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Corporate Shaming Revisited: An Essay for Bill Klein

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Corporate Shaming Revisited: An Essay For Bill Klein

David A. Skeel, Jr.[†]

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David A. Skeel, Jr.

INTRODUCTION

I was thrilled, to say the least, when Mitu Gulati invited me to participate in the “Criteria for Good Laws of Business Associations” symposium he and Mark Ramseyer were organizing to honor Professor William Klein. After directing countless students to *Business Organization and Finance*, Klein’s classic pocket guide to the economics of the corporation, and greatly admiring his other work, I had never met Bill in person.¹ Bill was, and is, almost larger than life, one of the abiding figures of our discipline. The symposium would be a chance to meet Bill, and to debate corporate law scholarship with a remarkable group of corporate law scholars, each of whom has been touched by Bill’s work, friendship, or example.

Rather than a round of celebratory toasts, the organizers proposed a working symposium that would shift the focus from Bill himself to his ideas and concerns. (This shift from the person to a debate of ideas is by all accounts deeply characteristic of Klein the colleague and scholar.) Each of the participants was asked to explore a question that Bill Klein has worried over for years: why do corporate law scholars rarely seem to “identify goals and objectives,” to “weigh proposals against explicitly stated criteria and to engage in effective cost/benefit analysis?” To get the ball rolling, Klein offered a detailed but tentative four-part schema—consisting of fairness, economic goals, control of political and economic power, and administrative considerations—to serve as a starting point.

There was one last marching order, as I understood it. Each participant was invited to pick an article of our own and to look at it anew through the lens of the Kleinian typology. We were instructed, in a sense, to take the criteria for a test drive in our own work. Along the way, we could consider how Bill’s challenge to more carefully articulate our assumptions and his tentative list of criteria might cause us to see the earlier work in a new light.

1. WILLIAM A. KLEIN & JOHN COFFEE, JR., *BUSINESS ORGANIZATION AND FINANCE* (9th ed. 2004).

After rooting through my own articles, I decided to revisit an article of mine on a governance strategy I refer to as “corporate shaming.”² The corporate shaming article stood out for several reasons. First, guided by the poet William Carlos Williams’s remark that “sometimes one’s early work gives one the creeps,” I tried to pick an article that I can still bear to reread. The shaming article seemed, at least as I remembered it, to meet this standard. Second and more to the point, the shaming article had forced me to ponder a variety of concerns that do not often figure prominently in my own work. Like much corporate scholarship, my articles tend to have a consequentialist orientation, focusing on incentives and how corporate law does and does not influence the behaviors of managers, directors, and shareholders. Shaming raises these issues, but it also raises questions of legitimacy and power, and thus seems an ideal context for exploring the Kleinian typology. So that is what I propose to do.

In the remarks that follow, I briefly revisit the issue of corporate shaming by considering four very different contexts in which it arises. I then conclude by offering some more general thoughts about the Kleinian typology, the exercise of applying it to a particular issue, and the nature of contemporary corporate law. My hope is that the remarks will in some small way do justice to the rigor, verve, and passion Bill himself has brought to scholarly exchange for more than forty years.

I. WHAT “SHAMING” MEANS AND HOW IT WORKS

“Shaming,” according to two leading scholars, “is the process by which citizens publicly and self-consciously draw attention to the bad dispositions or actions of an offender, as a way of punishing him for having those dispositions or engaging in those actions.”³ The enforcer expresses moral outrage at the offender, expecting that the intended audience will respond with similar moral disapproval.

Shaming works best in closely knit communities whose members hold similar views about morality and appropriate social behavior. Japan is frequently described as a country where shaming sanctions are widely and effectively employed. The diversity of the United States, and our sharp political polarization, makes the efficacy of shaming much less obvious in this country. Yet Americans do hold widely shared views about many issues, such as outrage at drunk driving. And nearly all of us participate in one or more communities that could be described as closely knit. In our families or our profession, for instance, relationships often are closely intertwined and our reputations matter

2. David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PENN. L. REV. 1811 (2001).

3. Dan M. Kahan & Eric A. Posner, *Shaming White Collar Criminals: A Proposal for Reform of the Federal Sentencing Guidelines*, 42 J.L. & ECON. 365, 368 (1999).

a great deal. In these contexts, shaming can be a powerful corrective when individuals violate the shared values of the community.

In recent years, shaming has drawn a great deal of attention as an alternative sanction in the criminal law, due in part to the creativity of a few state law judges. Because shaming sanctions—such as requiring a drug offender to hold a sign announcing that she was caught with cocaine or requiring a drunk driver to affix a “DUI: Offender” bumper sticker to his car—undermine the offender’s reputation, enthusiasts argue, they can further each of the traditional functions of criminal law.⁴ The threat of being shamed will deter would-be offenders, and the reputational penalties suffered by actual offenders, as a result of their shaming, will satisfy the retributive goals of the criminal law. In short, shaming can both deter and punish, and it does so in a way that expresses clear social condemnation of the offender’s actions.⁵

The enthusiasm is hardly unanimous, however. Shaming critics view it as a scattershot sanction that has wildly different effects on different offenders, seriously punishing some while glancing off those who are less susceptible to discipline. They also worry that harnessing community enforcement really may not be such a good thing. “Once the state stirs up public opprobrium against an offender,” as James Whitman puts it, “it cannot really control the way the public treats that offender.”⁶ If shaming sanctions are too easy to apply, they also may be used indiscriminately. This ease of access is particularly worrisome given that offenders may have little opportunity to defend themselves.⁷

Corporations regularly figure in the shaming debates, in part because several courts have required corporate polluters to issue public apologies for their misbehavior. But private parties also enforce corporate shaming sanctions. CalPERS engages in shaming when it announces a “focus list” of companies with poor corporate governance, as did Bob Monks when he ran an advertisement with silhouettes of the directors of Sears during a campaign to persuade Sears to divest its financial services businesses.⁸

In the discussion that follows, I briefly consider four different examples of shaming or shaming-like behavior in corporate law. These illustrations suggest both the promise and the perils of shaming sanctions and force us to consider the kinds of tradeoffs that Professor Klein attempts to formalize in his criteria

4. The examples in this sentence are cited and described in Stephen P. Garvey, *Can Shaming Punishments Educate?*, 65 U. CHI. L. REV. 733, 734-35 (1998).

5. *Id.* at 740-49.

6. James Q. Whitman, *What Is Wrong with Inflicting Shame Sanctions?*, 107 YALE L.J. 1055, 1088 (1998).

7. See, e.g., Tony M. Massaro, *Shame, Culture and American Criminal Law*, 89 MICH. L. REV. 1880 (1991). In Kleinian terms, critics of shaming are particularly worried about fairness (Criterion I) and power (III) issues, whereas its defenders have tended to emphasize efficiency (II).

8. Both of these examples are discussed in more detail in Part IV, *infra*.

for good laws.

II. THE “TONE AT THE TOP” AND SHAMING WITHIN THE FIRM

Three years after the corporate scandals first broke, regulators and scholars continue to debate the issue of how best to address the flaws in American corporate governance. In a remarkable recent speech, Stephen Cutler, who was Director of Enforcement at the SEC at the time, pointed to “the tone at the top” as a particular concern.⁹ “An awful lot of people seem to be paying an awful lot of attention to ‘tone at the top,’” Cutler noted. “Articles are being written about it. Speeches (in addition to this one) are being given about it.”

After reciting a long list of companies the SEC had recently pursued, Cutler drew two connections to his “tone at the top” theme. The first was simply that the CEOs in many of the companies were “breaking the law,” which suggested that “they couldn’t have been setting a particularly melodious tone.”¹⁰ But the misbehavior was not limited to the CEOs themselves. “Violations of the securities laws,” according to Cutler, “are very frequently the product of both individual failings and a deficient corporate culture.” The “tone at the top” contributed to this pernicious culture, and a different tone might have encouraged a healthier culture.

Shaming first entered Cutler’s portrait as a small, implicit part of the role Cutler sets out for the SEC in prodding corporate leaders to attend to the institutional culture in their firms. “We’re trying,” he said, “to get the fundamentally honest, decent CEO or CFO or General Counsel—the one who wouldn’t break the law—to say to herself when she wakes up in the morning: ‘I’m going to spend part of my day worrying about, and doing something about, the culture of my company.’”¹¹ The SEC’s principal tool in this quest is imposing stiff fines and seeking other formal sanctions when corporations and their executives violate the securities laws. But these traditional sanctions are supplemented by shaming, as is evident by the speeches Cutler gave throughout the country. In each of the speeches, including this one, he named names, holding up wayward executives and companies for informal condemnation.

Far more striking, however, is Cutler’s suggestion that the companies themselves should engage in internal shaming. After underscoring that “the managers themselves have to comply with the letter and the spirit of the rules,” and exhorting managers to “make character a part of the firm’s set of key hiring criteria,” Cutler encouraged them to use shaming-like strategies when

9. Stephen M. Cutler, *Tone at the Top: Getting It Right*, Speech at 2d Annual Corporate Counsel Roundtable, Securities and Exchange Commission (Dec. 3, 2004).

10. *Id.*

11. *Id.*

employees behave in an unethical fashion.¹² The company “should take appropriate action against the employee—swiftly and firmly. . . . And as much as possible (and consistent with privacy concerns), the punishment and the reason for it should be clear to the company’s other employees.”

Here is the vision: the managers should serve as enforcers, punishing offenders and making the punishment public enough to serve as a warning to other employees within the company. In theory, this could be done without disclosing the name of the offender. But the offender’s identity will often be known—particularly if she is a high-level officer—and the offenders will be shamed within the internal community.

The prospect of intra-company shaming raises two questions: will it work, and is it fair to the employee who is sanctioned? Start with fairness. Holding an employee up to criticism to “convey to [the company’s] other employees in a clear and forceful way that such conduct [is] unacceptable” seems to treat the employee as a means rather than an end, subordinating her interests, and invading her privacy in order to shape the company’s corporate culture. If we can be sure that employees will only be singled out in this fashion if they have in fact violated a rule, and the company has adequate process protections in place, the force of the objection weakens. But it does not dissolve altogether. The risk that an employee’s sense of shame will be manipulated to achieve the goals of the company remains. This is one context where fairness concerns should take precedence over the potential efficacy of the sanctions, particularly if the punishment comes at a time when the company itself is being criticized.¹³ It is interesting to note that employment law protections are designed to take just these kinds of concerns into account.

In addition to these fairness concerns, there also are questions as to the efficacy of internal shaming. If other employees view the implicit or explicit naming of names as overbearing, for instance, the sanction could backfire, prompting a backlash against the managers who imposed it. It also would be a mistake to assume that internal shaming can be used to transform a corporation’s internal culture. Shaming does not create, or recreate, a company’s values; it reflects them. If the managers who set the tone are themselves ethically challenged, they probably will not be actively policing employees who play fast and loose with accounting or securities rules. For similar reasons, shaming strategies will not by themselves counteract the ethos of a bubble market. If the relevant enforcement communities—other employees at the firm, the firm’s shareholders, and investors generally—are themselves

12. *Id.*

13. If the company itself is being criticized, there is an increased risk that an employee may be singled out as a scapegoat. Still another concern with internal shaming sanctions is that they make us “accountable to strangers, those who don’t know us whole, and may judge us out of context.” See Jeffrey Rosen, Comments at Anita Allen Book Symposium (Dec. 1, 2004).

caught up in the gold rush, the shaming mechanism may simply break down. When *Fortune* reporter Bethany McLean tried to persuade *Fortune* to run her expose of Enron, to give a related example, she encountered repeated resistance, and the story itself had little impact when it was first published.

III. THE WALL STREET PERP WALK

Long before he became the face of New York's post-9/11 resolve, Rudy Giuliani perfected the perp walk during his tenure as U.S. Attorney for New York.¹⁴ When the time came to arrest the prominent Wall Street traders and bankers his office was accusing of insider trading and other violations, Giuliani turned the arrests into a public spectacle. Handcuffs were slapped on in front of television cameras, and footage of the defendants being paraded out of their homes or offices featured prominently on the evening news. The perp walks were a brilliant public relations move. They not only shamed the defendants;¹⁵ they also sent a signal to other Wall Street traders, and, of course, helped to help raise Giuliani's own profile.

Are perp walks an appropriate governance device? One obvious concern is the absence of process. At least at first glance, perp walks seem to punish the defendants before they have had the chance to fully respond to the allegations. Information asymmetries, such as the absence of any way for ordinary citizens to know whether the charges are warranted, increase the danger that a defendant may be unfairly singled out for shaming.¹⁶ In theory, Giuliani and other prosecutors were themselves taking a risk when they raised the public profile of the arrests, which might seem to reduce the likelihood of prosecutorial misbehavior. If the defendants in a perp walk case are later exonerated, the U.S. attorney will have egg on his face.¹⁷ But in practice, this risk was quite limited. Many of the relevant federal crimes—such as mail and wire fraud, perjury, and obstruction—are defined so broadly that prosecutors can almost always obtain some kind of conviction. The breadth of the federal criminal code gives prosecutors an enormous margin for error.

One obvious response to this mismatch between the positions of the enforcers and of the offenders would be to curtail the scope of the federal criminal law, so that the crimes charged bear a closer resemblance to what the

14. For a critical discussion of Giuliani's strategies for prosecuting white collar Wall Street defendants, in a chapter entitled "Rudy Giuliani's Reign of Terror," see DANIEL FISCHER, *PAYBACK: THE CONSPIRACY TO DESTROY MICHAEL MILKEN AND HIS FINANCIAL REVOLUTION* 98-127 (1995).

15. At least in a general sense. In their narrowest conception, shaming sanctions assume that the offender will be ashamed of their behavior. Some of Giuliani's defendants may not have been. I am using shaming in a broader sense, without limiting it to contexts where the offender internalizes the sanction.

16. In more explicit Kleinian terms, serious fairness (Criterion I) and power concerns (III) must be weighed against potential efficiency benefits (II) such as deterrence.

17. As it turned out, one of Giuliani's defendants did indeed get off. But most did not.

defenders are actually being accused of doing.¹⁸ But a much smaller and more realistic response might also help: why not take the pretrial-media maneuvers into account when defendants ask for a change in venue? Because high-profile cases are central to a federal prosecutors' reputation, the risk of losing control of the case would serve as a partial check on prosecutors' pretrial behavior.

IV. SHAMING BY SHAREHOLDERS: CALPERS AND INDIVIDUAL ACTIVISTS

The most pervasive enforcers of shaming sanctions in American corporate governance have been corporate shareholders. In 1992, frustrated by the Sears directors' complacency as the company's stock price wallowed, shareholder activist Robert Monks purchased a full-page ad in the *Wall Street Journal* that consisted of silhouettes of the nine Sears directors, together with a caption listing the name and position of each. The headline of the ad, in huge bold print, described the directors as "Non-Performing Assets." Monks and his frequent ally Nell Minow are convinced that the ad induced the directors to make several of the changes he had been advocating for months. CalPERS, California's public pension, uses an analogous strategy. Each year, CalPERS shines the spotlight on a small group of companies by releasing a "focus list" of companies with poor corporate governance. Quite frequently, this attention spurs the companies to make immediate changes such as separating the CEO and board chair positions or adding independent directors.¹⁹

Although shaming is often touted as a low cost alternative to traditional sanctions in the criminal law context, cost is a serious obstacle for private-shareholder activists like Monks and Minow. A full-page ad in the *Wall Street Journal* costs well over \$100,000, which discourages frivolous shaming campaigns but also chills the use of the shaming strategy to prompt genuinely beneficial changes. This is unfortunate. Corporate directors are in many respects an ideal target for shaming sanctions, since they are, in Minow's words, "the most reputationally sensitive people in the world."²⁰ How might we encourage good shaming without also opening the floodgates to its more pernicious twin? Here is one possible answer: if a shareholder activist wages a proxy campaign that garners significant support—say, at least 35% of the shareholder vote—the company should be required to subsidize any shaming efforts undertaken as part of the campaign. The "significant support"

18. For a more nuanced and somewhat different view of the related issue of pretextual prosecutions, see Darryl C. Richman & William J. Stuntz, *Al Capone's Revenge: An Essay on the Political Economy of Pretextual Prosecution*, 105 COLUM. L. REV. 583 (2005). Note that even a narrower criminal code wouldn't completely solve the problem, since it wouldn't address the use of perp walks by prosecutors who mistakenly believed that conviction was likely.

19. The Monks and CalPERS's illustrations are described in detail (together with a reprinting of Monks' ad) in Skeel, *supra* note 2, at 1836-41 (CalPERS), 1844-50 (Sears ad).

20. Skeel, *supra* note 2, at 1812.

threshold is a rough but useful gauge of the importance of the governance issues raised by the shareholder's campaign.²¹

With shaming by CalPERS and other public pension funds, the shaming calculus is quite different. CalPERS does not face the kinds of cost constraints that limit shaming by private shareholders. With CalPERS, the most serious problem is political. Because CalPERS officials are politically appointed, there is an ever-present danger that its investing decisions will be shaped as much by politics as by economics. The recent ouster of CalPERS's head is an all too vivid reminder of this danger. A second concern is CalPERS's tendency to rely on broad governance yardsticks of somewhat questionable significance when it chooses its focus list. On the positive side of the ledger, CalPERS and other public pensions have often taken the lead in identifying companies whose poor governance interferes with their performance. Overall, shaming by CalPERS and other public pensions seems to enhance corporate governance, but this is less uncomplicatedly the case than with private shareholders who have their own money on the line.

V. SHAMING SENTENCES AND PENALTIES FOR CORPORATE OFFENDERS

The final illustration returns us to the public enforcement context that has drawn the most attention from criminal law scholars. Just as judges have devised creative shaming sanctions for drunk drivers and drug users, courts have sometimes required corporate defendants to proclaim their offense to the world. Companies that have violated the environmental laws, for instance, may be instructed to publish an apology for their misbehavior in a local newspaper.

Corporate apologies, or corporate shaming, offer several of the classic benefits of shaming sanctions. Requiring the company to issue an apology is a low-cost sanction for the government, since the offending company foots the bill, and the public statement expresses condemnation for the misbehavior in a way that fines alone do not. The most important question is efficacy, whether the sanction will have any effect on the company's internal culture and its managers' behavior.

Even if the answer is uncertain—either because the prosecution itself has already shamed the company, or because the company's managers and employees do not take the message to heart—shaming is ideally suited to many kinds of violations. The fit is particularly apt for regulatory violations for which the company can appropriately be blamed. Moreover, as with several of the sanctions discussed already, there are several simple ways that courts could add to the bite of the sanctions. At least for criminal law violations, courts could

21. This approach is borrowed from a proposal advocated by Lucian Bebchuk and Marcel Kahan. Lucian Arye Bebchuk & Marcel Kahan, *A Framework for Analysing Legal Policy Towards Proxy Contests*, 78 CAL. L. REV. 1071, 1085 (1990).

require key managers to appear in person at the sentencing.²² In addition, if the company is instructed to issue a public apology, the statement could include the names of the company's principal managers and perhaps even employees who were directly involved in the misbehavior. Shaming individuals, rather than just the corporation, reintroduces dignity concerns. But if the conduct is genuinely blameworthy—and it involves regulatory violations such as price fixing or polluting rather than highly charged issues like sex or race discrimination—it is appropriate to name names.²³

The most serious downside of court-imposed shaming sanctions is the risk that idiosyncratic judges will impose outrageous sanctions. Unlike private shareholders, judges do not bear the costs of their sanctions, so the principal checks on their creativity are conscience and good judgment, together with the company's right to appeal the appropriateness of the sanction. Adding a template—a basic, suggested form of corporate apology—to the sentencing guidelines might help to further reign in inappropriate judicial creativity.

In short, corporate shaming sanctions are not appropriate for every violation, and there is a danger that the sanctions may sometimes say as much about the judge as about the offender. But these concerns are limited enough, and the benefits great enough, to justify continued, even increased use of this strategy.

CONCLUSION

More than with almost any corporate law issue I can think of, shaming sanctions directly implicate each of the four sets of issues in the Klein typology: fairness, efficiency, administrative costs, and choice of decision maker. This brief essay has argued for an approach that attempts to seriously engage each of the criteria—though I suspect in a less systematic fashion than Professor Klein would advocate.

Thinking back over the exercise of applying the Kleinian typology to a corporate law issue, I am struck even more by how prominent a role the typology gives to issues of fairness, power, and legitimacy. Corporate shaming raises these concerns, but it seems quite unusual in this respect. Almost everywhere else in corporate law, questions of legitimacy lay far in the background. They are subsumed into other inquiries or ignored altogether. The literature seems to have other fish to fry.

Why is this? Two reasons stand out. One is simply that, to borrow Bill Bratton's felicitous phrase, "corporate law makes us all welfare

22. This is a major theme of Jayne W. Barnard, *Reintegrative Shaming in Corporate Sentencing*, 72 S. CAL. L. REV. 959 (1999).

23. In Kleinian terms, the retributive and efficiency benefits of the shaming outweigh fairness concerns, except with explosive issues like discrimination.

consequentialists.”²⁴ Corporate law scholars hold very different views as to the appropriate balance of power among managers, directors, and shareholders, and more generally, about the proper role for legal regulation. But nearly everyone assumes that the goal is to shape the parties’ behavior, and to counteract problems such as the agency costs that arise from the separation of ownership and control, in order to promote more efficient production of goods and services.

The second reason is that the scope of corporate law has dramatically narrowed over the course of the past hundred years.²⁵ Until the early twentieth century, debates over the corporation included worries about monopoly and the relationship between management and labor—not just internal governance issues such as shareholder voting rules and the duties of corporate directors. Over the course of the twentieth century, many of these issues were hived off from corporate law. The most obvious historical reason for this was that charter competition discouraged the states, who had always been the principal regulator of internal corporate governance, from engaging in aggressive regulation.²⁶ Over time, most dramatically during the New Deal, Congress and federal regulators stepped in and established separate regulatory frameworks for labor law, antitrust, and environmental law. As a result, the domain of corporate law steadily shrank. Now it includes only internal corporate governance, together with the disclosure and antifraud provisions in the federal securities laws.

If we widen our lens to consider labor, antitrust, and environmental law, among others, as part of the overall regulation of business enterprise, legitimacy, and power issues figure much more prominently. It is not accidental that in several of the instances where corporate shaming raises serious power or fairness concerns, the most obvious correctives come from areas other than corporate law.²⁷

Notice how the Kleinian typology prods us to consider how all of these pieces fit together. Taking the typology seriously suggests the need for a broader conception of corporate law, one that is at the least aware of the other pieces that comprise our overall regulation of corporate enterprise. A more capacious perspective may not immediately change the conclusions we reach

24. William W. Bratton, *Welfare, Dialectic, and Mediation in Corporate Law*, 2 BERKELEY BUS. L.J. 59, 61 (2005).

25. This is a central theme of Ed Kitch’s contribution. Ed Kitch, *The Simplification of the Criteria for Good Corporate Law or Why Corporate Law Isn’t As Important Anymore*, 2 BERKELEY BUS. L.J. 35 (2005).

26. For an excellent discussion of this dynamic, see Jacob S. Hacker & Paul Pierson, *Business Power and Social Policy: Employers and the Formation of the American Welfare State*, 30 POL. & SOC. 277 (2002).

27. See, e.g., *supra* Part I (employment law as check on internal shaming); Part II (possible responses to concerns of “perp walks”).

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about internal governance issues. But it might, and it certainly will influence the questions that corporate law scholars ask. And questions, as Bill Klein has long understood, are how the scholarly enterprise moves forward.

