Global Corporate Governance and Legal Education

Bernhard Grossfeld
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Bernhard Grossfeld*

Darker and darker
The black shadows fall;
Sleep and oblivion
Reign over all.¹

I. INTRODUCTION

“Law is the formal instrument of orderly change in society.”²

TODAY we come together to remember and to honor Ibrahim Shihata (1937-2001),³ the former Director-General of the Organization of the Petroleum Exporting Countries (“OPEC”) Fund for International Development. For a long time he was general counsel of the World Bank, where he presided over the International Centre for Settlement of Investment Disputes and over the Multilateral Investment Guarantee Agency. When he retired after seventeen years, he was Senior Vice-President and Special Adviser to the Bank’s president.

I do not call him “Dr.” Ibrahim Shihata; I do not even mention his academic credentials from Egypt, his native country, and from the United States, nor the many books which he authored. All of this does not even scratch the surface of what he stood for. When he died after a long illness on May 28, 2001, he was remembered for his honest willingness to serve and for the human touch which he gave to all his endeavours. He was much more than a magician of cash flows.

Lives of great men all remind us

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3. See Id. at 1341-48; see also Daoud L. Khairallah, Dr. Ibrahim F.I. Shihata—A Memoir, 35 Int’l. Law. 1337 (2001). Dr. Shihata’s last article was The World Bank and the IMF Relationship—Quo Vadis?, 35 Int’l. Law. 1349 (2001).
We can make our lives sublime,
And, departing, leave behind us
Footprints on the sands of time;
Footprints, that perhaps another,
Sailing o'er life's solemn main,
A forlorn and shipwrecked brother,
Seeing, shall take heart again.\(^4\)

But notwithstanding the poetical touch in his life, it is not a lawyer's first job to discuss poetry. For this reason I will focus on a subject that was of particular concern for him: corporate governance. It was an important part of his work, when the World Bank made corporate governance assessments across five continents, using as a benchmark the "Principles of Corporate Governance" from the Organization of for Economic Co-operation and Development.

This fits well into the concept of cash flows to which I just alluded because by far the most important cash flow in our global environment is triggered by private actors—by corporations. Since the time of Bank of Augusta,\(^5\) they have stood in the center of our financial world, pumping up and distributing capital. They not only create the "cash flow of justice," but they also contribute to the "cash character" of our culture. With Ibrahim Shihata's awareness of these often hidden powers, we might find a proper cultural balance.

But I do not want to talk only about international economic law, or more precisely about international financial law. I am speaking at a law school, the Dedman School of Law, which is strongly devoted to the students' interests. Therefore, it seems proper to address the subject of international financing from a point of view that is closer to the students' experience and more down to their earth, their professional prospects. Therefore, I will start with corporation law, and I will then try to turn to financial statements.

II. NEW BEGINNING

"Law without loyalty cannot strengthen the bonds of Empire."\(^6\)

A. Sarbanes-Oxley

Corporations are just everywhere; as profit or non-profit organizations, they are accepted as our way of life. They are so firmly established as a matter of course that only three years ago we learned about "The End of

History for Corporate Law.” But then Enron showed us that history had not come to an end; corporate governance is a hot topic once again in the wake of Sarbanes-Oxley.

B. OLD WINE

Law, says the priest with a priestly look,
Expounding to an unpriestly people,
Law is the word in my priestly book.
Law is my pulpit and my steeple.

Sarbanes-Oxley, with its creeping federalization of corporation law, indeed opened a new area, notwithstanding all the criticism trying to defend the genius of American corporation law, “the genius” being state competition for corporate charters. Roberta Romano started the salvo of criticism against the “quack corporate governance” of Sarbanes-Oxley under the motto: “It’s hard to argue logic in a feeding frenzy.” In her eyes policy entrepreneurs were successful “in opportunistically coupling” their ideas to Enron’s collapse. She argues that the act oversteps “the traditional division between federal and state jurisdiction” without any need for it.

Her criticism is mainly directed toward the independent audit committee and executive certification of financial statements. These corporate governance provisions “should be stripped of their mandatory force and rendered optional . . .” The matter should be left to competitive legal systems: “the best path to ameliorating the misguided congressional promulgation of substantive governance mandates through SOX is to conform it to the states’ enabling approach to corporate law.” The “race to the top” doctrine then appears as old wine put into new bottles in favour of Delaware’s dominance as the corporate state of America.

13. Id. at 4.
14. Id. at 7.
15. Id. at 9.
16. Id. at 10.
C. Omissions

I do not know whether Sarbanes-Oxley makes the world a more ethical place, but when criticizing it, at least a few words should be said about the present position of the effective markets theory, along with Adam Smith's religious picture of the invisible hand. Does the market still have genius status? Is it a firm basis for logic? Probably not:

"Law has not been replaced by the social sciences, and law has not become a legal science. Applying market concepts to legal reasoning is useful but it offers no simple answers, only new ways of understanding the underlying qualities and constraints of our exchange relationships. Ultimately, we have no economic calculus that relieves us from the challenge and opportunity of doing justice - we have no escape from engaging in a normative discourse concerning the ethical and aesthetic values of law."  

What about accounting and rating as the conditions for market efficiency? Today these trades hold all our financial apples—good and bad alike. Without structural and financial transparency, "effective markets" and "shareholder value" remain myths, remain catchwords in their truest sense. There is often no reference to anti-takeover "poison pills" that severely hamper the market in corporate shares. Should it be mentioned that increased liabilities under state law tend to be neutralized by state law asset protection trusts? Roberta Romano correctly alludes to Delaware's success in keeping the incorporation state as the venue for insolvency filings, but does not call it opportunistic. Having all this in mind, I wonder whether the criticism meets the urgent need for repair.

III. NEW FOCUS

"A nation's well being, as well as its ability to compete, is conditioned by a single, pervasive cultural characteristic: the level of trust inherent in the society."  

Corporations are not only everywhere, but they are likewise nowhere. A corporation exists “only in contemplation of law, and by force of the law; and where that law ceases to operate, and is no longer obligatory, the corporation can have no existence.”27 Academic theory also tells us that corporations do not really exist; rather, they are a convenient connection point for a bundle of relationships from here to eternity—to legal immortality.28 In spite of this we continue to discuss the issue in its global context29 by starting with the traditional concept: a corporation (derived from the Latin corpus, meaning “body”) is seen as a body of resources to act as an entity producing all kinds of goods for chaotic markets. That is why “the future of corporate governance” is often a synonym for reforming the current corporation law.30 Instead of that, I would like to start with the question of whether the lawyers’ traditional views are still realistically focused. Could it be that the traditional basis of knowledge and expertise is retreating and that it cannot serve as the solid ground which we could take for granted?

Let me indicate the direction in which I intend to go: the pre-traditional picture for a corporation was a “pump for capital,” an instrument that absorbs money from many small springs at the lowest possible cost. Let me add to this the post-traditional view: the main emphasis of Sarbanes-Oxley is on the accounting committee and executive certification, both indicating a trend into fields that lawyers had previously disassociated from corporation law.31

IV. RACES

The preponderance of traditional corporation law for corporate government is illustrated by Delaware as the centerpiece of the discussion. The “race to the bottom”32 was substituted by “the race to the top,” but both topics are drying out, as it was recently formulated by Mark J. Roe: “that which persists in Delaware is that which the federal authorities tolerate.”33 Sarbanes-Oxley has increased federal pressure on state corpora-
tion law.

To what extent is corporation law a prominent feature of a corporation’s performance on capital markets? Does it grant the social credit on which investors rely? Would you invest in a Delaware corporation if its shares were not registered with the Securities and Exchange Commission? Would you invest in a corporation that does not control its compliance with Sarbanes-Oxley?

V. DIRECTORS’ LIABILITY

But even if corporation law, seen in isolation, is still reliable, countervailing powers are on the rise. There is a tendency to sharpen directors’ liability, but by the same token the number of asset protection trusts is increasing. Accordingly, even liability may no longer be what it seemed to be before, an effective deterrent of improper activity. The new instruments of debtor protection first spread from the Cook Islands, near New Zealand, and from there to Alaska and Delaware. It remains controversial whether American courts are willing to recognize Cook Islands trusts, but Delaware may be expected to grant full faith and credit to creatures of its own jurisdiction.

The Santa Fe discussion may get a new angle when claims under the Sarbanes-Oxley Act run into state asset protection trusts. In Santa Fe Indus. v. Green, the Supreme Court observed, with regard to Rule 10b-5 promulgated under the Securities and Exchange Act, that “Congress did not expressly provide a private cause of action for violations.” It held the cause of action to be “traditionally relegated to state law.” But the Court also emphasized the appropriateness of its decision “in this instance.” Has Sarbanes-Oxley changed the “instance” as a kind of “legislative guidance?” And after all, Delaware has become a place of refuge for insolvencies.

36. Lawrence v. Goldberg, 279 F.3d 1294 (11th Cir. 2002); Fed. Trade Comm’n v. Affordable Media, L.L.C., 179 F.3d 1228 (9th Cir. 1999); Lischer, supra note 24.
38. Santa Fe, 430 U.S. at 477.
39. Id. at 478.
40. Id.
VI. CYBERLEX*

The Internet brought us CyberLex, and thereby new views on corporate law. The virtual entity corporation fits neatly into the world of cyberspace; it is a natural candidate, or even a native of this new land. Being an "artificial being, invisible, intangible, and existing only in contemplation of law," it is based on signs and on signs alone. The corporation finally meets the environment of its own creation. The combination of new semiotics and new logistics changes the corporate world. In a word, Internet technology is disrupting antiquated institutional arrangements, and forces us to ask questions we did not think of before. Corporate havens and offshore banking are booming; international financial centers are blossoming.45

An English court once asked: "Can the Island of Tobago [the Robinson Crusoe Island] pass a law to bind the rights of the whole world?" Almost 200 years earlier the answer was "no"; today the answer is "yes." But the question remains: does the modern answer create social credit?46

VII. NEW SEMIOTICS

Legal and cultural developments are not only driven by the natural but also by the semiotic environment. Here a new giant appears on the horizon. Given the importance of China and of Chinese expatriates in international production and trade, and given the strong position of Chinese language and writing on the Internet, we will soon have to deal with corporations, incorporated in foreign states, whose statutes we cannot read and the "fuzzy logic" hermeneutics of which we do not know.

A difference in writing styles is often mentioned by way of anecdote (exotism49), whereas in reality it indicates a tremendous gap in worldviews, given the social nature of literacy and the closeness between literacy and cognition.50 Different writings stand for different roots of identity and for different concepts of order. Writing comes close to mapping: it maps the men-viewed environment and tells them how and where to go. What are we going to do, when we are no longer able to under-

* Id. at 1407.
stand or control the semiotic pattern?51

VIII. EUROPEAN UNION

The regression of corporation law is not only characteristic of the United States; it is likewise visible in Europe. There we witness a dramatic change towards the recognition of foreign corporations. In two decisions, the European Court of Justice did away with the "seat theory" of incorporation.52 Under this rule a corporation had to be established according to the law of the place where it has its central administration.53 Now, corporations can be set up under the law of any member state regardless of the place of the corporation's seat.54 The highest German Federal Court transferred the new rule into the German-American Treaty on Friendship, Commerce, and Shipping. This decision opened the door for Delaware corporations.55 And not just for Delaware corporations: other states will refer to most favored treatment clauses in similar treaties. Just think of Japan and—one day or another—China.56

The situation might not be seen too pessimistically because of the chance that European corporate governance structures will emerge. Harmonized national corporate governance codes are mushrooming and the European corporation will certainly set the standard.

IX. CORPORATE POWER

Unfortunately, we cannot take these changes light-heartedly. Though history might not have normative power,57 "a page of history [can be] worth a volume of logic."58 From there we learn that these entities with unlimited life enjoy the privilege of unrestricted growth over time, coupled with the power of interest and compound interest. Corporations are centers of economic and political power in the hands of management.59 We can recognize their strength from their fruits: their ability to trigger cash flows.60 We cannot anthropomorphize these legal "persons" and we

55. NEUE ZEITSCHRIFT FUER GESELLSCHAFTSRECHT [NZGJ 531 (2003); BETRIEBSBERATER 2004, 1868.
56. Grossfeld & Hoeltzenbein, supra note 51.
cannot put them on the same level with natural persons. They have to be controlled by other means.

The lawyers' innocence in this respect is sometimes breathtaking. We are concerned with all kinds of tax abracadabra, with too perfect theories for too perfect solutions—making us appear like magicians for all seasons. Right now we learn how firmly lawyers believed in the term "insurance broker" as a model for loyalty to clients. The Eliot Spitzer "lecture" might have told us about contingent commissions and bid-rigging—the stuff of a dynastic epic. Add to this the "tying" that occurs when a broker tells insurers that he will work with them only if they also commit to buying their reinsurance from him. The target broker's shares lost 46 percent within a week, amounting to a loss of $11.5 billion. At the same time 3,000 employees lost their jobs. Brave new world!

We too had many pretty toys when young;
A law indifferent to blame or praise,
To bribe or threat; habits that made hold wrong
Melt down, as it were wax in the sun's rays;
Public opinion ripening for so long
We thought it would outlive all future days.
O what fine thought we had because we thought
That the worst rogues and rascals had died out.
We pieced our thoughts into philosophy,
And planned to bring the word under a rule,
Who are but weasels fighting in a hole.

Carefully observing imagination is more important than intelligent hindsight following disasters in order to clean them up.

X. ACCOUNTING

Accounting is a prime example for the need of a new macro-legal approach. Money rules the world and the flow of money is activated and

channelled through accounting. Even small adjustments in accounting practice can have an enormous impact because of the large number of people and dollars involved. Statistically relevant effects are the world of accounting.

A. History

It is here that Sarbanes-Oxley's emphasis on auditing committee and executive certification reaches global dimensions. Accounting becomes a prime factor for a corporation's social credit world-wide. That is why international standards are the order of the day; call them Generally Accepted Accounting Principles in the United States or International Financial Reporting Standards in the European Union. Certainly, the two sets compete with each other in a kind of numbers war, but it looks as if tendencies towards convergence are emerging. These hopes are also based on the fact that all rules of accounting have the same source: Luca Pacioli's book *Summa arithmetica, geometrica proportioni e proportionalita* published in Venice in 1494. Anyhow, comparative law faces new challenges. Both sets of rules, even when equal or similar in language, operate and are interpreted in the context of different cultural patterns of order.

B. Impact

The impact of these rules is dramatic. Present value concepts push aside historical cost accounting, hidden reserves are largely outlawed. Earnings turn out to be more volatile, and the need for equity capital becomes more urgent. The interaction of the rules with corporate valuation techniques and with rating will be discussed later. In both sets, accounting for the good will of subsidiaries under the good will impairment test increases volatility.

European accounting firms are directly involved with U.S. corporate governance when they prepare or furnish an audit report with respect to


73. Infra.

any issuer that is registered or should be registered with the Securities and Exchange Commission. In addition, the Public Company Accounting Oversight Board may determine that a foreign firm that does not issue audit reports is treated the same as one that does issue audit reports if it plays “a substantial role in the preparation and furnishing of such reports.”

I wonder whether this is applicable for audits of foreign subsidiaries that are to be included in a global group account. Sarbanes-Oxley defines an “audit report” as a document or other record that is prepared “for purposes of compliance by an issuer with the requirements of the securities laws.”

C. Examples

Accounting also tells us that there is no safety in numbers, that fuzzy numbers are to be expected. I want to give two examples.

1. Earnings

Accounting rules give wide discretion for estimates to calculate earnings, leaving much to guessing. Given the pressure on management to reach expected earnings, the results are foreseeable. Accrual accounting allots revenues as earnings to specific periods in which they are not necessarily received. There is a “cult” around viewing quarterly numbers as the firm’s distilled health certificate, but unfortunately it is often a myth. The art (or charade) of earnings management is widespread. The analysts’ estimates of earnings are miraculously beat by a penny! Management has many levers to pull to make their numbers: optimistic adjustments for sales inflate earnings, pessimistic ones store earnings for thinner times. Understating bad debts raises earnings, overstating them leads to higher profits when the estimates are reversed. Adjustments of inventory have similar effects, as have forecasts on unusual gains and losses. Earnings are merely opinions.

Of course, keeping stock prices high has a purpose: executive compensation. Equity incentives in the form of stock options increase the motivation to produce earnings that propel share prices. They create a beat-the-number treadmill.

75. Id.
76. Id.
79. Id. at 80.
80. See Alex Berenson, The Number 227 (2003).
2. Cash Flows

We are not much better off with cash flows, which we tend to see as facts. But even cash is not sacrosanct and can trumped up. Trade securities inflate operating cash flows when they are sold; this masks the volatility of the business. Cutting inventories and delaying payments to suppliers raises cash flows but tends to hurt future growth. Selling receivables for less than face value increases cash immediately but reduces future (otherwise higher) cash. But piles of cash flows do not just boost liquidity; they may indicate a putting off of badly needed overhauls to cut costs, and they may lure employees into tougher bargaining positions for higher salaries.

All these “skills” have immediate consequences for valuation techniques that turn around the volatility of earnings and cash flows. To the extent that volatility can be manipulated the results of evaluations can be manipulated. This helps to keep share prices higher than they might otherwise be, which in turn can raise executive bonuses.

XI. VALUATION

“Valuation is an art rather than a science,” and “it is recognized that the ‘value’ of property is not a concrete tangible attribute but an abstraction derived from the economic uses to which the property may be put.”

Accounting does not tell us the value of the firm—as the original good will is not shown on the balance sheet. But it is this value that counts for investors in case of emergency.

Here valuation techniques step in. They were originally limited to merger or squeeze out situations but the new “good will impairment test” makes them a regular pattern of accounting. Due to the fact that multinational corporations have many foreign subsidiaries, even cross-border valuation techniques become routine business.

The prevailing Discounting Cash Flow Method uses the beta factor to measure a firm’s individual volatility and hence the risk involved; it is a kind of legal mathematics. But it looks more arithmetically trustworthy

83. Faleyes, supra note 60.
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than it really is. Much depends on which market index is chosen and for what period of time. In addition, the method is based on the efficient market hypothesis, which is no longer uncontested. Markets might be less effective than we have imagined. In any event, the evaluation of a firm depends on sound accounting techniques – and that is a risk factor in itself of particular proportion.

XII. FANNIE MAE/FREDDIE MAC

So far, we have discussed accounting, valuation, and rating as more or less isolated instruments of social control. But the macro-economic and macro-legal consequences only become apparent when we see their interactions, their statistical macro-justice. A prime example is the recent story of Fannie Mae and its smaller rival Freddie Mac, the two U.S. housing finance giants. They deserve a more detailed case study. These Government Sponsored Enterprises (“GSE’s”) are federally chartered (Fannie Mae 1938, Freddie Mac 1970) as an aftermath of the Great Depression. Although they are owned by private shareholders, they have a line of credit from the Treasury and exemption from state and local taxes. As the mortgage finance duopoly they ensure a steady flow of funding into the home mortgage market. These entities do this by buying mortgages from banks and other lenders and providing them with cash to make new loans. Thus, these two firms own or guarantee roughly half of the $7.9 trillion of U.S. mortgages outstanding.

Fannie Mae is the second-largest financial institution in the United States. Year after year it had shown non-volatile earnings, telling us that its business was not risky. But on Sept. 22, 2004 a bombshell exploded: the Office of Federal Housing Enterprise Oversight (“OFHEO”) accused the firm of having routinely “smoothened” its quarterly earnings to make them appear less choppy than they really were in order to reduce the costs of refinancing. The argument is that Fannie Mae incorrectly applied rule FAS 133 to spread out losses over many years rather than taking an immediate hit. Fannie Mae might also have taken too much leeway under rule FAS 91 by not correctly adjusting the rate of amortiza-

93. Id. at i.
tion for premiums and discounts on loans when interest rates changed.\textsuperscript{96} It is alleged that billions of dollars of losses on options and other derivative contracts designated to hedge interest-rate risks had been deferred through faulty accounting techniques.\textsuperscript{97}

If these allegations are correct, Fannie Mae’s business was riskier than admitted. They may have used non-standard accounting techniques to reassure markets that earnings were stable. If the price to earnings ratio of shares holds steady even as interest rates for mortgages change, it looks like a supreme performance. This appearance provides a higher rating and improves the margin between the interest earned on home mortgages in its portfolio and its own borrowing costs. It also increases the value of the firm.\textsuperscript{98}

Within a week of the OFHEO intervention Fannie Mae’s stock shares lost 15 percent of their value.\textsuperscript{99} All of the sudden there appears on the horizon a money pinch; Fannie Mae might have to post an after-tax loss of $9 billion on a core capital of $38 billion.\textsuperscript{100} Fannie Mae’s executives “will now have to explain why anyone should believe a word they say.”\textsuperscript{101}

The accounting policy has implications far beyond the individual firm. Steady earnings and a calm market reassure Capitol Hill and deter any changes in the rules, making private competition very difficult. In addition, it gives huge political clout: Fannie Mae has bipartisan legions of lobbyists to protect its franchise value.\textsuperscript{102}

\section*{XIII. PENSION ACCOUNTING}

Pension accounting is another field of high interest. To what extent can firms use pension and health benefits funds to adjust their earnings? Given the huge pension and retiree-benefits obligations, the flexibility of accounting rules also gives corporations the chance to mint income and to ease swings in earnings. For purposes of earnings management corporations just change assumptions within their benefits plans or cut benefits. This shows less volatility and risks; shareholders are generally unaware of these effects.

\textsuperscript{96} Id.
\textsuperscript{97} Id. at vii.
\textsuperscript{98} Hagerty, \textit{supra} note 93.
XIV. RATING

Da mihi facta, dabo tibi iu ("Give me the facts, then I will give you the law").

So far we have concentrated on internal monitoring to keep corporate power in line with social expectations. But, though we agree that a board of directors with independent members can do a lot, we also know that independence means staying on distance—and this is a rare quality within a society that cheers networking. Therefore, we must turn to other forms of monitoring, that is, to external monitoring.

Rating has risen to the highest ranks in financing and corporate control. It triggers the power of interests and compound interests; it channels the cash flow of justice: the higher the rating, the lower the interest rate the borrower must pay. It is booming far beyond the rating agencies—it is invading all layers of business. Because the management of a firm is risk oriented first, the risk factor is equally important for any corporate group.

But rating is not just isolated credit scoring. It is slowly moving towards corporate governance scoring: how transparent is the governance system, how effective are internal controls?

Here traditional aspects of corporation law merge with the exigencies of rating. Corporate and corporate-groups structures are risk and transparency-driven. Unfortunately, lawyers—so far—have not discussed the issues. But management's fiduciary duties with regard to particular actions might be reviewed for how they influence the ratings and, thereby, the costs of capital.

XV. BASEL II

The New Basel Capital Accord ("Basel II"), the Basel Committee on Banking Supervision "International Convergence of Capital Measurement and Capital Standards," opens a new chapter in rating. It sets up international standards for the regulation of banks to encourage market discipline through disclosure requirements. This will spill over to all fields of risk evaluation. Basel II has three pillars: (1) minimum capital requirements, (2) supervisory review of capital adequacy, and (3) public disclosure. These pillars are designed to establish levels of capital for internationally active banks. The applicable formula is based on the concept of a capital ratio, where the nominator represents the bank's capital and the denominator the risk-weighted assets. The resulting ratio may be no less than 8 percent. You see that the definitions of risks (credit risk

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104. Id.
108. Id.
109. Id.
and market risk) and the rules of accounting are decisive. In cross-border transactions, problems of how to translate financial information acquire a central role. Comparative law reaches a new realm.

XVI. LEGAL RELEVANCE

A. ACCOUNTING

The traditional view might not immediately recognize the legal importance of these new factors in corporate governance, but they reach far beyond our micro-legal view into macro-legal proportions. But why should lawyers know about these technical fields, and where does their special knowledge come into play? Let us put together some examples.

I want to mention the auditing committees that have spread under Sarbanes-Oxley. To be a member of such committees means sitting on a very hot seat; it is particularly hot for the at least one “financial expert” who has to be a member of every auditing committee. The Sarbanes-Oxley Act defines this “financial expert” as follows: he has to have through “education and experience [you hear the word “education?”] an understanding of generally accepted accounting principles and financial statements.” The required “experience” includes “an understanding of audit committee functions.” It goes without saying that they cannot work without expert information. Could this be a professional alley for law students?

Another example is accountants’ liability, an equally hot issue after Enron. Certainly, Bily v. Arthur Young and Co did much to alleviate a heavy burden, but Enron might have changed this as well. Lawyers who want to represent accountants should know more of their clients’ world.

As far as details are concerned, I do not want to discuss again the questions of how options are to be accounted for. But lawyers should at least have an idea of how they can be abused through timing. It is tempting for every chief executive officer to manage the timing of an option re-pricing date opportunistically. Options are systematically timed to coincide with

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111. Grossfeld & Hoeltzenbein, supra note 51.
112. Grossfeld, Core Questions of Comparative Law, supra note 71.
113. The term was coined by Alfred Conard from the University of Michigan School of Law.
116. § 7265.
favourable movement in the company's stock price.\textsuperscript{119}

B. Valuation

Likewise booming is the field of valuation – it is sufficient to mention \textit{Weinberger v. UOP, Inc.}\textsuperscript{120} and its aftermath. Valuation has become a lawyer's "paradise."\textsuperscript{121} An additional push comes from the "good will impairment test"\textsuperscript{122} that makes the valuation of subsidiaries a standard technique for financial statements.

C. Rating\textsuperscript{123}

Rating appears to be a black box for lawyers. The big three rating agencies ostensibly function as a disinterested priesthood: they wield power through letter grades they hand out.\textsuperscript{124} Certainly there is some discussion about regulations for rating agencies and their potential liability, but so far very little is known about the rating techniques, including what they are and what they should be. The process itself has remained a mystery of finance. But "correct" ratings will give rise to numerous litigious questions, as the agencies get the bulk of their revenues from the entities they are rating. Under Basel II,\textsuperscript{125} rating will become a matter of concern for practically all firms; cross-border ratings will soon add a global touch.

XVII. Law Schools\textsuperscript{126}

Ye lawyers, who live upon litigants' fees,
And who need a good many to live at your ease;
Grave or gay, wise or witty, whate'er your degree,
Plain stuff or Queen's Counsel, take counsel of me.\textsuperscript{127}

A. New Wine

What does all this mean for law schools? Now, the question is, whether we may continue to celebrate the "old wine" approach? Does shareholder value paint a real situation? Is it just a trick to minimize capital costs and to keep control of an ever-growing cash flow in the hands of a


\textsuperscript{122} Id.


\textsuperscript{124} Id.

\textsuperscript{125} Id.

\textsuperscript{126} Id.

\textsuperscript{127} \textit{Summary of Events}, 7 AM. L. REV. 387 (1872-1873).
The traditional history of corporate law saw Delaware as a "powerful force . . . for convergence on an efficient model," and most commentators came to the conclusion that "the ideological and competitive attractions" of shareholder primacy "will become undisputable." Accounting (though briefly mentioned), valuation, and rating did not form part of the great scheme. This happened a short time before Enron (not a Delaware corporation) and before Sarbanes-Oxley federalized U.S. corporation law. But we had already learned that Delaware could only operate within a frame drawn by federal law. Delaware was opportunistic in adjusting. Had we really attended to the forces that had driven Enron and its colleagues? Are we teaching corporation law from hindsight to clean up or from foresight to establish best practices?

**B. Proposals**

It is not my idea that we should turn lawyers into accountants. But to those who want to understand the corporate society, we should give a chance to find out what the relevant issues are, and we should prepare them for an intelligent and sustained discussion with accountants. Let's open windows and let's encourage their willingness to learn. We should introduce them briefly to the basics of double accounting, which can be explained in two hours, and into the structure of financial reporting. Topics could be the function of the balance sheet to show equity capital as the balance between assets and liabilities, and the elements of cash flows and accrual accounting. Add to this the difference between cash flows and profits and the role of the income statement. Indispensable is a short introduction into group accounts and the concept of consolidation. Completely up to date would be a discussion of the good will impairment test. That's it; a two hour course is sufficient. Introduction and motivation are the core—leave everything else to learning when going ahead.

Most important, however, the course should be taught from a law school's perspective, keeping constantly in mind what can be expected from law students, for whom it is just a window opening course. If accounting were as difficult to learn as it is sometimes presented by the "priests" or "gatekeepers," there would not be so many accountants around.

**XVIII. Conclusion**

"There is nothing like a dream to create the future."
Though poetry is not the lawyer's first task, I did not want to miss it on this very occasion, when the memory of Ibrahim Shihata might encourage us to do our job as wholeheartedly as he did his. The world is darker and deeper than we imagined when we pursued a career in law; probably we were sometimes even misguided by great words about “justice” and the power of our concepts. Ibrahim Shihata was driven by his experience that a chaotic environment (at least it looks chaotic to the human mind) challenges all of our talents and all of our integrity. Similarly, the student's eyes make the professor run. I would like to come to an end with a quote from Robert Frost:

The woods are lovely, dark and deep.
But I have promises to keep,
And miles to go before I sleep,
And miles to go before I sleep.\(^{134}\)

\textit{Requiescat in pacem!} We should honor the example that Ibrahim Shihata set by trying to leave \textit{our} footprints on the sands of time.
