Spring 2019

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Recommended Citation
Faith Stevelman & Sarah C. Haan, Board Governance for the Twenty-First Century, 74 Bus. Law. 329 (2019).

Board Governance for the Twenty-First Century

By Faith Stevelman and Sarah C. Haan†*

Introduction

A decade after the global financial crisis, corporate governance is in a state of flux. A conceptual shift is underway. Years ago, in "first wave" governance, boards had a cozy relationship with the company C-suite. In "second wave" governance, which took hold in the 1970s, legal academics reimagined the board's role, conceptualizing directors as monitors charged with limiting waste and abuse that can arise in agency relationships. Now, we find ourselves at the threshold of "third wave" governance, in which boards are asked to grapple immediately and candidly with both the financial aspects of business and new environmental, social, and governance ("ESG") challenges that present themselves in governing globalized firms.

The conceptual shift has significant implications for the role of the board. Are public company directors capable of partnering effectively with CEOs in "third wave" governance? Will reformers promote the evolution of board structures and practices in a way that does justice to the term *governance*? Current board structures, which rely on non-management directors working part-time, present challenges to robust board governance. Structural reforms will have to make good on the promise of greater board engagement in corporate identity formation—the process through which a twenty-first-century company develops its long-term strategy and values.

One approach might be to say that this is too much to expect of public company directors, and to grapple more candidly with the policy and legal implications of this shortfall. But this is not the tack taken in Stephen Bainbridge and Todd Henderson's *Outsourcing the Board.*[1] Indeed, Professor Bainbridge has been a prolific and influential defender of "board primacy," and he maintains these commitments in the new book. Instead of killing off the board or reducing its centrality to corporate governance, *Outsourcing the Board* emphasizes the board while proposing a radical change in structure.

Bainbridge and Henderson argue that corporate law should be amended to allow an entity, rather than individual humans, to constitute the board. They

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1. Stephen M. Bainbridge & M. Todd Henderson, Outsourcing the Board: How Board Service Providers Can Improve Corporate Governance (2018) [hereinafter OTB].

use the term "board service providers" to describe these outside, entity-boards ("BSPs"). Once BSPs become a valid option under state law, *Outsourcing the Board* proposes that shareholders could vote for a traditional board, comprised of natural persons, or elect a BSP that would take on the board role. Emphasizing the efficiencies that accrue from coordinating joint action through firms, Bainbridge and Henderson argue that BSPs are likely to be more efficient and high performing than boards comprised of natural persons. To reiterate, the BSP they envision is not a consultant to the firm; rather it would replace the internal board.[2]

As *Outsourcing the Board* does, this essay affirms the centrality of the board in corporate governance and the need for candor in addressing the pragmatic challenges that boards face. Nevertheless, we observe profound problems with BSP governance that merit caution in the adoption of Bainbridge and Henderson's proposal. Our most fundamental objection is that board service cannot be conceived of as being essentially transactional. Construing the board's role as a mere portfolio of tasks and formal judgments analogous to ones performed by consultants and advisors to the firm is a conceptual error. Certainly, there are distinct tasks that boards execute. But the goal of "third wave" governance, from the board's perspective, will be to partner with the C-suite in accommodating ESG mandates and financial and operational goals to create long-term value. We view such corporate identity formation as a complex, informationally saturated, fiduciary responsibility incompatible with outsourcing to BSPs. In the alternative, we suggest a set of structurally modest board reforms which would promote the directors' ability to make a greater contribution to governance.

I. *Outsourcing the Board:* A Critique of the BSP Concept

A. Validating the Importance of Board Governance

Outsourcing the Board presents the shift to BSP governance as a structural innovation that will enable boards to fulfill their governance duties more efficiently. In the authors' Coasean view, the optimal contracting required to produce a highly effective board simply cannot be realized by treating each director as an individual sole proprietor. Placing their faith in the enabling, experimental spirit of corporate law,[3] the authors contend that legislatures should have set board structure in the broad set of optional, enabling statutory terms, rather than in the narrow set of legally mandatory corporate laws.[4]

Bainbridge and Henderson suggest that the positive stock price performance and revenue streams of competitor, publicly traded companies with BSP gover-

2. At the UCLA conference on *Outsourcing the Board*, Bainbridge and Henderson concluded that a hybrid board of humans and an outside firm/BSP is likely unworkable.

3. Praise for flexibility and experimentalism in corporate law is widely embraced in the field. For an early, influential treatment, see Roberta Romano, The Genius of American Corporate Law (1993) (arguing that flexibility is the key to corporate law's success).

4. *See* OTB, *supra* note 1, at 7–8.

nance will cause other companies to convert.[5] BSPs that deliver better governance products and services will attract more and cheaper funding, initiating a virtuous cycle of BSP uptake and success. As Bainbridge and Henderson suggest, there would be real benefits from enabling the market for corporate governance to flourish apart from the takeover market, especially given the murky empirical studies of the efficiency gains from takeovers. If BSP funders were able to distinguish which corporate reforms were due to BSP adoption, and not due to other market or institutional factors, this would be an excellent innovation. But the most important point is this: *Outsourcing the Board* embraces the centrality of board governance, notwithstanding the authors' faith in markets and experimentalism.

B. BSPs Might Foster Board Service as a Meritocratic Profession

Outsourcing the Board boldly addresses the core paradox and central failing of contemporary corporate governance. That is, while the governance system places increasing reliance on directors, in the current system they often lack the information, time, and perhaps even expertise to deliver on their responsibilities. Neither market forces nor legal mandates have yet to fix this. *Outsourcing the Board* notes that BSPs could be staffed with teams of experts.[6] And clearly, boards need greater expertise in such areas as finance, accounting, industry best practices, law and governance, public relations, and technology.

By envisioning board service as a profession that qualified candidates could train for and build expertise in, the authors make an important contribution. The BSP model supports the emergence of board service as a full-time profession. At present, the law's codified reliance on independent directors—i.e., outsiders—to promote objectivity and viewpoint diversity in consideration of the CEO's proposals and performance has all too often meant that public company directors are employed full-time in another demanding job. This goes far to explain why boards sometimes fail to see or understand major business risks. Partial attentiveness is untenable as a norm of public company board service.

Furthermore, the authors' view that competition produces quality implicitly rejects the status quo in which boards are too often staffed with white men who have become cozy in their positions. If BSPs fostered the emergence of board service as a meritocratic profession—one that a person could train and compete for—this would help topple the old-guard status quo. The high cost of proxy contests and the absence of term limits have inhibited turnover in corporate boards. Opacity surrounding the search process for new directors has too often enabled continued CEO influence and has confined the search to established networks in which diversity is limited.

5. *See, e.g.*, *id.* at 92–93.
6. *See id.* at 97–100.

C. Directors as Natural Persons Accountable in Civil Society

The emergence of widespread ESG interest is coinciding with deregulation and a shift in favor of private ordering, thrusting corporations once again into important civic controversies. These enhanced responsibilities should fall on the shoulders of natural persons serving as directors. In the current structure, directors are accountable through moral conscience and, at times law, for the choices firms make. This is not a new phenomenon: *Outsourcing the Board* includes a detailed chapter on the early modern development of corporate boards, where directors were enmeshed in problems of civic concern.[7] It describes how in the East India and colonial trading companies, directors became a liaison between the local communities and the distant state sovereign.[8] The directors heard trading and community complaints and resolved disputes between stakeholders in company towns that could not be resolved by the citizens alone, or by the distant sovereign.[9] Through these acts, directors became a locus of moral and political authority and governance in their own right, neither sovereign nor merely private citizen. Scholars familiar with the discourse of republican civil society envisage modern corporate directors in just this manner. Bainbridge and Henderson rightly suggest that boards no longer act with the authority of the sovereign, but they incorrectly imagine BSPs in apolitical terms. In so doing, they give short shrift to the obligations of moral conscience and accountability that lie with directors in modern firms.

D. Fiduciary Duties When Boards Have No People on Them

Outsourcing the Board contends that what is necessary is merely an alteration to state corporate statutes, which provide that directors must be natural persons.[10] But the BSP—a unitary board with no people on it—presents a major change to many legal features of corporate law. For example, although Delaware law allows a board of only one director, the provision is an outlier in a statutory framework which everywhere else contemplates a board of multiple natural persons. (The one-person board is likely a nod to incorporated sole proprietorships.) The Delaware statute describes how many directors of the board must attend a meeting for it to be valid and how many directors of the board must vote in the affirmative for a merger, sale of assets, charter amendment, or other action to be valid. The statute defines the valid constitution of subcommittees of directors and provides that conference calls constitute valid meetings of the board so long as all directors can participate and hear the back-and-forth. In sum, merely substitut-

7. *Id.* at 17–29.

8. *Id.* at 21–23.

9. *See* Philip J. Stern, The Company-State: Corporate Sovereignty and the Early Modern Foundations of the British Empire in India (2011) (providing a detailed account of how the corporation was concerned not simply with the bottom line but also with the science of colonial governance).

10. *See* OTB, *supra* note 1, at 148–52 ("If state corporate laws were amended to allow firms to serve as directors . . . the change would cascade through much of the rest of the corporate governance legal system.").

ing BSPs for traditional boards will not go far enough to create coherence in the state statutory framework of corporate law.

Second, stock exchange listing standards and federal corporate law now rely heavily on the operation of board committees—especially, audit, compensation, and nominating committees. *Outsourcing the Board* appears to envision teams of experts who could serve these functions. But the problem is that the people in the BSP are not directors, they are BSP employees or even independent contractors, and as such not legally situated to serve on board committees.

Antitrust law imposes limits on the same director serving on companies that might collude to dampen competition. Interlocks are challenged generally under section 8 of the Clayton Act, but the federal antitrust enforcement agencies may use other antitrust statutes to challenge interlocking directorates, including section 5 of the Federal Trade Commission Act and section 1 of the Sherman Act.[11] The existence of a competitive industry need not be proven to demonstrate a violation of these bars to common directors. These bars to "interlocking" directors will inhibit BSPs from serving as the board of companies whose businesses are common or complementary (the very businesses where their industry expertise would be most valuable). It will not be entirely or objectively clear which companies a BSP would be banned from taking on.

But the most trenchant legal problems facing BSPs relate to the law of fiduciary duty, the most vital area of corporate law. Remarkably, *Outsourcing the Board* contains hardly any discussion of directors' fiduciary duties.[12] In regard to the duty of care, although many jurisdictions allow corporations to insulate directors from monetary damages for breach of the duty of care, the duty still exists as a crucially important standard of conduct even in those jurisdictions, where it continues to mandate that directors take action in an informed and deliberate manner.[13] The persistence of fiduciary care is underscored by the availability of injunctive relief even where a company's exculpation provision ensures that its directors cannot be personally liable for monetary damages for the duty's breach.[14] The heart of the duty of care is the precept that directors must become apprised of "all material information reasonably available" to him or her prior to making a decision for the company.[15]

Again, under the proposal outlined in *Outsourcing the Board*, the entire board would be comprised of a single legal entity, the BSP.[16] Decisions made by the BSP would constitute decisions of the board, and because the board would be embodied by a single, legal entity, there would be no board-level deliberation. Instead, the actual deliberation would happen at a level removed from the client-company, inside the BSP, by persons who would be employees or independent

11. Respectively, 15 U.S.C. § 19, 15 U.S.C. § 45, and 15 U.S.C. § 1.

12. The book's index does not even have entries for "fiduciary" or "duty" or any related concept.

13. *See, e.g.*, Del. Code Ann. tit. 8, § 102(b)(7) (Supp. 2018).

14. *See, e.g.*, Arnold v. Soc'y for Sav. Bancorp, 678 A.2d 533, 542 (Del. 1996).

15. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

16. *See* OTB, *supra* note 1, at 90 ("The board would be an 'it,' not a group of individual men and women.").

contractors of the BSP firm. Indeed, if they are independent contractors, the persons fulfilling the required tasks would have contractual duties to the BSP, and hence their "fiduciary" service to the client-company would be even more attenuated.

The law evaluates directors' satisfaction of the duty of care in terms of the quality of the deliberative process they undertake to approve a corporate decision.[17] With a BSP, however, decisions made by the BSP would constitute decisions of the board, and hence there would be no board-level deliberation, and no record of board deliberation in board minutes. Courts applying fiduciary care analysis have considered the number of board meetings called and their length; the materials reviewed by board members to prepare for such meetings; which directors were present and which registered their absence with the corporate secretary; the quality of the materials they were given at the meetings; and whether the directors' reliance on any expert data was reasonable. *Outsourcing the Board* is vague on the matter of BSP process. Would there be ceremonial meetings of the BSP, or perhaps the cost savings of eliminating them altogether? They would have compensation and institutional incentives to conform to the BSP's procedures and standards, in the BSP's interest, which would be likely to favor delivering high-volume services over more difficult-to-measure quality ones. The uncertainty inherent in the application of fiduciary care principles to a BSP is a substantial hurdle.

True, *Outsourcing the Board* does contemplate a deliberative process at the BSP—in fact, the efficiency gains from collective effort by a group of experts is precisely what recommends the BSP model to the authors. And yet, the extraordinary breadth of what that internal process might be is left vague. "Where the board is called upon to make a decision," the authors write, "the CEO would meet with the contact person at the BSP, who would then bring the full resources of the BSP to bear on making the decision."[18] However, crucially, the BSP's deliberating teams would not be composed of fiduciaries responsible to the client-company and its shareholders. Because BSP employees engaged in the deliberative process requisite to these kinds of complex decisions owe no fiduciary duties to the company-client, but do owe such duties to the BSP itself, a new set of conflicts of interest is introduced to board decision-making and corporate governance.

There are other, pressing corporate fiduciary law hurdles to the BSP initiative. As exemplified in the Delaware Supreme Court's decision in *Malone v Brincat*, under the fiduciary duty of candor, potential liability varies depending on whether the directors who approved of and promulgated misleading information (for example, an SEC filing) did or did not know the information was misleading.[19] That is, there is an intent feature to the law that would become incoherent in BSP governance.

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17. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 874–88 (Del. 1985).
18. OTB, *supra* note 1, at 98.
19. *See* Malone v. Brincat, 722 A.2d 5, 9 (Del. 1997).

Within the doctrine of the duty of loyalty, BSP governance will present real problems under the doctrine of corporate opportunity. Similar to a natural person on two companies' boards, but even more spread throughout the economy, a successful BSP would have corporate control and possession of confidential company information which could be used to benefit one firm more than the other. If the BSP owned comparatively more stock at a firm that was prospering—obtaining financing and expanding its ventures—shareholders at the firm not similarly prospering would have a colorable claim that the BSP had benefitted itself by favoring the firm where it held more stock with better access to funding and more promising ventures.[20]

Principles operative under the fiduciary law of demand excusal are also relevant. Unless shareholders have voted out the old BSP in favor of a new BSP, the current BSP will be stymied in dismissing shareholder litigation under the demand excusal jurisprudence. Where the same BSP is the subject of the shareholder lawsuit, it will be impossible to show that a majority of directors are making an informed, impartial decision that the shareholder lawsuit is not in the best interest of the company.

Finally, there are company-specific costs attendant to resolving the legal uncertainties that BSPs would create. This is because, in a world of enabling state law, merely changing the law will be insufficient. For individual firms to proceed with the potential for BSP governance, an amendment to the certificate of incorporation or bylaws would be required. Because of the magnitude of the change involved in BSP governance, corporate law is likely to require that firms embrace BSP governance in their charters, a document which must be kept public, on file with the Office of the Secretary of State (unlike corporate bylaws). Charter amendments, under corporate law, must be initiated by the incumbent board and then ratified by a majority of the shares outstanding voting in the presence of a quorum. This makes the switch to a BSP more unlikely because incumbent boards are likely to resist the shift to BSPs. But it also makes the change costlier for firms, because a shareholder vote must take place (with the company presenting a fully vetted, detailed proposal). In any event, the uncertainties and costs associated with these legal changes are not insubstantial and must be weighed against the hypothetical benefits of BSP governance.

E. Risks to Companies and the Economy

But there are other, pragmatic and market concerns presented by the potential for BSP governance. The barriers to entry for BSPs are high, and therefore, a danger that there might be only a few BSPs serving many public companies. In this event, there might be an overall reduction in the competition for director services, and suboptimal governance results. Currently, other than law professors, there are no actors clamoring for this change. Would BSPs form and then pursue

20. Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971) (finding that partially owned subsidiary's opportunity to expand was sacrificed in favor of another partially owned company's expansion, which required justification based on intrinsic fairness standard).

legal reform, or would entrepreneurs seek to change state corporate laws first? Although Bainbridge and Henderson imagine efficiency gains from the adoption of the BSP model, there is no empirical evidence to present to the entrepreneurs to persuade them that the gains outweigh the costs.

There are other market reasons to be skeptical of BSPs' success. To flourish, and to attract sufficient talent, BSPs would have to bring in significant revenue. As stand-alone firms, BSPs would have costs that conventional boards do not, including their own overhead and administrative expense, marketing and funding costs. Yet the annual cost to a corporation for a BSP board—the authors say they "expect that the BSP would bill client corporations a basic annual fee for services"[21]—could not reasonably exceed the annual cost of a conventional board. The Disney board, discussed throughout the book, received total combined compensation of about $3.5 million for fiscal year 2017.[22] Assuming that a BSP could charge a company such as Disney a service fee of comparable amount, each BSP would need many clients the size of Disney to operate like a mid-size law firm or a modest investment bank, which, we are told, will allow them to achieve meaningful gains in expertise and efficiency. For the sake of comparison, consultancies like Bain & Co. routinely bring in annual revenues that exceed a billion dollars.[23] The same is true of major law firms.[24]

The authors of *Outsourcing the Board* are not recommending a thought experiment, and thus there will be real costs to individual firms and the economy. The legal reforms they recommend will impose genuine transaction costs. The organization and financing of BSPs will involve real-world investment and debt, set-up costs and legal fees. Corporations will incur costs to change their governance so they can hire BSPs. If these costs are borne without a commensurate benefit, then the BSP becomes a drag on the economy. As a real-world experiment and not a thought experiment, the risk of loss is not benign.

F. Social Harms and Hyper-Concentration

For the past few decades, the law of antitrust has scrutinized only whether corporate consolidation threatens worse prices for consumers; other social issues have been irrelevant. At present, however, there is strong pressure to return to an earlier strand of antitrust law that took seriously what Louis Brandeis referred to as "the curse of bigness." This broader antitrust law emerged in the progressive era after the deleterious social effects of the big business trusts had become obvious. In a similar vein, commentators are currently observing hyper-concentration present

21. OTB, *supra* note 1, at 100.

22. *See* Walt Disney Co., Notice of 2018 Annual Meeting and Proxy Statement 16 (Jan. 12, 2018), https://www.thewaltdisneycompany.com/wp-content/uploads/2018-Proxy-Statement.pdf (total combined compensation was $3,520,341).

23. *See, e.g.*, *To the Brainy, the Spoils*, Economist, May 11, 2013, at 65 (Bain & Co. revenue for 2011 was $2.1 billion).

24. *See, e.g.*, Gina Passarella Cipriani, *The 2018 Am Law 100 Ranked by Gross Revenue*, Am. Law. (Apr. 24, 2018), https://advance.lexis.com/api/permalink/955682cd-9df3-4f72-a599-c7f5cc23cbb2/?context=1000516 (31 of the Am Law 100 had gross revenue of more than $1 billion in 2017).

in the corporate economy and suggesting it is having negative effects on democratic process, civil liberties, fair wages and innovation.[25]

This is relevant to the BSP proposal because the question presents itself: who will be the board of the BSP? Will the BSP have another BSP as its board—and who will be the board of that BSP? The possibility of "infinite regress" was broached and acknowledged by one of *Outsourcing the Board*'s authors at a UCLA Law Conference on the BSP proposal in September 2018. We refer to the danger of this recursive corporate control structure as the "Russian nesting dolls problem."

The Russian nesting dolls problem raises concerns about opacity and a loss of accountability to shareholders and lawmakers, as described above. But a second-order problem is one of broad social harm. If the BSP proposal became successful, there would be a real risk that each BSP would play a governance role in most large companies through a network of interconnected entities, or in a single, all-powerful caste of controlling business owners. One consequence of the Russian nesting dolls problem is the concentration of managerial power across the economy into fewer and fewer hands; this is a variation on the merger-based monopoly problem, and it would likely exacerbate some of the most dangerous externalities of corporate structure. These include wealth and income inequality driven by higher executive compensation, a reduction in employees' bargaining power, hegemonic and stultifying workplace norms, a lack of accountability mechanisms for serious malfeasance, and even greater corporate influence on the political process. Given what we described above in terms of progress in corporate fiduciary law and in heightened ESG expectations—not to mention the lingering resentment and populism arising from the financial crisis—it would seem a terrible moment to adopt a more bureaucratic, faceless corporate control structure.

G. In Conclusion

Outsourcing the Board is right to encourage experimentation, to a point. And we applaud its embrace of the continued centrality of boards in corporate governance. Indeed, the authors are correct to suggest that greater professionalization of board service would go far to improve corporate governance. But we are skeptical of the BSP solution to improving boards. The scope of required legal reform is vast and its costs indefinite. The claims of superior efficiency are undocumented by any empirical evidence, either in *Outsourcing the Board* or outside it. And it has the potential to cause harm—not just by imposing significant transaction costs without corresponding benefit, but also by eviscerating fiduciary duties and rendering corporate control even more opaque and consolidated. Most fundamentally, we think that board service has never been less amenable to a transactional orientation, or one guided by superficial paradigms. As envisioned in *Outsourcing the Board*, the BSP proposal scales back directors'

25. *See, e.g.*, Lina M. Khan, *Amazon's Antitrust Paradox*, 126 Yale L.J. 710 (2017); David Leonhardt, *Corporate Giants, Hurting the Economy*, N.Y. Times (Nov. 26, 2018), https://nyti.ms/2zrgUju; Tim Wu, The Curse of Bigness: Antitrust in the New Gilded Age (2018).

corporate identity-formation function right at the moment in history when, we believe, boards should be digging in deeper.

II. Proposed Improvements to Boards

Bainbridge and Henderson are correct that trial and error, and common sense, provide the best guides to improving governance. While we oppose the BSP approach, we too believe that board governance can and must be improved. Time and information constraints, and other structural conventions, must change to meet the demands of heightened competition and stakeholders' expectations that boards will partner with CEOs in corporate identity formation.[26] Enumerated below are relatively low-cost, low-risk changes we believe would improve boards' ability to deliver on the promise of improved corporate governance.

A. Eliminating the Unitary CEO/Chairman of the Board

Public companies should eschew a unitary CEO/Chairman of the board. The notion that in a mature firm, CEOs should exercise power over running a firm's financial and business affairs, while also appropriately *presiding* over the body that has authority over evaluating his or her leadership, tenure, compensation and scope of authority—as well as responsibility for the integrity of the governance structure generally—strains credulity.[27] Giving the CEO power over board leadership, agenda setting, and control over the flow of discussion sends the wrong mes-

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26. Michael E. Murphy, *The Nominating Process for Corporate Boards of Directors: A Decision-Making Analysis*, 5 Berkeley Bus. L.J. 131, 148 (2008) ("The contemporary influence of the CEO in the nominating process is difficult to assess in the absence of studies comparable to those conducted in the late 1980s, but it is clear that CEOs may have the dominant voice in the nominating process even if not included in the membership of a nominating committee composed of independent directors."). John C. Bogle, the founder of Vanguard mutual funds, has validated the concept that CEOs retain substantial control over the selection of director candidates. *See generally* John C. Bogle, *Democracy in Corporate America*, Daedalus, Summer 2007, at 24. The post-financial-crisis era is witnessing a flourishing of new governance ideas. *See, e.g.*, Kelli A. Alces, *The Equity Trustee*, 42 Ariz. St. L.J. 717 (2010); Kristin N. Johnson, *Addressing Gaps in the Dodd-Frank Act: Directors' Risk Management Oversight Obligations*, 45 U. Mich. J.L. Reform 55 (2011) (proposing institutional reforms to effect improved risk management functions in financial firms); Nicola Faith Sharpe, *Informational Autonomy in the Boardroom*, 2013 U. Ill. L. Rev. 1089 (proposing new boardroom processes to increase the unbiased information made available to directors).

27. *See* Luis L. Goldberg & Justine Lee, *Board Leadership Structure*, Conf. Board (Aug. 2010), https://www.conference-board.org/retrievefile.cfm?filename=DN-011-10.pdf&type=subsite [https://perma.cc/6WK7-KHJ3] ("The chairman would have such responsibilities as: presiding at board meetings; having ultimate approval over board agendas, length of discussion time for agenda items, and information flow to the board; and working with the corporate governance committee to coordinate CEO and board assessments."); *Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance: Hearing Before the Subcomm. on Sec., Ins. & Inv. of the S. Comm. on Banking, Hous. & Urban Affairs*, 111th Cong. 47, 55 (2009) (statement of Ann Yerger, Executive Director, Council of Institutional Investors) ("The chair of the board is responsible for, among other things, presiding over and setting agendas for board meetings. The most significant concern over combining the roles is that strong CEOs could exert a dominant influence on the board and the board's agenda and thus weaken the board's oversight of management.").

sage to the CEO/Chair and the other directors.[28] Corporate statutory law in the United States reflects this genuine distinction in the offices of directors and officers. The statutes provide that the board's authority is original and preeminent, and that the board selects and can dismiss the CEO at will. The CEO's authority, beyond conducting ordinary business affairs, must be documented through resolutions of the board adopted by a majority of the directors, as would be reflected in board minutes. By statute, the board is not an advisory cabinet serving at will to the CEO; rather, the CEO is the agent of the board-as-principal. The clear demarcation in roles, with the board's role being plenary and preeminent, and the CEO's authority being delegated and delineated by the board, would seem to mandate a separation between the CEO and leadership of the board.[29] Because the unification of CEO and Chair has also undermined the force of the monitoring function, the trend is strongly against unifying the positions.

A non-CEO Chair is less likely to take umbrage to directors' comments suggesting areas for improvement. A non-CEO chairman of the board can triangulate and diffuse ego-based tensions which might arise and, otherwise, unproductively detract from genuine engagement with the issues. In recognition of this dynamic, in many countries, including the United Kingdom, allowing the same person to serve as CEO and chairman of the board is legally prohibited or strongly discouraged.[30] And while such a mandatory, legal rule has been opposed in the United States on the rationale that "one size does not fit all,"[31] there is a practical and legal trend in this direction,[32] as well as sound logic in its favor.[33] The governance

28. For an empirical analysis of the trend against a unified CEO/Chair, see, for example, Charles P. Cullinan, Pamela Barton Roush & Xiaochuan Zheng, *CEO/Chair Duality in the Sarbanes-Oxley Era: Board Independence Versus Unity of Command*, 16 Res. on Prof. Resp. & Ethics Acct. 167 (2012) (empirical analysis of CEO-Chair unity post Sarbanes-Oxley finding decrease in practice of unity, likely attributable to higher expectations of governance). *But see* Steven Davidoff Solomon, *A Lack of Consensus on Corporate Governance*, N.Y. Times (Sept. 29, 2015), https://nyti.ms/1M0eAwr.

29. Joann S. Lublin, *Drive to Split CEO, Chairman Roles Gains Steam*, Wall St. J. (Jan. 17, 2012), https://www.wsj.com/articles/SB10001424052970203735304577165041967514410 ("About 19% of concerns in the Standard & Poor's 500-stock index now have independent chairmen, up from about 11% in 2007, according to GMI, a governance-research firm.").

30. *OECD Corporate Governance Factbook 2017*, Org. Econ. Co-operation Dev. 97 (2017), http://www.oecd.org/daf/ca/Corporate-Governance-Factbook.pdf ("Nearly two thirds of the jurisdictions with a one-tier board system require or encourage the separation of the board chair and the CEO.").

31. For the position that a hard rule would be unproductive, see, for example, Stephen Bainbridge, *Should the CEO Also Be the Chairman of the Board?*, ProfessorBainbridge.com (Aug. 4, 2009), https://www.professorbainbridge.com/professorbainbridgecom/2009/08/should-the-ceo-also-be-the-chairman-of-the-board.html.

32. Section 972 of the Dodd-Frank Act increased disclosure requirements for companies that maintain unitary a CEO/Chairperson, making the issue more visible to shareholders. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 972, 124 Stat. 1376, 1915 (2010).

33. In 2014, 47 percent of S&P 500 boards had separate CEO and chair roles, up from 23 percent in 2000, and 28 percent of chairs were independent, versus just 9 percent. *See* Spencer Stuart Board Index 2014, at 8 (2014), https://www.spencerstuart.com/~/media/pdf%20files/research%20and%20insight%20pdfs/ssbi2014web14nov2014.pdf.

reforms enacted after the financial crisis reflect the persistence of CEO hubris and board blind spots.[34]

B. Transparency About CEO Involvement in the Director Search Process

There is still reason for concern that CEOs exert influence on the director selection process, notwithstanding the existence of nominating committees of non-management directors.[35] The NYSE and NASD listing standards mandate that only independent directors serve on nominating committees.[36] Hence, open, formal CEO involvement in the selection of candidates is not the primary issue at present. The problem is that the existence of such committees has too often wrongly been presumed to end the matter of CEO influence over the selection of board candidates (and hence CEOs' influence over board processes generally).[37] This area is understudied, due to continued opacity on the issue of indirect CEO influence. Furthermore, members of nominating committees or search firms are not likely to volunteer that they liaison with the CEO in making their choices, because this is incompatible with the perception of professionalism associated with their office. Nevertheless, there is soft widespread acknowledgment that CEOs are invited to vet the committees' or search firms' choices, or have veto power over them—even when the CEOs are not formally part of the nomination process.[38] Nominating committee charters too often fail to be defin-

34. For a comprehensive treatment of duality, concluding that the practice is generally detrimental to firms, see Thuy-Nga T. Vo, *To Be or Not to Be Both CEO and Board Chair*, 76 Brook. L. Rev. 65, 67 (2010) (concluding that "theoretical arguments and empirical evidence, as reflected in financial and nonfinancial metrics, strongly suggest that a corporate governance structure with a nonexecutive Chair, instead of a dual CEO-Chair, is better suited to the fulfillment of the directors' fundamental responsibilities to oversee business operations and monitor management for the purpose of enhancing shareholder value.").

35. *See, e.g.*, Aure'lien Eminet & Zied Guedri, *The Role of Nominating Committees and Director Reputation in Shaping the Labor Market for Directors: An Empirical Assessment*, 18 Corp. Governance: Int'l Rev. 557 (2010) (documenting, in French public companies, that directors with a reputation for active participation are sought after where the CEO's influence in the nomination process is marginalized).

36. *See* N.Y. Stock Exch., Listed Company Manual §§ 303A.01, 303A.02 (2019), http://wallstreet.cch.com/LCM/; NASDAQ, Inc., Stock Market Rule § 5605(e)(1).

37. There are interesting new research initiatives. *See, e.g.*, David H. Zhu & Guoli Chen, *Narcissism, Director Selection, and Risk-Taking Spending*, 36 Strategic Mgmt. J. 2075 (2015) (using theories on personalities in governance research on director selection and CEO-board relations and finding that CEO narcissism effectuates a contagion that can derail board oversight over excess CEO risk taking).

38. Continued CEO informal influence was supported by commentary among Conference Board members at the UCLA law conference on *Outsourcing the Board*, but there is clearly inadequate data on the issue. For further validation of continued CEO influence over director candidate nominations, see J. Robert Brown, Jr., *The DeMythification of the Board of Directors*, 52 Am. Bus. L.J. 131 (2015) (arguing that notwithstanding the professionalization of the nominating process, directors are chosen for their compatibility with the CEO's views, rather than for their qualifications); Charles M. Elson, *The Duty of Care, Compensation, and Stock Ownership*, 63 U. Cin. L. Rev. 649, 656 (1995) (noting in pre-Sarbanes-Oxley commentary that "the board of directors, theoretically composed of representatives of various shareholding groups, is instead peopled by individuals selected by management"); Michael K. Molitor, *The Crucial Role of the Nominating Committee: Re-Inventing Nominating Committees in the Aftermath of Shareholder Access to the Proxy*, 11 U.C. Davis Bus. L.J. 97, 104–05 (2010) ("Traditionally, the

itive about the CEO's role in vetting and/or approving new director nominations.[39] Clearly, independent nominating committees are largely meaningless if CEOs circumvent the selection process *ex ante* or *ex post*.

CEO influence in nominations is an area where genuinely full disclosure with private ordering could go far to resolving the problem. Nominating committee charters should expressly indicate whether the CEO is allowed any input in the selection process, in what measure, and at what point. Where charters affirmatively state no input is permitted, it would give nominating committees cover for firm resistance. At stake is whether the nominating committee operates, in essence, as a surrogate for or partner to the CEO-as-chooser. If members of the nominating committee were required to certify that their determinations were made without any input from the CEO, or at least to declare the precise nature of CEO influence, this might bond their good-faith independence in the nomination process and enable further research.

C. Promoting Better Boards Through Greater Diversity

Board gender and demographic diversity is another area where private ordering can go further to advance progress. The SEC is under pressure to raise the bar for disclosure (at minimum) of board demographic diversity and efforts to promote it.[40] With global regulatory efforts in the background,[41] nominating committee charters should be out in front on these proposals. They should routinely, and in detail, describe the company's commitment to board demographic diversity, the steps the committee has undertaken to that end, and the progress achieved toward these goals. As many non-U.S. (and now California[42]) legal regimes have moved toward regulation and quotas, companies will need to renew their commitments to nominating committee effort and detailed disclosure if they wish to fend off state intervention.

There are numerous studies which indicate that diverse boards avoid pitfalls common to homogeneous ones and that board diversity positively impacts finan-

board itself (or perhaps a nominating committee) nominates candidates, often at the suggestion of the corporation's chief executive officer."); Michael E. Murphy, *The Nominating Process for Corporate Boards of Directors: A Decision-Making Analysis*, 5 Berkeley Bus. L.J. 131, 132 (2008) ("[M]anagement effectively controls the corporate ballot.").

39. Ali C. Akyol & Lauren Cohen, *Who Chooses Board Members?*, 16 Advances Fin. Econ. 43, 51 (2013) (finding grounds for skepticism about recruitment of independent-thinking director nominees and observing that "[t]here is limited evidence in the literature on how directors are nominated" partly due to "the unavailability of data").

40. *See, e.g.*, Ning Chiu, *Congressional Lawmakers Push SEC Chairman to Focus on Board Diversity Disclosure*, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (July 6, 2017), https://corpgov.law.harvard.edu/2017/07/06/congressional-lawmakers-push-sec-chairman-to-focus-on-board-diversity-disclosure/.

41. For a survey of the international context, see, for example, Deloitte, Women in the Boardroom: A Global Perspective (4th ed. 2015), https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Risk/gx-ccg-women-in-the-boardroom-a-global-perspective4.pdf.

42. Cal. Corp. Code § 301.3 (2018).

cial performance.[43] There is widespread popular support for initiatives which would expand the demographic diversity of corporate boards.[44] Demographic diversity is intended to bring greater viewpoint diversity to corporate governance, potentially better decision-making, and even heightened profitability.[45] Board diversity also validates valuable commitments to procedural justice in firms[46] and is itself a matter of social justice—especially because board diversity commonly positively impacts diversity throughout layers of management and the workforce. Diversity is, hence, both a matter of commercial/financial and ESG commitments.[47]

The initiative to expand board demographic diversity began decades ago, with Campaign GM.[48] As the growing roster of regulatory interventions indicates, the absence of greater demographic diversity in corporate leadership ranks can no longer be written off as a "pipeline" problem that competition for talent or patience will cure. Again, there is an increasingly thick set of laws and regulations mandating greater diversity on boards.[49] While quotas are disfavored in the United States, it is clear that there are in-group biases, social network effects,

43. For a comprehensive statistical treatment of the superior financial performance of firms with higher levels of gender, racial, and ethnic diversity in corporate leadership in the United Kingdom, Canada, Latin America, and the United States, see Vivian Hunt, Dennis Layton & Sara Prince, *Diversity Matters*, McKinsey & Co. (Feb. 2, 2015), https://www.mckinsey.com/~/media/mckinsey/business%20functions/organization/our%20insights/why%20diversity%20matters/diversity%20matters.ashx.

44. *Focus on Board Composition*, KPMG 1 (2017), https://boardleadership.kpmg.us/content/dam/boardleadership/en/pdf/2017/focus-on-board-composition.pdf ("As we look ahead to 2018, we expect board composition and the related issues of director diversity, tenure, and qualifications to remain high priorities for companies, boards, investors, and other stakeholders.").

45. Amy J. Hillman, Christine Shropshire & Albert A. Cannella, Jr., *Organizational Predictors of Women on Corporate Boards*, 50 Acad. Mgmt. J. 941, 943 (2007) (discussing some of the specific benefits to having a diverse board, such as: "improved brainstorming, creativity, consideration of diverse perspectives, and questioning of the status quo"). For a more skeptical examination of the business rationales for diversity, in comparison with moral and social rationales, see Lisa Fairfax, *The Bottom Line on Board Diversity: A Cost-Benefit Analysis of the Business Rationales for Diversity on Corporate Boards*, 2005 Wis. L. Rev. 795.

46. For a path-breaking analysis of the relevance of the procedural justice literature to promoting employees' contribution to corporate governance, see Marleen A. O'Connor, *A Socio-Economic Approach to the Japanese Corporate Governance Structure,* 50 Wash. & Lee L. Rev. 1529 (1993).

47. For an overview of the contemporary literature and debates on the impact of greater diversity in corporate leadership, see Lawrence J. Trautman, *Corporate Boardroom Diversity: Why Are We Still Talking About This?*, 17 Scholar 219 (2015).

48. *See* Donald E. Schwartz, *Proxy Power and Social Goals—How Campaign GM Succeeded*, 45 St. John's L. Rev. 764 (1971) (describing the history of the Campaign GM movement and its informal success).

49. On September 30, 2018, California Governor Jerry Brown signed into law Senate Bill 826, which requires publicly traded companies that were incorporated in California or have principal executive offices located in California to include females on their boards of directors. The legal durability of the law is in question, however. For analysis and commentary on the various legal and regulatory requirements relating to gender diversity on boards outside of the United States, see, for example, Catherine M. A. McCauliff & Catherine A. Savio, *Gender Considerations on the Boards of European Union Companies: Lesson for US Corporations or Cautionary Tale*, 16 Geo. J. Gender & L. 505 (2015). For further discussion of the importance of greater demographic diversity, see Aaron A. Dhir, Challenging Boardroom Homogeneity: Corporate Law, Governance, and Diversity (2015); Darren Rosenblum & Daria Roithmayr, *More Than a Woman: Insights into Corporate Governance After the French Sex Quota*, 48 Ind. L. Rev. 889, 890 (2015).

and structural norms (like the absence of term limits) which are impeding nominating committees' achievement of demographic diversity, and hence are limiting achieving both optimal demographic and viewpoint diversity on boards.

After the financial crisis, corporate legal academics devoted further research to the deleterious impact of groupthink on corporate deliberations.[50] Once there is a critical mass of diverse directors, it has been shown, boards benefit from the airing of more diverse viewpoints in their deliberations. Boardroom deliberations benefit from shared trust among directors, which suggests caution in forcing demographic change too quickly.

D. Soft Term Limits for Directors

While we do not endorse legal term limits on board service, soft term limits would send a positive message that continued service is not a right, and that timing-out of board service is normal. This expectation would make it easier not to renominate directors who are inactive and easier to maintain the cognitive independence which is the purpose of having nonmanagement directors in the first instance.[51] Furthermore, if directors are aware that their service on a particular board is most likely limited to a term of (several) years, they are more likely to exert a positive, vigorous effort (because this positive record and reputation would help them gain a new position). Board term limits are becoming more prevalent in the United States.[52] Moreover, they are legally mandated in some other countries. (Term limits could apply to the BSP or the natural persons on an internal board.) Relatedly, the positive impact of having a fresh perspective in evaluating corporate performance is reflected in the legally mandated practice of having audit partner rotation every five years.[53]

Certainly, there might be situations where an exigent circumstance—a hostile tender offer, for example, or a board member's exceptional service—would warrant deviation from enforcement of a term limit. Nevertheless, given the operation of status quo bias and over-confidence bias (which likely colors directors' sense of their persistence and value on the board), the absence of even informal term limits likely fosters inertia and undermines optimal deliberative rigor and creativity on boards. Boards could include soft term limit "targets" in their nom-

50. For an exploration of the concept of groupthink and analysis of its impact on Enron and other contemporary firms' governance debacles, see Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. Cin. L. Rev. 1233 (2003).

51. For a comprehensive treatment of the tenure/term limits issue, using an empirical data set that finds elongated director terms in the past decade, see Yaron Nili, *The "New Insiders": Rethinking Independent Directors' Tenure*, 68 Hastings L.J. 97 (2016).

52. Although Institutional Shareholder Services does not affirmatively recommend the adoption of director term limits, its general policy is to "scrutinize boards where the average tenure of all directors exceeds fifteen years for independence from management and for sufficient turnover to ensure that new perspectives are being added to the board." RiskMetrics Grp., 2010 U.S. Proxy Voting Guidelines Summary 18, 22 (2010), http://www.issgovernance.com/files/RMG_2010_US_Summary Guidelines20100225.pdf.

53. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 203, 116 Stat. 745, 776 (codified as amended at 15 U.S.C. § 78j-1 (2018)).

inating committee charters, company bylaws, or corporate reports. The greater turnover that soft term limits would occasion could help refute the colloquialism that public company boards are still too often "pale, male and stale."

E. Board Professionalism

We believe that it is past time to acknowledge that being a director of a public company is a profession—a service profession—and one that requires significant education, experience, and adherence to professional values.[54] These values include loyalty to the client, diligence, good faith, and confidentiality. While there is some contention around the discussion of director "professionalism," or "professionalization," we believe that the controversy is mostly semantic.[55] That is, we do not recommend formal educational credentialing, as in law or medicine. (This is the basis for claims that professionalization means elitism and cartelization.) Nevertheless, it is apparent that substantial education, expertise, and professional experience (all broadly defined) are requisite to successful service as a director. Corporate proxy statements must disclose these professional attributes of board nominees, for shareholder consideration.[56] Like Bainbridge and Henderson, we deplore the practice of putting celebrities on boards just for show. And we believe that within the board of directors there must be teams of expertise relevant to the management of the business.

Should there be standards of professional conduct for directors, the way there are for lawyers and doctors? We believe that the extensive body of fiduciary duty jurisprudence, and the growing body of federal standards for director conduct, are indeed analogous professional standards of conduct. These legal, professional standards may become the basis of liability in extreme cases, as is true with doctors and attorneys, for example. But they persist as professional standards of conduct (especially true in regard to fiduciary care, as discussed above) even where monetary liability is not a concern.[57]

Professionalism is associated with life-long learning, too. Should there be continuing education requirements for directors? In essence, the fiduciary jurisprudence enacts those as well. As part of the standard of conduct for fiduciary care and the duty of oversight (monitoring), directors are expected to know the relevant standards in their industry and other applicable best practices standards.[58]

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54. Ira M. Millstein, *The Professional Board*, 50 Bus. Law. 1427 (1995) (examining the content of "professionalism," while rejecting the idea that being a director of a public company should be a full-time, specialized vocation).

55. For discussion of what is at stake, for better and worse, in the conversation about lawyers' "professionalization," see Dana Remus, *Reconstructing Professionalism*, 51 Ga. L. Rev. 807 (2017); Rebecca Roiphe, *The Decline of Professionalism*, 29 Geo. J. Legal Ethics 649 (2016).

56. 17 C.F.R. § 229.401(e)(1) (2019).

57. For an astute examination of "acoustic separation" in corporate law, see Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 Fordham L. Rev. 437 (1993).

58. *See* Donald C. Langevoort, *Commentary,* Caremark *and Compliance: A Twenty Year Lookback*, 90 Temp. L. Rev. 727 (2018) (assessing potential areas for greater director oversight in light of the current compliance environment).

Is being a director of a public company less of a professional service because it is not full time? Many lawyers and directors practice less than full time, and this does not influence the applicable standard of professionalism. A more widespread acknowledgment, including an acknowledgment by the companies where they serve, that being a public company director is a profession might help support a sense of shared mission in the board and high professional standards.

F. Board Self-Evaluation

Board self-evaluation is gaining recognition as an important feature of encouraging optimal board service.[59] Consulting firms and governance rating agencies are increasingly focusing on whether boards practice a regular self-assessment process, and what self-assessment practices yield superior data and performance.[60] Mandatory disclosure currently demands reporting of certain objective features of board conduct, including attendance at board and committee meetings, but self-assessment can yield far more finely tuned data about board performance quality. As the burgeoning literature on board self-assessment reveals, the outlines of what would be illuminating internal metrics of board conduct are becoming apparent.[61]

In a situation where the board chair is separate from the CEO, the chair is in a position to evaluate the responses to confidential internal board surveys, and to make constructive changes to the board. Especially because shareholder derivative lawsuits for lack of director diligence have virtually been eliminated by charter exculpation clauses, board chairs should endeavor to gather and synthesize data about what their directors do know and think about the company's best interests. This internal information would also operate as an important reference point in the selection of new director candidates by the company's nominating committee.

G. Creating a Corporate Informational Infrastructure that Supports Enabled Boards

When activists press for swift cash payouts or other fundamental changes, they customarily come armed with impressive-looking, sophisticated studies

59. *See, e.g.*, Report of the NACD Blue Ribbon Commission on Board Evaluation (2010).

60. *See, e.g.*, Ernst & Young, Accelerating Board Performance: The Importance of Assessments (2015), https://www.ey.com/Publication/vwLUAssets/ey-accelerating-board-performance-through-assessments/$File/ey-accelerating-board-performance-through-assessments.pdf; Holly J. Gregory, *Rethinking Board Evaluation*, Prac. L. (Mar. 2015), https://www.sidley.com/-/media/publications/march15_thegovernancecounselor.pdf (scrutinizing the contours of genuinely useful board self-assessment and the growing focus thereon, including in the NYSE listing requirements).

61. For example, a substantial proportion of directors report that they would like to spend more time on discussion of corporate strategy than they do at present. NACD Public Company Governance Survey, Executive Summary 2017–2018, at 4 (2018) ("Directors themselves admit that they need to do a better job in contributing to strategy. Seventy-one percent of directors indicate that their boards must better understand the risks and opportunities that affect performance and drive strategic choices over the next 12 months. Sixty-seven percent of them report that their boards must improve their contribution to the development of the strategy, while the same number of respondents feel that it is important for their boards to strengthen the monitoring of strategy execution.").

and reports. In this situation, the incumbent directors are likely to feel defensive, to be at an informational disadvantage, albeit hopefully a temporary one. This state of affairs reflects the fact that although boards have a legal obligation to stay abreast of corporate affairs, they do not have financial, legal, accounting, engineering, or other industry experts readily at hand to support them in synthesizing corporate information. To be clear, boards do have *authority* to hire experts as needed (as reflected in the corporate statutes which provide them safe harbor for reliance on experts in good faith).[62] And the benefits of directors resorting to counsel from investment bankers and attorneys is well illustrated in the M&A jurisprudence. But the problem of insufficient support in obtaining expert counsel and unbiased information goes deeper.

Leaving aside high-profile transactions, including the intervention of activist hedge funds and commentators, Bainbridge and Henderson agree there is a basic informational problem facing boards: i.e., CEOs controlling the company-specific information that directors require to do their jobs—controlling the content, the timing, and the tenor of that information, and potentially to the CEOs' benefit. Kobi Kastiel and Yaron Nili describe this problem as "board informational capture."[63] What can be done to overcome CEO informational bottlenecks?

This is another area where better private ordering can ameliorate the problem. Kastiel and Nili argue for the creation of a dedicated office within the corporation—in their terminology, a "board suite"—charged with supporting directors' needs for timely, concise, unbiased information, potentially from many different areas of the firm. Years ago, Melvin Eisenberg had recognized the board's role in establishing multiple, independent, backstopping channels of information reporting immediately to board directors rather than the C-suite.[64]

In the age of extraordinarily adept information technology, this cannot be an insurmountable or even particularly costly problem to surmount. The office of the corporate secretary could be expanded to accommodate this liaison function. Or a new office could be recognized, albeit under the authority of the board and not the CEO. More adventurous, ambitious firms could embrace an information-savvy culture where they steward their data into a kind of "corporate coursera" for the board's and senior managers' use. Most of the corporate information the directors would seek would exist already within the firm or could be synthesized from existing data with relative ease. Given the strategic and risk management upside of superior information stewardship, the incentives would seem compatible. While costly outside bankers, lawyers, or consultants might sometimes be beneficial, the persistent internal office charged principally with information

62. *See, e.g.*, Del. Code Ann. tit. 8, § 141(e) (Supp. 2018).

63. Kobi Kastiel & Yaron Nili, *"Captured Boards": The Rise of "Super Directors" and the Case for a Board Suite*, 2017 Wis. L. Rev. 19, 25.

64. *See* Melvin A. Eisenberg, *Corporate Governance: The Board of Directors and Internal Controls*, 19 Cardozo L. Rev. 237 (1997) (revisiting the concept of the monitoring board and the auditing literature on internal controls, including the Treadway Report, and finding that directors must increasingly attend to the establishment of multiple robust systems of internal reporting and data gathering, consistent with their fiduciary responsibilities and securities law mandates).

management would not need to be staffed by costly experts. Encouraging directors to speak freely with managers throughout the enterprise would impose little or no cost, and might inspire efficiency benefits connected to superior morale and perceived accountability. The barriers to effectuating such informational practices and resources are not meaningfully technical or financial. Once there is trust in the boardroom, and a CEO who looks favorably to vigorous board engagement, the path to effectuating an informationally thick leadership culture would mostly be straightforward.

H. The Duty of Candor: CEOs to Directors, and Among Directors

Much more can be done to ensure that CEOs are candid with the board, and directors are fully candid with one another. The principal levers will be compensation clawbacks or the denial of severance packages, as evidenced recently in the CBS Les Moonves case.[65]

The law is not the most reliable guarantor of candor in this sphere. Stating the issue formally, if a director (including but not limited to a CEO serving on the board) is in possession of information he or she prefers not to reveal, but which would arguably be relevant to the board, can that information lawfully be withheld from the board? This question has been presented in high-profile news headlines recently, in relation to controversial actions at Facebook,[66] in relation to Fiat Chrysler Automobile CEO's failure to inform the board for a year about his serious illness (which thwarted succession planning),[67] and in relation to a CBS director's awareness of the CEO's improper sexual activity.[68] Of course, these are only a few high-profile examples from only this past year; so there is reason to believe achieving optimal candor among directors and between the board and the CEO is a significant problem.

The answer to this question, arguably, is not governed by the fiduciary duty of candor, which has been circumscribed, in Delaware, to situations where boards communicate with shareholders.[69] (Where a director or CEO withholds infor-

65. *See* Edmund Lee & Rachel Abrams, *CBS Says Les Moonves Will Not Receive $120 Million Severance*, N.Y. Times (Dec. 17, 2018), https://www.nytimes.com/2018/12/17/business/media/les-moonves-cbs-severance.html.

66. *See, e.g.*, Sheera Frenkel, Nicholas Confessore, Cecilia Kang, Matthew Rosenberg & Jack Nicas, *Delay, Deny and Deflect: How Facebook's Leaders Fought Through Crisis*, N.Y. Times (Nov. 14, 2018), https://www.nytimes.com/2018/11/14/technology/facebook-data-russia-election-racism.html.

67. *See, e.g.*, Deborah Ball & Eric Sylvers, *Fiat Says It Didn't Know CEO Was Ill*, Wall St. J. (July 27, 2018), https://www.wsj.com/articles/fiat-chryslers-sergio-marchionne-was-seriously-ill-for-a-year-before-dying-1532620292.

68. *See, e.g.*, James B. Stewart, *"Disaster for CBS Shareholders": Damning Report on Moonves Reveals Total Failure at Top*, N.Y. Times (Dec. 4, 2018), https://www.nytimes.com/2018/12/04/business/leslie-moonves-cbs-board.html ("As a draft report prepared by CBS's outside lawyers now makes clear, many of the company's employees, including high-ranking executives and even members of its board, were aware of the former chief executive Leslie Moonves's alleged sexual misconduct and subsequent efforts to conceal it.").

69. *See, e.g.*, Malone v. Brincat, 722 A.2d 5 (Del. 1998) (finding that the duty of care and the duty of loyalty are relevant at all times to directors' truth-telling, but confining the duty of candor,

mation from the remainder of the board about self-dealing transactions, the duty of loyalty applies—but this is a distinct matter.[70]) Most likely, a CEO or director withholding relevant material information from the other board members presents a breach of the duty of good faith.[71] Fiduciary good-faith doctrine bars officers and directors from favoring their private interests over their firm's best interests, and such breaches cannot be exculpated in charter exculpatory clauses.[72] Fortunately, the "what information" problem can be resolved, in most instances, by recourse to the securities law standard of "materiality."[73]

Fortunately, the existence of this disclosure/candor duty can be resolved without recourse to jurisprudence or the courts by creating such a responsibility via the company's codes of ethics. Because almost all public companies have codes of conduct that govern their executives,[74] such codes would appear to be an ideal place for a company to specify a duty of candor among board members, in relation to material information relevant to the company's best interests and directors' planning and duties. Precisely where the bar was set on "material" information and timely disclosure could be left to the resolution of individual companies. The truly troubling cases where the board's essential duties are thwarted—as in Facebook, CBS, and Fiat Chrysler—are not likely to be the tough calls.

Conclusion

As we move toward "third wave" corporate governance, reformers are correct to focus on improving the effectiveness of corporate boards. Activist shareholders press for fundamental change, and boards cannot remain passive. Nor may boards take a hands-off approach to social, ethical, and environmental matters, merely complying with minimum standards in state and federal regulations.

In the best-managed firms, CEOs will partner with directors who are informed, independent thinkers capable of fulfilling their role in strategic and ESG corporate identity formation. There will be clearer expectations surrounding board time and participation, and greater institutional support to help directors obtain the information they need to make a difference. "What are the core com-

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formally, to instances in which a shareholder response is solicited by the board). For further analysis of the limits of the duty of candor, see Faith Stevelman, *Transparency and Accountability, Rethinking Corporate Fiduciary Law's Relevance to Disclosure*, 34 Ga. L. Rev. 505 (2000).

70. *See, e.g.*, Fleigler v. Lawrence, 361 A.2d 218 (Del. 1976) (holding that Mr. Maynard, the lead director at a power company he had contracted with to supply his mills with electricity, had breached his duty of loyalty to the power company where he kept silent as the other directors ratified a ruinous supply contract in his favor).

71. *See* Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. Cin. L. Rev. 1187, 1195 (2003) ("Officers who intentionally keep directors in the dark on an important matter are almost surely violating fiduciary and agency law responsibilities.").

72. *See, e.g.*, Del. Code Ann. tit. 8, § 102(b)(7) (Supp. 2018).

73. The foundational case is *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

74. Section 406 of the Sarbanes-Oxley Act of 2002 requires companies to disclose their codes of ethics (or explain why they do not have them), and then to disclose any waivers from that code granted to top corporate officers. 15 U.S.C. § 7264 (2018). However, for a persuasive critique of weakness in the ethics code disclosure/waiver regime, see Usha Rodrigues & Mike Stegemoller, *Placebo Ethics: A Study in Securities Disclosure Arbitrage*, 96 Va. L. Rev. 1 (2010).

parative advantages of this enterprise?" directors will ask during strategy formation and evaluation. "How can we raise the level of ethical and environmental stewardship here, to inspire our stakeholders?" boards should ask in concert with their CEOs. These kinds of partnerships cannot realistically be effectuated between a CEO and a BSP. Still, Bainbridge and Henderson should be applauded for authoring a serious treatment of one of corporate law's most pressing issues. Will reformers, inside their firms and beyond, commit to structural improvements that will help boards *govern*? We hope the answer is yes.