO's portfolio amounted to \$350 billion.²⁴

Although JP Morgan described the CIO's objectives as risk management and hedging,²⁵ the SCP increased in both size and riskiness during 2011 and early 2012. The notional amount of the portfolio increased from \$4 billion to \$157 billion and more importantly, the portfolio increased in risk as the CIO took the portfolio into a net long position and ceased to engage in hedging trades.²⁶ Traders described the portfolio as "huge" and of a "perilous size" by the end of March 2012.²⁷

Initially the SCP was a source of substantial revenue for JP Morgan, generating \$1.8 billion in revenues from 2008 to 2011.²⁸ By early 2012, however, the market had turned against the CIO, and the SCP was losing money.²⁹ Rather than reducing the trading activity, the CIO increased the size of its trades in an effort to recover on its losing positions.³⁰

Even when the Whale's trading losses came to light, JP Morgan employees failed to acknowledge and address the problem.³¹ In an effort to hide the growing size of its losses, the CIO began to manipulate its method of valuing the credit derivatives in its portfolio.³² The fake valuations, hiding billions of dollars in losses, were so substantial that Bruno Iksil described them as "idiotic."³³ Additionally, JP Morgan used the artificial numbers in its regulatory filings, misstating the company's financial position to regulators and investors and hiding losses totaling hundreds of millions.³⁴

In April 2013, JP Morgan booked a \$718 million loss, but it did not disclose the amount of that loss publicly.³⁵ Instead, following the media

22. *Id.* at 35.

23. *Id.* at 21.

24. *Id.* at 22.

25. *Id.* at 22, 42–43.

26. *Id.* at 35. It appears that the SCP's shift in trading strategy was intended, at least initially to reduce the level of the CIO's risk weighted assets. *See id.* at 52.

27. *Id.*

28. *Id.* at 56.

29. *See id.* at 35 (describing the SCP's losses during early 2012).

30. *Id.* at 73–76.

31. *Id.* at 96.

32. *Id.* at 5, 96.

33. *Id.* at 96.

34. *Id.* at 6.

35. Michael J. Moore & Dawn Kopecki, *Dimon Saw \$1 Billion Potential Loss When He Made 'Teapot' Remark*, BLOOMBERG (July 13, 2012), <http://www.bloomberg.com/news/2012-07-13/dimon-saw-1-billion-potential-loss-when-he-made-teapot-remark.html>.

reports in April, CEO Jamie Dimon told analysts that the Whale was “a complete tempest in a teapot.”³⁶ On May 10, 2012, JP Morgan publicly announced a loss of \$2 billion resulting from derivatives trading by the CIO.³⁷ By the end of the year, the bank reported cumulative losses of \$6.2 billion.³⁸

The Whale generated tremendous publicity. At two separate congressional hearings in June 2013, members of Congress reprimanded JP Morgan executives, including CEO Jamie Dimon about the loss and the bank’s response.³⁹ Dimon eventually conceded that he was “dead wrong” in initially characterizing the matter as “a complete tempest in a teapot.”⁴⁰ Dimon also acknowledged to Congress that the bank showed “bad judgment,” was “stupid” and “took far too much risk.”⁴¹ In March 2013, the Senate released a 300-page report of the findings by the Senate Permanent Subcommittee on Investigations that the bank had misled investors and regulators.⁴² In conjunction with the report, the Subcommittee held an additional hearing on March 15, 2013, at which five JP Morgan employees (but not Dimon) testified.⁴³

Following investigations by multiple regulators on two continents, JP Morgan eventually agreed to pay over a billion dollars to settle charges that it violated banking and securities laws and manipulated the markets.⁴⁴ Bruno Iksil, who both personally executed the majority of

36. Polya Lesova, *Dimon: London Whale Issues "Tempest in a Teapot"*, MARKETWATCH (Apr. 13, 2012), <http://www.marketwatch.com/story/dimon-london-whale-issues-tempest-in-a-teapot-2012-04-13-937450>.

37. Dan Fitzpatrick, Gregory Zuckerman & Liz Rappaport, *J.P. Morgan's \$2 Billion Blunder*, WALL ST. J., (May 11, 2012), <http://online.wsj.com/news/articles/SB10001424052702304070304577396511420792008>.

38. Patricia Hurtado, *The London Whale*, BLOOMBERG QUICKTAKE (Sept. 12, 2014), <http://www.bloombergvew.com/quicktake/the-london-whale>.

39. See *A Breakdown in Risk Management: What Went Wrong at JPMorgan Chase?: Hearing Before the Comm. on Banking, Housing, and Urban Affairs*, 112th Cong. (2012), available at <http://www.gpo.gov/fdsys/pkg/CHRG-112shrg78850/pdf/CHRG-112shrg78850.pdf>; see also *Examining Bank Supervision and Risk Management in Light of JPMorgan Chase's Trading Loss: Hearing Before the Comm. on Financial Services*, 112th Cong. (2012), available at <http://financialservices.house.gov/uploadedfiles/112-136.pdf>.

40. Lesova, *supra* note 36.

41. *Senate Report Blames JPMorgan Senior Managers For Bad Bets That Led To 'Whale' Loss*, HUFF. POST (Mar. 14, 2013 5:00 PM), http://www.huffingtonpost.com/2013/03/14/senate-report-jpmorgan-london-whale_n_2878702.html.

42. Senate Report, *supra* note 17.

43. See *JPMorgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses: Hearing Before the Perm. Subcomm. on Investigations of the Comm. on Homeland Sec. and Gov't Affairs*, 113th Cong. (2013), available at <http://www.gpo.gov/fdsys/pkg/CHRG-113shrg80222/pdf/CHRG-113shrg80222.pdf> & <http://www.gpo.gov/fdsys/pkg/CHRG-113shrg85162/pdf/CHRG-113shrg85162.pdf> (two volumes).

44. Silla Brush, *JPMorgan to Pay \$100 Million Fine on CFTC London Whale Claim*, BLOOMBERGBUSINESS (Oct. 16, 2013 5:27 PM), <http://www.bloomberg.com/news/2013-10-16/jpmorgan-to-pay-100-million-to-settle-cftc-claims-chilton-says.html>.

the CIO trades and assisted in covering them up, was not charged criminally.⁴⁵ Nor were Ina Drew, who managed the CIO and Jamie Dimon.⁴⁶ Two “mid-level” JP Morgan employees were indicted—Javier Martin-Artajo, Iksil’s boss and Julien Grout, another CIO trader.⁴⁷ As of last year, Martin-Artajo and Grout were in Europe resisting extradition to the United States for trial.⁴⁸

One of the issues about the whale that drew substantial congressional concern was the fact that, although JP Morgan claimed that the purpose of the CIO was to engage in hedging, both the investment strategy of the office and compensation structure of the CIO employees were inconsistent with this claim. For example as the Senate Report observed, JP Morgan’s public statements repeatedly characterized the SCP as “hedging risk.”⁴⁹ In fact, at the same time that the bank was making the statements, the SCP’s investments amplified the bank’s level of risk.⁵⁰ Notably, the SCP’s trading activities were inconsistent with hedging even before the events of 2012, but in earlier years, the SCP’s risks resulted in profits rather than losses.⁵¹

JP Morgan’s management and board ignored the risks associated with the CIO’s derivatives trading. Although JP Morgan was touted for its “best-in-class risk management,”⁵² “from January 1 through April 30, 2012, CIO risk limits and advisories were breached more than 330 times.”⁵³ These breaches were not concealed by a single rogue trader, but were repeatedly reported to Morgan management.⁵⁴ Nonetheless, they were routinely ignored.⁵⁵ The congressional investigation revealed “a bank culture in which risk limit breaches were routinely disregarded, risk metrics were frequently criticized or downplayed, and risk

45. Iksil agreed to cooperate with prosecutors in their case against his former boss Martin-Artajo and fellow trader Julien Grout. See ‘London Whale’ Bruno Iksil to avoid charges over JPMorgan \$6.2bn loss, RT (Aug. 14, 2013 1:59 PM), <http://rt.com/business/jpmorgan-london-whale-iksil-432/>.

46. Agostino Fontevicchia, *London Whale And Ina Drew Off The Hook As Two Ex-JPMorgan Traders Face Criminal Charges*, FORBES (Aug. 14, 2013 1:07 PM), <http://www.forbes.com/sites/afontevicchia/2013/08/14/london-whale-and-ina-drew-off-the-hook-as-two-ex-jpmorgan-traders-face-criminal-charges/>.

47. *Id.*

48. Christina Rexrode, *Two charged in London Whale losses still in Europe*, MARKETWATCH (Jan. 29, 2014 1:12 PM), <http://www.marketwatch.com/story/two-charged-in-london-whale-losses-still-in-europe-2014-01-29>.

49. See, e.g. Senate Report, *supra* note 17 at 12–13 (quoting earnings call statements by CFO Douglas Braunstein).

50. See *id.* at 12 (explaining that “as then configured, the SCP would have amplified rather than reduced the bank’s losses in the event of a credit crisis”).

51. See *id.* at 55 (“JPMorgan Chase has been unable to explain how the 2011 trading strategy that produced the \$400 million gain functioned as a hedge or credit loss protection for the bank.”).

52. *Id.* at 153.

53. *Id.*

54. *Id.* at 25.

55. *Id.*

evaluation models were targeted by bank personnel seeking to produce artificially lower capital requirements.”⁵⁶

B. *Beyond the Whale*

In the months that followed the discovery of the whale, JP Morgan’s legal troubles continued. In July 2013, the bank agreed to pay \$410 million to settle charges that it manipulated electricity prices in California and the Midwest over a two-year period.⁵⁷ Regulators claimed that JP Morgan traders “gamed a complex web of rules that help set the cost of electricity.”⁵⁸ The Federal Energy Regulatory Commission determined that JP Morgan traders had designed twelve separate bidding strategies with the intent to receive above-market payments, which JP Morgan did, in fact receive.⁵⁹

In September 2013, JP Morgan announced a settlement with the office of the Comptroller of the Currency, in which it agreed to pay an \$80 million fine and to refund an additional \$309 million to consumers in connection with charges that JP Morgan engaged in unfair credit card billing practices and improper debt collection litigation.⁶⁰ Although JP Morgan did not admit to wrongdoing, according to the OCC, Morgan violated sold consumers products that they did not want and engaged in a variety of improper litigation practices that included filing inaccurate sworn documents in court.⁶¹

In October, JP Morgan agreed to pay \$5.1 billion to settle claims by the Federal Housing Financing Agency that it had misled Fannie Mae and Freddie Mac about the quality of nearly 129 mortgage-backed

56. *Id.*

57. Ryan Tracy & Dan Fitzpatrick, *J.P. Morgan Settles Electricity-Market Case*, WALL ST. J. (July 30, 2013, 5:45 PM), <http://online.wsj.com/news/articles/SB10001424127887324170004578637662037547582>.

58. *Id.*; see also Jessica Silver Greenberg & Ben Protess, *JPMorgan Caught in Swirl of Regulatory Woes*, N.Y. TIMES DEALBOOK (May 2, 2013, 10:00 PM), http://dealbook.nytimes.com/2013/05/02/jpmorgan-caught-in-swirl-of-regulatory-woes/?_php=true&_type=blogs&_r=0 (quoting a confidential government document stating that JP Morgan devised “manipulative schemes” to transform “money-losing power plants into powerful profit centers.”).

59. *In re Make-Whole Payments & Related Bidding Strategies*, 144 FERC ¶ 61068 (July 30, 2013), available at <http://www.ferc.gov/EventCalendar/Files/20130730080931-IN11-8-000.pdf>.

60. See Alan Zibel & Andrew R. Johnson, *J.P. Morgan Settles Consumer Cases*, WALL ST. J. (Sept. 19, 2013, 7:20 PM), <http://online.wsj.com/news/articles/SB10001424127887323308504579085020022276480>.

61. *In the Matter of JPMorgan Chase Bank, et. al*, Consent Order No. 2013-138 (Sep. 18, 2013), available at <http://www.occ.gov/static/enforcement-actions/ea2013-138.pdf>; *In the Matter of JP Morgan Chase Bank, et. al*, Consent Order No. 2013-139 (Sep. 19, 2013), available at <http://www.occ.gov/static/enforcement-actions/ea2013-139.pdf>.

securities for which they paid approximately \$33 billion.⁶²

On November 15, 2013, Morgan agreed to pay a group of institutional investors \$4.5 billion to settle investor litigation over its sale of mortgage-backed securities.⁶³ The following Monday, it finalized a record-setting \$13 billion settlement with the Justice Department over the same activities.⁶⁴ As part of the settlement, Morgan admitted to making "serious misrepresentations" to investors.⁶⁵ In January 2015, JP Morgan agreed to pay approximately \$500 million to settle a class action lawsuit arising out of the sales.⁶⁶

In December 2013 JP Morgan agreed to pay \$108 million to settle charges that it allegedly colluded with other big banks to manipulate European and Japanese interest rates.⁶⁷ The settlement covers only the Japanese benchmark; JP Morgan and several other banks continue to maintain their innocence regarding the Euribor rate.⁶⁸ In March 2014, the FDIC filed suit against JP Morgan along with 15 other banks in connection with the rate-rigging scandal.⁶⁹

Additionally, in January 2014, JP Morgan agreed to pay a fine of \$2 billion to resolve investigations that it failed to warn the government about Bernard L. Madoff's Ponzi scheme.⁷⁰ Documents filed by the government indicated that JP Morgan employees suspected that Madoff was involved in a Ponzi scheme as early as 2007, if not much earlier. In June 2007, for example, JP Morgan chief risk officer John Hogan⁷¹

62. Devlin Barrett, et al., *J.P. Morgan Settles with FHFA*, WALL ST. J. (Oct. 25, 2013 8:04 PM), <http://online.wsj.com/news/articles/SB10001424052702303615304579157931846055864> (the settlement included claims made against JP Morgan as well as claims based on the activities of Washington Mutual and Bear Stearns).

63. Dan Fitzpatrick & Julie Steinberg, *J. P. Morgan Reaches \$4.5 Billion Settlement with Investors*, WALL ST. J. (Nov. 15, 2013 6:26 PM), <http://online.wsj.com/news/articles/SB10001424052702303289904579200283310122754>

64. James O'Toole and Evan Perez, *JPMorgan Agrees to \$13 Billion Mortgage Settlement*, CNN MONEY (Nov. 29, 2013 7:26 PM), <http://money.cnn.com/2013/11/19/investing/jpmorgan-mortgage-settlement/>.

65. *Id.*

66. See Julie Steinberg, *J.P. Morgan to Pay \$500 Million to Settle Lawsuit*, WALL ST. J. (Jan. 9, 2015), <http://www.wsj.com/articles/j-p-morgan-to-pay-500-million-to-settle-lawsuit-1420836735>.

67. Danielle Douglas, *JPMorgan Chase, Citigroup first U.S. banks to be fined in rate-rigging scandal*, WASH. POST (Dec. 4, 2013), http://www.washingtonpost.com/business/economy/eu-fines-first-us-banks-in-rate-rigging-scandal/2013/12/04/828468da-5cf6-11e3-95c2-13623eb2b0e1_story.html.

68. *Id.*

69. Trefis Team, *FDIC Sues 16 Global Banks For Roles In Manipulating LIBOR*, FORBES (Mar. 18, 2014 1:50 PM), <http://www.forbes.com/sites/greatspeculations/2014/03/18/fdic-sues-16-global-banks-for-roles-in-manipulating-libor/>.

70. See Mark Hamblett, *Bharara Says JPMorgan Deal Sends Message on Compliance*, N.Y.L.J. (Jan. 8, 2014), <http://www.newyorklawjournal.com/id=1202636806032> (the \$2 billion consisted of a \$1.7 billion forfeiture for two counts of violating the Bank Secrecy Act and an additional \$350 civil fine to the Comptroller of the Currency).

71. Notably, John Hogan returned to Morgan in June 2013 after a brief leave of absence as

wrote an email in which he described Madoff's returns as "speculated to be part of a Ponzi scheme."⁷² The recitation of facts in the deferred prosecution agreement also referenced an Oct. 16, 2008 internal Morgan memo in which a trader "described JPMC's inability to validate Madoff's trading activity or even custody of assets; questioned Madoff's 'odd choice' of a small, unknown accounting firm; and reported that JPMC 'seem[ed] to be relying on Madoff's integrity' with little to verify that such reliance was well-placed."⁷³ Between the date of the memo and Madoff's December 2008 arrest, JP Morgan redeemed \$275 million of its own money from Madoff.⁷⁴ JP Morgan also reportedly earned \$435 million in profits on the investor funds that Madoff deposited in the bank between 1993 and 2008.⁷⁵

The resolution of the Madoff case required JP Morgan to acknowledge wrongdoing and included a deferred prosecution agreement that gives the Justice Department the right to pursue criminal charges against JP Morgan if the bank fails to live up to the settlement terms.⁷⁶ The deferred charges are a willful failure to establish an anti-money laundering program, and failing to file a suspicious activity report.⁷⁷

The litigation issues continue. The SEC is also investigating allegations that Morgan violated anti-bribery laws by hiring the children of well-connected politicians in China in exchange for receiving business.⁷⁸ Documents reviewed by the *New York Times* reveal that Dimon met at least one of the applicants that JP Morgan subsequently hired, although he is not personally accused of any wrongdoing.⁷⁹ As

Chairman of Risk. See Matthias Rieker & Dan Fitzpatrick, *John Hogan Returns to J.P. Morgan as Chairman of Risk*, WALL ST. J. MONEYBEAT (June 13, 2013, 11:38 AM), <http://blogs.wsj.com/moneybeat/2013/06/13/john-hogan-returns-to-j-p-morgan-as-chairman-of-risk/>.

72. Danielle Douglas, *Government extracts \$2 Billion in fines from JPMorgan in Madoff case*, WASH. POST (Jan. 7, 2014), http://www.washingtonpost.com/business/economy/jpmorgan-to-pay-government-17-billion-to-settle-madoff-allegations/2014/01/07/9f62839a-77a6-11e3-b1c5-739e63e9c9a7_story.html.

73. U.S. DEP'T OF JUSTICE, J.P. MORGAN CHASE BANK N.A. – DEFERRED PROSECUTION AGREEMENT, EXHIBIT B, at 4 (Jan. 6, 2014), available at [http://www.justice.gov/usao/nys/pressreleases/January14/JPMCDPASupportingDocs/JPMC%20DPA%20Packet%20\(Fully%20Executed%20w%20Exhibits\).pdf](http://www.justice.gov/usao/nys/pressreleases/January14/JPMCDPASupportingDocs/JPMC%20DPA%20Packet%20(Fully%20Executed%20w%20Exhibits).pdf).

74. *Id.*

75. Louis R. Davis & Linus Wilson, *Estimating JP Morgan Chases' Profits from the Madoff Deposits*, 14 RISK MGMT. & INS. REV. 1, 107–19 (2011).

76. Douglas, *supra* note 72.

77. Hamblett, *supra* note 70.

78. See Jessica Silver-Greenberg, Ben Protess & David Barboza, *Hiring in China by JPMorgan Under Scrutiny*, N.Y. TIMES (Aug. 17, 2013, 8:01 PM), <http://dealbook.nytimes.com/2013/08/17/hiring-in-china-by-jpmorgan-under-scrutiny/?ref=todayspaper&r=0> (reporting on the opening of an investigation by the SEC).

79. Jessica Silver-Greenberg & Ben Protess, *Chinese Official Made Job Plea to JPMorgan Chase Chief*, DEALBOOK (Feb. 9, 2014, 10:06 PM), <http://dealbook.nytimes.com/2014/02/09/chinese->

one commentator observed in response to the reports, “opaque hiring practices and nepotism can be a symptom of a poor compliance culture at a company.”⁸⁰

JP Morgan was not unique in its involvement in these various types of wrongdoing. Most if not all of the investigations and enforcement actions detailed in this section involved multiple financial institutions. As commentators have noted, the big banks have been repeat offenders, both with respect to financial fraud and broader types of misconduct,⁸¹ and the financial crisis focused regulator attention on uncovering and addressing this activity. JP Morgan’s actions, as described in this article, are not exceptional but illustrative.

III. PUBLICNESS AND SHAREHOLDER EMPOWERMENT

A. Corporate Publicness

The focus on JP Morgan and its wrongdoing by regulators, policymakers and the press, and the demand for accountability in terms of the pursuit of enforcement actions and the imposition of fines and penalties can be understood as a response to JP Morgan’s “publicness.” Publicness reflects the public’s awareness of and concern about JP Morgan’s misconduct. It also reflects an understanding that JP Morgan’s misconduct was not a private matter between the company and its shareholders but had a broad effect on consumers, customers, the bond markets, the energy markets, interest rates, regulators and more. Corporations in general, and financial firms in particular, have experienced increased publicness since the financial crisis of 2008, as policymakers and ordinary citizens came to recognize the widespread impact that corporate misconduct can have on the affairs of non-shareholder stakeholders and the broader economy.

The publicness view of the corporation is not new. Early corporations prior to the industrial revolution were viewed with great distrust, precisely because of their capacity to inflict substantial harm.⁸²

official-made-job-plea-to-jpmorgan-chase-chief/?_php=true&_type=blogs&_r=0.

80. Alexandra Wrage, *Cautionary Tale: U.S. Bribery Probe Into JP Morgan's Hiring Practices In China*, FORBES (Aug. 20, 2013, 10:29 AM), <http://www.forbes.com/sites/alexandrawrage/2013/08/20/cautionary-tale-u-s-bribery-probe-into-jp-morgans-hiring-practices-in-china/>.

81. See Edward Wyatt, *Promises Made, and Remade, by Firms in S.E.C. Fraud Cases*, N.Y. TIMES, (Nov. 7, 2011), http://www.nytimes.com/2011/11/08/business/in-sec-fraud-cases-banks-make-and-break-promises.html?_r=0 (explaining that “nearly all of the biggest financial companies” are “repeat offender[s]”).

82. See Jill E. Fisch, *Frankenstein's Monster Hits the Campaign Trail: An Approach to Regulation of Corporate Political Expenditures*, 32 WM. & MARY L. REV. 587 (1991).

Fear of corporate power led to limitations on which businesses would be permitted to operate in the corporate form as well as restrictions on corporate size, powers and duration.⁸³ Early debates about the regulation of the railroads, the adoption of the federal antitrust laws in response to the merger boom of the late 1900s, and the longstanding restrictions on corporate political activity prior to the Court's decision in *Citizens United*,⁸⁴ were all based on the publicness of the corporation.⁸⁵

The public impact of the corporation was also a key factor in the adoption of the federal securities laws.⁸⁶ Congress identified the rationale for the legislation in section 2 of the Securities & Exchange Act of 1934, explaining that “transactions in securities . . . are effected with a national public interest” and that “national emergencies, which produce widespread unemployment . . . and adversely affect the general welfare, are precipitated, intensified and prolonged by [misconduct in the securities markets].”

Publicness has a distinctive legal definition within the framework of federal securities regulation. Under federal law, a corporation can become a “public company” in one of three ways—raising capital in the public markets, listing on a national securities exchange or becoming sufficiently large in terms of asset size and shareholder base.⁸⁷ Becoming a public company has several consequences. Public companies must make periodic disclosures to the SEC and to shareholders, which include annual reports, quarterly reports and 8-Ks. Public companies are subject to the federal proxy rules and the restrictions of the Williams Act in the event of a takeover. Officers, directors and 10% shareholders of public companies are subject to Section 16(b) restriction on short swing trading.

Although securities regulation of public companies initially focused primarily if not exclusively on investor protection and capital market

83. See, e.g., *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 567 (1933) (Brandeis, J., dissenting) (describing historical limitations on the use of the corporate form and warning of the “social significance” and potential harm from “removing all limitations upon the size and activities of business corporations”); Charles Yablon, *The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880-1910*, 2007 J. CORP. L. 323, 359 (“Prior to 1899, Delaware had one of the most restrictive incorporation statutes in the country. Charters could only be granted by judicial order, and there were limitations on the duration, amount of capital, and purposes for which a corporation could be formed”).

84. *Citizens United v. FEC*, 558 U.S. 310 (2010).

85. See, e.g., *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652 (1990) (upholding regulation of corporate political speech based on the compelling interest in preventing its “corrosive and distorting effects”).

86. See Jonathan Glater, *Private Offerings and Public Ends: Reconsidering the Regime for Classification of Investors under the Securities Act of 1933*, 48 CONN. L. REV. (forthcoming 2015) (describing legislative history of the federal securities laws).

87. Langevoort & Thompson, *supra* note 13, at 351.

development, some commentators have convincingly argued that modern securities regulation has moved from private to public law as it looks to address the effect of public companies on broader social, political and economic interests.⁸⁸ Early evidence of this shift came with Congress' adoption of the Foreign Corrupt Practices Act (FCPA) in 1977 in which Congress prohibited public corporations from paying bribes to foreign officials.⁸⁹ Although the prohibition of bribes did not directly further shareholder interests (and may in fact have damaged those interests by making US corporations less competitive overseas), Congress situated the prohibition in the federal securities laws and vested authority over its enforcement in the SEC.⁹⁰

The corporate governance scandals in Enron and WorldCom generated a public reaction and a regulatory response in the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley).⁹¹ Above the reforms implemented by Sarbanes-Oxley were greater oversight over financial reporting and the creation of a new regulator to supervise the accounting industry, the Public Company Accounting Oversight Board (PCAOB).⁹² Like the FCPA, Sarbanes-Oxley was a response to the perceived "publicness" of large public companies and, in particular, a perception of the need to regulate such companies because of the broad "public" effects of their conduct.⁹³ A similar pattern can be seen in the requirements imposed by Dodd-Frank on corporate disclosure of their use of corporate minerals⁹⁴ and resources extraction.⁹⁵

88. *Id.* at 372. *See also id.* at 342 (describing one objective of contemporary securities regulation as focused on responsibility and accountability beyond shareholders and to society more generally).

89. 15 U.S.C. § 78dd-1(a) (2006). *See Langevoort & Thompson, supra* note 13, at 373.

90. *Cf.* Barbara Black, *The SEC and the Foreign Corrupt Practices Act: Fighting Global Corruption Is Not Part of the SEC's Mission*, 73 OHIO ST. L.J. 1093 (2012) (arguing that the target of the FCPA, combatting bribery, is not properly part of the SEC's mission of protecting investors).

91. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15, 18, 28, and 29 U.S.C.); *see also* Sale, *Public Governance, supra* note 14, at 881 (identifying roots of publicness in the scandals involving Enron and other companies and noting changes adopted by the Model Business Corporation Act in response).

92. For a general analysis of the PCAOB and congressional authority to create it, *see* Donna Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and its Public/Private Status*, 80 NOTRE DAME L. REV. 975 (2009).

93. *See Langevoort & Thompson, supra* note 13, at 340 (describing the "effort to create more accountability of large, economically powerful business institutions that is only loosely coupled with orthodox (and arguably more measurable) notions of investor protection.").

94. *See* Conflict Minerals, 77 Fed. Reg. 56274, 2012 WL 3611799 (Sept. 12, 2012), *available at* <http://www.gpo.gov/fdsys/pkg/FR-2012-09-12/pdf/2012-21153.pdf>. In particular, Dodd-Frank's new disclosure requirements with respect to public companies' use of conflict minerals and resource extraction reflect a similar conception of publicness. In Dodd-Frank, Congress required public companies to investigate the extent to which their product use conflict minerals—gold tantalum, tin and tungsten, and to disclose the results of that investigation. *Id.* Although the requirement is framed as part of public company reporting, commentators have observed that this disclosure does not appear to be targeted toward investor or capital market protection. *See also* Jenna Greene, *D.C. Circuit Panel*

B. Shareholder Empowerment as a Response to Publicness

The failures at Enron, WorldCom and other companies at the end of the dot com bubble were another example of corporate publicness, as the public was treated to media reports detailing the effect of the failures not just on stockholders but on employees and communities.⁹⁶ The public nature of these failures generated a demand for accountability, and many corporate executives were criminally prosecuted for their role in the scandals.⁹⁷

The scandals were also widely denounced as a failure of corporate governance.⁹⁸ In response, commentators and policymakers sought to reform corporate governance by increasing shareholder empowerment.⁹⁹

The settlement agreement in the reorganization of WorldCom/MCI reflects this shareholder empowerment approach to governance

Hammers Conflict Mineral Rule, THE LIT. DAILY (Jan. 8, 2014), <http://www.litigationdaily.com/id=1202637092964/DC-Circuit-Panel-Hammers-Conflict-Minerals-Rule?slreturn=20150401150207> (reporting on oral argument before DC Circuit, in which SEC Assistant General Counsel Tracey Hardin conceded that providing investor protection was not the main point of the rule); *Nat'l Assn. of Mfrs. v. SEC*, 748 F.3d 359, 365 (D.C. Cir. 2014) (describing "Congress's judgment that supply-chain transparency would promote peace and stability by reducing the flow of money to armed groups").

95. Congress required the SEC to adopt a rule mandating disclosure of government payments made by US public companies in connection with the commercial development of oil, natural gas, or minerals. Dodd-Frank Wall Street Reform and Consumer Protection Act § 1504, 22 U.S.C. § 286tt (2012). See Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. 56365 (Aug. 22, 2012), available at www.sec.gov/rules/final/2012/34-67717.pdf. According to the SEC, "Congress intended that [the rule] would increase the accountability of governments to their citizens in resource-rich countries for the wealth generated by those resources." *Id.* In adopting the rule, the SEC explicitly observed that the social benefit contemplated by Congress "differs from the investor protection benefits that our rules typically strive to achieve." *Id.*

96. See, e.g., Rick Bragg, *ENRON'S COLLAPSE: WORKERS; Workers Feel Pain of Layoffs And Added Sting of Betrayal*, N.Y. TIMES (Jan. 20, 2002), <http://www.nytimes.com/2002/01/20/us/enron-s-collapse-workers-workers-feel-pain-layoffs-added-sting-betrayal.html> (describing how Enron's collapse caused 4000 employees to lose their jobs).

97. See, e.g., Alexei Barriionuevo, *Enron Chiefs Guilty of Fraud and Conspiracy*, N.Y. TIMES (May 26, 2006), <http://www.nytimes.com/2006/05/25/business/25cnd-enron.html?pagewanted=all> (reporting on jury conviction of Enron executives Kenneth Lay and Jerry Skilling).

98. See, e.g., Patty M. DeGaetano, *The Shareholder Direct Access Teeter-Totter: Will Increased Shareholder Voice in the Director Nomination Process Protect Investors?*, 41 CAL. W. L. REV. 361, 365 (2005) ("Enron was the first in the string of recent corporate scandals that have highlighted the systemic corporate governance failures in America."); see also, Renee M. Jones, *Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance*, 92 IOWA L. REV. 105, 137 (2006) (identifying other contemporaneous accounting scandals and describing claims that these scandals were due to a lack of effective board oversight).

99. See, e.g., Judy Warner, *10 Years After Sox: The Legacy of Enron*, NAT'L ASS'N OF CORPORATE DIRECTORS (Sep. 26, 2012), <https://www.nacdonline.org/Magazine/Article.cfm?ItemNumber=8951> (citing ISS counsel Patrick McGurn as stating that the "more important [governance changes] are the changes that have empowered shareholders").

reform.¹⁰⁰ In the report, Corporate Monitor Richard Breeden proposed 78 corporate governance reforms, all of which MCI accepted.¹⁰¹ The governance reforms included substantial new rights and powers for WorldCom shareholders, such as the right to propose shareholder resolutions even if those resolutions did not meet the requirements under SEC Rule 14a-8, the right to fill board vacancies, propose candidates for director elections and have a genuine choice of director nominees.¹⁰² Significantly, the Report explained a fundamental component of the shareholder empowerment approach: “Rather than more regulation to protect shareholders, these recommendations seek to give more power to shareholders to protect themselves.”¹⁰³

The trend to increase shareholder empowerment in the name of improved corporate governance has continued. Lucian Bebchuk published his widely cited defense of shareholder empowerment in 2005.¹⁰⁴ Shareholder empowerment figured prominently in the Committee on Capital Markets Regulation’s law reform agenda in 2006.¹⁰⁵ The Committee’s Report devoted an entire section to improving shareholder rights, focusing on such issues as allowing shareholders authority over the adoption of takeover defenses, majority voting, and proxy access.¹⁰⁶ Many commentators have similarly characterized the 2008 financial crisis as a corporate governance failure.¹⁰⁷

The calls for increased shareholder empowerment have been effective. Many issuers have eliminated classified boards in favor of

100. RICHARD C. BREEDEN, REPORT TO THE HON. JED S. RAKOFF, THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK ON CORPORATE GOVERNANCE FOR THE FUTURE OF MCI, INC. (2003), available at <http://www.law.du.edu/images/uploads/restoring-trust.pdf> [hereinafter RESTORING TRUST].

101. *Id.*; see also *WorldCom's revenge*, THE ECONOMIST (Aug. 29, 2003), <http://www.economist.com/node/2024897>.

102. RESTORING TRUST, *supra* note 100 at 3.

103. *Id.* at 6.

104. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).

105. See INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 93 (2006), available at <http://capmktreg.org/app/uploads/2014/08/Committees-November-2006-Interim-Report.pdf> [hereinafter CAPITAL MARKETS REPORT]; see William B. Bratton & Michel Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 655 (2010) (describing the Committee’s defense of shareholder empowerment).

106. CAPITAL MARKETS REPORT, *supra* note 105, at 93 (“The strength of shareholder rights in publicly traded firms directly affects the health and efficient functioning of U.S. capital markets.”).

107. See, e.g., JAMES P. HAWLEY, SHYAM J. KAMATH, & ANDREW T. WILLIAMS, CORPORATE GOVERNANCE FAILURES THE ROLE OF INSTITUTIONAL INVESTORS IN THE GLOBAL FINANCIAL CRISIS (2011); HAMID MEHRAN, ET AL., CORPORATE GOVERNANCE AND BANKS: WHAT HAVE WE LEARNED FROM THE FINANCIAL CRISIS? (2011), available at http://www.newyorkfed.org/research/staff_reports/sr502.pdf.

annual elections,¹⁰⁸ shifted from plurality to majority voting standards¹⁰⁹ and increased the degree to which corporate boards are independent of management.¹¹⁰ Investors have enjoyed growing success in persuading boards to adopt poison pills that require a shareholder vote for their adoption or extension, or to eliminate poison pills entirely. Shareholders have also sought to exercise greater influence in operational decisions. Most recently, in the wake of the Supreme Court's decision in *Citizens United*,¹¹¹ shareholders have introduced proposals seeking greater disclosure or control over corporate political spending.¹¹²

In Dodd-Frank, Congress sought to harness the growth in shareholder power not just to improve management accountability to shareholders, but toward a broader public objective. Accountability, under Dodd-Frank, is no longer just about making boards faithful agents of the shareholders; it is also about making corporations more responsible public actors. Although several aspects of Dodd-Frank illustrate the shift,¹¹³ this essay will focus on Dodd-Frank's treatment of executive compensation and, in particular, the implementation of "Say on Pay."

The efficacy of using shareholders as a vehicle to addressing corporate publicness raises several considerations. First, shareholder empowerment might be defended on the basis that it is less intrusive than direct regulation. Shareholder empowerment is a form of private ordering.¹¹⁴ Changes implemented through private ordering are more flexible than those imposed through regulation, enabling individual firms to tailor those changes to their specific needs rather than adhering to the dictates of a mandatory one-size-fits-all rule.¹¹⁵ Private ordering

108. See, e.g., *121 Companies Agreed to Move towards Annual Elections*, HARVARD SHAREHOLDER RIGHTS PROJECT, <http://srp.law.harvard.edu/companies-entering-into-agreements.shtml> (last visited May 20, 2015) (explaining that 121 companies shifted from staggered boards to annual election of directors in response to shareholder proposals submitted by the project).

109. See Choi, Fisch, Kahan, & Rock, *Does Majority Voting Improve Board Accountability?*, (forthcoming 2015) (providing statistics on the shift from plurality to majority voting at S&P 1500 firms).

110. See, e.g., Jeffrey Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465 (2007) (detailing the shift from insider-dominated to largely independent boards of directors).

111. *Citizens United v. F.E.C.*, 558 U.S. 310 (2010).

112. See *Corporate Political Spending: A Resource*, THE CONFERENCE BOARD, <https://www.conference-board.org/politicalspending/> (last updated Jan. 14, 2015) (describing increased use of shareholder proposals "on the topic of corporate political activity").

113. See notes 94 and 95, *supra*, and accompanying text. (describing conflict minerals and resource extraction rules).

114. See Jill Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY LJ. 435, 440 n. 17 (2012) (explaining concept of private ordering).

115. See, e.g., Troy Paredes, Comm'r, Sec. Exch. Comm'n, Statement at Open Meeting to Propose Amendments Regarding Facilitating Shareholder Director Nominations (May 20, 2009), available at <http://www.sec.gov/news/speech/2009/spch052009tap.htm> (defending private ordering over a mandatory approach as enabling greater flexibility for firm-specific tailoring).

also reduces the risk of regulatory error— market forces can discipline firms that adopt value-decreasing approaches.

In addition, shareholder empowerment offers a mechanism for harnessing a range of views. As Lisa Fairfax has explained, public company shareholders hold a range of divergent interests—including their time horizon, the extent to which they focus on financial return, and the extent to which they are concerned with the interests of non-shareholder stakeholders.¹¹⁶ Public company shareholders may include hedge funds, retail investors, social investors and union pension funds—enabling shareholder action to provide input on a variety of public and social values. Fairfax has demonstrated that shareholder efforts to advance a variety of social and public objectives have been successful in influencing corporate policy.¹¹⁷

There are limitations to relying on shareholders as agents of publicness however. The most important limitation is that of capacity. Shareholders have limited information about the corporations in which they invest and limited expertise in operational decision-making.¹¹⁸ Shareholders often engage in herding— following the lead of an activist hedge fund with respect to a financial transaction or demanding high profile governance reforms despite the absence of empirical support for their efficacy.¹¹⁹ Shareholders may also rely excessively on the advice of third party intermediaries such as Institutional Shareholder Services.

A more serious problem with relying on shareholder empowerment is that shareholders are imperfect agents for the public generally. Shareholder interests are not always aligned with those of other stakeholders or the public more generally.¹²⁰ Specifically, shareholders are likely to place greater weight on profit maximization than other stakeholders.¹²¹ In addition, because most shareholders are diversified, they may have a greater tolerance for risky operational decisions, which also result in higher average returns, than non-shareholder stakeholders.¹²²

116. Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L.J. 53, 83–85 (2008).

117. *See id.* at 93.

118. *See* Bratton & Wachter, *supra* note 105, at 695–97 (describing how information asymmetries make it difficult for investors to evaluate managerial decisions through stock price reactions).

119. *See* Roberta Romano, *Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174 (2001) (finding that institutional activism has little or no effect on targeted firms' performance).

120. *See* Fairfax, *supra* note 116, at 100–01.

121. *Id.*

122. *See* Bratton & Wachter, *supra* note 105, at 723.

IV. SHAREHOLDER EMPOWERMENT AND EXECUTIVE COMPENSATION

Policymakers have identified various concerns with the amount¹²³ and structure of executive compensation for many years, and they have sought to address those concerns through a wide range of approaches.¹²⁴ Commentators disagree about the extent to which existing pay levels and practices are problematic, the nature of those problems and the feasibility of proffered solutions.¹²⁵

In responding to these concerns, Dodd-Frank enacted a series of new requirements applicable to public companies. These include disclosure requirements—issuers are required to provide a variety of new compensation-related disclosures including the extent to which executive pay is tied to performance,¹²⁶ the ratio between the CEO's compensation and that of the median employee,¹²⁷ potential conflicts of interest involving compensation consultants¹²⁸ and the degree to which employees are permitted to hedge investments in the company's stock.¹²⁹ In addition Dodd-Frank required public companies to conduct a periodic advisory shareholder vote on executive compensation (Say on Pay) and golden parachutes.¹³⁰

Although one concern about executive compensation is the agency problem,¹³¹ the compensation reforms speak to broader concerns, including excessive concentration of wealth,¹³² the potential that

123. CEO pay, in particular, has grown dramatically. CEO pay grew about 875% from 1978 to 2012. See Lawrence Mishel & Natalie Sabadish, *CEO Pay in 2012 Was Extraordinarily High Relative to Typical Workers and Other High Earners*, ECON. POL'Y INST., June 26, 2013, at 2, available at http://docs.google.com/viewer?url=http://www.epi.org/files/2013/ceo-pay-2012-extraordinarily-high.pdf&hl=en_US&embedded=true/ (the average CEO of a top 350 firm received \$14.1 million in compensation in 2012, including exercised stock options).

124. See, e.g., LUCIAN BEBCHUK & JESSE FRIED, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* (2004) (identifying agency problems in executive compensation; Jill E. Fisch, *Teaching Corporate Governance Through Shareholder Litigation*, 34 GA L. REV. 745, 761–62 (2000) (describing the federal government's efforts to address excesses in executive compensation through various tax and disclosure requirements).

125. See, e.g., Jill E. Fisch, *Leave it to Delaware: Why Congress Should Stay out of Corporate Governance*, 37 DEL. J. CORP. L. 731, 748–49 (2013).

126. 15 U.S.C. § 78n (2012).

127. *Id.*

128. *Id.* § 78j-3.

129. *Id.* § 78n.

130. *Id.* § 78n-1.

131. See, e.g., Lucian Bebchuk & Jesse Fried, *Executive Compensation as an Agency Problem*, 17 J. ECON. PERSP. 71 (2003).

132. The pay ratio requirement, for example, was triggered by the dramatically growing disparity between CEO pay and that of the average worker. In 1980, the ratio of top executive to factory worker pay was 42 to 1. See Jennifer Liberto, *CEO Pay is 380 Times Average Worker's - AFL-CIO*, CNN MONEY (Apr. 19, 2012), <http://money.cnn.com/2012/04/19/news/economy/ceo-pay/>; see also Michael Hiltzik, *CEO-to-worker pay gap is obscene; want to know how obscene?*, LA TIMES (Oct. 20, 2013),

executive pay practices reduce managerial incentives to invest in productivity and training, and the relationship of executive pay structures to risky business decisions.¹³³ The Occupy Wall Street movement, for example, one of the most visible critics of executive compensation, argues that high levels of executive pay hurt the 99 percent—the average worker, not the average shareholder.¹³⁴

In implementing its new regulatory requirements, Congress may have been focused primarily on shareholder interests, despite the broad focus of the new reforms. Congress may instead have been seeking to generate disclosure that would be broadly available to the general public in the hopes that customers and citizens more generally might use this information to pressure executives to change their behavior. An alternative interpretation of the requirements is as a mechanism for harnessing shareholder voice in the broader public interest. Congress may have intended investors who learn of a company's behavior through these new provisions to exercise traditional shareholder tools to pressure the company to change its policy—selling their stock, introducing shareholder proposals or voting against directors who fail to effect change. Say-on-Pay—a mandated non-binding shareholder vote on the corporation's compensation package—goes further and creates a discrete tool for this exercise of shareholder power. Say-on-Pay thus enlists shareholders to serve as an agent of social change.

A. *The Early Experience with Say on Pay*

Early experience with Say-on-Pay provides an opportunity to consider the effectiveness of the shareholder empowerment approach. Experience with Say-on-Pay is, of course, limited. Only three (and a half) seasons of annual meetings have occurred since the adoption of the SEC's implementing rule.¹³⁵ So far, however, it is unclear that affording shareholder voting power over executive compensation has

<http://www.latimes.com/business/la-fi-hiltzik-20131020,0,770122.column> (in 2012, the ratio of CEO to average worker pay was about 350 to 1); Elliot Blair Smith & Phil Kuntz, *CEO Pay 1,795-to-1 Multiple of Wages Skirts U.S. Law*, BLOOMBERG (Apr. 30, 2013), <http://www.bloomberg.com/news/2013-04-30/ceo-pay-1-795-to-1-multiple-of-workers-skirts-law-as-sec-delays.html> (At some companies, it is far higher. Former JC Penney CEO Ron Johnson's pay package in 2011 was 1795 times that of an average JC Penney employee.).

133. See, e.g., Wm. Gerard Sanders & Donald C. Hambrick, *Swinging for the Fences: The Effects of CEO Stock Options on Company Risk Taking and Performance*, 50 ACAD. MGMT. J. 1055 (2007) (finding, in study of 950 US CEOs, that CEOs with a large quantity of stock options make bigger but riskier bets in their operational decisions).

134. William Lazonick, *How High CEO Pay Hurts the 99 Percent*, OCCUPYWALLSTREET.NET, <http://occupywallstreet.net/story/how-high-ceo-pay-hurts-99-percent> (last visited Oct. 17, 2014).

135. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6010, 6011, 6012 (Feb. 2, 2011).

been effective in addressing the public values of reducing high pay levels, the increasing concentration of wealth or the limited connection between pay levels and performance.

First, failed Say-on-Pay votes have been rare. Voting results have remained fairly consistent over the past four years—on average more than 90% of shareholder votes have been cast in favor of the plan, and compensation plans at approximately 2% of companies have failed to receive majority approval.¹³⁶ In light of the widespread claims about problematic compensation packages, one would have expected to see a far higher percentage of votes cast against such packages.

Second, the evidence suggests that executive pay levels have not decreased since the adoption of say on pay; if anything, they have increased.¹³⁷ In addition, although shareholders and proxy advisors appear highly focused on pay for performance, recent data suggests that the connection between CEO compensation and stock performance remains weak.¹³⁸ Say on pay votes do not differ at companies that create shareholder value versus those that destroy value.¹³⁹ Perhaps more importantly, current incentive-based pay structures do not appear to be correlated with better future performance.¹⁴⁰ A recent large-scale study, for example, found that incentive-based compensation is negatively correlated with both stock price and operating performance. The more corporate CEOs are paid, the worse their companies perform in the future.¹⁴¹ Another study found that, although issuers appear to be restructuring their compensation packages in an effort to win shareholder support, the changes do not appear to increase firm value.¹⁴² Finally, US income inequality continues to rise, with one

136. See *2014 Say on Pay Voting Results*, STEVEN HALL & PARTNERS (Dec. 31, 2014), <http://www.shallpartners.com/our-thinking/short-takes/2014-say-on-pay-voting-results/> (reporting say on pay results for 2014 at 3045 issuers); Fisch, *supra* note 125, at 756 (reporting similar voting results for 2011 and 2012).

137. See, e.g., David Larcker et al., *Ten Myths of 'Say on Pay'* 1-2 (Rock Center for Corporate Governance at Stanford University, Working Paper No. CGRP-26, 2012), available at <http://ssrn.com/abstract=209470410>.

138. Eric Chemi & Ariana Giorgi, *The Pay-for-Performance Myth*, BLOOMBERG BUSINESSWEEK (July 22, 2014), <http://www.businessweek.com/articles/2014-07-22/for-ceos-correlation-between-pay-and-stock-performance-is-pretty-random>.

139. MARK VAN CLIEAF & KAREL LEEFLANG, *THE ALIGNMENT GAP BETWEEN SAY ON PAY VOTING AND CREATING VALUE* 6 (2014), available at ircinstitute.org/pdf/final-sop-dec-2014.pdf (finding “no large Say-on-Pay voting differences (FOR vs. AGAINST) for subsets of companies which created value versus those that destroyed value over five years”).

140. Michael J. Cooper, et al., *Performance for Pay? The Relation Between CEO Incentive Compensation and Future Stock Price Performance*, SOC. SCI. RESEARCH NETWORK (Oct. 1, 2014), <http://ssrn.com/abstract=1572085>.

141. See *id.* at 28 (reporting that CEOs that accepted the highest levels of incentive compensation underperformed in terms of both stock and operating performance).

142. See David F. Larcker, et al., *Outsourcing Shareholder Voting to Proxy Advisory Firms* 3

researcher reporting that, during the economic recovery from 2009 to 2012, the top 1% captured 95% of the income gains.¹⁴³

These results should not be surprising. As Bill Bratton and Michael Wachter explain, a shareholder empowerment model of the firm “sends management a simple instruction: in all circumstances, manage to maximize the market price of the stock.”¹⁴⁴ JP Morgan—and other financial firms in the 2000s—got that message.¹⁴⁵ The move to increasingly risky business decisions that offered the potential for high upside rewards in stock price but also the potential for massive losses, was the result.

Ironically, shareholder empowerment, rather than operating as a solution, appears to be a contributing cause of problematic business practices in general, and excessive risk in particular. In one recent study, scholars examine the effect of shareholder empowerment at banks during the financial crisis. The study finds that banks with greater shareholder empowerment were more likely to be bailed out.¹⁴⁶

Another recent study seeks to determine whether the size and structure of executive pay—issues that are targeted in say on pay votes—were correlated with economic performance of the big banks during the financial crisis.¹⁴⁷ The study, which looked at 95 big banks, found that, prior to the adoption say on pay, the compensation of big bank executives was already performance based and structured in a way that closely aligned the interests of the executives with those of shareholders. Counter-intuitively, however, a closer alignment did not appear to improve the banks’ performance during the financial crisis. If anything, good governance appears to have adversely affected the banks’ performance. As the authors explain: “there is no evidence that banks with CEOs whose incentives were less well aligned with the

(Rock Center for Corporate Governance at Stanford University, Working Paper No. 119, 2012), available at <http://ssrn.com/abstract=2101453> (finding that companies that amend their executive compensation plans to avoid a negative recommendation from proxy advisory firms exhibit statistically significant negative stock price returns on the date these changes are disclosed).

143. EMMANUEL SAEZ, STRIKING IT RICHER: THE EVOLUTION OF TOP INCOMES IN THE UNITED STATES (2013), available at <http://elsa.berkeley.edu/~saez/saez-UStopincomes-2012.pdf>.

144. Bratton & Wachter, *supra* note 105 at 658–59.

145. *Id.* at 718–19 (Bratton & Wachter offer the example of Countrywide, which enjoyed impressive stock price returns prior the financial crisis as it expanded into increasingly risky strategies); see also Shawn Tully, *Meet the 23,000% Stock*, FORTUNE, Sept. 15, 2003, at 204, available at http://archive.fortune.com/magazines/fortune/fortune_archive/2003/09/15/349151/index.htm (between 1982 and 2003, Countrywide had the best stock price performance of any Fortune 500 Company, returning 23,000% on its equity). As we now know, those same risks led Countrywide into failure.

146. Daniel Ferreira et al., *Shareholder Empowerment and Bank Bailouts 2* (European Corp. Governance Inst., Working Paper No. 345/2013, 2012), available at <http://ssrn.com/abstract=2170392>.

147. Rudiger Fahlenbrach & Rene M. Stulz, *Bank CEO Incentives and the Credit Crisis*, 99 J. FIN. ECON. 11 (2011) (observing that regulatory reforms were aimed at increasing the alignment of executive pay with performance and giving shareholders more voice).

interests of their shareholders performed worse during the crisis.”¹⁴⁸ Moreover “[s]ome evidence shows that banks led by CEOs whose interests were better aligned with those of their shareholders had worse stock returns and a worse return on equity.”¹⁴⁹

To the extent that aligning executive compensation with stock price creates an incentive for excessive risk-taking, Say on Pay exacerbates this problem by tying a general concern about shareholder value to a specific stick—the threat of a negative vote on executive pay packages that do not demonstrate a sufficient correlation between executive pay and stock price. As Bratton and Wachter observe, although compensation offers a promising governance tool for restructuring management incentives, shareholder empowerment does not enhance that promise and, instead, may “get in the way.”¹⁵⁰

Even if shareholders attempted to cast their Say-on-Pay votes in accordance with general societal interests, the effectiveness of such efforts would be limited for several reasons. The compensation disclosure mandated by Dodd-Frank and the SEC’s implementing rules is lengthy and complex,¹⁵¹ and investors have limited capacity to evaluate and analyze it.¹⁵² BlackRock, for example, one of the largest institutional investors, voted shares at 14,872 shareholder meetings worldwide in 2012, including almost 3,800 in the United States.¹⁵³ Although BlackRock has an unusually large staff of approximately twenty people to make voting decisions, that staff’s ability to review detailed compensation information for thousands of companies is limited. As a result, BlackRock relies on proxy advisory services such as ISS and Glass Lewis to collect

148. *Id.* at 24.

149. *Id.* at 12-13 (the authors found that a one standard deviation increase in the dollar incentives derived from a CEO’s holdings of stock and stock options in 2006 was correlated with a lower return on equity of 10.5 percentage points in 2008).

150. Bratton & Wachter, *supra* note 105, at 662.

151. See JPMORGAN CHASE & CO., NOTICE OF 2013 ANNUAL MEETING OF SHAREHOLDERS AND PROXY STATEMENTS (Apr. 10, 2013), available at <http://www.sec.gov/Archives/edgar/data/19617/000001961713000255/jpmc2013definitiveproxysta.htm> (JP Morgan, for example, devoted 22 pages of its 2013 proxy statement to executive compensation disclosure which included information about compensation levels and structure, the firm’s compensation principles and practices, stock options, change of control benefits, and policies on hedging).

152. A further problem is that the compensation disclosure mandated in the proxy statement, and on which shareholders vote, discloses prospective compensation but, because 75% of executive compensation is performance-based, the actual pay received will vary from this disclosure depending on the company’s operating results. See Larcker, *supra* note 137, at 3 (“in 2011, the median expected value of CEO compensation among large U.S. corporations differed from the median earned value by \$2 million, or 18 percent”).

153. Susanne Craig, *The Giant of Shareholders, Quietly Stirring*, N.Y. TIMES (May 18, 2003), http://www.nytimes.com/2013/05/19/business/blackrock-a-shareholding-giant-is-quietly-stirring.html?pagewanted=all&_r=0.

and summarize information from the proxy statement.¹⁵⁴

Other investors with more limiting staffing and funding for corporate governance rely more heavily on proxy advisors. In some cases investors explicitly authorize the proxy advisors to vote their shares in accordance with the advisors' recommendations.¹⁵⁵ Investors rely on proxy advisory firms for both information and advice because they may lack sufficient expertise to evaluate the quality and structure of a firm's compensation package. In addition, use of proxy advisors is often less costly than analyzing corporate pay practices internally.

Relying on proxy advisors carries its own problems. Critics of proxy advisory firms have observed that proxy advisors are virtually unregulated, have no investment in the companies they are evaluating and, in some cases, are subject to conflicts of interest.¹⁵⁶ Proxy advisors may also have limited expertise in evaluating executive pay practices.¹⁵⁷ Although a complete analysis of proxy advisor recommendations is beyond the scope of this essay, two points are worth noting. First, pay structure is not a one-size-fits-all proposition. Different companies operate very differently, and a plan that is ideal for one may be inappropriate for another. Yet ISS's evaluation of executive pay takes a largely standardized approach to compensation both in the metrics for evaluating pay levels and pay structure and in the rejection of certain forms of non-standard compensation.¹⁵⁸ Institutional endorsement of this approach creates the potential for "homogenization" of executive pay packages.¹⁵⁹ In turn, this reduces the willingness of firms to

154. *Id.*

155. See Larcker, *supra* note 137, at 12, exhibit 6 (listing thirteen firms that followed ISS negative say on pay recommendations in 2011 more than 96.7% of the time; *but see* Choi et al., *Who Calls the Shots? How Mutual Funds Vote on Director Elections*, 3 HARV. BUS. L. REV. 35 (2013) (questioning extent to which mutual funds blindly follow ISS recommendations with respect to director elections).

156. See Daniel M. Gallagher, *Outsized Power & Influence: The Role of Proxy Advisers* 8 (Washington Legal Foundation, Working Paper No. 187, 2014), available at www.wlf.org/upload/legalstudies/workingpaper/GallagherWP8-14.pdf (summarizing criticisms).

157. See *Evaluating the ISS Test of CEO Pay for Performance for Say-on-Pay Votes*, PAY GOVERNANCE, <http://paygovernance.com/evaluating-the-iss-test-of-ceo-pay-for-performance-for-say-on-pay-votes/> (last visited Oct. 17, 2014) (criticizing ISS failure to use realizable pay in evaluating pay for performance and reporting that, when realizable pay is substituted, more than 10% of issuers for which ISS had found a misalignment "had realizable pay that was actually aligned with performance."). Notably, however, ISS has repeatedly responded to criticisms of its methodology. See, e.g., CAROL BOWIE, *EVALUATING PAY FOR PERFORMANCE ALIGNMENT ISS' QUANTITATIVE AND QUALITATIVE APPROACH* (2014), available at <http://www.issgovernance.com/sites/default/files/EvaluatingPayForPerformance.pdf> (updating ISS approach to include calculation and use of "realizable pay").

158. See Larcker, *supra* note 137, at 10 (observing that proxy advisors typically recommend against a plan that includes nonstandard benefits "such as tax-gross up payments, personal use of corporate aircraft, and large golden parachute payments or supplemental pension programs," but explaining that such benefits can be economically justified in particular cases).

159. See *Homogenization of Executive Pay Plans: The Unintended Consequences of Say on Pay*

experiment with different pay structures and engage in the type of individualized firm tailoring that may be value increasing.¹⁶⁰

Second, ISS's conception of performance-based pay¹⁶¹ relies exclusively on two measures of performance—pay relative to peers and pay relative to total shareholder return or TSR.¹⁶² Shareholders demand performance-based compensation as an essential tool in creating appropriate incentives for appropriate managerial decision-making and have focused on linking pay TSR in particular as an essential consideration in evaluating pay plans, in part because TSR is the most important performance metric from a shareholder perspective.¹⁶³

Incentive-based compensation is obviously desirable, but the selection of appropriate metrics for measuring executive performance is necessary for performance-based pay to encourage appropriate decision-making. In particular linking executive pay too closely to stock price performance is potentially problematic for the same reason that traditional stock options were—it creates an incentive to take excessive risks because of the correlation between risk and stock market return.¹⁶⁴ As Exxon Mobil's Compensation Committee recently explained:

We concluded that a formula based approach that relies heavily on one- or three-year total shareholder return could encourage inappropriate risk taking and have a lasting and negative impact on ExxonMobil's business by encouraging a focus on more immediate results at the expense of our long-term business model.¹⁶⁵

In sum, determining the appropriate size and structure of executive pay packages, like many corporate decisions, is a

Votes, PAY GOVERNANCE, <http://paygovernance.com/homogenization-of-executive-pay-plans-the-unintended-consequences-of-say-on-pay-votes-2/> (last visited May 1, 2015) (describing the homogenization of pay plans).

160. *See id.* (observing the need for plans to be tailored to a particular firm's business strategy).

161. Time-based awards (including standard stock options and time-vesting stock awards) that are not granted due to the attainment of pre-set goals are not considered strongly performance-based in this context.

162. Bowie, *supra* note 157.

163. JAMES F. REDA & DAVID M. SCHMIDT, THE X FACTOR: WHAT LTI MEASURES DRIVE CORPORATE PERFORMANCE? (2014), available at http://www.compasstr.com/uploads/2/6/1/1/26115423/the_x_factor_-_what_lti_measures_drive_corporate_performance.pdf; *see also Facts Behind 2013 "Turnaround" Success for Say on Pay Votes*, GEORGESON REPORT (Aug. 28, 2013), available at <http://hosted.verticalresponse.com/221914/687da05d2a/> (explaining that improved TSR performance is a critical factor explaining the success of companies that have turned around their say on pay votes).

164. *See, e.g.*, Sydney Finkelstein, *Rethinking CEO Stock Options*, BLOOMBERG BUSINESSWEEK (Apr. 17, 2009), <http://www.businessweek.com/stories/2009-04-17/rethinking-ceo-stock-optionsbusinessweek-business-news-stock-market-and-financial-advice> (explaining that "Stock options have turned out to be incredible engines of risk-taking").

165. EXXONMOBIL, EXECUTIVE COMPENSATION OVERVIEW 8 (2013), available at www.exxonmobil.com/Corporate/Files/news_pub_ir_execcomp2013.pdf.

complex task. It requires a significant amount of information and analysis and that is also informed by the desired objectives—whether those objectives are maximizing firm value, increasing long term growth and sustainability or alleviating wealth and income disparities in society. Although the role of shareholder voting in making those determinations continues to evolve, there is little evidence to date that shareholder empowerment has addressed the perceived shortcomings.

B. Shareholder Empowerment and Compensation at JP Morgan

The mess at Morgan offers a concrete example of the role of shareholder empowerment in addressing compensation and, in particular, the incentives for risk-taking that can be created by the structure of executive pay packages. The Senate Report carefully examined the level and structure of the pay of the key executives at the CIO and found that they were highly compensated for the SCP's trading activities.¹⁶⁶ For example, Ina Drew, head of the CIO, received compensation of \$14 million in 2011 and \$15 million in 2010,¹⁶⁷ at the same time that the New York Times reported median CEO pay in 2010 of only \$9.6 million.¹⁶⁸ Drew was the third-highest compensated executive at JP Morgan in 2010.

Collectively, the seven employees in the CIO received a total of \$105 million in compensation between 2010 and 2011, the years leading up to the whale.¹⁶⁹ Achilles Macris, the International Chief Financial Officer, Martin-Artajo and Iksil, the three employees most directly involved in the whale, were among the most highly compensated employees at JP Morgan.¹⁷⁰ According to the Senate Report, Macris received total compensation of \$14.5 million in 2011, Martin-Artajo received compensation of almost \$11 million, and Iksil was paid almost \$7 million.¹⁷¹ Because their compensation was so high, it was reviewed directly by Morgan CEO Jamie Dimon.¹⁷²

166. Senate Report, *supra* note 17, at 59.

167. JPMORGAN CHASE & CO., NOTICE OF 2012 ANNUAL MEETING OF SHAREHOLDERS AND PROXY STATEMENTS 20 (Apr. 4, 2012), available at http://investor.shareholder.com/common/download/download.cfm?companyId=ONE&fileid=556146&filekey=e8b56256-365c-45aa-bbdb-3aa82f0d07ea&filename=JPMC_2012_proxy_statement.pdf.

168. Daniel Costello, *The Drought Is Over (at Least for C.E.O.'s)*, N.Y. TIMES (Apr. 9, 2011), http://www.nytimes.com/2011/04/10/business/10comp.html?_r=1&ref=todayspaper

169. Shanny Basar, *London Whale Seven Received \$105m Over Two Years*, FIN. NEWS (Mar. 15, 2013), <http://www.efinancialnews.com/story/2013-03-15/senate-report-jp-morgan-london-whale-team-paid-105-m>.

170. Senate Report, *supra* note 17, at 59.

171. *Id.* at 58.

172. *Id.* at 59.

Why were the compensation levels so high? JP Morgan explained in its 2011 Annual Report that Drew's high compensation level was based on her role in "creating shareholder value through risk management activities."¹⁷³ Yet, as the Senate Report found, the CIO was not engaged in risk management but rather in risky derivatives trading. The Senate found that, in fact, Marcis, Martin-Artajo and Iksil were all compensated as investment bankers rather than as risk managers. The Report observed "not only were the SCP employees compensated like Investment Bank employees, but they were compensated at levels that were at the top range of, or better than, the best Investment Bank employees."¹⁷⁴

Equally important was the structure of this compensation. Specifically, the SCP's employees' compensation was linked to SCP profits and to profits of the bank as a whole.¹⁷⁵ As a result, the Senate Report concluded that the employees' compensation structure created an incentive for them to take excessive risks in an effort to generate profits rather than an incentive to mitigate risk despite the potential losses that might result from a risk mitigation strategy.¹⁷⁶

As the Senate Report noted: "Incentive-based compensation systems are premised on the basic assumption that one of the factors that influence individuals' performance and conduct is financial reward."¹⁷⁷ Compensation that rewarded effective risk management would suggest that the SCP functioned as a hedge, while compensation that rewarded profitmaking would suggest that the SCP functioned more as a proprietary trading operation. The compensation history for key employees with responsibility for SCP trading suggests that "the bank rewarded them for financial gain and risk-taking more than for effective risk management."¹⁷⁸

That this structure affected the behavior of the Morgan employees cannot be doubted. The Senate Report found no explicit structures or incentives designed to encourage risk management by CIO employees and, in fact, the trading activities by the CIO in 2012 had nothing to do with risk management. As the Report noted, with respect to CIO Chief Investment Officer Drew, "policing risk conflicted with her interest in generating gains."¹⁷⁹

173. JPMORGAN CHASE & CO., NOTICE OF 2011 ANNUAL MEETING OF SHAREHOLDERS AND PROXY STATEMENTS 20 (Apr. 7, 2011.) available at http://www.sec.gov/Archives/edgar/data/19617/000119312511091290/ddef14a.htm#toc149447_10.

174. Senate Report, *supra* note 17, at 59.

175. *Id.*

176. *Id.* at 57.

177. *Id.*

178. *Id.*

179. *Id.* at 155.

These compensation plans suggest a corporate governance failure. Did shareholder empowerment help? Say-on-Pay focuses on the compensation of the top five executives named in a corporation's proxy statement.¹⁸⁰ For JP Morgan, this did not include most of the employees in the CIO. It did, however include CEO Jamie Dimon and CIO head Ina Drew, who were two of the most highly compensated employees at the entire company. Both Dimon's compensation package and Drew's were explicitly disclosed to and approved by JP Morgan shareholders pursuant to the Say-on-Pay rules. Before, during and after the whale and the revelation of JP Morgan's other problems, shareholders continued to approve JP Morgan's compensation packages overwhelmingly. Shareholders approved the packages by votes of 96% in 2009 and 2010, and a vote of 73% in 2011.¹⁸¹ Even in May 2012 after news of the whale had begun to spread (although before the worst of the losses and other problems had been revealed), shareholders overwhelmingly approved JP Morgan's executive compensation plan by a vote of 91.5%.¹⁸² In May 2013, shareholders approved the compensation plan (which no longer included Ina Drew) by a vote of 92.2%, and in 2014, the plan (which included nearly doubling Jamie Dimon's pay) received the support of 77.9% of voting shareholders.¹⁸³ Although the variation in the level of shareholder support may have conveyed some dissatisfaction with the events described in this essay, there has been no year in which approval of the pay package was in jeopardy.¹⁸⁴

Nor did shareholders appear to hold Dimon accountable for a lack of oversight. Following the financial crisis, shareholders and regulators demanded that several large banks separate the positions of CEO and Chairman of the Board.¹⁸⁵ Shareholders argued that this governance change creates additional checks and balances to limit an unhealthy concentration of power and constrain poor decision-making.¹⁸⁶ In

180. The vote applies to compensation disclosed as part of Item 402 of Regulation S-K.

181. JPMORGAN CHASE & CO., *supra* note 167, at 20.

182. Dawn Kopecki & Christine Harper, *JPMorgan Says 91.5% of Shareholders Approve Pay Proposal*, BLOOMBERG (May 15, 2012), <http://www.bloomberg.com/news/2012-05-15/jpmorgan-says-91-5-of-shareholders-approve-pay-proposal.html>.

183. Emily Glazer, *J.P. Morgan Holders Give Pay Plan Tepid OK*, WALL ST. J. (May 20, 2014), <http://www.wsj.com/articles/SB10001424052702304422704579573922673276830>.

184. *Id.* In contrast, former Citigroup CEO Vikram Pandit was forced to leave his position after shareholders rejected Citigroup's executive compensation plan in 2012. *Id.*

185. Richard Leblanc, *American Banks Should Split the Chair and CEO Roles*, HUFFINGTON POST BUSINESS, (April 16, 2013), http://www.huffingtonpost.com/richard-leblanc/banks-chair-ceo_b_3071970.html.

186. Charles Tribbett, *Splitting The CEO And Chairman Roles - Yes Or No?*, RUSSEL REYNOLDS ASSOCS. (Dec. 2012), <http://www.russellreynolds.com/content/splitting-ceo-and-chairman-roles-yes-or-no>

addition, some studies have found that CEO pay levels are higher at companies that combine the Chair and CEO positions.¹⁸⁷

JP Morgan shareholders voted on a proposal to strip Dimon of his dual positions in both 2012 and 2013.¹⁸⁸ In 2012, the vote failed, receiving the support of 40% of the shares voted.¹⁸⁹ In 2013, after revelation of the whale, Dimon's widely quoted "tempest in a teapot" statement and his highly publicized testimony before Congress, the proposal to create an independent chairman received greater attention.¹⁹⁰ Nonetheless, shareholder support for splitting the positions declined to only 32%, a decline that was widely viewed as a victory for Dimon.¹⁹¹

One possible explanation is that, from a shareholder perspective, the damage in terms of JP Morgan's publicness was less significant than the firm's financial performance.¹⁹² Although the financial impact on Morgan from the investigations, lawsuits and scandals has been staggering,¹⁹³ the overall impact on Morgan's financial performance has been limited. More importantly, despite the public attention to its wrongdoing, JP Morgan has maintained its primary focus on shareholder value, as reflected in stock price.¹⁹⁴ In a recently-released document,¹⁹⁵ JP Morgan explained that its compensation structure ensures that pay is "**integrally linked to shareholder value** and safety and soundness."¹⁹⁶ The document offers compelling evidence that Say-on-Pay at JP Morgan is working just fine from a shareholder perspective yet, at the same time, offers reasons to question its effectiveness in addressing corporate publicness.

187. *Id.*

188. Dawn Kopecki & Hugh Son, *Victory for Dimon as JPMorgan Shareholders Reject CEO-Chairman Split*, BLOOMBERG (May 22, 2013), <http://www.bloomberg.com/news/2013-05-21/victory-for-dimon-as-jpmorgan-shareholders-reject-ceo-chairman-split.html>.

189. *Id.* (the full scale of the whale losses had not been disclosed as of the date of the 2012 annual meeting, although Dimon had already admitted that the incident was a "terrible, egregious mistake."); see also Francine McKenna, *Will 'Egregious' Error Sway the Say-on-Pay Vote at JPMorgan?*, AMERICAN BANKER (May 13, 2012), <http://www.americanbanker.com/bankthink/Jamie-Dimon-Say-on-Pay-JPM-1049266-1.html>.

190. Kopecki & Son, *supra* note 188.

191. *Id.*

192. As Bloomberg observed, JP Morgan faced a "barrage" of investigations into its operations, yet it had never earned more money than in 2012 and the first quarter of 2013. See Nick Summers, *Jamie Dimon Wins Big in JPMorgan Shareholder Vote*, BLOOMBERG BUSINESSWEEK (May 21, 2013), <http://www.businessweek.com/articles/2013-05-21/jamie-dimon-wins-big-in-jpmorgan-shareholder-vote>.

193. For example, in October 2013, the bank reported that it has set aside \$23 billion in reserves. The bank reported legal costs of \$ 9.2 billion.

194. See JP MORGAN CHASE, HOW WE DO BUSINESS – THE REPORT (2014), available at http://files.shareholder.com/downloads/ONE/3757111242x0x799950/14aa6d4f-f90d-4a23-96a6-53e5cc199f43/How_We_Do_Business.pdf.

195. See *id.* at 6 (explaining reasons for releasing the report).

196. See *id.* at 22–24 (emphasis added).

Incidentally, shareholders appear to have viewed one component of JP Morgan's pay plan as problematic—the substantial discretion that the board retains in awarding bonuses to its executives rather than relying on pre-determined performance metrics.¹⁹⁷ ISS recommended a vote against JP Morgan's pay package in 2011 because of “the discretionary nature of the Firm's executive compensation program.”¹⁹⁸ This negative recommendation likely played a role in the substantially lower vote in favor that year.¹⁹⁹ Similarly in 2014, the Florida State Board of Administration, a large pension fund that owns about 8.1 million shares said it voted against the compensation plan because it relied too heavily on the discretion of the compensation committee instead of using performance metrics.²⁰⁰ Yet, the JP Morgan was able to use this discretion to respond to the whale and other problems in a way that a more formulaic compensation plan would not have permitted. Specifically, in 2012, the board cut Jamie Dimon's compensation for 2012 substantially despite the bank's record earnings and stock price performance in response to the Whale, and it was able to do so because of the discretion that it had retained.²⁰¹

JP Morgan also had a longstanding practice of including provisions in its compensation contracts that allowed the company to cancel or claw back previously award compensation, again on a discretionary basis.²⁰² The clawbacks do not appear to be the result of ISS pressure or a shareholder initiative. In the case of the whale, JP Morgan used these clawbacks to recover compensation previously paid to the employees at the CIO. The bank told the Senate Subcommittee that it had obtained

197. JPMORGAN CHASE & CO., *supra* note 167, at 20. Morgan explained that it considered but rejected shifting to a more formulaic approach.

198. See McKenna, *supra* note 189. ISS also objected to Dimon's “above median CEO pay.” *Id.*

199. *Id.*

200. Glazer, *supra* note 183.

201. See, e.g., *J.P. Morgan (JPM) CEO Dimon's Bonus Cut Over 50% in FY12; Updates on CIO Unit*, STREETINSIDER.COM (Jan. 16, 2013), [http://www.streetinsider.com/Corporate+News/J.P.+Morgan+\(JPM\)+CEO+Dimons+Bonus+Cut+Over+50%25+in+FY12%3B+Updates+on+CIO+Unit/8011589.html](http://www.streetinsider.com/Corporate+News/J.P.+Morgan+(JPM)+CEO+Dimons+Bonus+Cut+Over+50%25+in+FY12%3B+Updates+on+CIO+Unit/8011589.html)

202. In contrast, ISS focuses on a list of “problematic” pay practices that may result in a negative recommendation but seemingly does not give firms credit for positive pay practices such as clawbacks. See INSTITUTIONAL SHAREHOLDER SERVICES, PROBLEMATIC PAY PRACTICES/COMMITMENTS ON PROBLEMATIC PAY PRACTICES Answer to FAQ 3 (2013), available at <http://www.issgovernance.com/file/files/ISSUSCompensationFAQs12192013.pdf>. It should be noted that Dodd-Frank Section 954 requires listed companies to establish clawback procedures for executive compensation although the SEC has not yet implemented this requirement through rule-making. See Joseph E. Bachtelder III, *Executive Compensation Under Dodd-Frank: an Update*, N.Y.L.J. (March 21, 2014), <http://www.mccarter.com/files/Publication/d7860a65-f88f-416e-ad21-0970132355ff/Presentation/PublicationAttachment/10d53cea-d540-4b7e-8ac5-8c7c6eab159d/NYLJColumnExecutiveCompensation03.pdf> (describing clawback requirement and SEC rule-making is expected later in 2014).

the maximum recovery permitted under its employment policies from the CIO employees through a combination of cancelling outstanding incentive awards and clawing back compensation previously paid. In total, JP Morgan reported recovering over \$100 million from the employees involved in the Whale or roughly two years' worth of compensation.²⁰³ The company's decision to claw back this pay, together with anticipation of the SEC's implementation of required claw backs under Dodd-Frank, appears to have sparked a broader implementation of claw back provisions among the leading banks.²⁰⁴

V. THE REGULATORY ALTERNATIVE—THE VOLCKER RULE

As this essay suggested at the outset, publicness frequently produces a regulatory response. JP Morgan's whale was no exception; it contributed to the final version of the Volcker Rule. The Volcker Rule implements Section 619 of the Dodd-Frank Act and "generally prohibits any banking entity from engaging in proprietary trading."²⁰⁵ Dodd-Frank gave the authority for developing and implementing the Volcker Rule to five agencies.²⁰⁶ These agencies developed proposed rules, which were submitted for public comment in October 2011.²⁰⁷

The rule as initially proposed was highly controversial. Collectively, the proposing agencies received over 18,000 letters of comment.²⁰⁸ Because of this controversy, the rule was stalled in political gridlock. The New York Times reported that "Wall Street lobbyists opposed the Volcker Rule more fiercely than any other regulation that has come from the Dodd-Frank law."²⁰⁹ Indeed, as of early 2012, the scope of the Rule remained uncertain. "Government infighting and intense lobbying" were slowing the adoption of the rule,²¹⁰ and many predicted

203. See JPMORGAN CHASE & CO., *supra* note 151 (reporting clawbacks of over \$100 million).

204. Liz Moyer, *Banks Bow to New York on Clawbacks*, WALL ST. J. (March 13, 2013, 8:17 PM), <http://online.wsj.com/news/articles/SB10001424127887324077704578358791840450814>.

205. Volcker Rule Adopting Release, *supra* note 16, at 1. Proprietary trading is defined as "engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments." *Id.* at 29.

206. 15 U.S.C. § 1841. The agencies were the Federal Reserve Board of Governors, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency ("OCC"), the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC).

207. Volcker Rule Adopting Release, *supra* note 16.

208. *Id.* at 4–5.

209. Ben Pross & Peter Eavis, *Rule That Curbs Bank Risk-Taking Nears Approval*, DEALBOOK, (Dec. 9, 2013), <http://dealbook.nytimes.com/2013/12/09/regulators-set-to-approve-tougher-volcker-rule/>.

210. Danielle Douglas, *Regulators adopt final Volcker rule limits on bank trading*, WASH. POST (Dec. 10, 2013), http://www.washingtonpost.com/business/economy/regulators-release-final-volcker-rule-limits-on-bank-trading/2013/12/10/f0d471ce-619f-11e3-8beb-3f9a9942850f_story.html.

that the initial proposal would be scrapped and rewritten, generating further delay in its implementation.²¹¹

In early 2012, Jamie Dimon was one of the more vocal opponents to the rule, terming it unnecessary and counterproductive.²¹² Dimon had particular credibility in that JP Morgan had avoided the losses suffered by other big banks during the financial crisis.²¹³ And then the Whale struck. When Dimon was called before Congress, he conceded that, if the Volcker rule had been in effect, it might have prevented JP Morgan's losses due to the CIO trades.²¹⁴

The Whale proved to be the catalyst necessary to break the congressional gridlock. On December 10, 2013, five federal agencies jointly voted to approve not just a final version of the Volcker rule, but a version that was more stringent than that originally proposed.²¹⁵ As adopted, the Rule is specifically designed to make it harder for banks to engage in risky trading strategies, although the Rule's effectiveness in this regard remains to be seen.²¹⁶

In particular, the toughened Volcker Rule narrowed the scope of the rule's carve-outs for permitted trading activities.²¹⁷ One of the most contested subjects in the debate over Volcker had been the degree to which bank hedging activities should continue to be permitted. The Whale exposed the fact that hedging is hard to identify and that trades described as hedging may nonetheless subject banks to substantial risk. As the Senate Report on the London Whale²¹⁸ explained, the Whale was a "hedge that wasn't."²¹⁹ The Report stated: "By characterizing the

211. David C. John, *Volcker Rule May Make the Financial and Banking System Riskier*, HERITAGE FOUNDATION (April 26, 2012), <http://www.heritage.org/research/reports/2012/04/volcker-rule-may-make-the-financial-and-banking-system-riskier>.

212. Joe Nocera, *When Will They Learn?*, N.Y. TIMES, OPINION (May 11, 2012), http://www.nytimes.com/2012/05/12/opinion/nocera-when-will-they-learn.html?_r=0.

213. *Id.*

214. In his testimony before Congress, Dimon was repeatedly pressed on the question of whether the Volcker rule, had it been in place, would have prevented JP Morgan's whale losses. *See, e.g.*, Steven Sloan & Silla Brush, *Dimon Gives Regulators New Ammunition for Volcker Rule*, BLOOMBERG (June 13, 2012), <http://www.bloomberg.com/news/articles/2012-06-13/dimon-gives-regulators-new-ammunition-for-tougher-volcker-rule> (quoting Dimon as conceding that the Volcker Rule's ban on proprietary trading "may very well have stopped parts of what this portfolio morphed into").

215. Douglas, *supra* note 210; Emily Stephenson & Douwe Miedema, *Regulators seek to curb Wall St. trades with Volcker rule*, REUTERS (Dec. 10, 2013), <http://www.reuters.com/article/2013/12/10/us-financial-regulation-volcker-idUSBRE9B705120131210>.

216. John Cassidy, *Two Cheers for the New Volcker Rule*, THE NEW YORKER (Dec. 10, 2013), <http://www.newyorker.com/news/john-cassidy/two-cheers-for-the-new-volcker-rule>.

217. Stephenson & Medema, *supra* note 215.

218. Senate Report, *supra* note 17.

219. Ron Rimkus, *Two Cheers for the New Volcker Rule*, THE NEW YORKER (Dec. 10, 2013), <http://seekingalpha.com/article/596871-jpmorgan-chase-and-the-london-whale-understanding-the-hedge-that-wasnt>. One OCC examiner described it as "a 'make believe voodoo magic 'composite hedge.'" *See* Senate Report, *supra* note 17, at 36.

[portfolio's] long purchases as offsets or hedges, the CIO was portraying them as trades undertaken to lower bank risk when, in fact, they raised risk." To address this concern, the Volcker Rule requires banks seeking to trade under the exemption for hedging to document the specific risks that their hedging trades are designed to address and to continue to monitor those trades to ensure that they continue to serve this purpose.²²⁰ Banks are also required to conduct "independent testing" to ensure that the trades used for hedging "may reasonably be expected to demonstrably reduce" the risks.²²¹

The Volcker rule also directly responds to the incentives created by the compensation structure of bank employees, as identified in the Senate Report on the Whale. In addition to banning proprietary trading, the Volcker rule explicitly prohibits bank employees who are engaged in exempted activities such as hedging or market-marketing from being compensated in a manner that rewards or incentivizes prohibited proprietary trading.²²²

VI. CONCLUSION

The financial crisis has focused increasing attention on public companies and on the extent to which their risky operational decisions affect the overall economy. Investors and regulators have pressured public companies to respond to this "publicness" by improving corporate governance. One popular governance change is increased shareholder empowerment. Dodd-Frank's advisory vote on executive compensation is an example of the shareholder empowerment approach.

Yet increased shareholder power is not necessarily a solution to corporate problems. Instead it can lead to an excessive focus and problematic focus on stock price. In turn, this can generate excessive risk-taking and other operational decisions that have a negative effect on long-term corporate value and may also impose negative externalities on other corporate stakeholders such as customers and employees. This essay argues the imperfect alignment between the interests of shareholders and non-shareholders makes corporate governance a poor tool for addressing the role of the corporation as a public actor.

The London Whale at JP Morgan illustrates the limitations of shareholder oversight. To the extent that JP Morgan's compensation structure created an incentive for Morgan employees to engage in excessive risk-taking, empowered shareholders had little reason to seek

220. Cassidy, *supra* note 216.

221. *Id.*

222. See Bonnie J. Roe, *The Volcker Rule's Impact on Incentive Compensation*, N.Y.L.J., Mar. 24, 2014, available at [https://www.cohengresser.com/assets/publications/324_ROE_NYLJ_\(3\).pdf](https://www.cohengresser.com/assets/publications/324_ROE_NYLJ_(3).pdf).

to limit those risks.

It would be naïve to blame either the financial crisis or the array of problems at JP Morgan on shareholder empowerment in general or executive pay structures in particular. Yet the Whale episode offers reasons to look beyond both in thinking more carefully about effective corporate governance. In particular, the Whale sounds a warning to think more carefully about the costs and benefits of shareholder empowerment versus economic regulation.

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