

MANIPULATION OF CORPORATE GOVERNANCE ABNORMALITIES OF MANAGING A CORPORATION

Vernon P. Dorweiler*, Mehenna Yakou**

Abstract

The purpose of this research is to describe conduct of corporate officers, in their use of corporate assets. That use is beyond lawful, for their corporate positions. Specifically, the paper (1) describes corporate officer actions, and (2) then identifies impacts on the corporation's reputation and leaders.

Findings are presented in Exhibits 1-3, in a form as assigned criminal liability, and the range and detail of sanctions imposed. Exhibit 4 analyzes select companies, detailing offenses charged. The paper summarizes industries of corporations, and categorizes the crises of business organizations.

This paper is to warn corporations of the liabilities associated with such conduct, with the presentation from a non-accusatory point of view (Leeds, 2003).

Keywords : Corporate Governance, Manipulation, Regulations.

* Michigan Technological University, Houghton, MI 49931

** Georgia College and State University, Milledgeville, GA 31061

1. Introduction

Corporate governance is intended to form a structure for a corporation. That structure is both organizational for the corporation, and procedural for on-going opportunities of the corporation (Alio, 2004). Clearly the structure provides for operations and their changes. It does provide structure for decisions, both strategic and operational.

The guidance of corporate governance can be manipulated by Directors and Officers (D&O) (Kochan, 2003). From the range of corporate governance, the D&O exceed the range in instances. Here that is termed manipulation, a neutral term for the interests represented. This research describes the conduct of officers, and the means to maintain the corporation within the range of corporate governance.

Some actions of corporations are within the business purpose, and others are not (Kelly, 2003). So the purpose of this research is to determine guidelines for the difference: business, and non-business.

2. Corporate Action

Generally corporate governance is considered as a State purview. Historically, it is the State that granted the corporate charter. Yet federal "intrusion" has been noted recently (Smith, 2003). Federal corporations have been found, limited primarily in the 20th century. A lead example is the Tennessee Valley Authority (TVA).

State versus Federal

With that federal exception, actions of corporations are regulated by individual States. Variation among States is limited by a joint commission, A Commission on Corporations. That provides a mostly common approach that is essential to allow "the free flow of commerce", in the US and world-wide.

Before this common effort, corporations could form and operate in a State that offers more openness. This affords opportunities to corporations, to defend actions based on chosen State laws. When commerce was considered essential to the national welfare, in the depression years of the 1930s, such manipulation was quashed in federal approach (Cialdini, 2004).

This research is focused on that practice under the current State law, within international scope of commerce. Note that the domestic laws determine the imbalance of commercial flow, and take action based only on extreme variation (Countryman, 2003).

Manipulation Defined

Manipulation is a personal action. That is, it cannot be mechanically generated; it can become systematic. Ordinarily manipulation is done by an individual to manage or influence often unfairly; to adapt or change to suit one's purpose, or advantage (Black, 1979). From this universal definition, it is clear that those in 'control' of assets have that right to determine an outcome.

Who in the corporation has such power? The corporate charter identifies persons with power over assets: officers of the corporation.

Note that officers are also directors where appointed to be part of the Board of Directors. Directors are not synonymous with internal officers; they may have a specialized role in the corporation, as outside directors. So then officers are empowered to perform acts for their own purposes; see Exhibits 1, 2 and 3.

Where officers conduct corporate decisions, for their own purposes, this is referred to as *manipulation* (Wade, 2002). Note that legal terminology, and general terms are consistent with the meaning of manipulation. Under corporate governance, officers can make decisions for their own purposes.

3. Regulation by Agency

Regulation of corporations is widespread (Veasey, 2003). A number of federal and State agencies is involved.

At the outset, state law initiates corporate life. Although federal law authorizes some corporations, the vast number are authorized, and created, under state law. Federal agencies are typified by the Tennessee Valley Authority (TVA), a utility serving the southeastern portion of the US.

Compared numerically, it is clear that States far exceed the federal government in authorizing corporations. This is due to the interstate power of corporations; they can, and do, execute business on an interstate basis. Property ownership, commercial transactions, and recognition — all deal with the corporate identity (Kickner, 2004). So then, which agencies regulate corporations?

State Regulation

On a State basis, the State's Commerce Commission is the fundamental agency, to form and regulate corporations. Each State sets its own regulations for that purpose. As indicated (above), the Federal Interstate Commerce Commission performs a limited task in that mode. Within this broad scope, federal corporations tend toward control of specific areas; likely, pricing and service.

For example, the Federal Reserve Board regulates banks and banking in interstate operation. Associated is the Freddie Mac agency that regulates mortgages in interstate operation. In the physical realm is the Interstate Energy Commission (formerly, the Interstate Commerce Commission). Their authority is setting prices and assuring delivery of electricity and gas, on an equivalent basis among the States. The main authority is setting prices, given the ability to meet demand for actual service and delivery.

Regulation of Agencies & Companies

As agencies perform (are in) essential services, a regulatory board is appointed in those areas. The areas are well defined by service area and geographic

area. The authority of such regulation is virtually total in their area of influence.

Those agencies promulgate regulations, and enforce their own regulations (Gellhorn, 1999). Both the focus of regulation and the reach (extent) of regulation and its coverage are included. If the board of an agency fails in any regard, courts (likely federal courts) provide relief, to fill the regulatory need.

Manipulation is likely seen in faulted regulation, or in absent regulation (Duska, 2004). To the manipulator, either existence or non-existence of regulation is of little importance. It is self-profit that is the main objective. Where officers are to comply with regulation, their failure to do so — or ignoring the existence — is now referred to as manipulation.

4. Authority over Corporations

SEC and States

The federal agency coming forth to regulate corporations is the Security & Exchange Commission. Their authority is based on the Interstate Commerce Clause of the US Constitution. By federal regulation, securities of corporations are found in charter, by-laws, relationships, corporate procedures. The SEC has a lawful foundation to regulate the conduct of corporations.

Federal regulation permits the scope and content, to control corporate practices. Again based on the Interstate Commerce Clause, necessary authority is provided to control the manipulation of practices, found initially in the 1920s and 1930s. Recently there has been a renewal of such manipulation practices. The rationale has changed; now the main rationale is to achieve personal wealth of corporate officers (Wade, 2002).

While it could be argued that was the basis earlier, the degree of wealth enhancement currently has led to destruction or criminal use of corporate property (including funds and reputation). As a consequence, regulation of corporations has tightened. Not only has regulation been enforced but influential methods have been employed: imputation and attribution (see Exhibit 1). For that influential use, terminology is determinative, to withstand legal arguments against authority for corporate actions. This is an opening for manipulation of the corporation.

5. Officers Involved in Manipulation

Illustration

Manipulation has become an expected practice of officers, to assure the outcome of their decisions. A record of extreme practices of corporate officers is available in business publications. See Exhibits 1, 2 and 3.

Officers

Exhibit 4 is a brief analysis of actions of companies that has been identified in manipulating corporate assets and performance.

Impact on Investors

Clearly, if officers are “pocketing” unlawful gains, by manipulating corporate governance, then that gain is diverted from its lawful owners (Brickey, 1991). That provides a basis for legal complaints by investors. Consequently, not only are governing officers given opportunity but investors also join in complaints due to diversion of their “just rewards”.

For non-manipulated corporations, profits are from operations, plus investment, without diversion. All profits generated are recognized. So then, to short profits is a violation, likely a crime.

6. Summary

The conduct of current business organization is viewed as opportunistic, competitive, and aggressive. Persistence in such modes of conducting business converts to manipulation of the corporation. This research is to analyze conduct of corporate officers, and to characterize conduct in meaningful terms. The most apt term is manipulation.

As presented, manipulation connotes use of others’ assets, for self-satisfaction, that is, to serve one’s purpose or advantage. So assets used for that purpose is distinct from the business goal of corporate governance. The title of this research then is proper(1) ignore corporate governance, and (2) disregard the rules for use of corporate assets, manipulate use of assets for an officer’s own purposes.

References

1. Alio, R. J., 2004, “What’s the board’s role in strategy development?” *Strategy & Leadership*, Vol. 32, No. 5, 34-37.

2. Bainbridge, S. M., 2003, “The Creeping Federalization of Corporate Law,” *Regulation*, Spring, 26-31.
3. Black, H. C., 1979, *Black’s Law Dictionary*, West Pub. Co, St. Paul, MN.
4. Brickey, K. F., 1991, *Corporate Criminal Liability: A Treatise on the Criminal Liability of Corporations, Their Officers and Agents*, Callaghan & Company, Wilmette, IL, Part II, Ch. 8.
5. Brown, K., 2003, “Weak Boardrooms and Weak Stocks Go Hand in Hand”, *Wall Street Journal*, Sept. 9, p. A1.
6. Cialdini, R. B., Petrova, P. K., and Goldstein, N. J., 2004, “The Hidden Cost of Organizational Dishonesty,” *MIT Sloan Management Review*, 67-73.
7. Countryman, A., 2003, “Governance gets more than a glance,” *Chicago Tribune*, August 3, p. B1.
8. Duska, R. F., 2004, “Six cures for current ethical breakdowns,” *Journal of Financial Service Professionals*, May, 23-26.
9. Gellhorn, W., Byse, C., and Strauss, P. L., 1989, “*Administrative Law: Cases and Comments*” (8th ed), The Foundation Press, Mineola, NY.
10. Kelly, K., 2003, “Sealed, Delivered but Not Yet Signed by CEOs,” *The Wall Street Journal*, July 25, p. B1.
11. Kickner, P. K. and Jackson, C., 2004, “Sarabanes-Oxley Act: Expanded Enforcement,” *The CPA Journal*, September, 13.
12. Kochan, T. A., 2003, “Restoring Trust in American Corporations: Addressing the Root Cause,” *Journal of Management & Governance*, Vol. 7, 223-231.
13. Leeds, R., 2003, “Breach of Trust: Leadership in a Market Economy”, *Harvard International Review*, Fall
14. Smith, H. J., 2003, “The Shareholders vs Stakeholders Debate”, *Sloan Management Review*, Spring 2003, pp 85-90.
15. Veasey, E. N., 2003, “State-federal Tension in Corporate Governance and the Professional Responsibilities,” *Journal of Corporation Law*, Vol. 28, No. 3, pp. 441-454.
16. Wade, C. L., 2002, “Corporate governance failures and the management duty of care”, *St. John’s Law Review*, 76, No. 4, pp 767-785.

Appendices

Exhibit 1: Assigning Criminal Liability

Imputation of Criminal Intent

Standard:	action within 'agency' course of 'agency' scope of 'agency' with participation or knowledge
Conduct:	contrary to role or antagonistic objectives
To be proven:	Intent to directly benefit corporation or forward some corporate purpose Assent to pattern of criminal conduct with responsibility to eliminate conduct

Attribution of Criminal Conduct

	vicarious liability: respondeant superior also as 'accessory liability'
	Actors: officer, manager, supervisor
To be proven:	direct action (as accessory before the fact) present at the location, with intent (as accessory after the fact)
Criminal act:	Select acts: securities fraud, mail fraud Foreign Corrupt Practices Act sensitive domestic payment offense against IRS laws
Sanctions:	fine, imprisonment, probation
Defense:	no knowledge, no participation
<u>Special statute: RICO</u>	Racketeer Influenced Corporate Organization Act
To be proven:	enterprise in interstate commerce pattern of criminal activity fraud, banking, domestic & foreign payment Foreign Corrupt Practices Act
Sanction:	forfeiture of gain

Exhibit 2. Range of Sanctions on Corporate Practices
(Bainbridge, 2003)

Range of Statutory Sanctions

Types of Sanctions

Administrative Order
Civil Sanctions
Disgorge results
Criminal Sanction
Obstruction of Justice
Ban from practice before agency
Plea re: Civil or Criminal issue

Types of Violations

Theft
Fraudulent Transactions
Fraudulent Accounting Practices
Destruction of
legally required instruments

Ex-Range of Statutory Sanctions

Defendants

Reach settlement
Restructure organization
Enter Bankruptcy

Plaintiffs

Firm
Director & Officer
Individual
Government, by agency (e.g., SEC)
Corporation, for recoupment
Shareholder, for lost stock value

Exhibit 3. Specific Violations and Sanctions
of Corporate Actions

Violations as Fraudulent Transactions

False financial statements
False research reports on securities in the market
"Spinning" share prices (for IPO)
Destroy/Alter business records
False business transactions
use of illegal incentives
Purchases based on "late timing/trading"

Violations as Fraudulent Accounting Practices

False reporting, to boost earnings
Hidden corporate costs
to exaggerate profit
Hidden organization structure,
to avoid recognition of liabilities
Create off-the-book organization units
Personal loans, without expectation of re-payment
Improper recognition of expenses/income

Direct Criminal Activity

Conspiracy to inflate profits,
To coverup illegal practice
Extraordinary Influence on investment banking
Enterprise corruption, under
Racketeer Influenced Corrupt Organization Act
Mail Fraud, Wire Fraud

Sanctions

Fines, imprisonment, interest
Disgorge "payments", forfeiture of proceeds

Restatement of financial statements
Displace Board of Directors,
in part or in total

Bankruptcy settlement
by negotiation
Organization spinoff,
avoiding bankruptcy
Disclosure of fraudulent transactions

Exhibit 4. Analysis of Business "Scandals"

Company/ Industry	Offices Involved	Charges	Comment
TYCO Conglomerate sell 50 units	CEO, CFO Corp Counsel	Acctg fraud	'poster child' for mislead acctg; sue auditors for failure to etect fraud estore public trust
Adelphia telecommu'ns 15 th largest high speed communication	Family Owned	Acctg fraud Deceptive transfers	private financing growth by acquis'n .. price dispute
Martha Stewart Marketing hhld, magazine, TV program	Chmn, CEO to Founding Editorial Director	Ob of Justice perjury conspiracy insider trading sec fraud	"persona" of corp impact on corpn employees brand change corp name
Hollinger Intl newspaper owner & publisher	CEO	unauth payment non-competition payments	after-the-fact 'Poison Pill' failure of Corp Governance 'durably weak'
Shell Oil Company exploration, production, refining and marketing		Acctg fraud inflate proven reserves access to PensionFund	corp governance reserves replace credit rating cut by S&P
HealthSouth manage H/C operations	Chmn, CEO by S-O Act: CEO, CFO	Acctg fraud assets, earnings S-O Act: req'd officer to certify	assets frozen lawsuit to find assets