INFORMATIONAL AUTONOMY IN THE BOARDROOM

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This Article illuminates a fundamentally misunderstood mismatch between corporate theory and the actual practice of boards of directors. Increasing attention has been paid to whether one person should serve as both CEO and board chairperson and the connection this has to corporate performance. The growing significance of the debate over board leadership structure is evident in recent regulatory trends: passage of legislation like the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 focuses on increasing disclosure requirements for companies that maintain CEO/Chairperson duality. The assumption underlying the legislation is that an independent chairperson will facilitate board independence, which will in turn lead to better detection of managerial corruption or incompetence.

This Article proposes a new analytical paradigm that suggests such standard, structurally oriented approaches to board reform without an effective process are not enough to improve board governance. The available evidence shows that separating the CEO and chairperson does little to eliminate or mitigate corporate failure. Instead, this Article suggests a reorientation away from board structure toward the processes by which boards actually make decisions and oversee managers. Effective board decision making and oversight requires that board members have informational autonomy. Board members currently lack the ability to get their own information about their companies' operations, placing them at the mercy of the CEO and the management team she controls. In order to act as a consistently effective check on CEO authority, board members need access

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to information-gathering channels that are not controlled by the CEO.

The conventional approach, focused as it is on board structure, provides limited insight into the information problem. This Article attacks the problem head-on. In doing so, it departs substantially from previous regulatory approaches, and proposes several methods to help boards achieve informational autonomy through solutions drawn from the Process-Oriented Approach.

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I. INTRODUCTION

Howard Schultz, who is the current Chief Executive Officer (CEO), President, and Chairman of Starbucks took a break from being CEO when he stepped down from the position in 2000. Afterwards, he served the company as chairman of Starbucks's board of directors. While chairman, he candidly admitted that he had failed to notice the compa-

ny's "strategic missteps."[1] He lamented that "even though I wasn't the CEO, I had been around as chairman; I should have known more."[2] Schultz's experience is not unique—many board chairs do not know what they should know to do their work effectively. There is an informational deficit with which board members work when monitoring their managerial teams' decisions. These are the flaws that led to Schultz's admission that he, the founder and formerly most senior manager of Starbucks, missed a major strategic crisis when he was chairperson of the board. His experience should serve as a cautionary tale to those who study board reform: tinkering with the leadership structure of boards does not get board members the information they need to be effective monitors of corporate performance.

Without the right information at the right time, boards cannot effectively monitor managers. Despite the critical importance of the flow of information in the work of a board, information has been surprisingly underemphasized in the scholarly and policy debates on board reform. Policy makers and commentators have instead focused on structure. Those who see tinkering with structure as the key to reform rely on a simple series of assumptions: (1) nonexecutive board chairs are independent of managers, (2) a "structurally" independent board chair means that the board itself will be "substantively" independent, and (3) independence is the critical variable in avoiding the kind of corporate scandals that have made headlines in recent years.[3] Attractive though it may be in its simplicity and logic, this chain of assumptions has not proven to work in the real world.

Some argue that separating the position of CEO and board chairperson is the best means of increasing directors' substantive independence which, in turn, will make directors more effective monitors of management.[4] Stated differently, they assume that ending CEO/Chairperson duality[5] will increase boards' ability to get information about management's performance without interference from the CEO, and augment their ability to engage in consensus-based decision making. These scholars who condemn CEO/Chairperson duality also argue that the dual CEO/Chairperson suffers from inherent conflicts of interest and does little to facilitate director autonomy.[6] Other scholars reject this view and favor maintaining CEO/Chairperson duality. They argue that a single

1. Adi Ignatius, *"We Had to Own the Mistakes,"* HARV. BUS. REV., July–Aug. 2010, at 108, 109. During the last two years that Schultz served exclusively as chairman and not as company CEO, Starbucks's stock went from approximately $32 per share to $18 per share.

2. *Id*.

3. *See* discussion *infra* Part II.A.

4. *See* discussion *infra* notes 85–97.

5. Duality refers to a leadership structure where the CEO simultaneously serves as the chairperson of the board.

6. *See* Paul Coombes & Simon Chiu-Yin Wong, *Chairman and CEO—One Job or Two?*, MCKINSEY Q., Q2 2004, at 42, 43; Paula L. Rechner & Dan R. Dalton, *CEO Duality and Organizational Performance: A Longitudinal Analysis*, 12 STRATEGIC MGMT. J. 155, 155 (1991).

leader provides a unified corporate voice and facilitates better internal communications.[7] Like those who seek to separate the positions, duality advocates seek to improve the quality of board decision making through increasing the independent information flow to boards and facilitating an environment better suited to consensus-based decision making.

The available evidence has shown that this approach simply does not have the intended effect. Multiple empirical studies have found that there is little to no connection between a separate and independent chairperson and firm performance.[8] In fact, non-CEO chairs are no more effective than a chairperson who is also CEO.[9]

Regardless of whether they advocate for or against CEO/Chairperson duality, commentators and regulators share the flawed assumption that structurally-oriented board reforms make directors better monitors and reduce corporate failure.[10] Reforms based on this assumption have proven ineffective, sometimes even having the opposite of their intended effect. Not only do these reforms fail to accomplish their stated goals of increasing director independence, they actually increase boards' dependence on their CEOs. This is in part because independent directors have less knowledge and information about the corporation than their inside director counterparts.[11] As a result, outside directors rely almost exclusively on the CEO for information about the company.[12] This information inevitably reflects the CEO's shortcomings and biases. Furthermore, directors often accept the CEO's interpretations of that information because they do not have the time or knowledge necessary to understand and digest it themselves.[13]

This Article shows that the *processes* boards use to acquire and assimilate information must now be the focus of reform. In contrast to regulations that increase cosmetic director independence while leaving

7. *See* discussion *infra* Part II.C.2.

8. *See* discussion *infra* Part II.B.

9. *See* discussion *infra* note 79.

10. *See*, *e.g.*, Nicola Faith Sharpe, *Process Over Structure: An Organizational Behavior Approach to Improving Corporate Boards*, 85 S. CAL. L. REV. 261 (2012) (arguing that process is more important than structure for board success); *see also* NASDAQ LISTING RULES § 5605 (2009); NYSE LISTED CO. MANUAL §§ 303A.01–.02 (2009), *available at* http://nysemanual.nyse.com/lcm/. *See generally* Sarbanes-Oxley Act of 2002 § 404, 15 U.S.C. § 7262 (2006); Dodd-Frank Wall Street Reform and Consumer Protection Act § 111, Pub. L. No. 111-203, 124 Stat. 1376, 1392–94 (2010) (to be codified at 12 U.S.C. § 5321). For instance, the New York Stock Exchange and NASDAQ require that listed companies staff independent nominating, compensation, and audit committees. NASDAQ LISTING RULES, *supra*; NYSE LISTED CO. MANUAL, *supra*.

11. *See* Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 161–67 (2010) (describing directors' information and knowledge limitations); *see generally* Nicola Faith Sharpe, *The Cosmetic Independence of Corporate Boards*, 34 SEATTLE U. L. REV. 1435 (2011).

12. Gatekeepers do provide an important source of third-party information, but many gatekeepers are still screened and selected by the CEO or are heavily influenced by management's views. *See* Lisa M. Fairfax, *Government Governance and the Need to Reconcile Government Regulation with Board Fiduciary Duties*, 95 MINN. L. REV. 1692, 1721 (2011); Fairfax, *supra* note 11, at 161–63 (discussing the limitations of third-party gatekeepers).

13. Sharpe, *supra* note 11, at 1453–56; *see also* discussion of information biases *infra* Part III.B.1.

information asymmetries unaddressed, this Article offers process-focused solutions. In prior work,[14] I have shown that board process more meaningfully impacts monitoring than board structure,[15] the essential attributes of an effective decision-making process that form the basis of the Process-Oriented Approach (POA),[16] and why managers exercise more corporate control than do boards over corporations.[17] Building on this prior work, this Article applies the POA to a current corporate governance debate that has been highlighted in recent regulatory efforts: whether the CEO and board chairperson should be the same or separate individuals.

The intuition animating the POA is that, to regulate board behavior, regulators need a descriptively accurate account of how boards operate. Directors face significant hurdles when it comes to obtaining and processing the information necessary for effective decision making. First, directors have problems with information access; the CEO is the dominant and often sole source of information.[18] Furthermore, the type of information provided offers little more than lagging indicators of corporate performance making it very difficult for outside directors to engage in meaningful managerial oversight.[19] Second, boards are burdened by problems of information accuracy. Both intentional and unintentional biases color the information boards receive.[20] Finally, time and knowledge constraints lead to problems with information assimilation.[21] Boards are small groups who engage in episodic meetings, are supplied with either too much or too little information, and are given too few opportunities for discussion or debate.[22] Infrequent meetings,[23] too few hours devoted to director duties,[24] and lack of knowledge about the industry in which the company operates mean that directors must overcome several obstacles to properly analyze the information presented to them.[25]

Placing an outside director in the position of board chairperson does not solve the informational deficiencies endemic to most boards be-

14. This Article is part of a larger project which incorporates a process-oriented approach drawn from organizational behavior theory into conventional analyses of corporate boards of directors. *See generally* Sharpe, *supra* note 10; Nicola Faith Sharpe, *Questioning Authority: The Critical Link Between Board Power and Process*, 38 J. CORP. L. 1 (2012).

15. *See generally* Sharpe, *supra* note 10.

16. *See generally* Sharpe, *supra* note 11.

17. *See generally* Sharpe, *supra* note 14.

18. Sharpe, *supra* note 11, at 1454.

19. *Id.*

20. *See* discussion *infra* Part III.B.1.

21. *See* discussion *infra* Part III.B.3.

22. *See* discussion *infra* Part II.C.2.

23. *See* THE KORN/FERRY INST., 34th ANNUAL BOARD OF DIRECTORS STUDY 10 (2007) [hereinafter KORN/FERRY].

24. The Korn/Ferry survey found that directors spent an average of sixteen hours a month on board business. *Id.* at 4–5. The sixteen hours include "the time taken reviewing and preparing, attending meetings and traveling." *Id*. at 10.

25. Fairfax, *supra* note 11, at 164–65.

cause it does not change the information flow between the CEO and her board. Thus problems involving access to information, accuracy of information, and assimilation of information remain. Reforms should accordingly focus on ameliorating each type of informational deficiency to the fullest extent possible.

This Article argues reforms seeking to improve board governance should apply the POA to reduce problems of information accuracy, access, and assimilation. It recognizes that while process and structure are not dichotomous, corporate governance should focus on process and allow it to dictate the best structure for each individual board. In contrast, for policy makers, the prevailing answer to how boards can govern effectively has been to focus on the structure and composition of boards.[26] This is most obvious in the regulatory trend toward increasing the structural or cosmetic indicia of board independence.[27] The POA stands in stark contrast to contemporary regulations. In fact, it illustrates that structure can be a negative constraint on process that may limit a board's ability to achieve true independence.[28] This Article argues that the debate over board leadership structure is an example of why process is more important than structure for boards to govern effectively. It takes my broader analysis about the significance of board process and the necessity of information access for board authority and demonstrates why both sides of this debate wrongly cling to structural mechanisms as the means to achieve greater board autonomy, when in fact better information processes are the key. It accordingly adds a unique, process-oriented voice to the growing discourse on substantive board independence and boards' informational challenges.[29] This Article contributes to the discourse on board independence by being the only Article to apply a processual analysis to the debate on board leadership structure.

The Article proceeds as follows. By way of background, Part II begins by explaining the agency-theory framework and how its adoption has led regulators and some scholars to focus on structurally-oriented re-

26. Sharpe, *supra* note 10, at 274–79; Sharpe, *supra* note 11, at 1443–47.

27. Sharpe, *supra* note 11, at 1435–36.

28. Some scholars have argued that social ties, structural bias, and director compensation all compromise an outside director's ability to be independent from the CEO's influence. Fairfax, *supra* note 11, at 145–56. This Article seeks to improve the independent decision making of the corporate board but acknowledges that there are social, financial, and psychological limitations that will continue to hamper independence. *See* Sharpe, *supra* note 10, at 286–90; Sharpe, *supra* note 11, at 1447–50.

29. For more on board independence, see Margaret M. Blair, *Reforming Corporate Governance: What History Can Teach Us*, 1 BERKELEY BUS. L.J. 1, 42–43 (2004) ("The team production approach to understanding corporate law emphasizes the role of strong independent boards of directors in maintaining the right balance among the competing claims and interests in corporations."); Fairfax, *supra* note 11, at 145–56; Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 452–58 (2008). For an article discussing informational challenges, see Geoffrey P. Miller & Gerald Rosenfeld, *Intellectual Hazard: How Conceptual Biases in Complex Organizations Contributed to the Crisis of 2008*, 33 HARV. J.L. & PUB. POL'Y 807, 810 (2010) ("The thesis of this Article is that the Crisis of 2008 was partially caused by a problem with the processing of risk-related information in complex organizations.").

forms. It provides a short overview of how agency theory emphasizes a board's responsibility to monitor management so as to reduce agency costs. It goes on to examine the most recent of regulatory efforts reflecting this focus, the provisions regarding board leadership structure in the Dodd-Frank Act as well as the scholarly debate surrounding the issue.

Policy makers and some scholars have argued that separating the position of CEO and board chairperson is an effective means of reducing agency costs because it increases board independence.[30] Part II problematizes this argument. It argues that advocates and opponents seek to improve a board's informational autonomy and ability to engage in consensus-based decision-making processes, but both ignore how boards actually function. By prioritizing structure over process, neither side of the debate manages to accomplish its goals.

Part III provides a descriptively accurate account of how boards function. Specifically, it defines consensus decision making and explores the literature suggesting that this is how boards function. It then demonstrates that due to the limitations that stem from the current structure of boards, boards are at the mercy of the CEO for the majority of their information. It offers a typology of the informational problems boards face, which include problems of accuracy, access, and assimilation. These problems inhibit effective decision-making processes and, more importantly, make consensus decision making impossible.

Part IV argues that there are processual solutions that directly address the informational problems identified in Part III, and strengthen boards' consensus decision making, increase true board independence, and improve the quality of directors' decisions. It directly applies the POA, which yields several practical suggestions for effective legal reform that regulators should adopt regardless of whether the chairperson and CEO are one in the same or not. For example, corporations can increase their board's access to internal information through utilizing information systems technology, establishing an internal information gatherer such as a corporate ombudsperson, or creating a means for enabling direct director access to the corporation's personnel. Part V considers the limitations of this approach. A brief conclusion follows.

30. *See* discussion *infra* Part II.C.1.

II. EMPHASIZING STRUCTURE AND IGNORING PROCESS

For centuries, in the wake of booms followed by busts, policy makers have quickly responded with regulation.[31] Scholars have condemned these hasty responses as "quack governance."[32] The Dodd-Frank Act is the most recent in a string of federal regulatory attempts to improve corporate governance and prevent future failures.[33] The effectiveness of such responses, particularly the empirical case for their necessity, has been the subject of significant academic criticism.[34]

This Article is not an attempt to weigh in on the wisdom of passing regulation in the wake of failure. Instead, it identifies section 972 of Dodd-Frank as a specific example of a favored regulatory method of improving corporate governance—structural changes to corporate boards of directors, like separating or combining the roles of CEO and Chairperson—and suggests that it fails to address the deeper informational problems that hinder boards' ability to effectively monitor.[35]

This Part begins by briefly examining why the structure of corporate boards of directors has been such a popular subject of policy-making initiatives and identifies the basic assumptions upon which these initiatives rest. It then goes on to explore the provision in section 972 of Dodd-Frank that requires companies to disclose and explain the structure of board leadership.[36] It shows that section 972 is becoming part of the standard domestic and international tool kit of having an independent director serve as board chairperson instead of the CEO.[37] It ends with an examination of the debate over board leadership structure and its impact on board efficacy, concluding that structure does not improve efficacy.

31. *See, e.g.*, Stephen M. Bainbridge, *Dodd-Frank*: *Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1786 (2011) (citing STUART BANNER, ANGLO-AMERICAN SECURITIES REGULATION: CULTURAL AND POLITICAL ROOTS, 1690–1860, at 257 (1998)); Larry E. Ribstein, *Bubble Laws*, 40 HOUS. L. REV. 77, 83 (2003); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523–24 (2005).

32. *See, e.g.*, Bainbridge, *supra* note 31; Romano, *supra* note 31.

33. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 972, 124 Stat. 1376, 1915 (codified at 15 U.S.C. § 78n-2) (2010); Bainbridge, *supra* note 31, at 1786 ("SOX was merely the latest iteration of this process, at least until Dodd-Frank came along."); *see, e.g.*, Charles M. Elson & Christopher J. Gyves, *The Enron Failure and Corporate Governance Reform*, 38 WAKE FOREST L. REV. 855, 855–56 (2003).

34. HENRY N. BUTLER & LARRY E. RIBSTEIN, THE SARBANES-OXLEY DEBACLE: WHAT WE'VE LEARNED; HOW TO FIX IT (2006); Bainbridge, *supra* note 31; Fairfax, *supra* note 11, at 140; Ribstein, *supra* note 31; Romano, *supra* note 31.

35. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 972.

36. *Id.*

37. *See* discussion *infra* Part II.B.

A. She Who Controls the Board, Controls the Firm

Regulators have wholeheartedly subscribed to the flawed belief[38] that structural board independence can improve firm performance and possibly help a firm avoid failure.[39] There are several assumptions that inform many federal mandates for independent directors. The overarching focus on board structure as a vehicle for corporate reform can be traced to the long-standing regulatory emphasis on agency theory.[40] Since the corporation separates ownership and control, shareholders as the principals and owners of the firm must closely monitor their agents, managers, who control the day-to-day business of the firm.[41] Boards are one means of minimizing agency costs, and their primary responsibility is monitoring managers.[42] These assumptions—that agency theory best describes the relationship among the firm's actors and that boards can minimize agency costs through monitoring—have dominated corporate gov-

38. For a discussion of the empirical evidence showing that independence does not necessarily improve firm performance, see discussion *infra* at Part II.B. and Sharpe, *supra* note 10, at 281–82.

39. Fairfax, *supra* note 11, at 140 ("Collectively, these reforms embrace the view that independent directors represent an ideal solution to the corporate-agency conundrum, helping to reduce corporate malfeasance and enhance corporate performance."); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1270 (1999) (explaining that the SEC has responded to corporate illegality in part by "promulgat[ing] regulations requiring disclosure of the committee structure and composition of boards of directors to encourage corporations to adopt 'best practices' with respect to board structure and functions").

40. *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 121 (1932); Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 21, 21–22 (Reinier R. Kraakman et al. eds., 2004) (noting that the first problem of agency is the conflict between firm owners and hired managers); Blair, *supra* note 29, at 30; Michael C. Jensen & William H. Meckling, *The Nature of Man*, J. APPLIED CORP. FIN., Summer 1994, at 4, 15–17; Lawrence E. Mitchell, *Structural Holes, CEOs, and Informational Monopolies: The Missing Link in Corporate Governance*, 70 BROOK. L. REV. 1313, 1315 (2005). *But see* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308–10 (1976); *see also* Lynn A. Stout, *On the Proper Motives of Corporate Directors (or, Why You Don't Want to Invite* Homo Economicus *to Join Your Board)*, 28 DEL. J. CORP. L. 1, 9–10 (2003).

41. Melvin A. Eisenberg, *The Conception That the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 825–26 (1999); Joan MacLeod Heminway, *Enron's Tangled Web: Complex Relationships; Unanswered Questions*, 71 U. CIN. L. REV. 1167, 1173 (2003). The debate over whether shareholder value or stakeholder value should be maximized is ongoing, with origins being credited to Adolf A. Berle and E. Merrick Dodd's debate over the issue. *See* A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1147 (1932).

42. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 549 (2003); James D. Cox, *Managing and Monitoring Conflicts of Interest: Empowering the Outside Directors with Independent Counsel*, 48 VILL. L. REV. 1077, 1082 (2003) (noting that monitoring managers is the "central task" of outside directors); Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 SAN DIEGO L. REV. 781, 782–83 (2003); Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1278 (1999); Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 797 (2001); *see also* COLIN B. CARTER & JAY W. LORSCH, BACK TO THE DRAWING BOARD: DESIGNING CORPORATE BOARDS FOR A COMPLEX WORLD 67–68 (2004); Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 11 (2002); Lynn A. Stout, *The Shareholder As Ulysses: Some Empirical Evidence on Why Investors in Public Corporations Tolerate Board Governance*, 152 U. PA. L. REV. 667, 673–77 (2003).

ernance regulation and best practices for decades.[43] Accordingly, policy makers have been quick to blame boards for failing to properly monitor CEOs and other executive managers, giving way to catastrophic firm failures.[44] This has led to a third assumption, that independent directors are best suited to fulfill boards' monitoring function and help firms maximize returns and avoid failure.[45] A fourth assumption, and the focal point of inquiry here, is that independence is best secured through structural changes to boards of directors.

As I have argued elsewhere, board reform efforts have mistakenly placed a heavy emphasis on board structure,[46] despite empirical evidence that such an emphasis is misguided.[47] In particular, reformers have pushed structural board independence almost to the exclusion of other, potentially more effective, alternatives.[48] I am not alone in offering this criticism; many of the contributors to this Symposium have similarly criticized modern policy-making initiatives for their myopic focus on independence.[49] Repeated corporate failures indicate that these criticisms are

43. Bainbridge, *supra* note 42, at 599; Dallas, *supra* note 42, at 801; Eisenberg, *supra* note 42, at 1278; Langevoort, *supra* note 42, at 802; *see also* CARTER & LORSCH, *supra* note 42, at 67–68; Ribstein, *supra* note 42, at 11; Stout, *supra* note 42, at 673–77.

44. Nicola Faith Sharpe, *Rethinking Board Function in the Wake of the 2008 Financial Crisis*, 5 J. BUS. & TECH. L. 99, 102 (2010); Lisa M. Fairfax, *Sarbanes-Oxley, Corporate Federalism, and the Declining Significance of Federal Reforms on State Director Independence Standards*, 31 OHIO N.U. L. REV. 381, 382–83 (2005).

45. For a detailed history and explanation of regulators' tendency to blame boards, and their preferred response of structural changes that increase the number of independent directors as well as stricter "standards for measuring independence," see Fairfax, *supra* note 11, at 137–40; *see also* Sharpe, *supra* note 10, at 274–75.

46. Sharpe, *supra* note 10, at 275; *see also* Barry D. Baysinger & Henry N. Butler, *Corporate Governance and the Board of Directors: Performance Effects of Changes in Board Composition*, 1 J.L. ECON. & ORG. 101, 102 (1985); Fairfax, *supra* note 11, at 135–36; Ribstein, *supra* note 42, at 11; Rodrigues, *supra* note 29, at 452 ("Corporate governance reformers generally presume (1) that outside independent boards are better than non-independent boards, and (2) that the more independent a board is, the better.").

47. Sharpe, *supra* note 10, at Part II.C (discussing the empirical research on board independence which finds that board independence is not strongly correlated to better firm performance); Fairfax, *supra* note 11, at 174–76 (examining the empirical evidence on director independence and concluding that "the empirical evidence does not convincingly prove that independent directors necessarily lead to more effective and efficient monitoring").

48. Sharpe, *supra* note 10, at Part IV (providing a detailed examination of corporate decision making and demonstrating how managers, not boards, control the corporation; the article then provides the attributes of an effective decision-making process that are necessary to board authority); Sharpe, *supra* note 11, at 1452 (identifying time, information, and knowledge as more important attributes of true independence than the structural and cosmetic criteria that recent legislation mandates); Rodrigues, *supra* note 29, at 457.

49. Margaret M. Blair, *Shareholder Value, Corporate Governance, and Corporate Performance: A Post-Enron Reassessment of the Conventional Wisdom*, *in* CORPORATE GOVERNANCE AND CAPITAL FLOWS IN A GLOBAL ECONOMY 53, 65–67 (Peter K. Cornelius & Bruce Kogut eds., 2003) (noting that there is "no convincing empirical evidence that the proportion of independent directors impacts future performance as measured by a variety of stock price and accounting measures" (internal citations omitted)); Fairfax, *supra* note 11, at 137; Claire Hill & Richard Painter, *Compromised Fiduciaries: Conflicts of Interest in Government and Business*, 95 MINN. L. REV. 1637, 1656 (2011) ("What is needed is independence in spirit, not independence determined by reference to some relationship one can formulaically describe, such as close kinship or a business partnership or contractual connection. There is no good way to discern independence in spirit."); Brett H. McDonnell, *SOX Ap-*

entirely warranted, as structurally-oriented regulations have not solved the problems that contributed to these failures.[50] Yet it is likely that regulators will continue to attempt unsuccessfully to focus on board independence, since it is an easy and tangible response to the blame that policy makers frequently place on boards for corporate failures. Indeed, policy makers have only been emboldened by the common refrain in the media and the general public that boards ineffectively monitor managers.[51] This propensity to blame corporate boards comes from an incomplete and flawed view of the problem. Consequently, the solutions that result from this faulty diagnosis are unlikely to result in the desired improvement in board oversight.

This Article assumes that policy makers believe the role of the board is to monitor managers and that independent decision making is the best way to do so.[52] While it uses the dominant assumptions as a starting point, it argues that if this is the goal, the chosen means of achieving the goal—the fourth assumption, preferring structural means of increasing director independence—is doomed. The belief that structural solutions lead to effective monitoring has encouraged an array of commentators—policy makers, some scholars, institutional investors, etc.—to advocate separating the position of CEO and board chairperson. The push toward separation has become more ardent in light of the fact that allowing the CEO to serve as board chairperson has been blamed

peals, 2004 MICH. ST. L. REV. 505, 529, 536 (2004) (noting the ways in which, under the current rules for director independence, directors "can be quite buddy-buddy with CEOs in fact. Audit committees can formally choose auditors when in fact they simply ratify what officers have suggested. Internal control procedures can yield disclosure committee meetings in which no one asks the hard questions. . . . New disclosure can look great, until you see the 10-K from which it was borrowed." Furthermore, "[c]urrent evidence on the effects of independent directors shows little sign of significant effect"); Rodrigues, *supra* note 29, at 458; Omari Scott Simmons, *Taking the Blue Pill: The Imponderable Impact of Executive Compensation Reform*, 62 S.M.U. L. REV. 299, 304 (2009) ("Despite decades of varied responses to address soaring executive compensation such [as] . . . board independence requirements, . . . executive compensation levels continue to soar, as does the saliency of executive compensation as a political issue."); Kristin N. Johnson, *Macroprudential Regulation: A Sustainable Approach to Regulating Financial Markets*, 2013 U. ILL. L. REV. 882, 895–98; Usha Rodrigues, *A Conflict Primacy Model of the Public Board*, 2013 U. ILL. L. REV. 1049, 1058–61; Omari Scott Simmons, *The Corporate Immune System: Governance from the Inside Out*, 2013 U. ILL. L. REV. 1107, 1138–39.

50. There is a question as to whether regulation is capable of solving these problems and if it is, whether it is the right means to do so.

51. John Schnatter, *Where Were the Boards?*, WALL ST. J., Oct. 25, 2008, at A11 ("[L]et us keep in mind that a significant set of checks and balances—ultimately ending with the boards of directors—has failed."); Zachary A. Goldfarb, *SEC to Examine Boards' Role in Financial Crisis*, WASH. POST, Feb. 20, 2009, at D01, *available at* http://www.washingtonpost.com/wp-dyn/content/story/2009/02/19/ST2009021903215.html; Ben Stein, *It's Time to Act Like Grown-Ups*, N.Y. TIMES, Nov. 11, 2007, at B8 (questioning directors' credentials and their "failure . . . to notice that something was amiss at . . . big banks"); Susanne Craig & Peter Lattman, *Companies May Fail, but Directors Are in Demand*, DEALBOOK (Sept. 14, 2010, 8:27 PM), http://dealbook.nytimes.com/2010/09/14/companies-may-fail-but-directors-are-in-demand/.

52. I do not actually think this is the best use of boards, except for a few specific instances in times of crisis. There are several other functions boards are better able to fulfill, such as stewardship and resource functions—for a description of the other board roles, see Sharpe, *supra* note 10, at 268–74—but I save tackling the role and purpose of the corporate board for future work.

for many corporate failures over the past several decades.[53] Unsurprisingly, major legislative efforts intended to respond to corporate failure have targeted board leadership structure. The Dodd-Frank Act is the most recent attempt to improve board independence through focusing on this structure.[54]

B. The Dodd-Frank Act and the Trend Against Duality

The financial crisis of 2007–2008 was one of the worst in U.S. history.[55] In a single quarter, the blue chip company Lehman Brothers (who eventually went bankrupt) lost $2.8 billion.[56] While commentators have identified multiple reasons why the crisis occurred, many posit that boards mismanaged risk and failed in their oversight duties, which directly contributed to their firms failing.[57] The government quickly reacted in the hopes of improving public sentiment and stabilizing the U.S. econo-

53. B. Ram Baliga et al., *CEO Duality and Firm Performance: What's the Fuss?*, 17 STRATEGIC MGMT. J. 41, 42–43 (1996) (recounting how Roger Smith's dual position as CEO and board chair was blamed for keeping the board from performing its oversight function which contributed to General Motors' failures in the early 1990s, as well as offering similar criticisms of IBM and Sears); Brian K. Boyd, *CEO Duality and Firm Performance: A Contingency Model*, 16 STRATEGIC MGMT. J. 301, 301–02 (1995) (stating that "duality has been blamed for poor performance and slow response to change in firms"); Olubunmi Faleye, *Does One Hat Fit All? The Case of Corporate Leadership Structure*, 11 J. MGMT. & GOVERNANCE 239, 240 (2007) (stating that market actors became more vocal against chairman/CEO duality in response to "high profile corporate scandals"); Thuy-Nga T. Vo, *To Be or Not to Be Both CEO and Board Chair*, 76 BROOK. L. REV. 65, 97–98 (2010) (explaining that the lack of separate chairman and CEO roles contributed, at least in part, to the failure of Enron's board of directors and the company's subsequent collapse); Nathaniel P. Flannery, *The Need for Balance: How Powerful Chairman-CEOs Put Shareholder Value at Risk*, FORBES (Aug. 19, 2011), http://web.archive.org/web/20111006084855/http://www.forbes.com/sites/nathanielparishflannery/2011/08/19/the-need-for-balance-how-powerful-chairmen-ceos-put-shareholder-value-at-risk/ (archived Oct. 6, 2011) (suggesting that recent scandals at companies such as John Deere and News Corp. are related to the companies' chairman-CEO duality).

54. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

55. Sewell Chan, *Dissenters Fault Report on Crisis in Finance*, N.Y. TIMES, Jan. 26, 2011, at B1; Jon Hilsenrath et al., *Worst Crisis Since '30s, With No End Yet in Sight*, WALL ST. J., Sep. 18, 2008, http://online.wsj.com/article/SB122169431617549947.html; Heather Stewart, *We Are in the Worst Financial Crisis Since Depression, Says IMF*, GUARDIAN (Apr. 9, 2008), http://www.guardian.co.uk/business/2008/apr/10/useconomy.subprimecrisis.

56. Jenny Anderson & Eric Dash, *For Lehman, More Cuts and Anxiety*, N.Y. TIMES, Aug. 29, 2008, at C1.

57. *See* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES, at xviii (2011) ("We conclude dramatic failures of corporate governance and risk management at many systemically important financial institutions were a key cause of this crisis."); Renee M. Jones & Michelle Welsh, *Toward a Public Enforcement Model for Directors' Duty of Oversight*, 45 VAND. J. TRANSNAT'L L. 343, 370–371 & n.141 (2012) ("[S]everal investigations into the causes of the 2008 financial crisis have concluded that the directors, and to some extent, senior managers of failed firms were unaware of the extent of risk the firms had incurred, and the firms' failures to fully disclose these risks."); Miller & Rosenfeld, *supra* note 29, at 810. *But see* David H. Erkens et al., *Corporate Governance in the 2007–2008 Financial Crisis: Evidence from Financial Institutions Worldwide*, 18 J. CORP. FIN. 389, 390 (2012) ("Our analysis shows that firms with more independent boards and greater institutional ownership experienced worse stock returns during the crisis period.").

my.[58] In response to the crisis, Congress passed the Dodd-Frank Act.[59] The Act amended the Securities Exchange Act of 1934, and it offered several board-related, structural solutions.[60] Most notably, section 972 of the Act increased disclosure requirements for companies that maintain CEO/Chairperson duality.[61] Under section 972, a registrant is required to disclose in its proxy statement why the position of CEO and board chairperson is combined or separated.[62] In accordance with SEC rule making, a registrant must:

> Briefly describe the leadership structure of the registrant's board, such as whether the same person serves as both principal executive officer and chairman of the board, or whether two individuals serve in those positions, and, in the case of a registrant that is an investment company, whether the chairman of the board is an "interested person" of the registrant as defined in section 2(a)(19) of the Investment Company Act (15 U.S.C. 80a–2(a)(19)).[63]

Regulators hope that by forcing corporations to be more transparent about leadership structure, shareholders can opt to avoid companies that appear to have greater issues of board capture than others.[64] In other words, in companies where the CEO and chairperson are the same individual, the board may be an ineffective monitor.

Some scholars have criticized Dodd-Frank's comply-or-explain provision as, at best, pointless, or even worse, pernicious.[65] Stephen Bainbridge has written that "proponents of a mandatory nonexecutive chairman of the board have overstated the benefits of splitting the positions, while understating or even ignoring the costs of doing so."[66] Paul Rose has even pointed out that Dodd-Frank's CEO/Chairperson disclosure provisions are not new, but were already mandated by current SEC regulations.[67]

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58. Sharpe, *supra* note 44, at 99–100.

59. Dodd-Frank Wall Street Reform and Consumer Protection Act.

60. *E.g.*, *id.* § 952.

61. *Id*. § 972.

62. *Id.*; Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, 68,345 (Dec. 23, 2009) (to be codified at 17 C.F.R. 229).

63. 17 C.F.R. § 229.407(h) (2012).

64. Z. Jill Barclift, *Governance in the Public Corporation of the Future: The Battle for Control of Corporate Governance*, 15 CHAP. L. REV. 1, 12–13 (2011) ("The SEC has designed rules, which give investors information on the inherent or the structural design of board membership, so that shareholders will know whether a dominant CEO or leader has exerted undue influence on board decision-making."); Megan Wischmeier Shaner, *Restoring the Balance of Power in Corporate Management: Enforcing an Officer's Duty of Obedience*, 66 BUS. LAW. 27, 53 (2010) (suggesting that the SEC's proxy disclosure enhancements regarding board leadership structure are a response to the increase in stockholder proposals requiring separation of the CEO and board chair roles).

65. Bainbridge, *supra* note 31, at 1795–1800; Paul Rose, *Regulating Risk by "Strengthening Corporate Governance,"* 17 CONN. INS. L.J. 1, 20–21 (2010).

66. Bainbridge, *supra* note 31, at 1799.

67. Rose, *supra* note 65, at 10 (citing to 17 C.F.R. § 229.407(h) (2010)). According to an August 2010 Conference Board report on board leadership structure:

> The Dodd-Frank Act, approved on July 16, 2010 and signed into law by President Obama on July 21, directs the SEC to adopt, no later than 180 days after the bill's enactment, rules requiring an

Although CEOs simultaneously chairing their board are still much more common in the United States than in other countries,[68] the Act's increased disclosure requirement is consistent with a growing trend both in the United States and overseas toward separating the positions.[69] The number of U.S. corporations that have an individual other than the CEO serving as chairperson of the board is increasing. As of 2008, estimates suggest that thirty-nine percent of the Standard & Poor's 500-stock index (S&P 500) have separated the position of CEO and board chairperson as compared to sixteen percent a decade earlier.[70] Advocates of ending duality push for a nonexecutive, independent director to serve as chairperson. When other high-level executives or former company chairpersons (as in the Starbucks example mentioned in Part I) fill the role,[71] they are not independent but are considered such. Although the number of companies that have an independent chairperson has also increased, they still represent only a small fraction of large corporations. A current estimate suggests that this number is now up to nineteen percent of the S&P 500.[72]

> issuer to disclose in its proxy statement the reasons why its board chairman and chief executive officer positions are held either by the same person or by different persons, as the case may be. The enhanced executive compensation regulations in Item 402 of Regulation S-K adopted in December 2009 . . . already require disclosure of the company's board leadership structure and a discussion regarding why the company determined that such structure was appropriate.

LOUIS L. GOLDBERG & JUSTINE LEE, CONFERENCE BD., ENHANCED DISCLOSURE IN THE DOW 30 AND SELECT FINANCIAL COMPANIES BOARD LEADERSHIP STRUCTURE 2 n.5 (2010), *available at* http://www.conference-board.org/retrievefile.cfm?filename=DN-011-10.pdf&type=subsite.

68. Vo, *supra* note 53.

69. Other countries, such as the United Kingdom for example, have taken much stronger positions on separating the position of CEO and chair. For instance, over twenty years ago, the Cadbury Committee issued a report that included a "Code of Best Practice." The committee recommended that separate individuals hold the position of CEO and chairperson. The results of these committees are embodied in the COMM. ON THE FIN. ASPECTS OF CORPORATE GOVERNANCE, REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE para. 4.9 (1992) [hereinafter CADBURY REPORT], *available at* http://www.ecgi.org/codes/documents/cadbury.pdf. Today, at least ninety percent of the largest companies in the United Kingdom have embraced the committee's recommendation and separated the positions. Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 CORNELL INT'L L.J. 493, 532 (2005) (citing DEREK HIGGS, REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS para. 5.3 (2003), *available at* http://www.ecgi.org/codes/documents/higgsreport.pdf). The recommendations were not mandatory, but instead The London Stock Exchange required companies to explain why they had not separated the roles. Jeffrey M. Stein & Parth S. Munshi, *The Changing Role of the Lead Director*, CORP. GOVERNANCE ADVISOR, Nov.–Dec. 2008, at 11, 12.

70. MILLSTEIN CTR. FOR CORP. GOVERNANCE & PERFORMANCE, CHAIRING THE BOARD: THE CASE FOR INDEPENDENT LEADERSHIP IN CORPORATE NORTH AMERICA 5 (2009); *see also* Charles K. Whitehead, *Why Not a CEO Term Limit?*, 91 B.U. L. REV. 1263, 1276 n.75 (2011) ("According to a Spencer Stuart survey, forty percent of S&P 500 companies had a separate Chairman and CEO in 2010, up from twenty-three percent in 2000.").

71. *See* discussion *supra* at Part I. For a discussion of what constitutes legal independence, see Sharpe, *supra* note 10, at 276–77.

72. Joann S. Lublin, *Drive to Split CEO, Chairman Roles Gains Steam*, WALL ST. J. (Jan. 17, 2012), http://online.wsj.com/article/SB10001424052970203735304577165041967514410.html ("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."). The number is slightly lower, only seventeen percent, when the sample set is broadened to include the S&P 1500, and "the incidence

Despite this growing trend, as with many suggested structural changes to boards,[73] empirical studies examining the connection between CEO/Chairperson duality on firm performance have found that splitting the position of CEO and chairperson has little to no effect on firm performance. In some instances, having a single individual hold both positions may actually improve firm performance.

A study of the Fortune 500 by B. Ram Baliga, R. Charles Moyer, and Ramesh S. Rao examined the impact of duality on firm performance as well as the effect of changes in a firm's duality status.[74] Their study showed that there was little evidence of operating performance changes and "there is no difference in performance between firms with total nonduality during the period and firms with total duality."[75]

In addition to finding only weak evidence that duality affects long-term performance, another study by Brian Boyd found that duality may have a positive effect on firm performance when the firm's resources are scarce or the firm faces highly complex conditions.[76] His findings lend support to the notion that each firm is unique, and circumstances may exist where duality is more advantageous for a firm than harmful.[77] Similarly, separating the positions may not be the best decision for a firm in the long term.[78]

Similarly, Catherine Daily and Dan Dalton concluded that where academics and practitioners seek to increase board independence through a separate and independent chairperson, empirical findings indicate that "separate chairs are not characterized by higher levels of independence than their dual counterparts."[79] In a meta-analysis published shortly thereafter, Dalton et al. wrote: "a conclusion that there is no actual relationship [between board leadership structure and firm financial performance] is quite aggressive."[80]

Nevertheless, the evidence is still mixed and context specific. A 2001 study by Rhoades et al. found that, "while there is a negative relationship between [nonduality] and firm performance for firms in the anti-

of independent chairs is concentrated on small and mid-cap firms." MILLSTEIN CTR. FOR CORP. GOVERNANCE & PERFORMANCE, *supra* note 70, at 17.

73. *See* discussion *supra* note 47.

74. *See* Baliga et al., *supra* note 53.

75. *Id*. at 49–50. Although "[f]rom the perspective of the financial marketplace, duality status changes are nonevents" there may be multiple explanations as to why. Explanations include the investment communities' limited ability to evaluate the effect of the change, the market valuation of the event may have already been reflected in the stock price because the change had been leaked prior to the actual event, or that duality status is not significant when compared to the other internal and external control mechanisms the firm has in place. *Id*. at 51.

76. Boyd, *supra* note 53, at 309.

77. *Id.*

78. *Id*.

79. Catherine M. Daily & Dan R. Dalton, *CEO and Board Chair Roles Held Jointly or Separately: Much Ado About Nothing?*, ACAD. MGMT. EXECUTIVE, Aug. 1997, at 11, 17.

80. Dan R. Dalton et al., *Meta-Analytic Reviews of Board Composition, Leadership Structure, and Financial Performance*, 19 STRATEGIC MGMT. J. 269, 282 (1998).

takeover studies, there is a positive relationship for firms in the compensation studies."[81] John Coates testified before Congress in 2009 and shared his thoughts on the mixed empirical findings. He stated "[t]he only clear lesson from these studies is that there has been no long-term trend or convergence on a split chair/CEO structure."[82] He concluded that legislative mandates regarding board leadership should be limited to "the largest firms" and should "permit even those firms to 'opt out' of the requirement through periodic shareholder votes."[83]

C. The Debate over Board Leadership Structure

The legislative response reflects increasing attention to the issue of leadership structure in the business and legal communities. The emphasis on leadership structure is unsurprising given the focus on agency theory generally and the importance traditionally assigned to the chairperson's position more specifically. The person who chairs the board has significant responsibilities, and the debate over whether an outsider or the CEO should sit at the helm turns on how important these responsibilities are to the strategic success of the corporation and successful board oversight. The chairperson of the board presides over board meetings, sets and approves board agendas, determines how much discussion time should be allocated to agenda items, and is responsible for "information flow to the board."[84]

The question of whether CEO/Chairperson duality should continue or end has come to the forefront of corporate governance debate. As explained in the following Subsections, commentators, regulators, and investors have made arguments on both sides of the duality issue. Those who advocate for a separation of the positions clearly view the issue through an agency-theory lens. In contrast, those who argue it is best to allow one person to fill both roles depart from the traditional agency-theory framework. Both sides of the duality debate, however, seek a common goal: to encourage increased information flow to the board, which facilitates consensus-based decision making. Unfortunately, ending duality in order to increase substantive board independence is pointless, as it fails to achieve this goal.

81. Dawna L. Rhoades et al., *A Meta-Analysis of Board Leadership Structure and Financial Performance: Are "Two Heads Better than One"?*, 9 CORP. GOVERNANCE 311, 317 (2001).

82. *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. 47–48 (2009) [hereinafter *Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance*] (statement of John C. Coates IV, Professor of Law & Economics, Harvard Law School).

83. *Id*. at 48.

84. Goldberg & Lee, *supra* note 67, at 3.

1. *Proponents of Role Splitting*

Many of the arguments against CEOs serving as board chairpersons are grounded in traditional agency theory.[85] Under traditional agency theory, managers are agents meant to maximize the interest of the corporation's principals, the shareholders.[86] To ensure that the agents act in the best interests of the principal—or in parlance of agency theory, reduce agency cost—shareholders must employ a combination of interest-aligning incentives and monitoring mechanisms.[87] As discussed, in publicly traded corporations, the board of directors is the primary monitoring mechanism.[88] This separates decision management and decision control, with the former residing in the hands of managers and the latter in the hands of the board.[89] It protects shareholders from managerial opportunism and reduces agency costs.[90] When a single individual occupies the position of board chairperson and CEO, it reduces the board's control and makes the board an extension of management, instead of its own autonomous oversight body.[91] From an agency theory point of view, this is problematic as it concentrates decision control and management in the same person, the CEO.[92] The concern is that "CEO duality diminishes the monitoring role of the board of directors over the executive manager, and this in turn may have a negative effect on corporate performance."[93] This can lead to a firm that pursues the CEO's goals at the expense of shareholder goals or compensates executives at higher rates than warranted.[94]

85. Dalton et al., *supra* note 80, at 271–72 ("The preference for the separate board leadership structure is largely grounded in agency theory concerns regarding the potential for management domination of the board."); Sydney Finkelstein & Richard A. D'Aveni, *CEO Duality As a Double-Edged Sword: How Boards of Directors Balance Entrenchment Avoidance and Unity of Command*, 37 ACAD. MGMT. J. 1079, 1081–83 (1994).

86. Dalton et al., *supra* note 80, at 270; Finkelstein & D'Aveni, *supra* note 85, at 1081.

87. Jensen & Meckling, *supra* note 40, at 313; *see also* BERLE & MEANS, *supra* note 40, at 121.

88. *See* discussion *supra* at Part II.A; AM. L. INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 3.02 cmt. d (1992) (discussing the board of director's "oversight function"); Paul E. Juras & Yvonne L. Hinson, *Examining the Effect of Board Characteristics on Agency Costs and Selected Performance Measures in Banks*, 7 ACAD. BANKING STUD. J. 87, 87 (2008); Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. CIN. L. REV. 1187, 1200 (2003); James D. Westphal, *Collaboration in the Boardroom: Behavioral and Performance Consequences of CEO-Board Social Ties*, 42 ACAD. MGMT. J. 7, 8 (1999).

89. Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 304 (1983).

90. *Id*. at 306.

91. Boyd, *supra* note 53, at 303 ("By serving as chairman, the CEO will acquire a wider power base and locus of control, thereby weakening decision control by the board. This reduction in board control facilitates pursuit of the CEO's agenda, which may differ substantially from shareholder goals." (internal citations omitted)); Finkelstein & D'Aveni, *supra* note 85, at 1082 ("Hence, to the extent that CEO duality 'signals the absence of separation of decision management and decision control', vigilant boards are unlikely to favor the dual structure.").

92. Boyd, *supra* note 53, at 303.

93. Khaled Elsayed, *Does CEO Duality Really Affect Corporate Performance?*, 15 CORP. GOVERNANCE 1203, 1204 (2007).

94. Boyd, *supra* note 53, at 303.

Advocates of separation argue that when a different individual fills each role it increases the board's independence, which in turn improves the board's ability to monitor the CEO.[95] An independent chairperson would serve as an additional source of information to the board.[96] Furthermore, the split would allow CEOs to focus on running the business, rather than governance, which would make companies with a split CEO/Chairperson better equipped to handle domestic and foreign competition. An independent chair may also increase the board's independence through setting the board's agenda and managing board meetings in such a way as to ensure adequate time for discussion.[97]

Agenda setting is one of the critical advantages often articulated for ending duality.[98] A frequent complaint is that agendas are focused either on present or past problems and do not provide boards with an opportunity to discuss forward-looking strategic concerns and opportunities.[99] In most firms, the chairperson, who in the United States is usually the CEO, typically sets and controls the agenda for board meetings.[100] This contributes significantly to the power disparity between boards and management, leaving decision control and management in the hands of the CEO.[101] In sum, it weakens the board's oversight ability.[102] Arguably, an independent chairperson can restore the monitoring balance which agency theory seeks.[103]

In addition to scholars, institutional investors have entered the board-structure debate, expressing a strong preference for ending CEO/Chairperson duality.[104] The conventional agency-theory model of

95. *See* Baliga et al., *supra* note 53, at 42.

96. Wm. Gerard Sanders & Mason A. Carpenter, *Internationalization and Firm Governance: The Roles of CEO Compensation, Top Team Composition, and Board Structure*, 41 ACAD. MGMT. J. 158, 164 (1998); Vo, *supra* note 53, at 87.

97. MILLSTEIN CENTER FOR CORP. GOVERNANCE & PERFORMANCE, *supra* note 70, at 6–7; Vo, *supra* note 53, at 87–88.

98. Finkelstein & D'Aveni, *supra* note 85, at 1082.

99. CARTER & LORSCH, *supra* note 42, at 26–27, 146–48.

100. *Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance*, *supra* note 82, at 55 (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.").

101. PAMELA S. TOLBERT & RICHARD H. HALL, ORGANIZATIONS: STRUCTURES, PROCESSES, AND OUTCOMES 118 (10th ed. 2009).

102. *Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance*, *supra* note 82, at 56 (statement of Ann Yerger, Executive Director, Council of Institutional Investors).

103. Agenda setting is a solution proposed by organizational behavior scholars that can shift decision-making control into the hands of the agenda setter. TOLBERT & HALL, *supra* note 101, at 118 (discussing agenda setting as an influential mechanism in decision making). For illustrations, see CARTER & LORSCH, *supra* note 42, at 146–48.

104. Williams and Conley write that "[d]uring the 2003 proxy season, many corporate governance shareholder proposals achieved majority votes, including initiatives to eliminate staggered boards, to separate the CEO from the chairman of the board, and to limit executive pay." Williams & Conley, *supra* note 69, at 528. As examples, the authors note that shareholder proposals brought by union

the firm is evident in many of their arguments, which mirror those of scholars who hold similar views. They see a clear connection between better oversight and a separate board chairperson.

The Executive Director for the Council on Institutional Investors, Ann Yerger, recently testified before Congress, stating: "[t]he Council believes separating the chair/CEO positions appropriately reflects the differences in the roles, provides a better balance of power between the CEO and the board—particularly when the CEO dominates the board, and facilitates strong, independent board leadership/functioning."[105] Additionally, TIAA-CREF, a large institutional investor that specializes in retirement planning for over 3.7 million people and manages approximately $502 billion in assets,[106] has also firmly advocated for a separation of the roles, or at the very least the appointment of a lead director.[107] Its policy statement on corporate governance states:

> In order to ensure independent oversight, TIAA-CREF believes that the separation of CEO and chair or appointment of a lead independent director is appropriate. In addition to disclosing why a specific structure has been selected, when the CEO and chair roles are combined, a company should disclose how the lead independent director's role is structured to ensure they provide an appropriate counter balance to the CEO/chair.[108]

Like scholars, institutional investors hope that splitting the positions will increase the board's independence from the CEO. Their hope is that this will lead to more optimal monitoring that will lower agency costs and help the firm avoid failure as well as increase value.

2. *Opponents of Role Splitting*

Supporters of CEO/Chairperson duality argue that it is the dominant leadership structure because it leads to the greatest generation of shareholder wealth.[109] Those who favor maintaining a dual CEO/Chairperson structure clearly depart from the traditional agency-theory approach.[110] For instance, the board's primary role is no longer

pension, health, and savings funds, especially the AFL-CIO, were "overwhelmingly concerned with corporate governance." *Id*. at 529.

105. *Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance*, *supra* note 82, at 56 (statement of Ann Yerger, Executive Director, Council of Institutional Investors).

106. *About Us*, TIAA-CREF, http://www.tiaa-cref.org/public/about-us/who-we-are-at-tiaa-cref (last visited Mar. 6, 2013). $502 billion figure is current as of September 30, 2012.

107. For a discussion of lead directors, see discussion *infra* at Part II.C.3.

108. TIAA-CREF, POLICY STATEMENT ON CORPORATE GOVERNANCE 11 (6th ed. 2011), *available at* http://www.tiaa-cref.org/ucm/groups/content/@ap_ucm_p_tcp/documents/document/tiaa01007871.pdf.

109. James A. Brickley et al., *Leadership Structure: Separating the CEO and Chairman of the Board*, 3 J. CORP. FIN. 189, 194 (1997); Vo, *supra* note 53, at 76–77.

110. Organizational behavior usually lends theoretical support for arguments favoring maintaining a dual CEO/Chairperson structure. Finkelstein & D'Aveni, *supra* note 85, at 1083 ("In contrast to agency theory, several perspectives based on organization theory support the idea that vigilant boards

monitoring, but advising and counseling.[111] As with monitoring, however, information access is critical to sound analysis and advice. The focus is also on structure, with duality supporters arguing that a combined CEO/Chairperson would have a tremendous informational advantage over an outsider serving as board chair.[112] This departs sharply from the opponents of duality who focus on independent information dissemination to the entire board, as opposed to information accumulation in the CEO.[113]

A chairperson who is also CEO of the company would spend greater time at the company, develop and maintain a deeper well of knowledge, and have significantly better access to information about the company than an outside director.[114] Effective CEOs have extensive knowledge and information about their companies' challenges and opportunities.[115] One of the costs of placing independent directors in the chairperson position is that eliminating connections to the company decreases their access to information.[116] Outside directors are largely dependent on the CEO for information.[117] Not only does this create tremendous information asymmetries,[118] it is also an inefficient way to transfer information from the CEO to the board and vice versa, in contrast to when one person fills both roles.[119] In sum, the CEO's access to information reduces transaction costs associated with transmitting infor-

of directors favor CEO duality."). Although there are organizational theorists who support the idea of having one person serve in both roles, this Article does not adopt a position on the duality debate. Instead, it focuses on identifying how structural solutions such as changing board leadership structure fail to account for the process-based remedies boards need to achieve the efficacy both sides of the debate seek.

111. *See* Vo, *supra* note 53, at 82. *Contra* Finkelstein & D'Aveni, *supra* note 85, at 1081 (noting that agency theory posits that boards of directors primarily serve monitoring roles).

112. Vo, *supra* note 53, at 78–79.

113. *See id.* at 87.

114. Goldberg & Lee, *supra* note 67, at 3 ("Those who support the preservation of this traditional structure of duality argue that a single leadership fosters more operational efficiency, facilitates internal communication from and to the board, and ultimately enables better business performance."); Vo, *supra* note 53, at 78.

115. Boyd, *supra* note 53, at 301; Brickley et al., *supra* note 109, at 194 ("Presumably, CEOs have unparalleled specialized knowledge regarding the strategic challenges and opportunities facing the firm."); Vo, *supra* note 53, at 78.

116. Fairfax, *supra* note 11, at 161–67; Ribstein, *supra* note 42, at 40 (analyzing the impact of post-Enron regulation, Ribstein writes "The problem is that monitors' other links with firms increase their access to information. If the fully independent monitor can duplicate the connected monitor's information, requiring greater independence just increases the firm's costs of obtaining information."); Sharpe, *supra* note 11, at 1453–54.

117. CARTER & LORSCH, *supra* note 42, at 46–47; Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals About Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285, 293 (2004); Sharpe, *supra* note 11, at 1453–54.

118. Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1, 46 (2006) ("When board approval is needed for a corporate action, the nonmanagement directors will be almost wholly dependent on the corporation's officers for the information on which their decision should be based."); Fairfax, *supra* note 11, at 161–67 (examining how information asymmetries limit independent/outside director efficacy); Mitchell, *supra* note 40, at 1319 (discussing asymmetries between corporate boards and executive management).

119. Vo, *supra* note 53, at 79.

mation to the board.[120]

An outside chairperson, who by definition is not a full-time employee of the firm, has much less time than the CEO to devote to her role as chairperson and developing firm-specific knowledge. The number of times boards meet is trending downward, with the average board of the Fortune 1000 meeting in person eight times annually, with a scant seven percent holding monthly meetings as compared to twenty-five percent twenty years earlier.[121] Although the opposite trend has been observed in terms of hours spent per month on board matters, for the average director this is now sixteen hours.[122] Unfortunately, the increase in time has arguably been a function of the dramatic increase in compliance requirements for boards over the last decade,[123] not time spent gaining substantive knowledge of the company's strategic challenges. Consequently, proponents of maintaining CEO/Chairperson duality argue that the CEO has the requisite time to devote to board matters and can do so more effectively than an independent director because of her substantive knowledge of the company's business, challenges, and opportunities.

In addition, separating the roles may increase tension between management and the board. Specifically, it can cause confusion about a company's leadership, which in turn may lead to "rivalry between the chairperson and the CEO."[124] Furthermore, management may distrust the promises of an outside chairperson with no connection to the company.[125] A unified CEO and chair reduces conflict between the board and management.[126] Arguably, when monitoring by outsiders increases, insiders become less trustworthy.[127] One explanation is that it encourages insiders, like the CEO, to take a gamesmanship approach to their jobs, seeking to "outwit clueless outsider directors, courts, and overly scrupulous auditors."[128] By combining the CEO and chair positions, the board's

120. Brickley et al., *supra* note 109, at 194.

121. KORN/FERRY, *supra* note 23, at 10.

122. *Id*. at 4–5. One acknowledgement that serving as board chairperson requires more time than the average independent director currently allocates to board responsibilities can be found in a report compiled by the Millstein Center for Corporate Governance and Performance containing findings from their Chairman's Forum (an organization of nonexecutive chairpersons of U.S. and Canadian publicly traded companies) found that an independent chairperson would have to devote additional time to handling the added responsibilities of serving as board chair, this time commitment can increase exponentially during times of crisis to the point that it is a full-time job. MILLSTEIN CTR. FOR CORP. GOVERNANCE & PERFORMANCE, *supra* note 70, at 7.

123. KORN/FERRY, *supra* note 23, at 10 (identifying an increase in 2003 in the number of hours directors devoted to board work and suggesting that this was "reflective of the fact that it was the year after Sarbanes-Oxley was enacted and boards were particularly focused on transforming governance"); Jay W. Lorsch & Robert C. Clark, *Leading from the Boardroom*, HARV. BUS. REV., Apr. 2008, at 104, 107 (noting that Sarbanes-Oxley has increased compliance requirements, so audit committee meetings are twice as long as they were before).

124. Martin Lipton & Jay W. Lorsch, *The Lead Director*, DIRS. & BDS., Spring 1993, at 28.

125. *See generally* Ribstein, *supra* note 42, at 41–43.

126. *See* Daily & Dalton, *supra* note 79, at 13.

127. Ribstein, *supra* note 42, at 42–43.

128. *Id*.

police role is deemphasized while its position as a collaborative partner with management is emphasized. This minimizes distrust between the two groups. As a result, there is a greater likelihood that the board will engage in a collaborative, consensus-based, efficient decision-making process.[129]

In sum, the CEO's knowledge, understanding, and access to information would, in turn, help her be a better chairperson, who improves the quality of the board's decisions through facilitating a better-informed and more collegial decision-making process. The downside, however, is information accumulation in the CEO/Chairperson, which increases the information asymmetries between her and her fellow board members.

3. Compromise: The Lead Director

Focusing again on board structure as a way of improving the board's monitoring ability, many companies have embraced a hybrid structure called the lead director. Over eighty percent of the companies that combine the CEO and chairperson position have appointed a lead director.[130] A lead director is an independent director who could be appointed at companies that have chosen to maintain CEO/Chairperson duality or where the non-CEO chairperson is an executive or former CEO of the company.[131] In contrast to the extensive responsibilities of the chairperson, the lead director usually chairs executive sessions, where the independent directors meet without the CEO or any other inside directors present.[132] Additionally, the lead director should serve as a liaison between executives and other independent directors.[133] Although a recommended list of lead director responsibilities includes reviewing or approving agendas and information sent to the board,[134] a survey of the DOW 30 as well as five selected financial institutions found that only a few companies included approving the agenda, helping with information flow (by approving "information sent to the board"), and "leading the CEO's evaluation" among the lead director's responsibilities.[135]

129. Vo, *supra* note 53, at 81 ("By enhancing collegiality and collaboration between board directors and company executives, a CEO-Chair may thus facilitate consensus that leads to smooth and efficient decision making.").

130. KORN/FERRY, *supra* note 23, at 7.

131. Some scholars and organizations use the terms lead director and independent director interchangeably. *See, e.g.*, Goldberg & Lee, *supra* note 67, at 3. Others distinguish the two. *See, e.g.*, Stein & Munshi, *supra* note 69, at 6.

132. BUS. ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERNANCE 17 (2010) [hereinafter PRINCIPLES OF CORPORATE GOVERNANCE]; Goldberg & Lee, *supra* note 67, at 3.

133. Goldberg & Lee, *supra* note 67, at 3.

134. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 132, at 17.

135. Goldberg & Lee, *supra* note 67, at 5–7 (Table 1 provides a list of lead director responsibilities. Eight of the twenty-nine companies that had a lead director "authorize the lead director to '*approve*' board meeting agendas;" six of the twenty-nine companies "authorize the lead director to '*approve*' information sent to the board;" and "[s]ix task the lead director with leading the CEO's evaluation").

Some have questioned the utility of the lead director position, largely on signaling grounds. In addition to the functional difference between the two positions, groups such as the Chairman's Forum[136] at the Millstein Center for Corporate Governance and Performance have objected to the appointment of a lead director in lieu of a non-executive chairperson. Simply put, they are not substitutes for one another. The participants in the Chairman's Forum were quite clear that the title "chairman of the board" has meaning.[137] Specifically, "it remains a strong hierarchical signal of board leadership to fellow board members, management and shareowners alike."[138] Since "the lead director is not perceived by their fellow board members as the board leader when in the shadow of the combined CEO and chairman," a lead director is not effective at "shaping board dialogue" and running the board.[139]

While the empirical evidence does not strongly support eliminating or maintaining duality, the scholarly arguments in favor and against share a common thread. Both sides believe that their position will result in the best informed, cohesive board that will engage in a consensus decision-making process.[140] Those who support CEO/Chairperson duality argue that CEOs are the most invested and possess the best information; additionally the unitary position supports a cohesive culture of trust that leads to consensus decision making.[141] Those who seek to end duality reason that an independent chairperson will help the board be more autonomous in its information-gathering pursuits and will better allow the board to operate by consensus, because it will no longer be dominated by the CEO.[142] In fact, a recent report compiled by the Millstein Center for Corporate Governance and Performance noted that its Chairman's Forum found that "leadership and consensus building" were the primary burdens of board chairs.[143]

Alarmingly, both sides are missing something of vital importance. They misunderstand the types of relationships directors share with their director counterparts, chairperson, and executive management, including the CEO. This results in an incomplete, if not inaccurate, understanding of the information available to boards and the manner in which boards make decisions.

136. The Millstein Center's Chairman's Forum is an organization of nonexecutive chairpersons of U.S. and Canadian publicly traded companies. MILLSTEIN CTR. FOR CORP. GOVERNANCE & PERFORMANCE, *supra* note 70, at 4.

137. *Id.* at 9.

138. *Id*.

139. *Id*.

140. Vo, *supra* note 53, at 78, 83 (summarizing arguments in favor of both sides).

141. *See* discussion *supra* Part II.C.2.

142. *See* discussion *supra* Part II.C.1.

143. MILLSTEIN CTR. FOR CORP. GOVERNANCE & PERFORMANCE, *supra* note 70, at 7.

III. MANAGING INFORMATION PROCESS

As Part II shows, agency-theory oriented board reforms, like section 972 of the Dodd-Frank Act, assume that boards will monitor management more effectively because of structural features like ending CEO/Chairperson duality. What this approach almost invariably misses is that information gathering and processing is crucial to good monitoring, and that structural changes affect that only indirectly, if at all. The organizational behavior framework strives to improve firm performance by focusing on how the individuals and groups within firms can act more effectively and adopt functional changes that will help a firm meet its strategic objectives.[144] It is a framework that highlights the shortcomings of the conventional approach to board reform, which relies on several flawed foundational assumptions about the nature of each of the board's primary relationships.

For example, the conventional, structurally-oriented approach to board reform views the director-to-director relationship as a collegial relationship that enables the board to operate as a consensus decision-making body within the corporate hierarchy.[145] In other words, directors are expected to be peers who are similarly situated with respect to knowledge and influence.[146] Boards face many informational problems that currently make consensus decision making almost impossible. Thus, the premise that most boards operate according to consensus decision making is wrong, and has implications for board performance.

This Part first defines consensus decision making. It then explains why it is an inaccurate characterization of a typical corporate board's decision-making process. Specifically, consensus decision making does not account for the ease with which different board members gather or process information. It concludes with a typology of the informational problems that boards face. Although other articles have examined concerns relating to information, this is the first to frame these concerns in light of boards' processual limitations. These informational problems must be addressed for boards to engage in consensus decision making and effective monitoring.

144. *See* GREGORY B. NORTHCRAFT & MARGARET A. NEALE, ORGANIZATIONAL BEHAVIOR: A MANAGEMENT CHALLENGE 26 (1990); Chip Heath & Sim B. Sitkin, *Big-B Versus Big-O: What Is Organizational About Organizational Behavior?*, 22 J. ORGANIZATIONAL BEHAV. 43, 51 (2001); Benjamin Schneider, *Organizational Behavior*, 36 ANN. REV. PSYCHOL. 573, 574 (1985) ("[Organizational behavior] is the confluence of individual, group, and organizational studies flowing from industrial-organizational (I/O) psychology and organization and management theory (OMT) with headwaters in psychology (social, psychometrics), sociology (organizational, work, occupational), and management (scientific, human relations).").

145. Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 3 (2002).

146. *See* discussion *infra* Part III.A.

A. Consensus Decision Making

To appreciate why the aforementioned assumptions about corporate hierarchy and the board's relationships are so deeply flawed, it is helpful to understand the two primary modes of decision making identified by the organizational behavior literature: consensus-based decision making and authority-based decision making.[147] Both advocates and opponents of CEO/Chairperson duality support a consensus decision-making process.[148] Analysis of this process will illuminate why a structural solution such as maintaining or abolishing duality will not dramatically change how boards make decisions because it does not significantly change the dynamic of the relationship among directors. More importantly, it also does not alter the information flow to the board or the information asymmetries between board members and the CEO.

Consensus-based decision making seeks to secure agreement from most of the members within a group on the course of action that is best for the entire group.[149] It works best when group members have similar interests, expertise, and knowledge as well as uniform access to relevant information.[150] It is a system of minimal hierarchy, where the group reaches decisions that have broad-based support. In contrast, under authority-based decision making, a single group makes decisions on behalf of the entire enterprise.[151] Structurally, authority-based decision making is best suited for situations "where there are information asymmetries among potential decision makers and the decision makers have different interests."[152] In a corporation, boards are this group.[153] Whereas the

147. For a description of these two modes of decision making, see KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 69–70 (1974).

148. *See* Vo, *supra* note 53, at 78–83.

149. JOHN R. SCHERMERHORN, JR. ET AL., ORGANIZATIONAL BEHAVIOR 183 (10th ed. 2008).

150. ARROW, *supra* note 147, at 69–70 (Arrow writes that the theory of consensus-based decision making is ideal in organizations "whose members have identical interests *and* identical information." Authority-based decision making is the opposite of consensus, so it is best for organizations where information is centralized with a particular decision maker the decision makers' preferences or interests differs. In other words, there are information asymmetries and differing interests.); *see also* Brett H. McDonnell, *Professor Bainbridge and the Arrowian Moment: A Review of* The New Corporate Governance in Theory and Practice, 34 DEL. J. CORP. L. 139, 154 (2009) (explaining that "[c]onsensus [decision making] works where all team members have identical interests and identical information" while at the same time noting that "[i]n a large corporation, no major constituency group comes close to achieving identical interests or identical information").

151. Stephen M. Bainbridge, *The Business Judgment Rule As Abstention Doctrine*, 57 VAND. L. REV. 83, 106 (2004).

152. *Id.*; CARTER & LORSCH, *supra* note 42, at 172–73 (explaining the paradox of board hierarchy and going on to explain why CEOs have tremendous power in practice (note that Carter and Lorsch explain why this is difficult), "there is an almost complete absence of formal hierarchy within the board. No director's opinion is supposed to be more important than another's. Even the chairman is supposed to deal with other directors as peer. . . . [Directors] operate very much as would a genuine partnership"); Langevoort, *supra* note 42, at 802.

153. CARTER & LORSCH, *supra* note 42, at 172 ("[T]he board sits at the pinnacle of its company's organization structure. . . . At least in theory, it is the body from which all power flows. In every country of which we are aware, the law makes it clear that the board is the boss and the CEO works for it."); Bainbridge, *supra* note 42, at 569, 605; Margaret M. Blair & Lynn A. Stout, *A Team Production*

board vis-à-vis the larger firm operates by authority decision making, theoretically the intraboard mode of making decisions is assumed to be consensus-based.[154]

The significant benefits of consensus decision making are one of the strongest arguments for why board governance is desirable.[155] While studies examining the outcomes of consensus decision making have found it to be a highly effective decision-making structure,[156] the success is dependent on the *inputs* into the decision-making *process*. These inputs can be divided into two groups—the decision makers (directors) and the tools the decision makers use to make decisions (information). The reality of many boards' relationships in practice reveals that there is an inherent contradiction in attempting to increase board independence through ending CEO/Chairperson duality without first improving the processes boards use to access information.

The decision-making process for most corporations is not a process of consensus. A cornerstone of consensus decision making is that no member of the decision-making group is dominant or superior to the rest. At most corporations, the decision-making process, however, is dominated by management, particularly the CEO, and not the board of directors.[157] In a related article, I divide the process into five steps—identification, analysis, choice of response, approval, and implementation—and argue that it is heavily dependent on information.[158]

Due to the independent, non-insider composition of the corporate board, management has significant information advantages at every step.[159] For instance, at the beginning of the process, the decision maker must identify the problems or opportunities that should be considered.[160] This is a gate-keeping step and delineates the universe of options the corporation will pursue or address. It is heavily biased by the identifier's goals and experiences. In the vast majority of decisions, the individual

Theory of Corporate Law, 85 VA. L. REV. 247, 290 (1999). This Article does not attempt to settle the debate as to whether it is the board or shareholders who hold the ultimate decision-making authority within the firm; it simply points out the general decision-making mode attributed to boards.

154. Bainbridge, *supra* note 145, at 3.

155. *Id*. at 12–27.

156. *Id*. at 12.

157. *Id*. at 51–54 (suggesting that in the *Smith v. Van Gorkom* case, duality led to the chairman/CEO having undue influence over the board); Z. Jill Barclift, *Corporate Governance and CEO Dominance*, 50 WASHBURN L.J. 611, 617–20 (2011) (explaining that a dominant, charismatic CEO controls the decision making and governance processes of a board); Lucian Arye Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 754–55 (2002) (suggesting that management exercises power and control over the board and its decision making); James A. Fanto, *Recognizing the "Bad Barrel" in Public Business Firms: Social and Organizational Factors in Misconduct by Senior Decision-Makers*, 57 BUFF. L. REV. 1, 33 (2009) (suggesting that certain dynamics, such as groupthink and the legal implications of board membership, give a CEO the ability to dominate board decision making); Sharpe, *supra* note 14, at 31.

158. For a more in-depth treatment of how managers control the decision-making process, see Sharpe, *supra* note 14, at 31; *supra* Parts II.B.1–5.

159. Sharpe, *supra* note 14, at 31.

160. *Id.* at 22–23.

identifying problems or opportunities is not an independent director, but a manager.[161]

The same pattern is repeated in the next step of the process, analysis. Managers analyze the problem or opportunity, which is largely information-dependent.[162] Managers may pass along the conclusions of their analysis or their choice of response to the boards, making boards passive recipients of the information managers deem relevant or important.[163] This means that when boards participate in the approval phase of decision making, they are doing so based almost exclusively on the information and knowledge obtained, screened, and then shared by the CEO and her management team.[164] Consequently, the board's decisions are not substantively independent, but instead a function of the CEO's control and preferences.

B. Typology of the Board's Informational Problems

The regulatory trend of increasing structural independence was intended to improve the board's ability to effectively perform its monitoring function. While the change was structural, there has been some discussion that the presence of independent directors was intended to promote better information flow from management to the board.[165] This should have resulted in better decision making.[166] In fact, independence has accomplished the opposite result. As a result of its outsider, independent compositions, boards face significant informational challenges which cannot be effectively addressed by structural solutions alone.[167] Rather, they can be addressed either exclusively by, or in conjunction with, process-based solutions. The description of informational problems that follows—problems of information accuracy, access, and assimilation—is meant to be illustrative, not exhaustive.

161. *Id*. at 24.
162. *Id*.
163. *Id*. at 24–26.
164. *Id*.
165. Fairfax, *supra* note 11, at 139 ("Independent directors also should promote transparent and accurate disclosures because their oversight should prevent managers from withholding or otherwise distorting information.").
166. *Id*. at 138–39.
167. Boards face other difficulties such as structural bias and groupthink. For a discussion of structural bias, see *id*. at 152–54; Antony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 U. ILL. L. REV. 237; *see also* Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith, and Structural Bias*, 32 J. CORP. L. 833 (2007); Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L. Q. 821 (2004). For a discussion of groupthink, see Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233 (2003); *see also* IRVING L. JANIS, VICTIMS OF GROUPTHINK: A PSYCHOLOGICAL STUDY OF FOREIGN-POLICY DECISIONS AND FIASCOES (1972); Bainbridge, *supra* note 145, at 32.

1. *Accuracy of Information*

Information is essential to effective monitoring,[168] and directors need complete and accurate information to engage in optimal decision making.[169] Unfortunately, directors, and particularly independent directors, are beholden to the CEO and other executive management for the information they receive. The dependence on management for information raises the specter of taint. The information may be tainted because of both unintentional and intentional biases.

Unintentional biases like confirmation and commitment biases are a well-discussed and often-cited reason that decision makers may be biased in their information acquisition, communication, and analysis.[170] Information gatherers like the CEO and her executive team are influenced by their own preferences, goals, and experiences.[171] When a CEO decides what information to include in a board packet, her choice is necessarily colored by the outcomes she desires. This tendency to identify information that confirms our expectations and disregards information that does not is known as confirmation bias.[172] She may feel that information that supports her position is more important and necessary to her board's decision making. She may ignore or not recognize information that undermines her position.[173] Similarly, if the CEO has already embarked on a course of action, she may acquire and communicate information to her board that endorses her position. This challenge, known as commitment bias, results in decision makers overvaluing the information that supports their past or present decisions, and undervaluing information that diverges from it.[174] Commitment bias is a less pernicious form of overconfidence bias which can plague the CEO and board alike. Additionally, as Donald Langevoort has noted, CEOs and other managers tend to be overconfident in the strategies they have chosen.[175] This is yet another reason they may avoid or ignore information that undermines their decisions.[176]

168. Fairfax, *supra* note 11, at 161; *see, e.g.*, *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

169. Stephen M. Bainbridge, *Independent Directors and the ALI Corporate Governance Project*, 61 GEO. WASH. L. REV. 1034, 1055–56 (1993) ("For effective management, those with the power to make decisions must have the necessary information, which must not be distorted by others' subjective interpretations.").

170. For a discussion of the problems with "the acquisition, analysis, communication, and implementation of information" in complex organizations, see, for example, Miller & Rosenfeld, *supra* note 29.

171. RICHARD M. CYERT & JAMES G. MARCH, A BEHAVIORAL THEORY OF THE FIRM 169, 171 (2d ed. 1992).

172. Miller & Rosenfeld, *supra* note 29, at 813–14.

173. Kristin N. Johnson, *Addressing Gaps in the Dodd-Frank Act: Directors' Risk Management Oversight Obligations*, 45 U. MICH. J.L. REFORM 55, 103–04 (2011).

174. Douglas G. Baird & Robert K. Rasmussen, *The Prime Directive*, 75 U. CIN. L. REV. 921, 936 (2007).

175. Langevoort, *supra* note 42, at 803.

176. *Id*.

Biases can go beyond the unintentional biases that affect even a neutral person, and can instead be harmful and intentional, such as self-interest bias. One form of self-interest bias takes place when a CEO confronts information that is different from her self-interest. Since it would be uncomfortable for the CEO to interpret the information in such a way that undermines her position, cognitive dissonance is a way for her to ignore alternative positions and frame the information in such a way that supports her point of view.[177] Another motivation that leads to the same outcome is loss aversion. A CEO wishing to avoid loss recognition or cover up a possible loss may take steps to avoid that loss being discovered, such as ignoring, distorting, or hiding information.[178] These biases feed into the concern that a CEO will not be honest or will falsely manipulate or unnecessarily withhold information. The worry that officers who are responsible for identifying, gathering, or generating information may manipulate it to influence outcomes in their favor has long been a concern of organizational scholars.[179] The result of such bias is that the information boards work with is likely inaccurate and far from complete, which hinders the board's ability to monitor and prevents it from engaging in consensus decision making.

2. *Access to Information*

The CEO is the board's primary information channel;[180] however, the CEO has tremendous informational advantages that the board does not share. Primarily, the CEO has access to information from a large range of sources on demand. The board, by contrast, does not have access to alternative information-gathering channels.[181] As I have discussed elsewhere, multiple information channels are critical to the board's decision-making process.[182] These channels determine the types of information available to the board and the amount of bias or taint associated with that information. Consequently, this affects the options and outcomes available to the board.

A dominant channel, controlled by the CEO, leaves the board disempowered and improperly informed. Outside directors recognize that the information they receive is limited and in a recent survey "independent directors were found to be less satisfied with the financial, operation-

177. Miller & Rosenfeld, *supra* note 29, at 816.

178. *Id*. at 816–17.

179. Eisenberg, *supra* note 118, at 46–47 (discussing the concern that officers may "spin the information they provide" to encourage the board to make a decision that the officers prefer as a specific example of a more generalizable problem within organizations) (citing to Paul Milgrom & John Roberts, *An Economic Approach to Influence Activities in Organizations*, 94 AM. J. SOC. S154, S156–57 (Supp. 1988)).

180. *See* discussion about third-party gatekeepers *supra* note 12.

181. For an analysis of why gatekeepers are not an effective information-gathering channel, see Sharpe, *supra* note 14, at Part II.B.1.

182. *Id.* at Part III.C.2.

al and strategic information they received than their nonindependent counterparts."[183] Boards' almost complete dependence on management for the information required to successfully oversee the same managers means that boards are unlikely to play a proactive role in monitoring.[184] Additionally, it also indicates that boards do not have the types of information necessary to make well-informed decisions.[185] For example, many managers do not provide the board with the performance metrics management, including the CEO, use when evaluating the corporation or potential strategic initiatives.[186] Consequently, boards are left without the critical and up-to-date information needed to best evaluate management, corporate performance, and strategic change.[187]

Unfortunately, the informational asymmetries that characterize the board's relationship with the CEO significantly impair a majority independent board from engaging in consensus decision making. As discussed, as long as the CEO or any other individual dominates the process, consensus decision making is not occurring. One could argue that a well-intentioned CEO, who faithfully passes along all information, could minimize problems of information access to tolerable levels. There is reason to be skeptical of such an argument. Authoritarian bias compounds informational asymmetries. Boards are more likely to trust the information received from a person in a position of authority, such as the CEO.[188] This leads to situations where directors may defer to management without sufficient analysis. Additionally, a variation of the overconfidence bias that affects the CEO's screening and communication of information can influence directors as well. Many directors are prone to overestimating the CEO's abilities. This often leads to passive acceptance of the CEO's recommendations.[189] Leveling these asymmetries is critical to improving board performance.

3. *Assimilation of Information*

Assuming that the board receives information that is unbiased, complete, and accurate, there is still the question of whether the board has the time or requisite skill necessary to properly assimilate the information. Boards usually receive their information at the last minute. It is

183. Robert J. Thomas et al., *How Boards Can Be Better—a Manifesto*, 50 MIT SLOAN MGMT. REV. 69, 72 (2009).

184. *Id.* at 69.

185. *Id.* at 70.

186. *Id.* at 73.

187. *Id.*

188. Miller & Rosenfeld, *supra* note 29, at 814–15.

189. Johnson, *supra* note 173, at 104. *Cf.* Langevoort, *supra* note 42, at 807 (describing the tendency of directors or other highly successful individuals to overestimate their own knowledge and as a result, ignore the information that comes from more knowledgeable insiders).

often poorly organized and voluminous.[190] This presents a separate set of challenges. This problem of information overload has been well vetted in the context of shareholder empowerment, but is of equal concern to directors.[191] Independent directors, who are by definition employed elsewhere, may have everything they need to make an informed decision except that they have not had the time to read and digest the substance of what they were given. The 2001 Tyco board is an excellent example of failure to assimilate information. The board knew of the executive loan program that resulted in public scandal, yet it did not investigate the loan terms or look into whether then-CEO Dennis Kozlowski had repaid the loans.[192] The result was a board that blindly trusted its CEO and that failed to investigate or process the information it had been given.

Understanding the firm-specific impediments to proper monitoring is a complex undertaking. Studies have shown that decision makers, who are otherwise intellectually capable of processing a complex choice, may, in practice, depart from thorough information analysis by employing simplified analytical shortcuts.[193] This can promote a tendency toward oversimplification that is more passive than would be ideal for a board tasked with active monitoring.[194] Complex information coupled with analytical oversimplification may also produce faulty assumptions, like directors wrongly believing the CEO's information is representative of the problem or solution. Stated differently, boards may fail to actively question the CEO's strategy and look for information and explanations that extend beyond that which they have been given. Moreover, a CEO's extensive knowledge and expertise may cause her to underestimate the complexity of the information she presents or the amount of detail necessary to understand a problem or opportunity, further reducing the quality of her board's decision making.

190. For a more detailed discussion of the problems with how and when boards receive information, see Sharpe, *supra* note 11, at 1453–55.

191. The shareholder empowerment movement seeks to shift decision-making power and control to the shareholders. This movement suggests "enhanced shareholder rights provide accountability and that accountability means lower agency costs, higher market prices, and, accordingly, a more competitive equity marketplace." William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PENN. L. REV. 653, 655 (2010). For a discussion of information overload in the context of shareholder empowerment, see Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L. Q. 417, 440–49 (2003) (discussing shareholder information overload caused by mandatory disclosures).

192. Mark Maremont, *In Plain Sight—Kozlowski's Defense Strategy: Big Spending Was No Secret*, WALL ST. J., Feb. 9, 2004, at A1; William C. Symonds, Commentary, *Tyco: How Did They Miss a Scam So Big?*, BLOOMBERG BUSINESSWEEK MAG. (Sept. 29, 2002), http://www.businessweek.com/stories/2002-09-29/commentary-tyco-how-did-they-miss-a-scam-so-big.

193. Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1051, 1077–78 (2000).

194. Miller & Rosenfeld, *supra* note 29, at 814 (discussing oversimplification bias as one response to complexity).

C. The Holes Left by Structure

As explained in Part II, one of the specific avenues by which proponents of board independence have suggested improving director autonomy is through splitting the position of board chairperson and CEO of the corporation.[195] Ending CEO/Chairperson duality without additional processual change is suboptimal because this simple structural change does not address the larger informational and knowledge asymmetries that exist within a typical corporation. As the organizational behavior literature convincingly demonstrates, empowering the board through better information-gathering and decision-making processes can help. In a related article, I establish the POA which supplies the specific attributes of such a process.[196] They include implementing a system for constructive conflict, using forward-looking information, proactively engaging in organizational goal setting, and utilizing independent information-gathering channels.[197] Ending CEO/Chairperson duality does nothing to provide the conditions under which these attributes might take hold and flourish, and so it does not materially improve a board's decision making. Instead, boards must adopt a POA to facilitate independent information gathering thereby decreasing their dependence on CEOs.

IV. PRESCRIPTIONS FOR IMPROVEMENT

For decades, Delaware has incentivized effective decision-making processes by making it and the information that underlies it a prerequisite for director protection under the business judgment rule. The courts have recognized that information is critical to a director's ability to fulfill her obligations under the fiduciary duty of care.[198] To receive the protection of the business judgment rule, directors must have informed themselves of "all material information reasonably available to them."[199] Furthermore, Delaware courts have been explicit that as part of the duty of care, boards must utilize an adequate process in making decisions.[200] *In*

195. Many U.S. corporations, however, have appointed a lead director as way of divorcing board leadership from the CEO. KORN/FERRY, *supra* note 23, at 7 ("Of those companies in North America where the CEO and chairman are the same person, 84 percent said in 2007 that they had appointed a lead director from among their nonexecutive, or independent, directors to preside at executive sessions and to evaluate the CEO."); Edward E. Lawler III & David L. Finegold, *The Changing Face of Corporate Boards*, MIT SLOAN MGMT. REV., Winter 2005, at 67, 68; *see also supra* Part II.

196. *See generally* Sharpe, *supra* note 14, at Part III.C (analyzing the attributes of an effective decision-making process).

197. *Id*. at 34.

198. Smith v. Van Gorkom, 488 A.2d 858, 874, 878, 893 (Del. 1985) (holding that the Trans Union board had breached their duty of care when they agreed to the sell the company to Marmon Group based in part on their failure to "inform themselves of all information reasonably available to them"); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); *see also In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 122 (Del. Ch. 2009).

199. *Aronson*, 473 A.2d at 812.

200. *See, e.g.*, Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 367 (Del. 1993) ("[D]irectors 'have a duty to inform themselves, prior to making a business decision, of all material information reasonably

re Caremark International Inc. Derivative Litigation found that "relevant and timely *information* is an essential predicate for satisfaction of the board's supervisory and monitoring role."[201]

Recognizing the importance of information and the decision-making processes it supports, this Part begins by suggesting a series of information-gathering channels that can help provide the type of information necessary to give boards an independent and effective decision-making process. It goes on to recommend a shift in regulatory patterns away from structural solutions and toward processual ones and describes how this might be accomplished. It concludes with an analysis of how the proposed solutions grounded in the POA can ameliorate boards' informational problems and help them become better monitors.

A. Independent Information-Gathering Channels

Internal governance mechanisms that can strengthen boards' consensus decision making and improve the quality of directors' oversight include processes by which boards gather information that is not produced or filtered by the CEO or her closest advisors. Legislation, like Dodd-Frank, has some provisions that recognize the importance of independent information channels. Specifically, Dodd-Frank includes whistleblower provisions that protect whistleblowers who report suspected wrongdoing to the SEC.[202] These formal mechanisms that can often bypass the board are not as effective as more informal mechanisms made directly available to board members.[203] For example, corporations can increase their board's access to internal information through utilizing information systems technology, establishing an internal information gatherer such as a corporate ombudsperson, or by creating a means for enabling direct board member access to the corporation's personnel.

1. Information Systems Technology

Information has become increasingly digital and remotely accessible. In response to the changing landscape, management scholars have suggested that corporations open access to information, so that directors

available to them. Having become so informed, they must *then* act with requisite care in the discharge of their duties.'") (quoting *Aronson*, 473 A.2d at 812); *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996).

201. 698 A.2d at 970.

202. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 922, 124 Stat. 1376, 1841 (2010) (codified at 15 U.S.C. § 78u-6 (Supp. IV 2010)).

203. H. Lowell Brown, *The Corporate Director's Compliance Oversight Responsibility in the Post* Caremark *Era*, 26 DEL. J. CORP. L. 1, 140 (2001) (showing that various information gathering techniques of boards, including informal communications with employees, can lead to better corporate governance).

can gather the information they want, when they want it.[204] As recently as 2007, only ten percent of directors were able to access the corporation's information virtually "through an online board portal."[205]

Directors should be able to access sales reports, customer complaint data, performance evaluations for employees such as mid-level executives, and strategy documents and budgets from operating subunits within the corporation. This access, which dramatically increases the quantity of information directors can review, should be accessible year-round, removing the time constraints that usually accompany the information directors receive.[206] It should also be generated by units during their ordinary course of business, and therefore it would be less likely to suffer from the same flaws seen in the information presented to the board by the CEO.

A disclosure regime that reveals whether or not companies have implemented the tools for effective decision making, including independent information-gathering channels, is a far more optimal means of tackling the informational problems boards confront than a structural solution like changing the chairperson of the board. Using advances in technology to open director access to informational channels like customer service or sales databases in the company can help to overcome issues of informational accuracy. Specifically, direct access to databases removes the selection and reporting biases that come from having an intermediary like a manager and then the CEO select the information that the board should receive. They provide a check on the CEO's honesty and more importantly (since most CEOs are well-intentioned and honest), help to counteract the CEO's tunnel vision or commitment to her goals that may prevent her from seeing challenges or superior courses of action. In short, it makes boards better monitors and advisors because they are armed with more accurate information that helps them to engage in closer to optimal decision making.

Independent access to information systems can also help to overcome the access problems that directors confront. There is no solution that will completely address the informational asymmetries that characterize the relationship between directors and the CEO. The CEO should be the most expert and knowledgeable person about the company's challenges and strategic outlook. The information gap, however, is too wide. It can be reduced through independent access to various databases,

204. CARTER & LORSCH, *supra* note 42, at 142 (noting that "[i]n the twenty-first century, [directors] should not have to wait until they receive information from management; they should be able to seek and access much of it on their own, electronically").

205. Thomas et al., *supra* note 183, at 72.

206. Carter and Lorsch write of several companies that have developed intranet systems which allow the board to access performance information and generate reports based on criteria they select. *See* CARTER & LORSCH, *supra* note 42, at 154. They write: "A few companies, ahead of the field, are developing intranet-based systems that enable boards to have relevant performance information at their fingertips. Information from a multitude of reports can be reorganized, summarized, and added to a database, and 'easy to use' graphical information can be accessed by directors." *Id*.

strategy documents, department reports, and other forward-looking information the company compiles. Directors who access these information channels may be less prone to the overconfidence and authoritarian biases that lead to unquestioned acceptance of the CEO's recommendations and proposals. Informed and intelligent questioning can help to uncover the weaknesses of the executive's approach as well as provide directors with an informed way to bring their expertise to bear on helping the company to succeed.

2. *Internal Information Gatherers*

Another option is appointing an independent, inside information gatherer, such as a corporate ombudsperson. Many firms have appointed a corporate compliance ombudsperson, which is often an individual or an office that reports directly to the CEO.[207] In order to operate as a source of independent information and knowledge, the board ombudsperson should report directly to the board.[208] The corporate ombudsperson could be tasked both with mitigating intra-firm conflict and gathering information needed by the board. A board ombudsperson would be independent of management and would present an option for employees who would like to discuss their concerns, especially concerns that might involve risk exposure for the corporation.[209] As an insider,[210] the ombudsperson would have access to wider sources of corporate information than is typically made available to the board. Due to her access to employees at all levels of the corporation, the ombudsperson is also more likely to identify or be notified of potential trouble spots for the firm before executive management, and in any case before problems become unmanageable.[211] Consequently, by ensuring that the board is made aware of potential problems, the ombudsperson can facilitate information flow to the board in a way that enables proactive solution formation.

Internal information gatherers such as a corporate ombudsperson can help with the informational biases that reduce the accuracy of information the CEO and her executive team provides. An ombudsperson often serves as an early indicator of the concerns that are troubling employees and lower-level management. This knowledge, which should be transmitted directly to the board, improves both the accuracy and access that board members have to information from the ground up.

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207. For an example of a company with an Ombudsman/CEO reporting structure, see *Corporate Governance: Ombudsman*, COCA-COLA ENTERS., http://ir.cokecce.com/phoenix.zhtml?c=117435&p=irol-govombudsman (last visited Mar. 6, 2013).

208. Jonathan E. McBride & James S. Hostetler, *Board Champions for the Ombudsman*, DIRECTORS MONTHLY, May 2008, at 15, 16.

209. *Id*. at 15.

210. Lynne L. Dallas, *Proposals for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudsperson*, 54 WASH. & LEE L. REV. 91, 130–36 (1997).

211. McBride & Hostetler, *supra* note 208, at 16–17.

3. *Open Access to Personnel*

Alternatively, a company could provide its board with open access to personnel, customers, and physical facilities instead of appointing an intermediary like an ombudsperson. This would give directors the opportunity to speak directly with lower and mid-level managers, and other key employees.[212] Directors would be able to gather firsthand information and develop independent accounts of the problems and areas that are critical to the firm's long-term success. Unlike the ombudsperson, directors would not have the same level of trust from employees and managers that an ombudsperson garners as a fellow insider to the employees she represents. The clearly defined role of outsider may be less concerning to employees, however, who may view an ombudsperson as a spy for senior management. In any event, the three methods of board information gathering discussed here are by no means exclusive. They could be integrated into a larger information-gathering process that allows directors multiple channels through which board members can gather information that is not generated, filtered, or directly controlled by the CEO. Open access to personnel presents boards with a varied range of viewpoints that can simultaneously counteract the CEO's biases and provide alternative approaches to the problems and opportunities the company encounters. It reduces informational asymmetries and the board's dependence on a single channel for the information it receives.

Increasing a board's sources of information is a better means of facilitating effective information flow, encouraging consensus decision making and ultimately facilitating board independence than is myopically focusing on board leadership structure. Each of the solutions described above, along with other information processes drawn from the POA, such as goal setting and a system for constructive conflict,[213] can be implemented with either leadership structure. A forced change in structure alone will not change the way the board receives and processes information because it is still grounded in the views and power of the CEO. In other words, it does not systematize information access, which remains in the CEO's discretion. Thus, it will not change how decisions are made or improve the level of substantive director independence.

212. Carter and Lorsch note that directors who travel with senior management to see distant operations "can transform relationships with senior management, allow [directors] to meet local staff, as well as build knowledge." CARTER & LORSCH, *supra* note 42, at 150. Carter and Lorsch also write that directors tell them "that they learn more about the business in casual conversation with management—often during meals or while traveling to company facilities—than they do in board meetings." *Id*. at 149.

213. Sharpe, *supra* note 14, at Parts III.C.3–4.

B. Flexibility and Process

Each corporation is unique, and many of the variables that help to determine the optimal structure are endogenous and cannot be set by a one-size-fits-all approach. For instance, an association of CEOs known as the Business Roundtable[214] 2010 Principles of Corporate Governance articulates a company-by-company approach to board leadership structure, because "[n]o one leadership structure is right for every corporation at all times."[215]

The proposed solutions are amenable to being implemented as either best practices promulgated through organizations like the Business Roundtable or through government regulation. Even if industry practice begins to change, Congress will likely continue to debate, consider, and sometimes pass legislation that bears directly on corporate governance. Thus, this Article proposes a better way of regulation. Instead of invoking the SEC's rulemaking authority to mandate disclosures about leadership structure of boards,[216] or forcing actual structural changes,[217] Congress should instead consider how to help boards improve their decision-making process. Disclosure requirements that consider how the company empowers independent decision making and information gathering for its board would give companies the flexibility to develop specific approaches tailored to their needs.

In the area of criminal prosecution, the Department of Justice's McNulty Memorandum[218] and its predecessor, the Thompson Memorandum,[219] set forth general principles on compliance programs. It encourages corporations to establish a compliance program to "prevent and to

214. The Business Roundtable is active in setting corporate governance public policy, the CEOs who make up the association's membership "comprise nearly a third of the total value of the U.S. stock markets."

215. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 132, at 16–17 ("The board should decide whether to combine or separate the positions of CEO and chairman of the board based on its assessment of what is in the best interests of the corporation and its shareholders based on the corporation's particular circumstances, and the board should evaluate its leadership structure periodically.").

216. *See* discussion of Dodd-Frank *supra* Part II.B.

217. For examples of structural changes, see Baysinger & Butler, *supra* note 46, at 102 (noting that corporate board reform proposals emphasize changes to board composition and independence); Fairfax, *supra* note 11, at 138 (writing that increasing director independence has been "[t]he principle corporate-governance response to the agency problem"); Ribstein, *supra* note 42. Improving independence is not the only response to corporate failure. *See id.* at 11–18 (describing other regulatory responses to corporate fraud); Rodrigues, *supra* note 29, at 452 ("Corporate governance reformers generally presume (1) that outside independent boards are better than non-independent boards, and (2) that the more independent a board is, the better."); *see also* Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7262 (2006); NASDAQ LISTING RULES, *supra* note 10, § 5605; NYSE LISTED COMPANY MANUAL, *supra* note 10, §§ 303A.01–.02.

218. Memorandum from Paul J. McNulty, Deputy Att'y Gen., to Heads of Dep't Components and U.S. Attorneys 8 (Dec. 12, 2006) [hereinafter McNulty Memorandum], *available at* http://www.justice.gov/dag/speeches/2006/mcnulty_memo.pdf.

219. Memorandum from Larry D. Thompson, Deputy Att'y Gen., to Heads of Dep't Components and U.S. Attorneys, at vi (Jan. 20, 2003) [hereinafter Thompson Memorandum], *available at* http://www.justice.gov/dag/cftf/corporate_guidelines.htm.

detect misconduct."[220] In the comments to the principle that encourages such a program, the DOJ states that it "has no formal guidelines for corporate compliance programs. The fundamental questions any prosecutor should ask are: 'Is the corporation's compliance program well designed?' and 'Does the corporation's compliance program work?'"[221] It goes on to provide guidelines on what the prosecutors should consider.

Similarly, the sentencing guidelines have looked to various actions by corporations as mitigating and aggravating factors in sentencing when calculating the organization's culpability score.[222] Specifically, they look to whether the organization had an effective ethics and compliance program.[223] They provide guidance on how to determine whether a program is effective. The guidance includes very broad inquiries that frame the values the programs support. For instance, the guidelines ask whether an organization promotes "an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[224] They also give more specific instructions to organizations, such as setting forth a reporting structure for the program. The guidelines state:

> Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the compliance and ethics program. Individual(s) with operational responsibility shall report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority, on the effectiveness of the compliance and ethics program. To carry out such operational responsibility, such individual(s) shall be given adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority.[225]

The guidelines do not, however, dictate a specific structure for a program that all companies must implement. They provide a flexible approach that allows corporations to determine what type of program and reporting system best suits their needs. While this example is still a structural change, it does illustrate how various governmental bodies can provide useful guidance to corporations. These approaches endorse and incentivize behaviors without mandating a specific structure for all corporations.

In contrast, pushing boards to separate the position of CEO and Chairperson asks corporations to adopt a unitary approach to governance. It is also in direct contravention of the empirical evidence on

220. McNulty Memorandum, *supra* note 218, at 12.

221. *Id.* at 14.

222. U.S. SENTENCING GUIDELINES MANUAL § 8C2.5 (2011), *available at* http://www.ussc.gov/Guidelines/2011_Guidelines/Manual_HTML/8c2_5.htm.

223. *Id*. § 8C2.5(f).

224. *Id*. § 8B2.1(a)(2).

225. *Id*. § 8B2.1(b)(2)(C).

board leadership structure.[226] Changing a corporation's leadership structure does not necessarily lead to better information access or consensus-based decision making. On the other hand, a POA to regulation can be designed to fit the endogenous nature of corporate governance. For instance, policy makers might require that boards put independent information-gathering channels in place and then look to how well designed and robust those programs are for helping a board to achieve true independence.

V. LIMITS OF THE PROCESS-ORIENTED APPROACH

The POA detailed above cannot prevent all corporate failures. It can, however, improve boards' ability to monitor and more effectively advise the CEO. The approach fills a portion of the policy-making space that is dominated by a misguided focus on structure. This Part considers some of the challenges and implications presented by the POA.

A. Undermining the CEO

One concern is that independent information-gathering channels would place the board in a position of managing, not monitoring, and undermine the CEO's ability to run the corporation. Moreover, if CEOs and boards thought that better information-gathering channels were an effective governance tool, they would have implemented these solutions already. Many CEOs are understandably worried about directors interfering in management, and are territorial about their information and their employees.[227] For example, a Boston Consulting Group/Harvard Business School Survey of 132 CEOs in 2001 found that almost half of North American CEOs did not agree with the proposition that directors should be able to access employees and facilities outside of the boardroom, while another quarter was unsure about the idea.[228]

A firm that is aware of the need to respect the CEO's position can craft solutions that balance the need to substantially enhance the board's monitoring capabilities against respect for the CEO's leadership. A firm, however, is unlikely to develop such a solution on its own. There are barriers that prevent boards from initiating this kind of change, such as status quo bias.[229] Additionally, without a specific requirement to do so, CEOs may not be willing to open these channels to the directors. A requirement, either in the form of a law or a best practices standard from an organization like the Business Roundtable, reduces the costs of direc-

226. *See* discussion *supra* at Part II.B.
227. CARTER & LORSCH, *supra* note 42, at 154.
228. *Id*. at 149, 212.
229. *See* Sharpe, *supra* note 14, at Part V.B.1 (discussing status quo bias and why it prevents directors from initiating substantive change).

tors confronting managers and demanding more information.[230] In the absence of such a requirement, directors (who are likely themselves CEOs at other companies) may be hesitant to interfere with the discretion and autonomy of the CEO for several reasons.[231] Director interlocks, where directors are CEOs and executive managers of other companies, can reduce director independence.[232] Directors may have many self-interested reasons, such as being from a company that transacts business with the company on whose board she sits.[233] Directors may feel that asking for information could lead to interpersonal conflict with the CEO and create more tension in the relationship between the CEO and the board.[234]

So as not to undermine the CEO's ability to effectively manage the firm, it would therefore be advisable for any corporation that provides for increased board information gathering to adopt sensible control mechanisms. For example, board members could be required to inform the CEO about meetings with lower-level managers, plant visits, etc., after they have taken place.[235] The board's goal should be to develop a deeper understanding of the business and procure the information it needs to monitor effectively, not to unduly undermine the ability of the CEO to lead.

B. Practical Limitations on Directors

Another concern is that information-gathering channels are of limited utility when it comes to information assimilation. Simply put, directors will continue to be part-time employees that do not have the time to digest the information they are given.

The approach suggested above and the broader POA provide several methods for improving assimilation, even in instances of limited time. There are discussion processes, such as constructive conflict,[236] that

230. Lynn A. Stout, *In Praise of Procedure: An Economic and Behavioral Defense of* Smith v. Van Gorkom *and the Business Judgment Rule*, 96 NW. U. L. REV. 675, 688–89 (2002) (describing how the business judgment rule reduces the "cost of confronting," which includes "the costs associated with asking the company's management for more information, or even challenging management's conclusions when the director does not agree with them").

231. Benjamin E. Hermalin & Michael S. Weisbach, *Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature*, FRBNY ECON. POL'Y REV., Apr. 2003, at 7, 18; Michael L. McDonald & James D. Westphal, *A Little Help Here? Board Control, CEO Identification with the Corporate Elite, and Strategic Help Provided to CEOs at Other Firms*, 33 ACAD. MGMT. J. 343, 345 (2010) (defining the "corporate elite as the collection of top managers of large corporations who sit on multiple boards of directors of large firm. . . ." The article goes on to suggest that CEOs who are subject to boards that exert greater control over their decisions are less likely to provide strategic assistance to CEOs when they sit on another corporation's board).

232. Sydney Finkelstein & Ann C. Mooney, *Not the Usual Suspects: How to Use Board Process to Make Boards Better*, ACAD. MGMT. EXEC., May 2003, at 101, 101.

233. *Id*.

234. Stout, *supra* note 230, at 689.

235. CARTER & LORSCH, *supra* note 42, at 149.

236. *See* Sharpe, *supra* note 14, at Part III.C.4.

can improve a director's ability to analyze and understand available information. None of the solutions discussed above changes directors from periodic part timers with limited involvement in the day-to-day operations of the company. Nevertheless, directors who have continuous access to the company's strategic information and challenges can choose to devote more time to learning about the firm's opportunities and challenges. It also affords directors with a means to research and verify information that supports the various proposals that are slated for each board meeting.

Directors may still be too busy or unable to properly understand the information they review due to a lack of expertise, but this is an improvement on the status quo, as most individuals are likely to digest information in small pieces over extended periods of time instead of a large volume presented shortly before the meeting. In short, it improves upon the problems of assimilation, but does not guarantee a change.

Additionally, like the problems with assimilation, it is easy for corporations to comply with regulations without it making a substantive difference. Stated differently, regulations that adopt the POA may simply be another compliance requirement that never rises above the level of a check-the-box obligation. Most directors, despite their time constraints, would like to do their job well.[237] Expanding their job definition to include more in depth and meaningful decision making will inspire many directors to rise to the challenge. Organizational behavior findings support this assumption and provide hope that information assimilation may actually occur.[238]

If the analysis and proposals in this Article were to be adopted, the most obvious change would be a shift toward a Process-Oriented Approach and away from a structural focus. Regulators would implement policy initiatives that allowed boards to endogenously determine their ideal structure, and the right mix of information processes for their specific corporation. Many of the solutions that regulators have employed are structural in nature, and they are all tailored to fit within the agency-theory paradigm. This Article has identified an alternative scholarly approach, which in this instance, is consistent with the goals of agency theory and helps to make boards into the more effective monitoring body that agency theory seeks.

237. *See* Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L. Q. 403, 438 (2001) (discussing altruistic behaviors and noting that directors have internalized the belief that "they ought to behave in a careful, loyal, and trustworthy fashion").

238. *See* Richard Moreland, *Social Categorization and the Assimilation of "New" Group Members*, 48 J. PERSONALITY & SOC. PSYCHOL. 1173 (1985); *see* Sharpe, *supra* note 14, at Part III.C.

VI. CONCLUSION

There is a fundamental and yet entirely misunderstood mismatch between recent corporate regulation and the way boards of directors work in practice. Regulators and some legal scholars have argued that board leadership structure is crucial to securing substantive board independence and improving corporate governance. The underlying intuition is that a structurally independent chairperson will facilitate substantive board independence, which will in turn lead to better detection of managerial corruption or incompetence. Recent legislation, such as the Dodd-Frank Act, reflects this mistaken understanding.

This Article argues that structurally oriented approaches to board reform address structure at the expense of process. Structural solutions without an effective process do not improve a board's decision making or broader firm performance. For instance, boards fail to function by consensus decision making because current corporate structures emphasize cosmetic independence. This puts boards at an inherent informational disadvantage. Changing the titular head of the board will not magically level this asymmetry.

This Article suggests a new analytical paradigm that reorients our focus away from board structure and toward board decision-making processes, which is more important to effective oversight than changing the title of an individual board member. The animating intuition is simple: effective board decision making and proper managerial oversight requires that board members have informational autonomy. Board members currently lack the ability to get their own information about their companies' operations, placing them at the mercy of the CEO and the management team she controls. Until boards have meaningful informational autonomy, they will never function as consensus-based decision makers or as the effective monitors that policy makers, shareholders, and the public desire.