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ABSTRACT

As a result of the worldwide economic downturn stemming from events over the past fifteen years, there has been an emphasis on the need to reform modern corporate governance norms in order to restore public faith in corporate America. The public has openly criticized the upper echelon of corporate management for its failure to prevent the recent crises, continued prosperity, and perceived capitalization on the losses of other corporate constituents. In particular, boards of directors of large corporations have increasingly been subject to scrutiny. This Note addresses the insularity of boards of directors for publicly held corporations and argues that the existing ideological frameworks are polarizing and preclude the possibility of reaching a solution. It then proposes a reform to the election process and reconceptualization of shareholder voting rights.

American corporate governance laws and regulations require every corporation to have a board of directors to serve as an intermediary between the owners and managers of the corporation. The problem with executive boards is that they are self-perpetuating, and shareholders are generally without recourse even if it is clear that a board has mismanaged a corporation. Consequently, reforms seeking to eradicate the pervasiveness of corporate managers' personal preferences from corporate decisions have similarly sought to prevent corporate managers' social connections from influencing corporate appointments. Nevertheless, an elite network of corporate

* J.D. Candidate, Fordham University School of Law, 2015; B.A., University of Wisconsin-Madison, 2012. I would like to thank Professor Caroline Gentile for her counsel and advice with this Note and all of my friends for their tremendous support and encouragement. I also would like to thank the editorial board and staff of Volume XX for all of their hard work and support.

officers remains influential over the process of identifying and selecting directors.

This Note is concerned with the insularity of boards of directors of publicly held corporations because of the inherent consequences of the combination of board entrenchment and unconstrained board activity. Specifically, it addresses how board insularity compromises the objectivity of directors and ultimately precludes the board from faithfully working toward the ultimate goal of shareholder wealth maximization. Ultimately, this Note offers a way to mitigate an incumbent board's dominion over the corporation through reform of the processes of director selection and election. It explains that a national standard is necessary to preserve the integrity of the institution of corporate boards in light of the ever-increasing responsibilities imposed on them. Furthermore, the proposed solution was reached with consideration of the need to balance the establishment of protective measures to monitor directorial action with the board's need for autonomy from individual managers', shareholders', and governmental interests. A compromise among these competing interests can be reached by reforming the process by which directors are selected to ensure their competency rather than through interference with the way in which an assumedly competent board carries out its duties. This Note concludes by arguing that the existing ideological frameworks, which articulate the primary purpose of the board, are polarizing and preclude the possibility of reaching a solution to counterbalance the currently unrestrained insularity of corporate boards.

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INTRODUCTION

"If you want to be on [corporate] boards, you have to fish where the fish are."[1] Selected by *Fortune* as one of the "50 Most Powerful Women in Business" for five consecutive years, Maggie Wilderotter emphasizes the importance of networking to obtain a position on a board.[2] In the last twenty-eight years, Wilderotter served as a director on the boards of twenty-three publicly held corporations.[3] In 2004 Wilderotter was both

1. Maggie Wilderotter, *How to Get on a Board*, BUS. WK. (Apr. 11, 2013), http://www.businessweek.com/articles/2013-04-11/how-to-get-on-a-board-by-frontier-communications-ceo-maggie-wilderotter.

2. *See Juno Appoints Maggie Wilderotter to Board of Directors*, PRNEWSWIRE (Nov. 25, 2014), http://www.prnewswire.com/news-releases/juno-appoints-maggie-wilderotter-to-board-of-directors-300000682.html; *Fortune's 50 Most Powerful Women in business*, FORTUNE (Oct. 10, 2013, 12:05 PM), http://fortune.com/2013/10/10/fortunes-50-most-powerful-women-in-business/.

3. Wilderotter, *supra* note 1.

appointed to the board of directors of Frontier Communications Corporation and hired as its Chief Executive Officer ("CEO").[4] Subsequently, Wilderotter attributed landing her current job as well as her appointment to various boards to successful networking.[5]

As a result of the worldwide economic downturn stemming from events over the past fifteen years, there has been an emphasis on the need to reform modern corporate governance norms in order to restore public faith in corporate America.[6] In particular, the public has openly criticized the upper echelon of corporate management for its failure to prevent the recent crises, its continued prosperity, and its perceived

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4. Currently, Wilderotter is a director at Frontier Communications Corp., Proctor & Gamble Co., and Xerox Corp. as well as at many other non-profit corporations. *See Maggie Wilderotter*, WALL ST. J., http://topics.wsj.com/person/W/maggie-wilderotter/946 (last visited Dec. 1, 2014). Most recently, Wilderotter was appointed to the board of directors of Juno Therapeutics, which became a publicly held corporation less than one month after her appointment as director following completion of its initial public offer on December 19, 2014. *See Juno*, *supra* note 2; JUNO THERAPEUTICS, INC., NASDAQ.COM, http://www.nasdaq.com/markets/ipos/company/juno-therapeutics-inc-923186-76993 (last visited Jan. 26, 2014).

5. *See* Wilderotter, *supra* note 1 ("I'd already served on a board with many of the directors who recruited me to be a CEO."); *see also Mary Wilderotter*, FORBES, http://www.forbes.com/profile/mary-wilderotter/ (last visited Sept. 24, 2014).

6. *See* William B. Chandler III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953, 953-54 (2003); Michael K. Molitor, *The Crucial Role of the Nominating Committee: Re-Inventing Nominating Committees in the Aftermath of Shareholder Access to the Proxy*, 11 U.C. DAVIS BUS. L.J. 97, 99 (2010) ("But the owners periodically become restless and angry, and calls for greater shareholder involvement in corporate governance have been increasingly insistent following Enron and the other scandals of the early 2000s and the 2008-2009 financial crisis."); *see also* Arthur R. Pinto, *An Overview of United States Corporate Governance in Publicly Traded Corporations*, 58 AM. J. COMP. L. 257, 279-83 (2010) (describing the federal government's response first to the 2001 Enron and WorldCom scandals, which precipitated the promulgation of the Sarbanes-Oxley Act of 2002, and second to the 2008 crisis of large financial institutions, which not only precipitated increased federal government involvement in corporate governance of publicly held corporations, but also "limit[ed] the role of the states in corporate governance"); Zachary A. Goldfarb, *SEC to Examine Boards' Role in Financial Crisis*, WASH. POST (Feb. 20, 2009), http://www.washingtonpost.com/wp-dyn/content/article/2009/02/19/AR2009021903172.html. *See also infra* Part I.C.2.b.ii, for a discussion of the federal government's attempts to increase transparency and enhance accountability of corporate boards.

capitalization on the losses of other corporate constituents.[7] Consequently, reforms seeking to eradicate the pervasiveness of corporate managers' personal preferences from corporate decisions have similarly sought to prevent corporate managers' social connections from influencing corporate appointments.[8]

Wilderotter would not have had such a successful career if she were not effective at doing her job; however, her story corroborates suspicions that an elite network of corporate officers remains influential over the process of identifying and selecting directors.[9] Wilderotter's experience also confirms that the new regulations imposed on boards of directors of publicly held corporations have not significantly changed the ways in which corporations select people to serve on their boards.[10]

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7. Chandler & Strine, *supra* note 6, at 953-54 ("Propelled by genuine outrage at abuses within companies like Enron . . . and by fear of being held accountable for previous inaction, the federal government . . . and the nation's two largest Stock Exchanges . . . have adopted important new initiatives designed to improve the integrity of corporate America[.]") (footnotes omitted).

8. *See* Eric M. Fogel & Andrew M. Geier, *Strangers in the House: Rethinking Sarbanes-Oxley and the Independent Board of Directors*, 32 DEL. J. CORP. L. 33, 49 (2007) (likening nominating committees to "membership committees of private clubs" and director recruitment to a superficial contest whereby companies "compete for 'A-list' board members much like academy award parties vie for 'A-list' celebrities"); *see also* Robert Sprague & Aaron J. Lyttle, *Shareholder Primacy and the Business Judgment Rule: Arguments for Expanded Corporate Democracy*, 16 STAN. J.L. BUS. & FIN. 1, 18 (2010) (explaining that some commentators perceive the incumbent corporate boards' control over annual director elections "as a defect in the democratic process of electing boards of directors[,]" and that they advocate for "more effective oversight of directors by shareholders . . . to improve corporate performance and prevent the kinds of scandals and economic crises that rocked the American economy during the past decade").

9. In April 2014, Wilderotter spoke at Northwestern University's Kellogg School of Management's "Brave Leader Series" with her sister, Denise Morrison, who happens to be the President and CEO of Campbell Soup Company. During their appearance, the sisters expounded on the importance of networking, with Wilderotter agreeing that "networking is working" and explaining that as one of her strengths it has "opened up opportunities and different jobs that [she] had." *Sister CEOs*, KELLOGG NEWS (Apr. 15, 2014), http://www.kellogg.northwestern.edu/news_articles/2014/04152014-morrison-wilderotter-brave-leader.aspx (containing a link to a video of the sisters' commentary on the importance of networking); *see infra* Part I.A.1.a.

10. *See* Jena McGregor & Brigid Schulte, *Women still hold only 19 percent of U.S. board seats. What could change that?*, WASH. POST (Jan. 13, 2015), http://www.washingtonpost.com/blogs/on-leadership/wp/2015/01/13/women-still-hold-only-19-percent-of-u-s-corporate-board-seats-what-could-change-that/ (noting how

This Note is about the insularity of boards of directors of publicly held corporations.[11] It addresses the inherent consequences of the combination of board entrenchment and unconstrained board activity,[12] and it offers a way to mitigate an incumbent board's dominion over the corporation through reform of the processes of director selection and election.[13] Finally, this Note argues that the existing ideological frameworks, which articulate the primary purpose of the board, are polarizing and preclude the possibility of reaching a solution to counterbalance the currently unrestrained insularity of corporate boards.[14]

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organizations like WomenCorporateDirectors and Catalyst recognize the importance of networking in securing board appointments and quoting Susan Stautberg, co-founder of WomenCorporateDirectors, when she explained the important service provided by a membership directory of qualified businesswomen "to help introduce women to 'guys who may have only known people at their golf club or on the Business Roundtable. Women get handicapped because they haven't always been part of those networks"); PR NEWSWIRE, *Want to Land the Corner Office?*, SYS.CON MEDIA (Aug. 26, 2014), http://www.sys-con.com/node/3160497 ("The strength of your network could make or break your search, since most leadership hires result from referrals and connections, not postings or applications.). *But see* Dorie Clark, *How to Become a Corporate Board Member*, FORBES (Aug. 13, 2012), http://www.forbes.com/sites/dorieclark/2012/08/13/how-to-become-a-corporate-board-member/ (explaining that corporate boards no longer look to their social network to fill director positions because the Sarbanes-Oxley Act of 2002 imposed "very clear regulations for independent directors in terms of the credentials necessary to be a financial expert or compensation expert[,]" and boards now look to professional search firms to find new directors who "demonstrate proof in past experiences, degrees, focus, and the skill sets board members bring") (quoting Elaine Eisenman, Dean of Executive Education at Babson College); *see infra* Part I.C.2.b.ii.

11. This Note discusses boards of directors of publicly held corporations as opposed to boards of directors of closely held corporations.

12. *See infra* Part I.C.

13. *See infra* Part II.B (introducing a reform to regulate the election process of directors and to re-conceptualize shareholder rights).

14. Pinto, *supra* note 6, at 264 (explaining how a system of corporate governance monitors "the allocation of power and internal mechanisms designed to protect shareholders without undermining those who need to manage the corporation"); *see infra* Part III.

A. A BOARD HAS LEGAL CONTROL OF THE CORPORATION

From the outset, the corporate board operates as an intermediary between the ownership and management of the company, relegating shareholders to the role of passive investors.[15] Specifically, every publicly held corporation has a board of directors that has legal control over the corporation.[16] Similarly, every publicly held corporation has common stock that members of the public may purchase to become shareholders.[17] This separation of ownership and control is a defining characteristic of the corporation.[18]

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15. *See* ADOLF BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 120 (Macmillan Co. 1932); *see In re* Trados Inc. S'holder Litig., 73 A.3d 17, 38 (Del. Ch. 2013) ("Directors must exercise their independent fiduciary judgment; they need not cater to stockholder whim."); *see generally* Pinto, *supra* note 6, at 259-60 (explaining that although "[o]wnership usually implies control, . . . without a concentration of ownership in shares, managers who control corporate assets, information, and the voting mechanisms are in de facto control of the corporation with little oversight by the owners, i.e., the shareholders." And thus, "[s]hareholders of many publicly controlled corporations are passive"); Carol R. Goforth, *"A Corporation has no Soul"—Modern Corporations, Corporate Governance, and Involvement in the Political Process*, 47 HOUS. L. REV. 617, 629 (2010) (identifying their primary power as "vot[ing] with their feet' by selling their shares and buying into another business venture[,]" which they may do "if they do not like how 'their' corporation is being managed") (footnote omitted). *But see* Grant Hayden & Matthew T. Bodie, *Shareholder Democracy and the Curious Turn Toward Board Primacy*, 51 WM. & MARY L. REV. 2071, 2083 (2010) (calling into question the characterization of shareholders as "owners" of the corporation).

16. Jones Apparel Group, Inc. v. Maxwell Shoe Co., 883 A.2d 837, 850 n.36 (Del. Ch. 2004) ("[C]orporate power, as a default matter, is exercised through the board."); *e.g.*, MODEL BUS. CORP. ACT § 2.05 (2005); Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005) [hereinafter *Increasing Shareholder Power*] ("A central and well-settled principle of U.S. corporate law is that all major corporate decisions must be initiated by the board.").

17. *See* Molitor, *supra* note 6, at 99 (explaining that although "[s]hareholders 'own' the corporation, . . . the board of directors has nearly absolute control over it").

18. A basic attribute of a corporation is its separate legal existence from its owner. Specifically, the owners of shares of a corporation generally are not personally liable for the acts or debts of the corporation. This separation distinguishes the corporation from other business associations that do not exist as separate legal entities such as partnerships or limited liability companies. For example, the owners of a partnership are subject to unlimited personal liability for the obligations of the partnership. *See* Stephen M. Bainbridge & M. Todd Henderson, *Boards-R-Us: Reconceptualizing Corporate Boards*, 66 STAN. L. REV. 1051, 1074 (2014); *see generally* David McBride, *General Corporation Laws: History and Economics*, 74-WTR LAW & CONTEMP.

While the applicable state corporate code that governs a corporation will vary by the place of incorporation, all states require investors to relinquish control to a board of directors upon incorporation.[19] Although recent federal regulations seeking to increase transparency and accountability of publicly held corporations have targeted boards of directors,[20] the majority of corporate legal issues remain covered by state law.[21]

Importantly, to form a company, state laws require the incorporating investors to elect a board of directors.[22] Investors stipulate their expectations of the board in the charter of incorporation, and state laws typically afford investors broad discretion to define the role of the board.[23] Thus, in addition to the applicable state law, a board operates in

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PROBS. 1, 4-5 (2011) (discussing advantages and disadvantages of the separation of ownership and control and the purpose of a corporation as a legal entity that "facilitate[s] collective action by individuals").

19. *E.g.*, MODEL BUS. CORP. ACT § 8.01(b); *see also* Pinto, *supra* note 6, at 262 ("The corporate law of the state of incorporation will usually apply to the internal affairs of those corporations which deal with allocation of power within the company how the company is managed and controlled.").

20. *See infra* Part I.C.2.b.ii for a discussion of new regulations that emerged during the 2000s following the 2002 corporate scandals and 2008 financial crisis.

21. Pinto, *supra* note 6, at 262 n.27 ("The internal affairs are usually viewed as the law which governs the intra-corporate relationships involving the corporations and its officers, directors, and shareholders. Thus issues of formation, voting, fiduciary duty, structural changes, and internal corporate power and structures have traditionally been state law issues.") (citation omitted).

22. Although corporate laws vary by state, all require the shareholders of a publicly held corporation to elect a board of directors upon incorporation. *See, e.g.*, DEL. CODE ANN. tit. 8, § 108 (2014) (requiring the directors to be named either in the charter or at an organization meeting).

23. For example, many corporations contain a bylaw "precluding director nominations by shareholders unless preceded by a notice given to the corporation by a certain time before the shareholder meeting[.]" Lawrence A. Hamermesh, *Director Nominations*, 39 DEL. J. CORP. L. 117, 136 (2014). Additionally, state business codes generally contain default rules, most of which are flexible because states want businesses to incorporate there. *See, e.g.*, Jones Apparel Group, Inc. v. Maxwell Shoe Co., 883 A.2d 837, 853 (Del. Ch. 2004) (holding for the Jones Apparel Group because it had properly adopted a default rule set out under Section 213(b) of the *Delaware General Corporation Law* ("DGCL")); Edward P. Welch & Robert S. Saunders, *Freedom and Its Limits in the Delaware General Corporation Law*, 22 DEL. J. CORP. L. 845, 847 (2008) (explaining that "much of the DGCL creates statutory rules that are merely 'defaults[]' [that] apply only so long as the parties to the corporation choose not

accordance with its corporation's incorporating charter and bylaws.[24] After incorporation, however, any changes to a board's duties are subject to formal procedural requirements.[25]

B. A BOARD'S EVERY ACTION MUST PROMOTE SHAREHOLDER WEALTH MAXIMIZATION

Although a corporate board has numerous responsibilities,[26] it is important to consider the duties of the board in light of its primary purpose—to manage the corporation in a way that maximizes the value of the shareholders' common stock.[27]

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to deviate from them"); *see also* William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663, 664 (1974) (discussing the advent of modern liberal corporation statutes and the origin of the race as acknowledged in Justice Brandeis' dissent in Ligget Co. v. Lee, 288 U.S. 517, 562-63 (1933)). *But see* Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1369 (2013) (rejecting the explanation that states shape their corporate statutes to entice companies to incorporate there as part of a "race"); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 635-39 (2003).

24. DEL. CODE ANN. tit. 8, § 141; Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 BUS. LAW 67, 72 (2003) (identifying "the corporation's charter and bylaws and by the corporate statutory law of the corporation's jurisdiction of incorporation" as resources from which to glean the parameters of a company's shareholders' rights).

25. *See, e.g.*, DEL. CODE ANN. tit. 8, § 103 (explaining the process to amend an instrument of the corporation, e.g., bylaws of the corporation), § 141(a) ("If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.").

26. Section 141 of the DGCL imposes on corporate boards the duty to manage or direct the business and affairs of their respective corporations. DEL. CODE ANN. tit. 8, § 141(a). Although state law does not articulate specific responsibilities the board must carry out to manage the corporation, modern corporate boards are generally expected to "approv[e] strategic plans, financial policies, and material transactions," and to "monitor[] management performance." Michael E. Murphy, *The Nominating Process for Corporate Boards of Directors: A Decision-making Analysis*, 5 BERKELEY BUS. L.J. 131, 151 (2008).

27. *See* Thompson v. Walker, 234 N.W. 144, 147 (Mich. 1931) ("It is the essence of this trust [that directors occupy in relation to stockholders] that it shall be so managed as to produce to each stockholder the best possible return for his investment."); Wojcik v. McNish, No. 267005, 2006 WL 2061499, at *5 (Mich. Ct. App. July 25, 2006) (finding that "a shareholder [undoubtedly] has an interest in having

In contemplating the board's purpose, the duties of a board can be analogized to the duties of a trustee.[28] Together, the directors serve as the trustee of the corporation's shares.[29] The fiduciary relationship that a board assumes upon the transfer of control from the shareholders defines the standard by which a board must fulfill its statutory obligation to manage or direct a corporation's business and affairs for the benefit of its shareholders.[30] Specifically, the transfer of control over the

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his investment become as profitable as possible"); Molitor, *supra* note 6, at 101 (explaining the traditional view "that the corporation should be operated primarily to maximize the wealth of its common shareholders"); A. A. Berle, Jr., *For Whom Corporate Managers are Trustees: A Note*, 45 HARV. L. REV. 1365, 1365 (1932) ("Historically, and as a matter of law, corporate managements have been required to run their affairs in the interests of their security holders.").

28. *Black's Law Dictionary* defines a "trust" as "a property interest held by one person (the trustee) at the request of another (the settlor) for the benefit of a third party (the *beneficiary*)." BLACK'S LAW DICTIONARY (9th ed. 2009); *cf. In re* Trados Inc. S'holder Litig., 73 A.3d 17, 42 n.16 (Del. Ch. 2013) ("As long as a board complies with its legal obligations, the standard of fiduciary conduct calls for the board to maximize the value of the corporation for the benefit of the *common stock*.") (emphasis added); LC Capital Master Fund, Ltd. v. James, 990 A.2d 435, 452 (Del. Ch. 2010) (rejecting an enterprise value standard because "it is the duty of directors to pursue the best interests of the corporation and its common stockholders"); Berle, *supra* note 27, at 1367 (noting that "corporate managements are trustees for corporate security holders").

29. It is important to note that as a corporation has a separate legal existence from its shareholders, a board of directors has a distinct legal existence from its directors. Duties and rights of the board are accomplished under the guidance and instruction of the directors, but no director on his or her own may derive from his or her directorial appointment individual power or outright personal control over the corporation. *See* MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 206 (8th ed. 2000) (clarifying that "[a] single director . . . has no power[,] [and] [i]nstead, directors can act only as a body"); Jill E. Fisch & Caroline M. Gentile, *The Qualified Legal Compliance Committee: Using the Attorney Conduct Rules to Restructure the Board of Directors*, 53 DUKE L.J. 517, 544 (2003) ("Directors act collectively, and they have generally been held to lack the authority to act for the issuer in their individual capacities."). Ultimately, directors are constrained by their joint decision-making ability within the scope of their roles on the board. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(c)(2) (describing how the corporate charters that authorize the board's power might similarly grant a board committee discretion to exercise some board authority without having to comply with subsection (b), which requires approval from the majority of a quorum for the transaction of business).

30. DEL. CODE ANN. tit. 8, § 141(a); *see, e.g.*, *In re Trados*, 73 A.3d at 36 (explaining that when directors exercise their statutory duty under Delaware corporate law, "the standard of conduct requires that directors seek 'to promote the value of the

corporation's management imposes upon a board the non-delegable duty of loyalty to manage the corporation to safeguard the shareholders' investments.[31] Thus, the fiduciary duty that a board owes its shareholders guides directorial conduct.[32]

Although boards' particular duties vary by corporation, as a general principle, boards must function in pursuit of shareholder gain through corporate profit.[33] This distinction between overall shareholder wealth maximization and shareholder profit is key, because it is possible for the corporation to profit at the expense of the shareholders.[34] Specifically, in

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corporation for the benefit of its stockholders'") (quoting eBay Domestic Holdings v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010)); *In re* Advance Nanotech, Inc., No. 13-51215 (MFW), 2014 WL 1320145, at *4 (Bankr. D. Del. Apr. 2, 2014) (noting that "normally a corporation does not owe fiduciary duties to its shareholders, rather, officers and directors owe fiduciary duties to the corporation"); *see generally* Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461 (1989) (describing the fiduciary rules that govern directorial duties).

31. Benihana of Tokyo, Inc., v. Benihana, Inc., 891 A.2d 150, 191 (Del. Ch. 2005) ("The duty of loyalty, in essence, 'mandates that the best interest of the corporation and its shareholders take precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally.'") (quoting Cede & Co. v. Technicolor, Ind., 634 A.2d 345, 361 (Del. 1993). *But see* Hayden & Bodie, *supra* note 15, at 2114 (explaining that more than half of state corporate codes contain provisions permitting directors to consider the interests of "all corporate constituencies . . . when making *certain* decisions") (emphasis added).

32. *In re Trados*, 73 A.3d at 37 ("In terms of the standard of conduct, the duty of loyalty therefore mandates that directors maximize the value of the corporation over the long-term for the benefit of the providers of equity capital, as warranted for an entity with perpetual life in which the residual claimants have locked in their investment.").

33. *See* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end[.]"). *See also* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176 (Del. 1986) (holding that when threatened with a takeover, the board is allowed to act in consideration of "various corporate constituencies", rather than solely for the stockholders' benefit). The *Revlon* exception nevertheless requires that board actions seek to maximize overall shareholder wealth. *Id.* at 176. *See infra* Part I.C.2.b.i.

34. Directors may act in ways that favor maximizing long-term profits, even if it produces less optimal short-term results. The underlying principal is to benefit shareholders, provided their goals remain within legal bounds. *In re Trados*, 73 A.3d at 36-37 (explaining that the extent that courts acknowledge that directors have a duty to their corporations to act "for the ultimate benefit of the entity's residual claimants" is limited by the fact that "'stockholders best interest(s) must always, within legal limits, be the end" and "[o]ther constituencies may be considered only instrumentally to

managing the corporation, a board need not consider the wishes of each shareholder.[35] Instead, it must strive to increase the value of the common stock.[36]

While the legal existence of a corporation is perpetual, the investment of a shareholder is at the very least limited to the investor's lifespan.[37] Thus, a board cannot tailor its management of the corporation to suit each shareholder's individual aims.[38] Therefore, the corporate board can be conceptualized as a trustee of the corporation's shares, and a shareholder can be viewed as an owner of an alienable interest in the corporation's common stock.[39]

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advance that end"); *see also infra* Part I.C.1. Directors become fiduciaries of the corporation once they are elected and must serve the best interests of all "and not merely the interests of those who elect them." Pinto, *supra* note 6, at 265. *Compare id.* (explaining that since the board is not legally the agent of the shareholders, it may act regardless of whether the majority of shareholders disapprove), *with* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law,* 85 VA. L. REV. 247, 293 (1999) (arguing that the "directors owe their fiduciary duties primarily *to the corporation itself*" and not the shareholders) (emphasis added).

35. *See infra* Part I.C.1. Further, a board does not need to consider non-shareholder interests. This distinction is also intrinsic to distinguishing shareholder primacy from shareholder wealth maximization because when investors purchase stock in a publicly held corporation, they become passive investors and relinquish their right to directly control the operation of the company. *See* Goforth, *supra* note 15, at 629; *see also infra* Part III.

36. *See* Gantler v. Stephens, 965 A.2d 695, 706 (Del. 2009) ("[E]nhancing the corporation's long term share value" is a "distinctively corporate concern[.]").

37. *See* DEL. CODE ANN. tit. 8, §§ 102(b)(5), 122(1) (2014); *see also* Lipton & Rosenblum, *supra* note 24, at 68 ("[shareholders] are not a single monolithic body. Far from the single owner of a building, the shareholders are a diverse and ever-shifting group of people and institutions, with differing interests and, in the case of institutional investors, differing obligations to their own diverse constituencies.").

38. *See* Molitor, *supra* note 6, at 157-58 (explaining that while many shareholders might have long-term interests, others might be spectators—solely interested in "increasing the company's stock price in the short-term"; institutional investors—like a social-interest group that owns shares and maintains "interests that actually conflict with the interests of most other shareholders; or investors of competitors—maintaining "an economic interest in the company's failure"); *see also infra* Part I.C.1.

39. *See* Ralph H. Delforge, *Corporations—Non-Delegable Powers of Board of Directors*, 34 MARQ. L. REV. 48, 49-50 (1950) ("Perhaps a satisfactory conclusion is that the board exercises its powers in a fiduciary capacity, for the benefit of stockholders, and by analogy, the general rule against a trustee delegating his authority may be applied.") (footnotes omitted); Andrew A. Schwartz, *The Perpetual*

C. A BOARD IS NOT SUBJECT TO ADEQUATE MONITORING *AT ANY LEVEL*

Confidence in the ability of corporate boards to effectuate their primary purpose is complicated by the fact that boards are insular.[40] Specifically, while it is the board that has legal control over the corporation, its directors remain largely insulated from any external interference in wielding the board's legal powers.[41]

There are two characteristics of boards that typically increase their insularity.[42] First, boards are insular because they are self-perpetuating.[43] Second, boards are insular because their directors are generally under no threat of incurring personal liability.[44] Ultimately, board insularity makes it impossible to ensure that directors will act in the objective best interests of the shareholders not only because directors' interests will diverge, but also because there is insufficient recourse for shareholders to take against these actors.[45]

This Note will argue that the process by which directors are elected must change to mitigate the consequences of board insularity, which compromises the objectivity of directors and ultimately precludes the board from faithfully working toward the goal of shareholder wealth

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Corporation, 80 G. WASH. L. REV. 764, 768 (2012) (arguing that scholars incorrectly disregard the attribute of a corporation's perpetual existence, which is one of the four defining features of the corporate entity: (1) limited liability, (2) centralized management, (3) alienable shares, and (4) perpetual existence).

40. *See infra* Part II.B.

41. Goforth, *supra* note 15, at 631-32 ("Shareholders, although theoretically the 'owners' of the corporation, do not have the ability to initiate most corporate actions and cannot substantially interfere with board discretion.") (footnotes omitted).

42. Professor Lucian A. Bebchuk breaks down the arguments of proponents of board insularity and ultimately concludes "the evidence favors the view that board insulation is detrimental, rather than beneficial, to the long-term interest of public companies and their shareholders" in, Lucian A. Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1677-78 (2013) [hereinafter *Insulating Boards*]. In this essay, Bebchuk offers the central claim of insularity proponents, that having boards insulated from shareholder pressure and limiting shareholder power for this purpose will serve the interests of long-term incorporations and their long-term shareholders. *Id.* at 1638. He explained that, "the extent to which incumbents are insulated from shareholder pressure depends on the extent to which they are insulated from the possibility of removal via a hostile takeover." *Id.* at 1652.

43. *See infra* Part I.A.

44. *See infra* Part I.C.2.

45. *See infra* Part I.C.

maximization.[46] Part I will demonstrate how the insularity of boards and the unavoidable extension of boards' insularity to their directors erode any reasonable confidence shareholders might have in their respective boards' ability to effectuate their primary purpose. Next, Part II will propose that a national standard is necessary to preserve the integrity of the institution of corporate boards in light of the ever-increasing responsibilities imposed on them. It will suggest that regulating the process by which people become directors, instead of the way in which they act once elected, will decrease the manifestation of the subjective interests of directors that jeopardizes the ability of boards to fulfill their primary duty. Part III will then argue that prevailing, ideologically driven viewpoints on the purpose of the corporate board conflict on a fundamental level, and it will explain how the solutions of proposed reforms are irreconcilable. Finally, this Note will conclude by emphasizing the importance of preserving the function of boards to manage the business of the corporation for shareholder wealth maximization even when new positive law might make the primary purpose seem secondary.

I. DIRECTORS BASK IN (THE) LIGHT OF BOARD ENTRENCHMENT AND AUTONOMY

Part I of this Note demonstrates how under the current system of corporate governance, board insularity is both unavoidable and without constraint. It identifies two primary attributes of modern corporate boards that attest to the prevalence of board insularity and explains how these factors, which essentially guarantee that directors will be influenced by their subjective interests, obfuscate boards' underlying duty to increase the value of the common stock for shareholder profit. Part I.A introduces the first attribute: how the incumbent directors' dominion over directorial elections has transformed the corporate board into a self-perpetuating entity. Part I.B introduces the second attribute:

46. This Note will analyze board insularity in the context of publicly held corporations that do not have a controlling shareholder. Where there is a controlling shareholder, the primary concern is the potential opportunism by the majority of shareholders at the expense of the minority shareholders. Instead, this Note focuses on the boards of companies that do not have a majority shareholder because the board of directors is less significant where there is a majority shareholder or a constituency of shareholders for numerous reasons.

how the directors' insularity from personal liability effectively allows directors to act autonomously. Finally, Part I.C pinpoints the inherent consequences of board insularity and concludes by identifying the disadvantages inherent in the existence of boards that are exacerbated by board entrenchment and autonomy.

A. A BOARD IS A SELF-PERPETUATING INSTITUTION

A characteristic of corporate boards that contributes to their insularity is the directors' ability to entrench themselves on boards despite shareholders' statutory rights to elect directors to the board and the federal government's attempts to ensure shareholders can exercise these rights.[47] Once directors have been elected, it is extremely difficult for shareholders either to replace or to remove them.[48] The ability of sitting directors to entrench themselves is largely dependent on their control over the selection of nominees for election to the board each year.[49] Similarly, the tendency for legal standards and regulations to establish a presumption in favor of directors protects directors from the threat of removal.[50] This is problematic because for as long as the corporation exists, so too will its board.[51] Thus, despite their election as

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47. Pinto, *supra* note 6, at 259 ("Because of the vacuum created by the separation of ownership from control, management of many large corporations has become self-perpetuating.").

48. *See* Sprague & Lyttle, *supra* note 8, at 18 ("A director has a better chance of being struck by lightning than losing an election" after explaining that, "shareholders' power to remove and replace directors has proven quite limited, with most directors facing a very low probability of being ousted—largely neutralizing the shareholders' vote as an effective means of ensuring director accountability.") (quoting former SEC chairman Arthur Levitt, Jr.) (citations omitted) (footnotes omitted).

49. *See infra* Part I.A.1; George W. Dent, Jr., *Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance*, 44 HOUS. L. REV. 1213, 1271 (2008) ("A principal obstacle to shareholder primacy is that a corporation's 'official' nominees for election to the board are chosen by a committee of incumbent directors."); Lee Harris, *Corporate Elections and Tactical Settlements*, 39 J. CORP. L. 221, 247 (2014) ("[T]he vast majority of elections are uncontested and incumbent directors are automatically re-elected.").

50. *See infra* Part I.A.2.

51. Specifically, once the separation of ownership and control occurs, unless the corporation dissolves, it will continue to be overseen by its board. *See generally* Mira Ganor, *Salvaged Directors or Perpetual Thrones?*, 5 VA. L. & BUS. REV. 267, 269 (2010) (demonstrating how even after a corporation fails, the board might remain intact).

individuals, directors on the same board have a reciprocal interest in perpetuating their status as directors;[52] when they work together to achieve that goal, they are not only largely insulated from replacement and removal, but also essentially guaranteed immunity from liability since individual director activity is not subject to any meaningful oversight.[53]

1. Directors Are Difficult to Replace

Board members control the nomination and selection process of candidates for director elections.[54] Consequently, incumbents do not face considerable opposition, and it is difficult for shareholders to replace directors.[55]

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52. *See* Murphy, *supra* note 26, at 169 ("[D]irectors commonly hope not only to secure re-nomination (a likely event)[,] but [also] to secure other directorial appointments. They are most likely to realize the benefits of board membership, as a vehicle for future advancement, by conforming to the behavior favored by other board members.") (footnotes omitted); *see also* Stephen P. Ferris, Murali Jagannathan & A.C. Pritchard, *Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments*, 58 J. FIN. 1087, 1089 (2003) (explaining that "directors of large firms might be attractive as candidates for other boards because of the networking contacts they represent"); *see generally* Molitor, *supra* note 6, at 105 ("Absent a particular director not wishing to continue serving on the board or some unusual circumstances, the same board members usually would serve term after term, subject to limited turnover.").

53. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 2 (1991) ("As a practical matter boards are self-perpetuating until investors become dissatisfied and a majority decides to redo everything to a new taste."); *see infra* Part I.C.2.

54. *See* Murphy, *supra* note 26, at 131 (explaining that shareholders have no "practical means of nominating their own candidates"); *id.* at 137 ("Apart from an occasional contest for control, the shareholders, deprived of access to the proxy machinery, were presented with a single slate of management-nominated candidates for approval."); Dalia Tsuk Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 WASH. & LEE L. REV. 1503, 1506 (2006) (explaining that "the ability of shareholders to affect corporate change is limited"); *see also* Molitor, *supra* note 6, at 104-05 (describing how "the board itself (or perhaps a nominating committee) [traditionally] nominates candidates, often at the suggestion of the corporation's chief executive officer"); *see generally* Hamermesh, *supra* note 23, at 134-35 (discussing the broad control directors have over nominating candidates).

55. *See* Molitor, *supra* note 6, at 107 ("In the end, management typically selects the nominees, . . . [and] the shareholders usually are shut out of any meaningful

In theory, shareholders have electoral rights.[56] State laws generally require corporations to hold annual shareholder meetings where shareholders vote to elect board members each year.[57] However, no positive law requires shareholders to participate directly in corporate affairs.[58] In fact, many shareholders do not actively engage in monitoring their investments to the extent that they may.[59] For instance,

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participation in the selection of directors.") (footnote omitted); William K. Sjostrom Jr., *The Case Against Mandatory Annual Director Elections and Shareholders' Meetings*, 74 TENN. L. REV. 199, 210 (2007) ("The reality is that the outcome of the vast majority of director elections is a foregone conclusion-the nominees chosen by management win."); *see also* Sprague & Lyttle, *supra* note 8, at 18 ("[T]he outcome of almost all board elections is a foregone conclusion—incumbent directors win.").

56. Shareholders vote to elect board members each year. *See, e.g.*, DEL. CODE ANN. tit. 8, § 211(b) (2014); *see also* Harrah's Entm't, Inc. v. JCC Holding Co., 802 A.2d 294, 311 n. 39 (Del. Ch. 2002) ("[T]he election of directors may be the most . . . important action [] that shareholders can take.") (citation omitted); Brett H. McDonnell, *Setting Optimal Rules for Shareholder Proxy Access*, 43 ARIZ. ST. L.J. 67, 114 (2011) ("Shareholder election of directors is a core legitimate and legitimating shareholder power. This is an area where directors are tempted to set sub-optimal rules that entrench themselves.").

57. *See* DEL. CODE ANN. tit. 8, § 216. In North Dakota and Minnesota, annual shareholder meetings and director elections are optional. N.D. CENT. CODE § 10-19.1-71 (2013); MINN. STAT. ANN. §302A.431 (2008); *see generally* Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1777 (2006) ("The right to elect directors is an important tool for stockholders, allowing them to hold centralized management accountable and thereby contributing to the creation of stockholder wealth by checking agency costs.").

58. *E.g.*, DEL. CODE ANN. tit. 8, § 212(a) (providing that "each stockholder shall be *entitled* [one] vote for each share of capital stock") (emphasis added); *see* Mitchell, *supra* note 54, at 1547-48 ("[S]tate corporation statutes and charters govern shareholder voting [and] determine which issues . . . require shareholder voting as well as the particular procedures that voting processes should follow. Historically, shareholders had . . . to vote [at the annual meeting]. But . . . with the rise of the large public corporation, proxy voting became the norm[.]"). The Securities Exchange Act of 1934 brought voting rules under various states' corporate laws under federal control. 17 C.F.R. § 240.12a–4 (2011) (listing requirements for voting by proxy). Despite the existence of federal proxy law, the significance of the shareholder vote has deteriorated to the point of being irrelevant. *See* Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT'L L.J. 129, 143 (2009) ("Shareholders' voting rights may also be overrated and are considered by some to be largely a fig leaf.").

59. *See infra* notes 113-118 and accompanying text, for a discussion of shareholder involvement in managing the corporation. It is accepted that despite their ownership

some shareholders vote through proxies, who do not necessarily consult the shareholders prior to elections.[60] Alternatively, other shareholders simply abstain from exercising their right to vote.[61]

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interests, shareholders will not play an active role in the decision-making process. Bernard S. Sharfman, *Why Proxy Access is Harmful to Corporate Governance*, 37 J. CORP. L. 387, 399 (2012) ("[T]he board is not required to follow the commands of its shareholders, even if shareholders pass a unanimous resolution requesting the board to act in a specific manner; shareholders may ratify a board's action, but the board must first approve the action[.]") (footnote omitted). Consequently, "many shareholders pay little or limited attention to the question of how to vote." Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 692 (2007) [hereinafter *Shareholder Franchise*]; *see also* Harris, *supra* note 49, at 246 (explaining that most shareholders may be categorized as "passive" because they "have limited ability or desire to affect the firm's strategic direction[,] [t]hey may hold their investment for years without ever even closely reading the firm's annual reports and proxy statements they receive in the mail[,] [t]hey never ask to review or inspect the books of the corporation[,] and [they] are unlikely to have the resources or desire to engage in litigation against the firm") (footnotes omitted).

60. *See* Michael S. Kang, *Shareholder Voting as Veto*, 8 IND. L.J. 1299, 1305-06 (2013) (explaining that many shareholders delegate their votes to proxy advisors that usually vote in a designated manner). In fact, corporations generally have to solicit shareholder proxies in order to satisfy quorum requirements. Sjostrom, *supra* note 55, 205 (2007). However, "not all shareholders are informed about the[ir] company[,] and those who do decide to participate in proxy access may have little information on the proper choice of director nominees." Sharfman, *supra* note 59, at 402. *See generally* Robert J. Klein, *The Case of Heightened Scrutiny in Defense of the Shareholders' Franchise Right*, 44 STAN. L. REV. 129, 177 n.3 (1991) ("The proxy system is the mechanism by which shareholders exercise their right to vote on issues of corporate governance, such as the election of members of the board of directors, mergers, or amendments to the corporation's bylaws."); Pinto, *supra* note 6, at 268-69 ("[S]tate statutes permit the use of proxies allowing shareholders to vote on certain matters prior to a meeting or assign their voting right to another person who will be present at the meeting. The actual voting takes place prior to any meeting[.]"). *Contra* Sagiv Edelman, *Proxy Advisory Firms: A Guide for Regulatory Reform*, 62 EMORY L.J. 1369, 1409 (2013) (finding that "[p]roxy advisory firms serve a very important function in facilitating the rational, efficient exercise of the shareholder franchise").

61. Shareholders withholding votes under the traditional scheme would not impact the results of an election because, "[u]nder the plurality voting rules . . . the contestant with the highest number of votes wins, regardless of whether the contestant secures a majority of the votes cast." Harris, *supra* note 49, at 223; *see infra* Part I.A.1.b.

In practice, elections are widely recognized as meaningless.[62] Although the federal government regulates aspects of board elections for publicly held corporations, its attempts at preserving shareholder involvement have largely been futile.[63] Shareholders have little-to-no influence over director "elections" for two main reasons.[64] First, the board controls the elections by determining the nominees.[65] Second,

62. Although mandatory under state laws, the effect of the statutes' corresponding language is such that failure to hold annual meetings will not affect an otherwise valid corporation's actions. *See, e.g.*, DEL. CODE ANN. tit. 8, § 211(c); MODEL BUS. CORP. ACT § 7.01(c) (2005). The practical result of this is what led courts to acknowledge openly that shareholder voting is an "unimportant formalism." Blasius Indust., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988); *see also* Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 616-17 (2006) ("As a formal matter, only the election of directors and amending the bylaws do not require approval before shareholder action is possible. In practice, of course, even the election of directors (absent a proxy contest) is predetermined by the existing board nominating the next year's board.") (footnote omitted); Harris, *supra* note 49, at 222 (describing corporate elections as "fundamentally broken" and explaining that they "give shareholders little real opportunity to participate meaningfully in deciding who should serve on the board"); Molitor, *supra* note 6, at 97 ("For decades, 'shareholder activists have criticized the fact that shareholders of public companies have no meaningful voice in the selection of directors."); Sjostrom, *supra* note 55, at 216 ("Characterizing the annual election of directors as a charade is nothing new[.]").

63. The SEC must approve all exchange listing standards. 15 U.S.C. § 78(s)(b); *see also* 17 C.F.R. 240 14a-8(b)(1) (2011); Sjostrom, *supra* note 55, at 202 ("[F]ederal proxy rules dictate procedures for the solicitation of proxies."). However, federal regulations of proxy solicitation and board composition do not establish any effective "checks" on board activity. *Id.* at 216; *infra* Part I.C.2.e.

64. Bainbridge & Henderson, *supra* note 18, at 1062 ("[T]"he corporation's nominal owners—the shareholders—lack both the legal right and, in most cases, the practical ability to exercise meaningful oversight of the corporation's management.").

65. Only one state expressly addresses the process of nominating directors. MD. CODE ANN. CORPS. & ASS'NS, § 2-504(f) (2014) (permitting corporations to adopt bylaws that require "any stockholder proposing a nominee for election as a director or any other matter for consideration at a meeting of the stockholders to provide advance notice of the nomination or proposal to the corporation before a date or within a period of time specified in the charter or bylaws"). However, the Maryland statute does not recognize that shareholders have an inherent right to nominate directors. *See* Sprague & Lyttle, *supra* note 8, at 18 (2010); *infra* Part I.A.1.a; *see also* Harris, *supra* note 49, at 223 ("Without the presence of competition, the incumbents are automatically re-elected to their posts, regardless of how shareholders vote."); Molitor, *supra* note 6, at 105 ("If a director resigned or declined to stand for re-election the board would need to select a new nominee, but it was the rare board that solicited suggestions from shareholders."); Murphy, *supra* note 26, at 132 ("The shareholders may be equity owners of the

proxy contests are generally cost-prohibitive and will not necessarily have the desired effect in the unlikely event that they are successful.[66]

a. The Incumbent Board Determines the Election "Slate"

Unless a corporation's charter and bylaws contain specific provisions governing the election process, incumbent boards need not consult with shareholders when determining director-nominees.[67] Consequently, the incumbent board has dominion over the composition of the "slate" of directors on which the shareholders vote.[68]

Although the incumbent board determines the election slate and generally need not account for its decisions, the federal government requires that corporations make certain public disclosures in the form of

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corporation, but when they are presented with an unopposed slate of directorial candidates, without having practical means of nominating their own candidates, it is clear that management effectively controls the corporate ballot."); Pinto, *supra* note 6, at 269 (pointing out the paradox that although directors need to obtain shareholder votes in order to be retain their positions, corporate managers are not concerned with their reelection because they "have control over corporate information and proxy materials and the cost of their solicitation is at corporate expense") .

66. *See* Sjostrom, *supra* note 55, at 212; *infra* Part I.A.1.b.

67. *See* Molitor, *supra* note 6, at 99 ("[T]he incumbent directors generally select the nominees, who are then virtually guaranteed of election under plurality voting."); *infra* note 193. *Contra Blasius*, 564 A.2d at 663 (explaining that while it may be true "that the board knows better than do the shareholders what is in the corporation's best interest[,] . . . it is irrelevant (except insofar as the shareholders wish to be guided by the board's recommendation) when the question is who should comprise the board of directors").

68. Molitor, *supra* note 6, at 99 ("Moreover, in publicly traded corporations, nearly all shareholders have no practical power to nominate board candidates."); Goforth, *supra* note 15, at 633 ("The shareholders have an annual meeting, but public shareholders rarely do more than approve the slate of directors proposed by existing management and whatever other management proposals the board has decided to place before the shareholders."); *see also* Global Newswire, *BioMarin Announces Planned Changes to Board of Directors Leadership Structure*, CNNMONEY (Jan. 7, 2015, 4:15 PM), http://money.cnn.com/news/newsfeeds/articles/globenewswire/10114567.htm (announcing that the chairman of the board had voluntarily stepped down from his position and was seeking re-election as a director and that the board would voluntarily revise the organizational structure of the board and company, but including at the end of the press release that "[a]ll of the planned changes are contingent on the reelection" of the former Chairman and two former directors pre-selected to fill the new positions created by the new board structure).

proxy statements for two main reasons.[69] First, the disclosures enable shareholders—especially those voting by proxy—to make informed votes.[70] Second, the board's decision-making process is not completely opaque.[71]

The Securities Exchange Commission ("SEC") regulates voting by proxy by stipulating categorical information that boards must disclose to their shareholders about the nominees for election to the board;[72] however, the compulsory disclosures are generally inconsequential and unlikely to be meaningful to an ordinary stockholder.[73] For example, pursuant to Rule 14a-4, incumbent boards must distribute proxy materials to shareholders to inform shareholders of the "slate" of nominees that the boards selected for election prior to elections.[74] This

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69. *See generally* Harris, *supra* note 49, at 228 (dubbing the corporate election "a heavily regulated affair[,]" describing the proxy statement as detailed and elaborate, and subsequently insinuating that the requisite disclosures constitute an effective mechanism by which the corporation informs its shareholders of the election process). *Contra* Sharfman, *supra* note 59, at 409 (explaining that ultimately, "proxy access is an inefficient tool of accountability").

70. Sjostrom, *supra* note 55, at 206 ("The proxy statement is designed to provide shareholders with *relevant* information regarding the matters up for vote for which proxies are solicited.") (emphasis added).

71. *Id.* at 205-06 (explaining that the SEC issued rules to regulate the solicitation of proxies "to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation") (citation omitted).

72. *See infra* Part II.C.2.b.ii.

73. Through § 14(a) of the Securities Exchange Act of 1934, the SEC regulates the content of proxy materials. Specifically, the SEC outlines what technical information a board must include in a proxy statement in Item 7 of Rule 14a-101. 17 C.F.R. § 240.14a-101 (2011). Pursuant to § 14(a), corporations must disclose biographical information about each nominees as well as any financial interest a nominee holds in the corporation. Further, a proxy statement relating to the election of an incumbent director requires the corporation to disclose whether the director failed to attend 75% of board and committee meetings or more and the director's compensation from the past year in addition to any financial transactions between the director and any other directors or the corporation. Sjostrom, *supra* note 55, at 206. There in nothing in § 14(a), however, that requires corporations to include a résumé for each nominee or anything about a nominee's qualifications that would demonstrate competence or establish suitability to serve on the board. Thus, incumbent directors fully control the process despite Rule 14a-4's requirement because they not only supply shareholders with the proxy material, but also interpret the "biographical information" requirement before distributing the slate.

74. 17 C.F.R. § 240.14a-4(b).

rule does not have any significant operable effect.[75] Consequently, the candidates are often incumbent directors.[76] Furthermore, although the New York Stock Exchange ("NYSE") and the NASDAQ Stock Market ("NASDAQ") now require listed corporations to have a nominating committee comprised of independent directors, the committees are still made up of incumbent directors who most likely nominate themselves.[77] Finally, in the rare case where a nominee is not an incumbent, unless the incorporating charter or bylaws expressly provide otherwise, a board need not justify its choice or confine its search to individuals specially-qualified or trained to carry out directorial duties.[78]

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75. *See e.g.*, Harris, *supra* note 49, at 224 (explaining that if incumbent directors perceive a potential challenge to their re-election, they often employ pre-voting settlements to "entice challengers to drop their bid in exchange for board seats and cold, hard cash" effectively excluding the shareholders from the "chance to vote on the directors' fate al all"); *see infra* Part I.A.1.b.

76. *See* Sjostrom, *supra* note 55, at 240 n.124 ("[C]ontrol will tend to be in the hands of those who select the [nominating] committee by whom, in turn, the election of directors for the ensuing period may be made. Since the [nominating] committee is appointed by the existing management, the latter can virtually dictate their own successors. Where ownership is sufficiently sub-divided, the management can thus become a self-perpetuating body even though its share in the ownership is negligible.") (quoting BERLE & MEANS, *supra* note 15, at 87-88).

77. *See* N.Y. Stock Exch., *Listed Company Manual*, § 303A.04 (Amended Nov. 25, 2009 (NYSE-2009-89)), *available at* http://nysemanual.nyse.com/LCMTools/bookmark.asp?id=sx-ruling-nyse-policymanual_303A.04&manual=/lcm/sections/lcm-sections/ [hereinafter NYSE Manual]; NASDAQ OMX Grp., *Equity Rules*, Rule IM-5605-6(e) Independent Director Oversight of Director Nominations (Amended Nov. 26, 2013 (SR-NASDAQ-2013-147), *available at* http://nasdaq.cchwallstreet.com/NASDAQTools/bookmark.asp?id=nasdaq-rule_5000&manual=/nasdaq/main/nasdaq-equityrules/ (requiring a nominee be considered on the suggestion of either a nomination committee composed wholly of independent directors *or* a majority vote of the board's independent directors). Although the nominating committees might have to be comprised of independent directors, directors still confer with other members of the board and officers of the corporation. *See also* Murphy, *supra* note 26, at 148 ("[I]t is clear that CEO's may have the dominant voice in the nominating process even if not included in the membership of a nominating committees composed of independent directors."); *see infra* Part I.C.2.ii, for a discussion of the federal government's misguided focus on the independence of directors.

78. *See* Daniele Marchesani, *The Concept of Autonomy and the Independent Director of Public Corporations*, 2 BERKELEY BUS. L. J. 315, 327 (2005) ("State laws generally do not provide mandatory director qualifications, and few are the cases in which corporations fill the gap."). Although the Sarbanes-Oxley Act of 2002 requires

Additionally, boards not only control the size and composition of the slate of nominees,[79] but also "use[] corporate funds, personnel, and

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that a board have an audit committee comprised by "independent" directors with at least one director who has financial or accounting experience, corporations retain discretionary power to determine the remainder of their boards' composition, and it is the incumbent board that usually makes those decisions. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 301, 116 Stat. 745, 776 (codified as amended at 15 U.S.C. § 7213). Under the NYSE and NASDAQ listing requirements, the nominating committee is required to identify perspective directors based on their qualifications; however, neither stock exchange outlines what makes an individual "qualified." For example, the NYSE requires a board's nominating committee have a written charter that lists its primary responsibility as "identify[ing] individuals qualified to become board members, consistent with *criteria approved by the board*[.]" NYSE Manual, *supra* note 77, § 303A.04(b)(i) (emphasis added).

79. State laws generally require a minimum of "one natural person." *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(b) (2014) (identifying a "qualified" director as "a natural person" that meets the requirements for service prescribed by the corporation). Unless the corporate charter stipulates about the board composition, the board may elect directors at its discretion. *See id.* ("Directors need not be stockholders unless so required by the certificate of incorporation or the bylaws. The certificate of incorporation or bylaws may prescribe other qualifications for directors."). Additionally, depending on a corporation's incorporating charter or bylaws, a board may not only expand the board's size by creating positions for additional directors, but also it may fill those seats, where the unelected directors will be entrenched by the next election. *See id.* at §§ 109(a), 141(b) (providing that the number of directors will be fixed in either the bylaws or the certificate of incorporation, and if the bylaws fix the number of directors and the corporation's certificate of incorporation confers upon the board the power to adopt, amend, or repeal bylaws, the board may alter the number of directors on the board); *id.* at § 142(e) ("Any vacancy occurring in any office of the corporation by death, resignation, removal or otherwise, shall be filled as the bylaws provide. In the absence of such provision, the vacancy shall be filled by the board of directors or other governing body."). *See* MODEL BUS. CORP. ACT § 8.03 (2005); *id.* at § 8.10. Although stockholders do not divest their right to adopt, amend, or repeal bylaws in instances where a corporation has conferred equivalent power over the bylaws unto the board, the board has the ability to orchestrate changes that would have a limiting effect on shareholders' ability to exercise power. For example, JDS Uniphase Corporation ("JDSU") conferred upon its board the right to adopt bylaws, and in May 2014 the board adopted a bylaw "governing notice provisions for the nomination of Directors" that many shareholders believed was detrimental to their rights. See the letter to the board demanding remedy to the bylaw written and released by Thomas Sandell, CEO of Sandell Asset Management Corp., a shareholder of JDSU, Press Release: Sandell Releases Letter to the Board of Directors of JDS Uniphase, MARKETWATCH (Jan. 13, 2015, 9:02AM), http://www.marketwatch.com/story/sandell-releases-letter-to-the-board-of-directors-of-jds-uniphase-2015-01-13; *see also* Hamermesh, *supra* note 23, at 132 n. 67, 136, 139, 150 (distinguishing between the "far more intrusive"

facilities to prepare, print, and distribute proxy materials."[80] The absence of any general requirement that the corporation's ballot include space either for a competing candidate or for "write-ins" underscores the board's dominion over the slate.[81] Therefore, the nominees generally run unopposed and win by default.[82]

b. Proxy Contests Are Futile

In the rare instance that a shareholder launches a proxy contest to canvass a competing slate, the board's slate usually prevails.[83] Electoral

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limitations on the right to nominate, which cannot be eliminated entirely, and advance notice requirements, which apparently "could restrict shareholder proposals or nominations by including an advance notice provision in the corporation's charter or bylaws" and noting that advance notice bylaws have "become standard in U.S. public companies" and upheld as valid by courts as long as they do not operate inequitably or unduly restrict the right to nominate) (citing MD. CODE ANN., CORPS. & ASS'NS § 2-504(f) (West 2013)).

80. Sjostrom, *supra* note 55, at 210; *see* Harris, *supra* note 49, at 241 (explaining that an insurgent has to bear the upfront costs for launching the proxy contest including hiring lawyers to make the requisite disclosures and paying to distribute the proxy statements to shareholders, "while the incumbent can pay for these expenses out of the corporate treasury"). *But see* DEL. CODE ANN. tit. 8, § 113 (allowing a corporation to adopt a provision in its bylaws where *subject to certain conditions and procedures*, the corporation *may* reimburse a shareholder for some expenses incurred in soliciting proxies) (emphasis added).

81. *See* Sjostrom, *supra* note 55, at 211 ("[I]t (is) generally impossible for a shareholder to use the corporation's proxy card to instruct the proxy to vote against a nominee or to vote for someone other than a nominee listed on the card."); *see also* Murphy, *supra* note 26, at 178 (explaining that "corporations are uniformly unresponsive to shareholder efforts to intervene in the sphere of decision making, and, in particular, resist shareholder participation in the nominating process. Communications between shareholders and the corporation are normally relegated to a shareholder relations department well removed from the centers of decision making") (footnotes omitted).

82. *See* Bainbridge & Henderson, *supra* note 18, at 1069 ("Because directors generally run unopposed, the shareholder vote is more advisory than anything else.").

83. *See* Sjostrom, *supra* note 55, at 212 ("[P]roxy contests for the election of for the election of directors outside of the takeover context are extremely rare[.]"); *see also* Bainbridge & Henderson, *supra* note 18, at 1114 ("[I]nstitutional investors occasionally nominate board members in order to influence governance of the firm."); Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW.

proxy contests are rare because they are prohibitively expensive.[84] Specifically, elections are costly to run, and independent actors have very little chance of winning.[85] Although Rule 14a-8(i)(8) under the Securities and Exchange Act of 1934 requires "companies (to) *permit* shareholder proposals," the requirements for properly completing a proposal establish a daunting threshold to meet.[86] A shareholder must first satisfy many procedural and substantive requirements to be eligible to submit a proposal, and the proposal must conform to another set of requirements before it can be submitted for consideration.[87] Then, the

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329, 336 (2010) ("Electoral challenges are in fact quite infrequent."); *Shareholder Franchise*, *supra* note 59, at 675; Sprague & Lyttle*, supra* note 8, at 18.

84. *See id.* (explaining that proxy contests typically cost insurgents between $5 and $10 million); Bainbridge & Henderson, *supra* note 18, at 1069-70 ("The only sure way to remove a director is through a proxy contest, in which a rival pays, win or lose, the full costs of distributing ballots to shareholders and convincing them to vote for the rival."); Molitor, *supra* note 6, at 106 ("Soliciting proxies is difficult and expensive. First, one must incur the expense of printing and mailing the proxy statement and engaging in other solicitation activities. In addition, one must ensure that any proxy materials comply with the SEC's detailed proxy rules, which almost certainly will require the assistance of expensive attorneys. The shareholder would also face potential liability for any materially false or misleading proxy materials. As a result, only the largest and most determined shareholders would consider mounting a proxy contest in favor of their own nominees, at least outside a takeover battle[.]") (footnotes omitted).

85. *See generally Increasing Shareholder Power*, *supra* note 16, at 856 (explaining how the current reimbursement scheme allows management to ignore the wishes of shareholders yet remain in power).

86. Rule 14a-8 under the Securities and Exchange Act of 1934 regulates when a corporation must include a shareholder proposal in its proxy statements and on its proxy card at shareholder meetings. 17 C.F.R. § 240.14a-8 (2011) (emphasis added); *see* Sprague & Lyttle, *supra* note 8, at 19-20 ("The effect of Rule 14a-8(i)(8) has been to prevent shareholder nominations of directors via proxy."). *Contra* Sharfman, *supra* note 59, at 382 (concluding that the amendment to Rule 14a-8(i)(8) "radically reduced the cost of getting proxy access proposals in front of a public company's shareholders" because prior to this change, disgruntled shareholders' only alternative "to present a proxy access proposal to other shareholders through the proxy process was to use their own solicitation materials under SEC Rules 14a-6 and 14a-12, which has historically been cost prohibitive") (footnote omitted).

87. *See, e.g.*, 17 C.F.R. § 240.14a- 8(i)(8) (providing that a corporation may exclude a shareholder proposal if the proposal "otherwise could affect the outcome of the upcoming election of directors"); *see* Sjostrom, *supra* note 55, at 207 ("Rule 14a-8a provides thirteen substantive grounds under which a corporation may exclude a proposal from its proxy materials.").

insurgent must campaign and convince generally passive shareholders to vote in support of the challenger's slate.[88]

Proxy contests are an essential option for shareholders because unless an insurgent mounts a full campaign, shareholders can only signal discontent by "withholding" their votes.[89] Under a majority-voting scheme, a shareholder's "withhold vote campaign" will successfully block the proposed slate from passing if it is joined by a majority of the shareholders;[90] however, even if the shareholders successfully thwart the management slate, the directors get to pick the replacement nominee.[91]

Although a corporation reimburses a successful insurgent, a corporation also reimburses the incumbent board's rebuttal to a contest regardless of the outcome.[92] The financial support for the incumbent

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88. *See Shareholder Franchise*, *supra* note 59, at 691-92 ("[T]o vote for the rival team, [shareholders] must be convinced not only that the incumbents' performance is sub-par, but also that the rival team would likely perform better. Otherwise, shareholders might well choose to stay with the devil they know.").

89. Bainbridge & Henderson, *supra* note 18, at 1094 (explaining that while an individual who desires to serve on a board can communicate with all of the shareholders of a company, the publicity and voting costs are prohibitive).

90. The current default voting scheme merely requires a nominee receive a plurality of the votes. Under the plurality voting scheme, where the election is uncontested, directors automatically obtain a plurality of the votes and are elected as long as quorum requirements are met. H. Rodgin Cohen & Glen T. Schleyer, *Shareholder vs. Director Control over Social Policy Matters: Conflicting Trends in Corporate Governance*, 26 NOTRE DAME J.L. ETHICS & PUB. POL'Y 81, 105-06 (2012). *But see* Klausner, *supra* note 23, at 1361 (supporting a majority voting requirement, which would "require[] directors, when running unopposed, to receive a majority of votes to be assured of retaining their seats" because it "may increase management responsiveness to shareholder demands is majority voting, a shareholder voting regime" and a study "found that the adoption of majority voting was associated with an increase in share price").

91. *See generally* Sprague & Lyttle, *supra* note 8, at 20 ("At best, shareholders could force certain directors off of the board, but could not select their replacements.").

92. Corporate funds finance the board's campaign against its shareholder. Thus, in effect, the shareholders'' money is working against them. *See* Rosenfeld v. Fairchild Engine & Airplane Corp., 128 N.E.2d 291, 293-300 (N.Y. 1955) (permitting incumbents' reimbursement from corporate treasury for expenses incurred in conducting their proxy solicitation where amounts were "reasonable" and the contest involved "policy" questions, rather than just "purely a personal power contest"); Bainbridge & Henderson, *supra* note 18, at 1070 ("Firms pay incumbents' costs no

board covers increased campaign costs, such as additional promotional materials and potential litigation costs arising from claims the board might have against the insurgent for any violation of a federal proxy rule.[93] Therefore, the prospect of reimbursement is unlikely to persuade a disgruntled shareholder to undertake a proxy contest.

2. Directors Are Difficult To Remove

Directors act in the guise of a single entity pursuant to their duties as the members of the board.[94] This makes it particularly difficult for shareholders to remove a director before the director's term ends.[95]

In theory, shareholders have the legal authority to remove directors.[96] Specifically, courts have generally recognized shareholders' inherent power to remove directors "for cause."[97] Moreover, some

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matter what, and incumbents are effectively spending shareholders' money to maintain their jobs.").

93. Insurgents are reimbursed when they win, but they rarely do. See *infra* Part I.C.2, for a discussion of formal obstructions to successful shareholder litigation. *See* Sjostrom, *supra* note 55, at 213; s*ee also* Bainbridge & Henderson, *supra* note 18, at 1070 (explaining that "given [their] asymmetry of costs and benefits . . ., proxy contests are exceedingly rare[.]").

94. *See supra* Introduction, Section B; *see also* Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 3 (2002) [hereinafter *Why a Board?*] (reporting that a corporate board is as a "collegial body that functions mainly by consensus").

95. *See* Sprague & Lyttle, *supra* note 8, at 18 ("In practice, the shareholders' power to remove . . . directors has proven quite limited, with most directors facing a very low probability of being ousted[.]"); *Increasing Shareholder Power*, *supra* note 16, at 856 ("[S]hareholders' existing power to remove directors is not generally sufficient to ensure that management will initiate all changes in governance arrangements that shareholders view as value-increasing.").

96. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(k) (2010); Roven v. Cotter, 547 A.2d 603, 609 (Del. Ch. 1988) (finding it "clear that the directors of Delaware corporations in general . . . have no vested right to hold office in defiance of a properly expressed will of the majority"); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985) ("If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.") (citing Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984)).

97. *E.g.*, DEL. CODE ANN. tit. 8, § 141(k). State corporate laws are generally silent on "cause," which is subject to judicial review. *See, e.g.*, Campbell v. Loew's, Inc., 134 A.2d 852, 860-61 (Del. Ch. 1957) (holding that, if proven, charges of having a "planned scheme of harassment" and action "deliberately obstructive" to the corporate business constitute "cause" for a director's removal).

statutes permit shareholders to vote to remove directors "without cause."[98] Notably, there are usually provisions adopted in the incorporating charters to negate this default.[99]

In practice, director removal occurs infrequently.[100] Once elected, directors become entrenched in their positions.[101] Board decisions and communication with shareholders are not attributed to individual directors because decisions regarding corporate operations come from the board, not the individual directors, as does the power to direct "board operations."[102] Furthermore, the procedural requirements and

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98. Insituform of N. Am., Inc. v. Chandler, 534 A.2d 257, 267 (Del. Ch. 1987) (holding "that when shareholders have the power to remove a director without cause, their subjective motivation in exercising that power is irrelevant").

99. *See* DEL. CODE ANN. tit. 8, § 141(k) (allowing corporations to stipulate in their charters of incorporation whether directors must only be removed "for cause"); *see, e.g.*, Essential Enters. Corp. v. Automatic Steel Prods., Inc., 159 A.2d 288 (Del. Ch. 1960) (demonstrating that where investors have not adopted a provision in the incorporating charter that directors may be removed "without cause," it will be extremely difficult, if at all possible, for the corporation's policy to be amended through bylaws); *see also* MODEL BUS. CORP. ACT § 8.08(a) (2005).

100. *See, e.g.*, Lawrence E. Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263, 1304 (1992) [hereinafter *A Critical Look*] ("Director removal is in fact rarely litigated."); William K. Sjostrom, Jr., & Young Sang Kim, *Majority Voting for the Election of Directors*, 40 CONN. L. REV. 459, 473 (2007) ("Shareholders do have the power to remove directors, but such power is extremely impractical to exercise in the public company context.") (footnote omitted); Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 789 (2007) (agreeing that shareholders in publicly held corporations generally lack the power to remove directors); *see also* Klein, *supra* note 60, at 140 (listing existing defenses available to incumbent directors to shield themselves from a potential proxy challenge including "creating advance notice requirements for shareholder nominations to the board, and eliminating the right of shareholders to remove directors without cause or to change the size of the board").

101. *See* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1752 (2006) [hereinafter *Director Primacy*] ("[S]uch [removal] measures necessarily require the support of other shareholders, which makes displacing inefficient but entrenched managers a costly undertaking."); *cf.* Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?*, 2013 U. ILL. L. REV. 821, 825-30, 833 (2013) (discussing the enhanced impact of shareholder involvement on board elections and their subsequent increased ability to "unseat directors"). *But see* Part I.C.2.b.

102. Board operations are for many practical purposes necessarily confidential. *See* Fisch & Gentile, *supra* note 29. ("Directors act collectively, and they have generally been held to lack the authority to act for the issuer in their individual capacities."); *see*

practical effect of initiating a proceeding to remove a director are burdensome to both the complaining shareholder and the corporation.[103]

In addition to the SEC's regulation of insurgent action, the provisions in a corporation's incorporating charter and bylaws govern campaigns to remove directors both for cause and without cause.[104] Nevertheless, whether cause exists for a director's removal is subject to judicial review,[105] and the standard of review applied by judges is highly deferential.[106] Further, shareholders do not have access to all of the internal proceedings and deliberations of a board, and they are unlikely to be able to identify a *single actor* responsible for independently causing a *single result*.[107] Ultimately, removal of directors of publicly held corporations is rare.[108] And thus, the combination of boards'

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also infra Part II.A (explaining why insularity is necessary. Thus, if a shareholder were able to single out a director for removal, then this principle would be undermined).

103. The SEC imposes strict requirements and restrictions limiting insurgents under Rule 14a-8, which narrowly interpreted the decision in *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 240 (Del. 2008) (holding that the company justifiably excluded a shareholder proposal from proxy materials where the proposal was illegal because, if adopted, the proposal would cause the board to abdicate its fiduciary duties to manage the company).

104. *See, e.g.,* DEL. CODE ANN. tit. 8, § 141(k).

105. *See* Campbell v. Loews, Inc., 134 A.2d 852, 861-62 (Del. Ch. 1957) (holding that accused directors are ensured the opportunity, at the corporation's expense, to defend themselves in "statement[s] which must accompany or precede the initial solicitation of proxies seeking the authority to vote for the removal of such director[s] for cause").

106. *See infra* Part I.C.2.

107. This is significant because then any removal would be board removal, not specific directors. For example, even decisions made by the audit committee cannot definitively be attributed to committee members. Fisch & Gentile, *supra* note 29, at 568-69. Nothing requires the committee to act in isolation, and increased liability for "special" directors would discourage "qualified" individuals from serving on boards. *See* Daniel P. Forbes & Frances J. Milliken, *Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups*, 24 ACAD. MGMT. REV. 489, 492 (1999) ("Because of the strictly confidential and highly interpretive nature of board activity, it is likely to be extremely difficult for researchers to measure the task performance of boards in ways that are both reliable and comprehensive.").

108. *See* Lucian A. Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43, 46 (2003) [hereinafter *Access to the Ballot*] ("In the absence of an attempt to acquire the company, the prospect of being removed in a proxy contest is far too remote to provide directors with incentives to serve shareholders."); Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 806-07 (1983) (explaining that director

dominion over director elections and the unlikelihood of director removal has allowed the modern corporate board to become a self-perpetuating entity, insulated from external pressures or interference.[109]

B. A BOARD IS AUTONOMOUS

Corporate boards also maintain insularity through their de facto autonomy, despite legal constraints purporting to constrain their power and role in managing the corporation.[110] Boards must be able to function autonomously in order to manage the corporation properly to maximize shareholder wealth;[111] however, it is important not to conflate the board's need for autonomy with the directors' desire for personal autonomy.[112]

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removal—either with or without cause—rarely occurs because of its cumbersome procedural requirements, which threaten needless disruption of "the centralized management services that directors are supposed to provide[,]" and "[i]nstead, directors are usually terminated informally (consent), through a takeover (a market mechanism), or in the election process (by a proxy fight)").

109. *See* Harris, *supra* note 49, at 223 ("[S]hareholders have no practical method of ousting underperforming directors."). See *infra* Part I.C, for a discussion of how much discretion courts afford business decisions of boards and how thoroughly directors are insulated from liability.

110. Top corporate managers are legally and factually autonomous for many purposes. *See, e.g.*, Eisenberg, *supra* note 30, at 1472 ("[U]nder corporate law, the shareholders normally cannot make ordinary business decisions, cannot make major structural decisions unless the directors concur, and cannot remove directors without cause."); Ann M. Scarlett, *A Better Approach for Balancing Authority and Accountability in Shareholder Derivative Litigation*, 57 U. KAN. L. REV. 39, 44 (2008) (explaining that "the law vests [elected] directors with almost unlimited authority to manage the corporation"); *see also infra* Part I.C.2.

111. *See supra* Introduction, Section B; *see also* Sharfman, *supra* note 59, at 401 (explaining that increasing director oversight in an attempt to reduce the frequency of errors resulting from irresponsible decisions will not only fail to guarantee enhanced corporate decision-making, but also risk the destruction of "the genuine values of authority").

112. *See infra* Part II.A (concluding that current protections over-insulate individual directors, but arguing that increased director liability would not resolve the underlying issue caused by unconstrained boards). Thus, this Note seeks to balance the establishment of protective measures to monitor directorial action with the board's need for autonomy from individual managers', shareholders', and governmental interests. *Contra* Blair & Stout, *supra* note 34, at 253 (arguing that "boards exist *not* to protect shareholders per se, but to protect the enterprise-specific investments of all the

Regardless of their legal rights,[113] shareholders have little-to-no influence over the operation of the board of directors of a company in which they invested.[114] In fact, having entrusted the ability to make decisions to the board upon incorporation, the shareholders' individualized interests are subsumed into the goal of overall economic prosperity for the corporation.[115] Hence, the shareholders' power to decide both in which state to incorporate and what provisions to adopt in the corporation's charter is essential in protecting their interests and determining the future management of the corporation after they relinquish control to the board.[116] Indeed, federal regulations and judicial practice effectively safeguard the board's status as an autonomous entity.[117] And thus, legal standards and longstanding practices that are

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members of the corporate 'team,' including shareholders, managers, rank and file employees, and possibly other groups, such as creditors.") (emphasis added).

113. Shareholder involvement in the oversight of the corporation is limited to being able to vote on (1) the election of directors; (2) amendments to the articles of incorporation; and (3) other fundamental transactions (e.g., mergers). *See, e.g.*, DEL. CODE ANN. tit. 8, § 108 (2014) (requiring shareholders to elect directors upon incorporation); *id.* at § 141(a) (allowing shareholders to select the provisions of the governing state law they will include in their business' certificate of incorporation); *see also* Scarlett, *supra* note 110, at 45.

114. Goforth, *supra* note 15, at 629-30 (explaining that not only do "shareholders have very little power in controlling, overseeing, or disciplining the managers of their corporations[,]" but also, shareholders "have no say over day-to-day decisions about the business"). *See infra* Parts I.C.2.b.ii (explaining why disclosures fail to ensure communication), II.B.3 (discussing and re-conceptualizing shareholder rights).

115. *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 38 (Del. Ch. 2013) ("The duty to act for the ultimate benefit of stockholders does not require that directors fulfill the wishes of a particular subset of (stockholders) . . . (that) may have idiosyncratic reasons for preferring decisions that misallocate capital.").

116. *See* DEL. CODE ANN. tit. 8, § 107 (powers of incorporators); Grant v. Mitchell, No. CIV.A. 18370, 2001 WL 221509, at *8 n.17 (Del. Ch. Feb. 23, 2001) ("The extent to which an incorporator can refuse to name a board of directors until the first annual meeting and manage the corporation pursuant to the powers [of incorporators under Section 107] has never been decided."); *see* Bainbridge & Henderson, *supra* note 18, at 1100 (acknowledging that state laws "generally allow[] firms to vary widely in their approach, so long as the divergences are set forth in the corporate charter and are effectuated in ways consistent with law"); Lipton & Rosenblum, *supra* note 24, at 72; Sprague & Lyttle, *supra* note 8, at 39. *See supra* Introduction, Section A.

117. *See* Marchesani, *supra* note 78, at 332 ("[The] concept of 'autonomy[]' . . . encompasses both freedom from interference and a positive aspect of self-governing."). See *infra* Part I.C.2, for a discussion of how there is insufficient legal recourse to hold boards or directors liable for their actions.

highly deferential to boards restrict the availability for shareholder-recourse against directors for losses incurred.[118]

C. THE INHERENT CONSEQUENCES OF INSULARITY

Boards are susceptible to opportunism,[119] collusion,[120] and paternalism[121] because America's current system of corporate

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118. *See infra* Part I.C.2.

119. *See* Lucian A. Bebchuk & Michael S. Weisbach, *The State of Corporate Governance Research* 6-7 (Fisher C. Bus., Working Paper 2009-03-020 Nov. 2009) (explaining that since the American Revolution, economics and scholars of corporate law have recognized that "directors' interests may not fully overlap with those of shareholders"); Renée B. Adams, Benjamin E. Hermalin & Michael S. Weisbach, *The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey*, 48 J. ECON. LIT. 58, 91 (2010) ("Directors have a fiduciary duty to protect shareholders' interests. Yet, their interests are unlikely to be perfectly aligned with the shareholders.").

120. *See, e.g.*, Adams et al., *supra* note 119, at 92 ("The three-level hierarchy of shareholders-directors-management generates some additional issues, such as possible collusion between directors and management[.]"); Eisenberg, *supra* note 30, at 1473 ("[T]op managers of publicly held corporations have little incentive to adopt rules that put constraints on their own positions. On the contrary, the incentive . . . may be to insulate themselves from such constraints."); Murphy, *supra* note 26, at 169 ("Although this is beginning to change with respect to gender and race, boards continue to be homogenous with respect to age, occupation, class, and status position. This gives boards the likelihood of shared mental models attitudes, beliefs, and experiences that contribute to group cohesion.") (footnote omitted). *Compare* Bernice Grant, *Independent Yet Captured: Compensation Committee Independence After Dodd-Frank*, 65 HASTINGS L.J. 761, 764 (2014) (asserting that a compensation committee ideally diminishes conflicts of interest inherent to a "captured" board and explaining that this "serv[es] the interests of management rather than shareholders" because the committee "lacks the independence and objectivity that is necessary to determine executive compensation in an arm's length fashion") (footnote omitted), *with* James D. Westphal, *Collaboration in the Boardroom: Behavioral and Performance Consequences of CEO-Board Social Ties*, 42 ACAD. MGMT. J. 7, 9-10 (1999) (supporting social interaction between the CEO and board members because it facilitates collaboration and encourages open communication and exchange of information).

121. Survey evidence shows "that American boards can be characterized as star ('hub-and-spoke') social networks, with the CEO at the hub." Adams et al., *supra* note 119, at 100, 66 n.15 ("With respect to monitoring the CEO, one imagines that directors who have close ties to the CEO (e.g., professionally, socially, or because the CEO has power over them) would find monitoring him more costly than directors with fewer ties[.]"). "Interlock" demonstrates the reach of the power of CEOs throughout the

governance engenders board insularity to extend to individual directors.[122] Specifically, there is a "tension between the competing goals of ensuring director independence and incentivizing [directors] to perform at a high-quality level."[123]

The modern corporate board's predominance over director elections and the unlikelihood of director removal corroborate the conclusion that the desire to incentivize directors has circumvented formalized attempts to deter directors from engaging in self-dealing.[124] Consequently, boards are undeniably insular, and whether their insularity manifests overtly or covertly, it tends to shield the directors from accountability, frequently to the detriment of shareholders.[125]

1. Interests Will Diverge

Although the objective purpose of the board is to ensure that the corporation is working to maximize the value of the company's shares, board operations remain under the direction of subjective actors.[126]

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corporate world. Interlock occurs when one firm's employee sits on another firm's board, and vice versa. *See* Benjamin E. Hermalin & Michael S. Weisbach, *Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature*, 9 ECON. POL'Y REV. 7, 18, (2003) ("These employees are generally the CEO or another person high in management in their respective firms. Given this type of relationship, the potential for collusive or quid pro quo behavior on the part of the 'interlocked' directors is particularly high."); *see also* Grant, *supra* note 120, at 785.

122. *See infra* Part I.C.2.

123. Bainbridge & Henderson, *supra* note 18, at 1067.

124. Lisa Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 138 (2010) [hereinafter *Uneasy Case*] ("Importantly, there is nothing to prevent corporate officers from self-dealing—that is, engaging in transactions that benefit themselves at the expense of the corporation.") (footnote omitted); Molitor, *supra* note 6, at 99 (recognizing that board insularity "presents dangers that the directors will shirk their responsibilities or, worse, serve their own interests at the corporation's expense"); *see also infra* Part I.C.2.a.

125. *See infra* Part I.C.2; *see also* Andrew Howard, *Groupthink and Corporate Governance Reform: Changing the Formal and Informal Decisionmaking Process of Corporate Boards*, 205 S. CAL. INTERDISC. L.J. 425, 428 (2011) ("When groups foster an environment of camaraderie, cohesiveness may cause a group to avoid facing hard questions and avoid conflict so it quickly reaches a consensus.").

126. *See* Adams et al., *supra* note 119, at 94 (explaining that subjective concerns do not dependably eliminate the consequences of the directors' diverging interests "reputational concerns are not sufficient to eliminate agency problems and they can, in fact, create additional ones. With respect to the latter, reputational concerns can

Specifically, even though directors are tasked to manage the corporation with an objective goal of increasing the value of the common stock, their personal preferences will undoubtedly permeate through their decisions.[127] Directors might have personal investments in the corporation or subconscious biases that will direct their conduct and ultimately preclude the board from faithfully fulfilling its purpose.[128] This is particularly true because it is impossible to ascertain definitively whether a director is capable of self-regulating.[129] Consequently, shareholders may understandably be wary of board decisions, and many proposed corporate reforms attempt to provide *some* method of recourse for the shareholders to deter directors from succumbing to the temptation of engaging in self-dealing.[130]

Further, in the context of a publicly held corporation, the personal preferences of one shareholder invariably conflicts with that of

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generate agency problems with respect to the agent's choice of risky projects") (quoting Bengt Holmstrom, *Managerial Incentive Problems: A Dynamic Perspective*, 66 REV. OF ECON. STUD. 169, 182 (1999)).

127. *See* BERLE & MEANS, *supra* note 15, at 6 ("The separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear."); Murphy, *supra* note 26, at 169 ("I'm always amazed at how common groupthink is in corporate boardrooms. Directors are, almost without exception, intelligent, accomplished, and comfortable with power. But if you put them into a group that discourages dissent, they nearly always start to conform. The ones that don't often select out.") (footnote omitted).

128. *See* Bainbridge & Henderson, *supra* note 18, at 1067 (explaining that "[t]he more stock a director owns, the less independent the director becomes"); *see generally* Eisenberg, *supra* note 30, at 1471-74 (categorizing divergent interests). *But see* NASDAQ OMX Grp., *supra* note 77, at Rule 5605(a)(2) ("Nasdaq does not believe that ownership of Company stock by itself would preclude a board finding of independence[.]").

129. *See* Eisenberg, *supra* note 30, at 1473 ("[T]op managers may fail even to recognize that positional conflicts exist. . . . [They] usually believe (often, but not always, correctly) that their actions are in the interest of the shareholders."); *see also* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 577 (2003) [hereinafter *Means and Ends*] (describing the concerns of directors who recognize that if a company fails under their direction, their "reputations and thus their future employability are likely to suffer").

130. *See* Francis v. United Jersey Bank, 87 N.J. 15, 36 (N.J. 1981) ("Shareholders have a right to expect that directors will exercise reasonable supervision and control over the policies and practices of a corporation. The institutional integrity of a corporation depends upon the proper discharge by directors of those duties.").

another.[131] For example, some shareholders have long-term interests, while others are interested in fulfilling a short-term goal.[132] Therefore, a board might properly make a decision that does not immediately maximize shareholder profits but potentially will yield a greater return in the long-term.[133]

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131. Not all shareholders will have identical expectations for the returns on their investments in the company's stock. Sharfman, *supra* note 59, at 400 (elaborating on the value of centralized authority for publicly held corporations when it is known that the interests of its members diverge and explaining that "[e]specially where there are a large number of shareholders, it is much more efficient for the board of directors and executive management, the corporate actors that possess an overwhelming information advantage, to make corporate decisions rather than shareholders") (footnote omitted). Thus, when they relinquish their control over their investment to the board, it is reasonable that they would expect the board's oversight to be carried out by competent guardians of their interest. *See* Roberta S. Karmel, *Is The Independent Director Model Broken?*, 37 SEATTLE U. L. REV. 775, 793 (2014) (explaining how the interests of shareholders "diverge along a number of dimensions" and that "'time horizons' for wealth maximization vary among" short-term and long-term shareholders); Stout, *supra* note 100, at 795 (suggesting that corporate "rules that insulate boards from shareholder pressures . . . serve[] the interests of investors who worry about director 'shirking' but fear shareholder 'sharking' even more") (footnote omitted); *see also* Hayden & Bodie, *supra* note 15, at 2121 (concluding that the assumption that "shareholders have a homogeneous interest in wealth maximization—is simply not true").

132. *See* Hayden & Bodie, *supra* note 15, at 2093-95 (2010) (arguing that board insulation from shareholder involvement is intrinsic to ensure shareholders are not able to promote their short-term interests at the expense of the long-term interest of the corporation); *see also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (explaining that directors owe a duty of care that "extends to protecting the corporation and its owners from perceived harm [even where] a threat originates from . . . other shareholders"); *In re* Lear Corp. S'holder Litig., 967 A.2d 640, 655 (Del. Ch. 2008) ("Directors are not thermometers, existing to register the ever-changing sentiments of stockholders . . . . During their term of office, directors may take good faith actions that they believe will benefit stockholders, even if they realize that the stockholders do not agree with them.") (footnote omitted).

133. *See In re* Trados Inc. S'holder Litig., 73 A.3d 17, 37 (Del. Ch. 2013) ("When deciding whether to pursue a strategic alternative that would end or fundamentally alter the stockholders' ongoing investment in the corporation, the loyalty-based standard of conduct requires that the alternative yield value exceeding what the corporation otherwise would generate for stockholders over the long-term.") (footnote omitted).

2. There Will Not Be Enough Accountability

Directors are not afforded the same autonomy as boards under modern corporate governance;[134] however, it is important to insulate directors from liability in order to ensure people remain willing to serve on boards.[135] Although boards are not required to serve the interests of individual shareholders, there are three types of lawsuits shareholders may bring against a corporate board and its directors: state law derivative suits,[136] state law direct suits,[137] and securities lawsuits.[138]

The designated purposes for shareholder litigation are deterrence and compensation.[139] Nevertheless, these mechanisms do not permit sufficient recourse for shareholders when boards fail to effectuate their

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134. *See supra* note 29 and accompanying text.

135. In general, board activity is necessarily confidential. Consequently, decisions of individual directors are relatively inseparable from board activity as a whole. Over time, some regulations have sought to establish a different level of insularity for directors. Nevertheless, these regulations ultimately fail to provide an adequate remedy. *See* Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 802 n.26 (2001) ("[T]here are ample reasons to doubt that directors have the time, incentive, or information to monitor fully."); E. Norman Veasey, Jesse A. Finkelstein, & C. Stephen Bigler, *Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 BUS. LAW. 399, 421 (1987) (explaining that the DGCL "is designed to ensure that directors and officers are adequately protected from liability resulting from the performance of their duties").

136. These lawsuits concern breach of a fiduciary duty resulting in harm to the corporation. *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006) (stemming from shareholders' complaint that directors' approval of President's compensation package, including a $130 million severance payment, was waste and a breach of their fiduciary duty).

137. These lawsuits concern breach of a fiduciary duty resulting in harm to shareholders. *See, e.g.*, Lyondell Chem. Co. v. Ryan, 970 A.2d 235 (Del. 2009) (involving shareholders' claim that the Lyondell board breached its fiduciary duties of care and loyalty by failing to seek out other bids during a merger).

138. These lawsuits concern misrepresentations or inadequacies in corporate disclosure and allow for claims that management misused its position to the disadvantage of shareholders. *See, e.g.*, Chiarella v. United States, 445 U.S. 222 (1980) (involving a claim made by the United States against Chiarella for allegedly violating Rule 10(b)).

139. Martin Petrin, *Assessing Delaware's Oversight Jurisprudence: A Policy and Theory Perspective*, 5 VA. L. & BUS. REV. 433, 457, 461-65 (2011).

duty to monitor the corporation.[140] Recent efforts to reform corporate governance and increase board and director accountability without impeding their ability to fulfill their duties have failed.[141]

a. Existing Legal Standards Enable a Board and its Directors to Thwart Liability

The Business Judgment Rule,[142] exculpation for duty of care claims,[143] indemnification,[144] and insurance[145] are some mechanisms that protect directors from liability in shareholder litigation.[146] Although it is necessary to limit directors' exposure to liability to attract individuals for service, the practical effect of these existing protective measures is to insulate directors and undermine potentially reliable constraints that might persuade directors to focus on objectively managing the corporation to maximize shareholder profit.[147]

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140. Although directors owe a non-delegable fiduciary duty, breach is difficult to prove, and restitution is very unlikely. *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009); *infra* Part I.C.2.a.

141. *See infra* Part I.C.2.b.

142. *See* Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981); Sprague & Lyttle, *supra* note 8, at 3 ("But under the business judgment rule, shareholders are often left with no legal recourse when their directors fail to maximize shareholder wealth.") (footnote omitted).

143. DEL. CODE ANN. tit. 8, § 102(b)(7) (2014).

144. *Id.* § 145.

145. *Id.* § 145(g).

146. *See* Marchesani, *supra* note 78, at 329 (explaining how fiduciary duties and personal liability rules for directors not only "fail to create a sufficient incentive to act in the best interest of the corporation," but also "make it unlikely that a director's exposure to liability will provide a serious incentive to act"); Mary Siegel, *The Illusion of Enhanced Review of Board Actions*, 15 U. PA. J. BUS. L. 599, 600 (2013) (disagreeing with "the conventional wisdom . . . that . . . the enhanced business judgment rule, *Revlon*, entire fairness, *Blasius*, and *Schnell* . . . require substantial judicial involvement and scrutiny[,]" and arguing instead that they apply "similar deference" to directors' judgment under the business judgment rule).

147. *See* Lisa M. Fairfax, *Managing Expectations: Does the Directors' Duty to Monitor Promise More Than It Can Deliver?*, 10 U. ST. THOMAS L.J. 416, 418 (2012) [hereinafter *Managing Expectations*] ("[T]he nearly insurmountable standard for imposing liability for oversight breaches at best may render the doctrine irrelevant for purposes of encouraging appropriate director behavior, and at worst may undermine the extent to which directors feel compelled to take their oversight role seriously.").

The Business Judgment Rule is the standard under which courts adjudicate claims brought against directors.[148] It proscribes "hindsight evaluations of decisions at the heart of the business judgment of directors."[149] The Business Judgment Rule is not only highly deferential to board members, but also extremely burdensome for claimants who must plead facts sufficient to rebut the presumption in favor of the directors.[150] This is problematic because of the asymmetry of information between a director and a shareholder.[151]

Directors generally owe fiduciary duties of care and loyalty to the corporation and, by extension, to its shareholders.[152] However, a corporation's certificate of incorporation may include "[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of

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148. Under this standard, a court operates from a presumption that, in making a business decision, the directors of a corporation acted (1) on an informed basis, (2) in good faith, and (3) in the genuine belief the action in question was taken in the best interests of the company. *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

149. *In re* Citigroup, Inc. S'holder Derivative Litig., 964 A.2d 106, 131 (Del. Ch. 2009).

150. *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009) ("The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors. The rule itself 'is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'") (citations omitted); *Managing Expectations*, *supra* note 147, at 434 (acknowledging that "[c]ourts have repeatedly emphasized the high hurdle shareholders must cross in order to prove an oversight breach"); Sprague & Lyttle, *supra* note 8, at 15-16 ("From the earliest days of the corporation, courts have demonstrated a reluctance to hold directors accountable for anything less than gross negligence or self-dealing.").

151. It is often difficult for shareholders to successfully rebut the presumption established by the Business Judgment Rule. *See, e.g.*, *Gantler*, 965 A.2d at 707 (Del. 2009) (finding proof that the directors' motive to entrench themselves was insufficient to rebut the presumption without the inclusion of additional facts sufficient to state a cognizable claim that the directors acted disloyally).

152. *E.g.*, McMullin v. Beran, 765 A.2d 910, 921 (Del. 2000) ("A director's duty to exercise an informed business judgment implicates the duty of care."); *id.* at 925 ("In properly discharging their fiduciary responsibilities, directors of Delaware corporations must exercise due care, good faith and loyalty whenever they communicate with shareholders about the corporation's affairs.").

fiduciary duty as a director."[153] A provision exculpating duty of care claims insulates directors from being held accountable from their actions in any meaningful way.[154] Essentially, it protects directors from liability for *any* action, regardless of whether the action falls within the scope of the directors' traditional duties, unless the claimant can (1) obtain evidence of the private workings of the board,[155] and (2) meet the high burden of proof necessary to succeed in a claim for breach of loyalty.[156]

For example, the Supreme Court of Delaware found for the directors in *Lyondell Chemical Co. v. Ryan* where shareholders had claimed that the Lyondell board breached its fiduciary duties of care and loyalty by failing to seek out competing bids during a merger.[157] Lyondell's incorporating charter included a provision exculpating directors from personal liability for breaching the duty of care.[158] Although directors cannot exculpate the duty of loyalty, the shareholders failed to establish that the Lyondell directors' shortcomings also implicated the duty of loyalty.[159] Specifically, the shareholders failed to prove that the directors, as fiduciaries, "intentionally fail[ed] to act in the face of a known duty to act, demonstrating a conscious disregard for

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153. DEL. CODE ANN. tit. 8, § 102(b)(7) (2014); *see also* MODEL BUS. CORP. ACT § 2.02(b)(4)(A)-(B) & (D) (2010).

154. *See* Guttman v. Huang, 823 A.2d 492, 501 (Del. Ch. 2003) (explaining that in *In re* Baxter International Inc., 654 A.2d 1268, 1270 (Del. Ch. 1995), the court held that where a corporate charter insulates directors from liability for breaches of the duty of care, "a serious threat of liability may only be found to exist if the plaintiff pleads a *non-exculpated* claim against the directors based on particularized facts") (emphasis in original); *see also* Lawrence A. Hamermesh, *Why I Do Not Teach Van Gorkom*, 34 GA. L. REV. 477, 479 (2000) ("Exculpatory charter provisions adopted pursuant to statutes, almost universally enacted since *Van Gorkom*, have rendered the damages claim for breach of the duty of care essentially non-existent."); Christine Hurt, *The Duty to Manage Risk*, 39 J. CORP. L. 253, 275 (2014) (explaining that where corporations adopt provisions exculpating their directors from liability for breaches of the duty of care, shareholders must "point to specific decisions made by the boards of directors" and "show that these decisions were not only grossly negligent (to overcome the business judgment rule), but also in bad faith (to overcome any applicable exculpation clause)").

155. *See infra* Part II.A.

156. *See In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 65-67 (Del. 2006).

157. Lyondell Chemical Co. v. Ryan, 970 A.2d 235, 244 (Del. 2009).

158. *Id.* at 239 (necessitating a finding that the duty of loyalty was breached in order to hold exculpated directors liable where an exculpatory provision in the charter of incorporation protected the "directors from personal liability for breaches of the duty of care").

159. *Id.* at 244.

his duties."[160] Thus, although the board's decisions did not apparently contemplate shareholder wealth maximization, the shareholders had no recourse for remedy absent evidence that was essentially impossible to obtain.[161] Additionally, it is notable that the shareholders did not bring this claim against a single director, but rather the entire board, despite the unlikelihood that the entire board oversaw all details of the intended merger.[162]

Although state corporate laws generally insulate board activity from outside review, shareholder derivative litigation permits shareholders to take legal action against directors' alleged mismanagement of the corporation or breach of their fiduciary duties.[163] However, a self-dealing transaction may remain insulated from attack under state laws because shareholders cannot successfully bring a suit against directors on behalf of the corporation without approval from a special litigation committee ("SLC").[164] Courts review an SLC's dismissal of a suit under a deferential standard:[165] unless "the [decision]

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160. *In re Walt Disney Co*., 906 A.2d at 67; *see also Lyondell Chem. Co*., 970 A.2d at 243 ("In the transactional context, [an] extreme set of facts [is] required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties.") (quoting *In re* Lear Corp. S'holder Litig., 967 A.2d 640, 654 (Del. Ch. 2008)).

161. *See supra* notes 245-246 and accompanying text.

162. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(c)(1) (2014).

163. *See* Mitchell, *supra* note 100, at 1286 ("Directors are punished for self-dealing by electoral removal, hostile takeovers, or derivative litigation. Although none of these is [sic] likely to happen to a particular board of directors, their aggregate pressure, at least theoretically, disciplines directors to act in the stockholders' interests.") (footnote omitted).

164. *See* McKee v. Rogers, 156 A. 191, 193 (Del. Ch. 1931) ("[A] stockholder cannot be permitted . . . to invade the discretionary field committed to the judgment of the directors and sue in the corporation's behalf when the managing body refuses."); *see also* Zapata Corp. v. Maldonado, 430 A.2d 779, 783-85 (Del. 1981).

165. Although SLCs face a higher standard to dismiss a derivative suit than board activity that falls under the protection of the Business Judgment Rule, the threshold is still too low: (1) the SLC members must be independent, and (2) the SLC must have made a good-faith investigation of reasonable scope to form a reasonable basis supporting its conclusion. *Zapata*, 430 A.2d at 788-89. *See* London v. Tyrrell, No. 3321-CC, 2010 WL 877528, at *11 (Del. Ch. Mar. 11, 2010) ("The second step of the analysis is discretionary. The court applies its own business judgment to the facts to determine whether the corporation's best interests would be served by dismissing the suit."); *see also* Beam v. Stewart, 845 A.2d 1040, 1049 (Del. 2004) ("Independence is a

does not appear to satisfy the spirit of the requirements[,]"[166] the SLC may refuse to file the lawsuit and stop litigation.[167] Ultimately, disinterested director approval will shield a corporation from future legal attacks, even with respect to self-dealing transactions, such as overly generous CEO compensation packages.[168]

Indemnification provisions are problematic because the promise of indemnity subverts the deterrence rationale for shareholder litigation and creates a moral hazard problem.[169] Most states permit corporations to adopt indemnification provisions to indemnify their directors.[170] Because nearly all corporations want to recruit sophisticated individuals to serve as directors, most offer indemnification as an incentive.[171] Directors already are under an improbable threat of personal liability. If directors know they will be indemnified in the unlikely event that they incur legal costs, they are even less likely to protect themselves against

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fact-specific determination made in the context of a particular case."); Kaplan v. Wyatt, 499 A.2d 1184, 1192 (Del. 1985) (proceeding to second step of *Zapata* is discretionary). *But see* Joseph M. McLaughlin, *Special Litigation Committees in Shareholder Derivative Litigation*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Apr. 25, 2010, 10:20 AM), http://blogs.law.harvard.edu/corpgov/2010/04/25/special-litigation-committees-in-shareholder-derivative-litigation/#2 ("SLC members are not given the benefit of the doubt as to their objectivity.").

166. *See Tyrrell*, 2010 WL 877528, at *11.

167. *See, e.g.*, *Zapata* 430 A.2d at 788 (explaining that following action taken by an SLC, a corporation "should have the burden of proving independence, good faith and a reasonable investigation, rather than presuming independence, good faith and reasonableness").

168. Urska Velikonja, *The Political Economy of Board Independence*, 92 N.C. L. REV. 855, 882 (2014).

169. Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors' Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 414 (2005) [hereinafter *Spare the Rod*] ("The combination of indemnification provisions and [directors and officers'] insurance essentially eliminates directors' financial liability for breaching their fiduciary obligations.").

170. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (2014) (shielding directors from liability for breaches of their duty of care). Note, however, that indemnification is permissible in direct, but not derivative, shareholder suits. In derivative litigation, insurance protects directors from incurring personal expenses from liability. *See* Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1067 (2006).

171. *Spare the Rod*, *supra* note 169, at 451 (indemnifying directors from breaches of the duty of care both minimizes their individual risk and incentivizes what would otherwise be a less attractive secondary employment).

risk.[172] Similarly, the use of indemnification undermines the compensation policy rationale of shareholder litigation because the corporation pays for the wrongdoing.[173] The corporation's legal costs, as well as any potential negative publicity from a lawsuit, negatively impacts its stock value.[174]

Lastly, most state business codes allow corporations to purchase director insurance.[175] The availability of insurance subverts the deterrence purpose of shareholder litigation and creates a moral hazard problem.[176] Although a corporation can indemnify its directors from liability in direct lawsuits, corporations can also acquire insurance to

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172. Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 600-01 (1983) ("Although there is no adequate guide to either the economic or practical impact of such settlements in due care litigation, any impact is reduced by the ready availability to directors of indemnification and insurance. Moreover, corporate practice reflects a trend toward the use of such protective devices.") (footnote omitted); John Armour, Bernard Black, & Brian Cheffins, *Delaware's Balancing Act*, 87 IND. L.J. 1345, 1397-98 (2012) ("A case can be made that independent directors acting honestly should face some risk of personal liability for severe dereliction of duty, even without self-dealing. As we have seen, however, Delaware courts have adopted a tough "conscious disregard of duty" standard for a plaintiff to show director lack of good faith at companies which have adopted Section 102(b)(7) charter provisions to eliminate director liability absent self-dealing or lack of good faith. The Delaware courts have never found the "conscious disregard" standard to have been met.") (footnote omitted).

173. Indemnification provisions compel a corporation to internalize the risk of losses incurred by its directors. This creates a moral hazard because the promise of indemnity encourages excessive risk-taking by allowing directors to externalize risks onto the corporation. Timothy P. Glynn, *Beyond "Unlimiting" Shareholder Liability: Vicarious Tort Liability for Corporate Officers*, 57 VAND. L. REV. 329, 418 (2004).

174. *See* Black et al., *supra* note 170, 1059-60 ("Companies and their directors are frequently sued under the securities laws and state corporate law, and settlements are common. But the actual payments are nearly always made by the companies involved—either directly or pursuant to directors' rights to indemnification—or by a D&O insurer, a major shareholder, or another third party.") (footnote omitted).

175. *E.g.*, DEL. CODE ANN. tit. 8, § 145(g) (granting corporations the power to purchase insurance on behalf of directors against any liability incurred arising out of their status in the corporation "whether or not the corporation would have the power to indemnify such person against such liability under this section").

176. Bainbridge & Henderson, *supra* note 18, at 1086 (acknowledging that "[t]he downside of insurance—[is] the moral hazard or shirking problem").

supplement their ability to protect directors' interests in case any alleged misconduct precludes the corporation from indemnifying its directors.[177]

b. Safeguards Created to Address the Issue of Insufficient Accountability Have Failed

State courts and the SEC have attempted to increase director accountability; however they have failed.[178] Directors remain insulated from liability and boards remain a self-perpetuating institution due to the confidentiality of board-related activity and as a result of the amount of deference afforded to boards.[179]

i. Judicial Attempts to Enhance Accountability

The actions of corporate boards are subject to enhanced judicial scrutiny under *Unocal Corporation v. Mesa Petroleum Co.* and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Incorporated*. When a corporation faces a hostile takeover, the target board's use of a defensive tactic triggers *Unocal* duties. [180] Alternatively, *Revlon* duties are triggered when shareholders are exposed to a transaction that will be their last chance to monetize their investment.[181] Ideally, the *Unocal* and

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177. *See* Veasey et al., *supra* note 135, at 404 ("Indemnification is not, of course, a substitute for insurance: Insurance can protect the directors where indemnification cannot, but indemnification can also protect the directors when insurance cannot.").

178. *See infra* Part I.C.2.b.

179. *See* Fogel & Geier, *supra* note 8, at 66-68 (protesting that the current system of corporate governance, which discourages shareholders from actively participating in oversight of the corporation, leaves shareholders no choice but to sell their shares when they are dissatisfied with management, and this system "perpetuates itself, and by virtue of this ultimate lack of accountability, has made American companies less competitive in the world"); Siegel, *supra* note 146, at 600 (explaining that judicial doctrine purporting to provide enhanced scrutiny of board activity not only fails to increase accountability, but also "create[s] high[er] burdens for plaintiffs").

180. A board's defensive actions in response to a *potential* hostile takeover are subject to the *Unocal* test, which requires (1) reasonable perception of harm to shareholders, and (2) reasonableness of action in relation to the threat posed. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

181. A board's defensive actions in response to an *impending* hostile takeover are subject to the *Revlon* test, which generally requires strict shareholder wealth maximization where the board must pursue a rational course of action designed to maximize shareholder welfare. *See* Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 501 A.2d 173, 181 (Del. 1986).

Revlon duties would prevent subjective director conduct that would not be deterred by the threat of liability under the Business Judgment Rule. Additionally, the compelling-justification test articulated in *Blasius Industries v. Atlas Corp.* intends to preclude boards from acting solely to thwart shareholders from exercising their right to vote to elect directors.[182] The equitable remedy created in *Schnell v. Chris-Craft Industries, Inc.* intends to prevent inequitable action—like perpetuating a board in office by changing the date and location of the annual meeting to prevent a proxy content against management—"simply because . . . [it is] legally possible."[183] Realistically, however, these mechanisms do not increase board accountability because they fail to enhance judicial oversight of board activity.[184]

The *Unocal* and *Revlon* tests remain largely deferential to boards' exercise of their business judgment. Board activity scrutinized under the *Unocal* standard has remained highly deferential, essentially finding that a target board's use of defensive tactics was permissible where the board has merely complied with its fiduciary duties.[185] Similarly, application of "enhanced" business judgment under *Revlon* to determine whether directors have acted to maximize "the company's value at a sale for the stockholders' benefit[,]"[186] is tempered by judicial recognition of the fact that the board is still exercising its business judgment and cannot predict the future.[187] Boards satisfy the "enhanced" standard by merely

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182. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661, 663 (Del. Ch. 1988) (holding where the board did not have a "compelling justification" to act "for the primary purpose of impeding the exercise of stockholder voting power[,]" that "even finding the action taken was taken in good faith, it constituted an unintended violation of the duty of loyalty that the board owed to the shareholders").

183. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439-40 (Del. 1971).

184. Siegel, *supra* note 146, at 624 (dubbing the enhanced business judgment test articulated in *Unocal* as "little more than a paper tiger"); *id.* at 630 ("Delaware courts most often defer[] to independent boards under Revlon as well."); *id.* at 645-46 (stating that *Blasius* and *Schnell* mandate judicial review, but "courts have made the hurdle to triggering either of these tests *so high* that that two tests are rarely used") (emphasis added).

185. *See id.* at 622-23 ("[N]ot only are board highly successful (seventy-nine percent) under Unocal, but boards consisting of a majority of independent directors are almost guaranteed to win: Only four independent boards have failed Unocal.").

186. *Revlon*, 501 A.2d at 182.

187. *In Re* Fort Howard Corp. S'holders Litig., 14 DEL. J. CORP. L. 699, 722 (1988) (explaining that when scrutinizing board activity under the *Revlon* requirement that a

exercising business judgment with the additional requirement of showing that possessed sufficient knowledge of the market to ensure the transaction price was adequate.[188] Although courts cannot remain deferential to boards when applying the *Blasius* standard and the *Schnell* doctrine,[189] courts only reluctantly hear cases triggering these tests.[190]

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disinterested board act in good faith to promote shareholder interests, the relevant consideration is the "intended" rather than the actual effect of the board's decision, "for the validity of the agreement itself cannot be made to turn upon how accurately the board did foresee the future"); *see also* Franklin A. Gevurtz, *Removing Revlon*, 70 WASH. & LEE L. REV. 1485, 1545 (2013) (rejecting *Revlon* as standard guiding directorial conduct since "there really is no sensible underlying rationale for the doctrine").

188. McMullin v. Beran, 765 A.2d 910, 918 (Del. 2000) ("Those methods may include conducting an auction, canvassing the market, etc. There is, however, 'no single blueprint' that directors of Delaware corporations must follow.") (footnote omitted); Siegel, *supra* note 146, at 629-30 ("Of the thirty-nine cases that found a corporation to be in a Revlon mode, courts in thirty-one cases (or seventy-nine percent) held that the boards had met their Revlon duties. Of those cases with successful outcomes, seventy-seven percent had boards with a majority of independent directors.") (footnotes omitted).

189. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661-664 (Del. Ch. 1988). *Blasius* requires more than mere satisfaction of fiduciary duty and good faith exercise of business judgment. A compelling reason for action must be given to justify action with intent to prevent shareholder vote on director election. *Id.* at 661. Similarly, *Schnell* demands scrutiny of board activity that is legal per se if it seems inequitable. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971). Thus, these standards, which are applicable only under specific circumstances, mandate judicial review.

190. As of 2013, only five cases have been found to trigger the *Blasius* test in Delaware courts, and the courts did not find compelling justification for the actions of the boards under scrutiny in four of the cases. "[A]t best, only one passed. The small number of cases under Blasius [sic] indicates the courts' reluctance to invoke a test that is impossible—or nearly so—for boards to pass." Siegel, *supra* note 146, at 643-44 (footnote omitted). As of 2013, only thirteen cases have been found to trigger the *Schnell* doctrine, "[d]espite its forty-plus year history, and its facial applicability to any aspect of corporate law[.]" *Id.* at 644 (footnote omitted). In ten of the thirteen cases, courts found a *Schnell* violation and struck down board action. *Id.* at 644 n.91. Courts are reluctant to invoke the *Schnell* doctrine because "allow[ing] courts, without boundaries or guideposts, to invalidate otherwise legal conduct . . . could 'imperil[]' the stability of Delaware law." *Id.* at 644.

ii. Federal Attempts to Enhance Accountability

Although corporate law remains under the purview of the states, the federal government has previously intervened in response to national economic crises.[191] The overarching theme of federal regulations has been investor protection.[192] The SEC has pursued this goal by promulgating requirements for mandatory disclosures,[193] proxy rules,[194] and director independence.[195]

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191. Pinto, *supra* note 6, at 263-64 (2010) ("Much of the development of federal law involves corporate governance and has been the result of significant corporate financial scandals and the perceived need for a federal response. A federal response signifies the importance of protecting the public investors and stock markets and the inability of state law to deal with systematic problems."). *See also* the U.S. Securities and Exchange Commission, the Securities Act of 1933, the Securities and Exchange Act of 1934, and Investment Company and Investment Advisers Act of 1940 (following the Wall Street Crash of 1929 and the start of the Great Depression); Williams Act of 1968 (responding to the surge of hostile takeovers); Sarbanes-Oxley Act of 2002 (following the 2000 bursting of the technology bubble and the 2001 corporate and accounting scandals at Enron, WorldCom, etc.); Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (following the 2008 financial crisis).

192. Note, however, this section does not recount every resolution or rule that relates to corporate governance or boards of directors promulgated by the SEC. Instead, it focuses on those particularly at issue right now. Marchesani, *supra* note 78, at 320 (explaining that by focusing on improvement of board monitoring, the latest reforms to the current system of American governance confirm that the corporate board "acts prevalently as the monitor of management for the benefit of the shareholders, thereby reducing costs arising from the separation of ownership and control of the corporation and the diffusion of shareholding").

193. The disclosure requirements are generally unexacting. Although they might increase transparency (*e.g.*, 17 C.F.R. §§ 240.13a-1, -11, -13 (1990) (requiring annual, quarterly, and other reports on prescribed forms); 17 C.F.R. § 240.13d-1 (1990) (requiring disclosure of beneficial ownership in excess of 5% of a corporation's shares)), they do not impose affirmative duties beyond honest disclosure with which a board must comply. *E.g.*, 17 C.F.R. § 229.407(d)(5)(ii) (2012) (requiring a corporation to disclose either that its board has at least one financial expert or to explain why it does not); *see also* Murphy, *supra* note 26, at 149-50 (reporting zero shareholder nominations as of a 2006 survey, three years after the SEC's enhanced disclosure rules intended to encourage board nominating committees to consider shareholder recommendations took effect).

194. Proponents of shareholder proxy access seek to empower shareholders by granting them direct access to submit information for a board to include in the mandatory disclosures during an election. *See supra* Part I.A; Karmel, *supra* note 131, at 781 ("SEC's final rules required only a brief description of 'significant economic and

The purpose of electing an "independent" director is to mitigate the impact of the directors' diverging interests and the collusion throughout the board, but by its definition it does not succeed.[196] First, it is under-inclusive because a majority shareholder that "had no ties to management" would still be considered "independent."[197] Second, once an "independent" director has served on a board, that director will invariably lose any supposedly independent qualities.[198] Finally, the

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personal relationships . . . between the director and the issuer.'") (citing 43 Fed. Reg. 58522, 58523 (Dec. 6, 1978)); *Insulating Boards*, *supra* note 42, at 1687 ("Providing shareholders with power and rights that enable them to hold directors accountable is overall beneficial for companies and their long-term shareholders in both the short term and the long term.").

195. Velikonja, *supra* note 168, at 883 ("Relatively recent changes to federal securities laws and listing standards have imposed a legal requirement that public companies maintain majority independent boards and fully independent audit, nominating, and compensation committees.").

196. See *supra* Part I.C.1, for a discussion of directors' diverging interests. *See, e.g.*, Grant, *supra* note 120, at 764 (explaining that requiring, for example, that boards have an independent compensation committee does not succeed in diminishing conflicts of interest that arise when the committee lacks independence from management because "[d]irectors who are nominally independent from management might still be subject to organizational behavior factors such as norms of reciprocity, groupthink, polarization, social cascades, and herding"); *see also* Marchesani, *supra* note 78, at 317 ("Common definitions of Independence fail to consider all of the ties that affect directors' independent judgment.").

197. Directors, under existing definitions, are not independent if they have any "material relationship" with the listed company. Under the NYSE listing requirements, a material relationship may "include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others." NYSE Manual, *supra* note 77, at §§ 303A.02, 303A.05. However, in addition to failing to *require* consideration of personal or social relationships, there is nothing that prevents a shareholder from serving on the board. In fact, under the NASDAQ requirements, it is expressly stated that ownership of stock does not necessarily preclude a finding of independence. *See* NASDAQ rules, *supra* note 77. Finally, while boards are instructed to "broadly consider all relevant facts and circumstances" when determining whether a perspective director has a material relationship with the company, the listed relationships are merely suggestions offered for possible consideration. *See* Grant, *supra* note 120, at 784-85; Marchesani, *supra* note 78, at 327 ("The new rules, however, do not adequately consider personal friendships and, more generally, social ties. An Independent Director may also fail to effectively carry out his responsibilities because he lacks competence.") (footnote omitted).

198. The designation of "independent" is problematic. *See generally* Dent, *supra* note 49, at 1271 (explaining that under the current system of corporate governance "legislation cannot create true board independence but only reduce formal contacts");

effect of the "independence" requirement ultimately serves to insulate directors further from liability for board activity.[199] Therefore, requiring independent directors does nothing to prevent harm from interested directors.

Most recently, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") and the Sarbanes-Oxley Act of 2002 ("SOX") responded to contemporary economic crises by attempting to temper board autonomy with increased transparency and accountability.[200]

Fogel & Geier, *supra* note 8, at 48 (concluding definitively that "a director or nominee who otherwise meets or exceeds the independence criteria [can] be independent"); Usha Rodrigues, *A Conflict Primacy Model of the Public Board*, 2013 U. ILL. L. REV. 1051, 1067-68 (2013) (identifying how the federal government's "enshrining the independent board for the public corporation" is problematic because it "created an entity suitable for but one purpose, dealing with managerial conflict" leaving corporate officers and investors to make all corporate decisions) (referencing Kelli A. Alces, *Beyond the Board of Directors*, 46 WAKE FOREST L. REV. 783, 783 (2011).

199. Because judicial mechanisms purporting to increase board accountability are especially deferential to decisions made by "independent" directors, the problems posed by insufficient accountability and entrenchment are self-perpetuating. *See* Siegel, *supra* note 146, at 621 (providing statistics for the amount of deference afforded to directors under the Unocal test); Marchesani, *supra* note 78, at 318 (explaining that while the most recent federal reforms made progress in beginning to clarify the definition of "independence," their corresponding rules "not only fail to take into account any of the additional personal characteristics that an effective director needs to have, such as motivation, competence, and time availability, but also fall short of addressing all of the existing structural issues"); *see also supra* Part I.C.2.b.i.

200. For example, § 971 of Dodd-Frank addressed the SEC's ability to determine the extent that shareholders would be allowed to access a corporation's proxy solicitation materials. Subsequently, the SEC issued Rule 14a-11 granting shareholder proxy access at all publicly held corporations. 17 C.F.R. § 240.14a-11 (2011). Ultimately, the D.C. Circuit Court vacated the rule. Bus. Roundtable v. SEC, 647 F.3d 1144, 1151 (D.C. Cir. 2011) (holding, in part, that the SEC "relied upon insufficient empirical data when it concluded that Rule 14a–11 will improve board performance and increase shareholder value by facilitating the election of dissident shareholder nominees"); *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 952, 124 Stat. 1376, 1392-94 (2010) (ordering the SEC to issue rules directing stock exchanges to require independent compensation committees); Lisa M. Fairfax, *Sue on Pay: Say on Pay's Impact on Directors' Fiduciary Duties*, 55 ARIZ. L. REV. 1, 18 (2013) [hereinafter *Sue on Pay*] ("The compensation reforms under Dodd-Frank also seek to enhance board accountability."); Karmel, *supra* note 131, at 786 ("Dodd-Frank further tightened the independence requirements for compensation

Notably, pursuant to § 301 of SOX, all boards must have an audit committee wholly comprised of "independent" directors.[201] In compliance with SOX, the NYSE, the American Stock Exchange ("Amex"), and NASDAQ submitted proposed corporate governance reforms to their respective listing standards for approval by the SEC.[202]

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committees, requiring that each member of compensation committees be independent and clarifying the standards by which committee members are determined to be independent."). Similarly, reforms under SOX fell short of their intended goal. New listing requirements in compliance with SOX require "companies adopt and disclose corporate governance guidelines addressing director qualification standards and director orientation and continuing education." Marchesani, *supra* note 78, at 327. However, the boards may elect not to have a financial expert on their auditing committees provided they "explain" why, Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7265, and while the stock exchanges require all directors on the auditing committee be "financially literate," boards retain discretion over defining when that designation applies. NYSE Manual, *supra* note 77, at § 303A.07 ("Each member of the audit committee must be financially literate, as such qualification is interpreted by the listed company's board in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee."); *see also* Sarbanes-Oxley Act, *supra* note 78, § 301 (ordering the SEC to issue rules directing stock exchanges to require boards of publicly held corporations to conform their listing standards to the requirements under § 301, primarily concerning director independence, board committees, and disclosure policies); Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817, 1829 (2007) [hereinafter *Social Construction*] ("A palpable theme in much of SOX is . . . insistence on more public accountability, so that large business corporations meet standards resembling those commonly expected of public and quasi-public institutions."). *But see* Velikonja, *supra* note 168, at 864 ("Most public companies have maintained a majority independent board since at least the late 1980s.").

201. 15 U.S.C. §§ 7201(3), 78j-1(m)(2)-(3) (2010).

202. Disclosure Regarding Nominating Committee Functions and Communications between Security Holders and Boards of Directors, Securities Act Release No. 8340, Exchange Act Release No. 48,825, Investment Company Act Release No. 26,262, 68 Fed. Reg. 66,992 (Nov. 28, 2003) ("Specifically, we are adopting enhancements to existing disclosure requirements regarding the operations of board nominating committees and a new disclosure requirement concerning the means, if any, by which security holders may communicate with directors. These rules require disclosure but do not mandate any particular action by a company or its board of directors; rather, the new disclosure requirements are intended to make more transparent to security holders the operation of the boards of directors of the companies in which they invest.") (emphasis added); *see also* PRICEWATERHOUSECOOPERS, THE SARBANES-OXLEY ACT OF 2002 AND CURRENT PROPOSALS BY NYSE, AMEX AND NASDAQ 37 (2003), *available at* http://www.pwc.com/en_us/us/sarbanes-oxley/assets/final_so_wp_2-boardsac.pdf.

The extent to which the stock exchanges elected to implement SOX varied, but they all complied with the minimum requirements.[203]

These federal reforms focusing on director independence as a way to increase board accountability fail at a conceptual level.[204] Specifically, these protective measures are fundamentally flawed because they depend on the amorphous "independent" director.[205] For example, although SOX outlines the requisite criteria to consider a director "independent," the criteria are vague and include a discretionary provision whereby the SEC may exempt the requirements for being considered independent.[206] Additionally, requirements that rely on the

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203. *Social Construction*, *supra* note 200, at 1824-25.

204. Howard, *supra* note 125, at 428-29 (explaining that "[e]ven if the board members are not associated with the corporation, or do not have common business enterprises, they still share the common reasons for seeking a board position and the prestige that is attached to that position. This element is sufficient to create a level of cohesiveness among independent board members, and the board at large, which puts the entire board at risk of succumbing to the pitfalls of groupthink"); *see also* Velikonja, *supra* note 168, at 867-73 (distinguishing the favored majority independent board from the questionable desirability of supermajority independent board); Schumpeter: Replacing the board, Economist (Aug. 16, 2014), http://www.economist.com/news/business/21612147-case-outsourcing-company-boards-replacing-board (echoing the argument made by Bainbridge & Henderson, *supra* note 18, to outsource company boards in light of the abject failure of SOX and Dodd-Frank's independence requirements to ensure good-governance - pointing out that eight of Lehman Brothers' ten directors were independent when the company went bankrupt and citing the extraordinary appointment of Chelsea Clinton to the IAC board in 2011 but recommending a hybrid of a majority of BSPs with a minority of positions reserved for other corporate appointments).

205. *Social Construction*, *supra* note 200, at 1847 ("Current scholarship and practice disagree substantially about what directors are supposed to do, and the resulting role conflict has led to a good deal of tension and uncertainty in the boardroom."); Velikonja, *supra* note 168, at 903 (explaining that despite limited evidence of the impact of independent corporate boards "independence has become a synonym for something 'noble,' 'expert,' 'objective,' and 'fair[,]'" and independent directors allegedly "tolerate less fraud and illegality" and "promote the firm's compliance with legal norms"); *see also* Marchesani, *supra* note 78, at 335 (explaining the inherent dangers in the idealization of director independence where the government "mistakenly relies upon individuals to have qualities of autonomy by virtue of meeting the definition of independence").

206. *See* 15 U.S.C. § 78j-1(m)(3)(B) (2010) (establishing the criteria for being considered independent); 15 U.S.C. § 78j-1(m)(3)(C) (2010) (creating an exemption to the requirement of having an independent director). While it granted broad discretion to

so-called "independent" status of a director are fatally flawed because the designation of "independent" will not continue to have the same meaning for any extended period of time.[207]

Other provisions of SOX impose ineffective reforms that distract boards from fulfilling their primary obligations.[208] For example, SOX requires boards to comply with accounting standards. Although it is in the interest of shareholders to have a board audit the corporation consistent with industry standards,[209] the requirement does little to enhance expectations for shareholders that directors will act objectively for shareholder profit.[210] Additionally, SOX does not appear to consider

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the stock exchanges in . . . the purpose of a federal regulation is to establish a national standard and by failing to articulate a baseline, this reform created more confusion than it resolved. *Cf. Social Construction*, *supra* note 200, 1819 n.12, 1824-25; Rodrigues, *supra* note 198, at 1054, 1079-80 (explaining that there is further confusion in light of the fact that under federal law, independence is "status-driven," but under Delaware law, the question of director independence is "situational" and cannot be determined ex ante).

207. David A. Katz & Laura A. McIntosh, *Boardroom Confidentiality Under Focus; Corporate Governance*, N.Y.L.J. 1 (Jan. 23, 2014) ("[T]here are no regulations or laws in the United States under which a long tenure would, by itself, prevent a director from qualifying as independent."); Murphy, *supra* note 26, at 174-75 ("The criteria for directorial independence relate only to financial ties, employment, and family relationship; they do not prevent the CEO, or the nominating committee working in tandem, from nominating directors who are social friends, fellow members of a club, association or charitable endeavor, or from taking into account a candidate's probable conduct as a team player on the board."). *But see* Marchesani, *supra* note 78, at 350 (concluding that when existing independent directors confer upon other directors the designation of "independent," this status should be permanent).

208. Instead of creating a corporate responsibility for the board to oversee, SOX creates additional board duties. *E.g.*, Fisch & Gentile, *supra* note 29, at 544 (explaining that a distinction exists "between a voluntary board decision to create a committee, which may be modified or abolished at any time, and a regulation that imposes 'long term structural power-related distinctions between different groups of directors of the same board[]'") (footnote omitted).

209. *Cf. Social Construction*, *supra* note 200, 1838 ("[T]he required auditing of internal controls has increased revenues substantially, and presumably profits as well.").

210. *Id.* at 1847 (noting that SOX "adds substantial director workload unrelated to wealth-maximization" and explaining how this is common problem: "The weak spot in the independence movement has always been that a company's senior management dominates the selection of independent directors, which means management can select for certain attitudes and preferences").

the proposition that "insider" directors are arguably more efficient and knowledgeable about the corporation.[211]

II. TURNING DOWN THE HEAT

Part II of this Note proposes a reform to establish a clear national standard for director elections in order to reconcile corporate governance policies and practices that are incompatible with realizing the primary purpose of the board. Part II.A explains why the insularity of directors is important to incentivize individuals to serve on boards. Part II.B argues that the extent to which boards are insulated from external interference must be tempered with constraints that advance the board's cardinal purpose, which can be done without a complete overhaul of current practice. Part II.B then demonstrates how a federal regulation, narrowly-tailored to address the need to regulate the election process, will mitigate the inherent consequences of insularity that are exacerbated by boards' control over director elections and directors' ability to evade, by legal means, the threat of incurring personal liability.

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211. *See Managing Expectations*, *supra* note 147, at 446-47 (questioning the ability of independent directors to perform their oversight responsibilities effectively in light of the fact that independent directors are "part-time" by definition, which means they might not be able to devote enough time to (1) accomplish their ever-increasing requirements; (2) "develop a meaningful understanding of the challenges facing their corporations[;]" (3) interact with other directors and management; (4) establish channels of communication through which to receive unbiased information); Velikonja, *supra* note 168, at 862 (explaining how "the share of independent directors on the board and the amount of relevant information that the board possesses are inversely correlated[]" and "[a]s the board reaches the majority independence mark, the marginal cost of the diminishing quality of information exceeds the marginal benefit of increased independence"); *see also* Rodrigues, *supra* note 198, at 1069 (agreeing that "increasing the independence of the rest of the board paradoxically reduces its autonomy by reducing the number of its information channels and making the remaining few sources all the more important"); Yaron Nili, *Director Tenure: A Solution in Search of a Problem*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG (Jan. 23, 2015, 9:02 AM), blogs.law.harvard.edu/corpgov/2015/01/23/director-tenure-a-solution-in-search-of-a-problem/ (explaining that proposals to automatically disqualify directors from being considered "independent" after ten years of service has the effect of placing "an arbitrary limit[] on the available pool of talent, where only a limited number of people possess both the management experience and industry knowledge required to serve capably as public company directors").

A. INSULARITY IS NECESSARY

If boards are to manage the business affairs of the corporation, they must be largely autonomous.[212] To remain autonomous, they must be able to make decisions without the constant threat of liability.[213] Thus, despite the inherent consequences of board insularity, it is necessary to insulate boards from direct oversight.[214] Specifically, the ability to monitor the corporation without being encumbered by the fear of intervention and with the assurance of limited liability is necessary because, without these guarantees, the risk of legal liability would deter people from serving on boards.[215]

Similarly, although positive law and corporate charters denote boards' duties, boards may delegate *any* of their responsibilities to

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212. *See* John Wilcox, *The Autonomous Board*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Nov. 11, 2013, 9:22 AM), http://blogs.law.harvard.edu/corpgov/2013/11/11/the-autonomous-board/ ("[D]espite the embedded connections and dependence on management, the board is expected to function autonomously."); *see also supra* Part I.B.

213. Some of the reasons why it is important to insulate directors from the threat of liability include the fear of discouraging directors from making risky decisions, which might ultimately prove to be beneficial to the corporation, the reluctance of judges to replace the judgment of directors who assumedly have business experience, in hindsight, with their own, and the acknowledgment of the fact that directors are not guarantors of the corporation. *Managing Expectations*, *supra* note 147, at 437-38; Katz & McIntosh, *supra* note 207 ("In order for boards to function effectively, directors must feel comfortable expressing their views in the boardroom on corporate matters honestly and freely, without concern that their conversations will be made public.").

214. This is not to say that boards should be insulated from all accountability. Specifically, the regulation of director elections by providing for a transparent and straightforward process and by giving shareholders the opportunity to contribute meaningfully will offset the insularity of boards from oversight during the year. *See infra* Part II.B. *Contra Insulating Boards*, *supra* note 42, at 1687 ("[E]xisting theoretical learning and the available empirical evidence do not provide a basis for insulating boards in the name of long-term shareholder value. To the contrary, they support the view that existing (or higher) levels of board insulation produce long-term costs that exceed their long-term benefits.")

215. *See, e.g.*, *Means and Ends*, *supra* note 129, at 605 ("[T]he diffuse nature of U.S. stockownership and regulatory impediments to investor activism insulate directors from shareholder pressure. Accordingly, the board has virtually unconstrained freedom to exercise business judgment. Preservation of this largely unfettered discretion is, and should always be, the null hypothesis."). *Contra* Klein, *supra* note 60, at 156 (suggesting a heightened standard of review for board action in cases where there is a significant threat to the shareholders' franchise interest).

committees, officers, or employees.[216] Corporate charters outline the obligations of respective corporations' boards, but they do not delineate the requirements of each board member.[217] Instead, directors are expected to execute their roles based on their collective subjective understanding of what is required of them and within the scope of their duties as board members.[218] Further, directors cannot be expected to answer to individual shareholders.[219] Directors must be able to anticipate the aims of the shareholders and carry out the board's supervisory duties accordingly.[220] Specifically, they must manage the corporation with the objective to maximize shareholder profit.[221] Thus, once the shareholders

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216. One of the only mandatory requirements for all publicly held corporations is to have a board of directors. *See* DEL. CODE ANN. tit. 8, § 141(a) (2014); MODEL BUS. CORP. ACT § 8.01(b) (2005) ("*All corporate powers* shall be exercised by or under the authority of the board of directors of the corporation, and the business affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors.") (emphasis added). Beyond this requirement, how a board carries out its duties is discretionary and subject to the determination of each corporation. *See Managing Expectations*, *supra* note 147, at 416-17 (explaining that corporate boards generally delegate their responsibility to manage the day-to-day operations of the board and instead the primary role of directors is merely to monitor corporate officers and employees to ensure they are acting in the corporation's best interest).

217. *See* Adams et al., *supra* note 119, at 81 ("Each board of directors is likely to have its own dynamics, a function of many factors including the personalities and relationships among the directors, their backgrounds and skills, and their incentives and connections.").

218. See *supra* Part I.B-C for a discussion of the autonomous nature of the board and the deference afforded to discretionary decisions that are not inconsistent with their fiduciary duties.

219. EASTERBROOK & FISCHEL, *supra* note 53, at 1 (explaining that an investor in a publicly held corporation generally only "has a small stake compared with the size of the venture," and "[t]he investor is therefore 'powerless'"); Scarlett, *supra* note 110, at 57 (explaining how "efforts to insulate the board from legal liability necessarily increases the board's authority while decreasing shareholders' ability to hold directors accountable"); *see supra* Part I.C.1.

220. *See supra* Introduction, Section B.

221. *See, e.g.*, Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1154 (Del. 1989) ("The fiduciary duty to manage a corporate enterprise . . . may not be delegated to the stockholders. Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.") (citations omitted); *see also* Cohen & Schleyer, *supra* note 90, at 111 ("The approach of the SEC and its staff reflects the general

cede power, they relinquish their control over the management and oversight of the company, and the only thing they can expect of the board is profit maximization;[222] the board has a free hand in determining how that is done within the legal limit.[223]

B. BUT INSULARITY MUST BE CONSTRAINED

Corporate boards must be completely insulated from pressure by non-shareholder corporate constituencies.[224] In fact, a duty that a corporation owes to any non-shareholder constituent is subordinate to the obligation of its board to maximize the value of the common stock.[225] Accordingly, a corporate board should not be completely insulated from pressure by the shareholders of the corporation.[226]

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understanding that, [because shareholders cannot direct the actions of the board], if a proposal would bind the board of directors to a particular action, without enabling the board to exercise its discretion, then the proposal may be excluded as contrary to state law.").

222. See *supra* note 15 and accompanying text, for a discussion of shareholders' role as passive investors.

223. See *supra* Part I.C, for a discussion of the broad discretion afforded to directors to exercise their business judgment.

224. Non-shareholder constituencies include employees, creditors, suppliers, consumers, etc. David Millon, *Radical Shareholder Primacy*, 10 U. ST. THOMAS L.J. 1013, 1013 (2013) ("Regard for the corporation's various non-shareholder constituencies . . . or for society more generally must not compromise the [corporate management's] primary obligation to its shareholders."). *Contra* Blair & Stout, *supra* note 34, at 253 ("[B]oards exist not to protect shareholders *per se*, but to protect the enterprise-specific investments of *all* the members of the corporate 'team,' including shareholders, managers, rank and file employees, and possibly other groups, such as creditors.") (emphasis added).

225. *See supra* Introduction, Section A; *see also* Bainbridge, *supra* note 62, at 605. *Contra* Blair & Stout, *supra* note 34, at 253.

226. The corporate board is the final decision-making authority of the corporation, and it must have autonomy to exercise its decision-making power without interference. However, the relevant "pressure" that the board should be cognizant of is the pressure to manage the corporation in the interest of the shareholders. *See supra* Introduction, Section B; Velikonja, *supra* note 168, at 862. *Contra Why A Board? supra* note 94, at 49 (agreeing that the board's main objective is shareholder wealth maximization, but arguing that the board should be able to function devoid of *any* external pressure); *Increasing Shareholder Power*, *supra* note 16, at 835 (agreeing that the board's main objective is shareholder wealth maximization, but arguing that because the board exists to serve the interests of shareholders, shareholders have ultimate authority over the board); *A Critical Look, supra* note 100, at 1272 (arguing that boards should be self-

Nevertheless, boards remain equally protected from influence by shareholder and non-shareholder constituents.[227]

The extent to which corporate boards can insulate themselves from any meaningful oversight responsibilities—without violating a standard of conduct—jeopardizes the integrity of the corporate form.[228] Shareholders entrust the board with absolute control over their investments.[229] The separation of control and ownership is the defining attribute of a corporation, but when there is no mechanism for accountability and the board has unfettered authority, shareholders can no longer remain confident they will receive optimal returns on their investment.[230] This explains much of the prevailing lack of confidence in boards.[231] Consequently, board insularity must be constrained.[232]

When a board is completely insulated from outside influence, at best, a director's diverging interests will be subconscious and any actions inadvertently influenced by the director's subjective benefit will

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perpetuating in order to allow directors to manage a corporation responsibly for the long term).

227. See *supra* Part I.A; *Managing Expectations*, *supra* note 147, at 438 (acknowledging that "the high hurdle that must be cleared in order to hold directors liable for breaching their oversight responsibilities may mean that fiduciary duty law will not be able to play a significant role in ensuring directors' vigilant adherence to their oversight responsibilities").

228. The fact that a corporate board has taken advantage of its ability to remain within the letter of the law while going against the spirit of the law by comprehensively insulating itself does not constitute a violation for which directors may be held accountable. *See Managing Expectations*, *supra* note 147, at 438 (recognizing that "[t]he relatively low threshold for satisfying the oversight duty . . . poses a danger that companies will structure their oversight policies around the minimum requirements needed to satisfy courts' liability standard"); *see also supra* Part I.C.

229. *See supra* note 15 and accompanying text.

230. Millon, *supra* note 224, at 1019 ("Ideally, accountability should provide the incentives needed to ensure that management acts in the best interests of the shareholders[.]"); Scarlett, *supra* note 110, at 57 ("In corporate law, authority and accountability are competing powers that are in tension, because more of one means less of the other."); *see supra* Part I.C.2.

231. *See supra* notes 1-14 and accompanying text.

232. See *supra* Part I.C.2, for a discussion of how personal liability rules and federal regulations fail to create sufficient incentive for boards to fulfill their primary purpose. *Cf.* Sharfman, *supra* note 59, at 401 (recognizing the need for a board to be able "to wield its authority" but that it must to some extent be accountable to its shareholders).

be unintentional.[233] Contrastingly, in the worst-case scenario, an unqualified majority investor might become a director of a corporation that has an exculpation provision in addition to director insurance.[234] Not only would that director be exempt from liability from a breach of the duty of care for any intentional action taken in his or her self-interest to the detriment of the overall value of the common stock, but the corporation would also finance the remedy from any successful claim.[235]

Because the current standards for adjudication of claims brought against directors are largely ineffective, the extent to which boards and their directors are insulated from any recourse from engaging in self-dealing requires regulatory, as opposed to judicial, change.[236] The existing regulations of boards exacerbate the inherent consequences of insularity.[237] By imposing additional requirements on boards and dictating how boards must carry out their traditional responsibilities, the relatively new federal regulations further undermine the expectation that their boards will focus on overseeing the management of the corporation to maximize shareholder profit.[238] Thus, these reforms obscure the primary purpose of the board.[239] This is because while almost all board

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233. *See supra* Part I.C.1.

234. *See supra* Part I.C.2.a

235. *See supra* Part I.C.2.a

236. Courts should continue to evaluate the conduct of directors "from the perspective of maximizing shareholder profit." Sprague & Lyttle, *supra* note 8, at 42 n.11; *see, e.g.*, Basic, Inc. v. Levinson, 485 U.S. 224, 235 (1988); *In re* Citigroup, Inc. S'holder Derivative Litig., 964 A.2d 106, 139 (Del. Ch. 2009); s*ee supra* Part I.C.2.b.

237. Concededly, the policies underlying the federal regulations generally parallel the aim for the board to monitor the corporation on behalf of the shareholders, for the profit of the shareholders. *See supra* Part I.C. Nevertheless, they risk having the effect of distracting boards from focusing on pursing their primary purpose without issuing more forceful requirements to ensure this focus is not superseded by the positive law.

238. *Managing Expectations*, *supra* note 147, at 444 (explaining that since boards have acquired greater responsibility, "from overseeing compensation packages and structure, to more actively monitoring the director election process and engagement with shareholders[,]" the time commitment required for board service has increased, and ultimately "[t]his increased time commitment has implications for effective board oversight because boards may be spreading themselves too thin by seeking to accomplish an increasingly wide range of tasks").

239. *See* Velikonja, *supra* note 168, at 904 ("The roles that independent directors play in the corporation's governance have *dramatically expanded* over the last forty years. Independent directors are a plausible *fix for any and all problems*, and they can credibly be sold as such.") (footnote omitted) (emphasis added); *see infra* Part III. *Contra* George S. Georgiev, *Micro-Symposium on Competing Theories of Corporate*

activity was previously scrutinized under the business judgment rule, now, directors' failure to carry out these new obligations will have specific consequences.[240] Subsequently, they create the need for a new national standard to ensure that the boards' duty to oversee the corporation to maximize shareholder wealth remains in the forefront.[241]

The ability of directors to entrench themselves on a board provides the impetus for corporate boards to insulate themselves from any external oversight.[242] Specifically, the incumbent board's monopoly over director elections is intrinsic to the unrestrained insularity of publicly held corporations from shareholder involvement.[243] In particular, the difficulty of determining which director made what decision or how the board specifically arrived at a decision raises concerns over the operation of unconstrained boards, and modification of the processes of director selection and election could resolve this issue.[244]

Governance: Shareholder vs. Investor Primacy in Federal Corporate Governance, 62 UCLA L. REV. DISCOURSE 66, 76 (2014) ("To the extent these provisions interfere with boards' authority, they to do so in favor of investors–by seeking to provide the market with adequate and accurate information in order to trade[.]").

240. *See* Martin Lipton, *The Spotlight on Boards*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Sept. 8, 2014, 9:17 AM), http://blogs.law.harvard.edu/corpgov/2014/09/08/the-spotlight-on-boards-2/ (listing fifteen "general" expectations of boards and offering five conditions for meeting these expectations, such as having "directors who have knowledge of, and experience with, the company's business, even if this results in the board having more than one director who is no 'independent';" providing "directors with regular tutorials . . . as part of expanded director education;" and maintaining "a truly collegial relationship among and between the company's senior executives and the members of the board").

241. *Cf.* Rodrigues, *supra* note 198, at 1055 (explaining that "because our law effectively requires that most public board members be independent, the quality of independence has become the defining feature of boards").

242. *See supra* Part I.

243. *See supra* Part I.A.1.

244. Although the SEC's disclosure rules purport to make board activity more transparent, they fail because they merely require that corporation's disclose some isolated information on their governance process. The disclosure requirements do not require boards to disclose the entirety of their actual process nor do they establish mandatory requirements for consideration. *See supra* notes 69-71 and accompanying text. Further because of the inherent confidentiality of boards and the endogenous nature of corporation, even where the disclosures render a board's process apparent, it is unlikely that individual director action will be subject to review. *See supra* note 121, 193 and accompanying text.

Board operations are generally confidential not only because other corporate constituents are not permitted to monitor the board,[245] but also because too much transparency would make a company vulnerable to its competitors.[246] It follows that shareholders, who are ordinary members of the public, are neither suited nor qualified to monitor the board.[247] Consequently, changing the law to permit shareholder oversight would exacerbate some of the current problems faced in selecting directors to oversee objectively the daily operations of the corporation like making sure a director does not have ties to a competitor.[248] Specifically, it would be far too costly to monitor *each* shareholder for *any* relation to competitor and tailor information accordingly.[249] And thus, it is ultimately easier to allow shareholders the opportunity to regulate who becomes a director instead of what the board does.[250]

Director selection and election are important because the obscurity of a board's internal decision-making process makes it near-impossible to remove a director and, as a result, essentially guarantees that the problems will not be remedied.[251] Replacement of directors might

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245. Although the board can delegate many of its duties to special committees and executive officers, a board cannot delegate its duty to monitor the corporation and oversee its management on behalf of the shareholders. *See supra* Introduction, Section C.

246. *See, e.g.*, Katz & McIntosh, *supra* note 207 (describing three categories of confidential, non-public corporation information, the unauthorized disclosure of which "could imperil a company's competitive advantage or commercial success . . . [or] lead to illegal insider trading and manipulation of the company's stock price").

247. *See* Unisuper Ltd. v. News Corp., No. 1699-N, 2005 WL 3529317, at *6 (Del. Ch. Nov. 7, 2005) ("Delaware's corporation law vests managerial power in the board of directors because it is not feasible for shareholders, the owners of the corporation, to exercise day-to-day power over the company's business and affairs."); *cf.* Rodrigues, *supra* note 198, at 1082 (recognizing that if shareholders were responsible for overseeing management of the corporation and dealing with managerial conflicts, "[i]ssues of confidentiality and the dangers of extortionate behavior would arise").

248. *See supra* note 121 and accompanying text.

249. *See infra* Part II.C.2.b.ii.

250. *See infra* Part II.B.1.

251. Director removal "for cause" is difficult to accomplish. *See supra* Part I.A.2. Director removal "without cause" is a bad standard to adopt because constantly subjecting directors to the threat of removal subject to any arbitrary explanation would discourage directors from actively carrying out their duties for the board. Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 807 (1983) ("[A]llowing the majority of shareholders to remove the directors at will can needlessly disrupt the centralized management services that directors are supposed to provide."). Similarly, a standard for

remain difficult under this new regime because incumbent boards would largely retain control over the election slate, and thus directors will remain relatively "irreplaceable;" however, mandatory reforms directed toward regulating the director election process will grant shareholders the security that they elected the proper person in the first place.[252] Additionally, allowing shareholders greater authority to intervene and dictate boards' agendas and decisions would only lead to more problems.[253] Specifically, constraint of board insularity calls for the SEC to reform mandatory federal rules and set baseline requirements from which boards must structure how their corporation selects and elects directors.[254]

1. Electing Directors

Although the current practice of having directors select the slate for director elections is flawed,[255] allowing incumbent directors to remain responsible for selecting the slate on the condition that they comply with a new process would mitigate many of the flaws. A new standardized process to elect directors that both establishes a threshold for the minimum involvement a corporation must guarantee its shareholders and considers the endogenous nature of corporate governance would alleviate the threat of entrenchment, increase transparency, and limit subjective considerations from influencing decisions on whom to elect

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removal "without cause" would disincline people from wanting to sit on that board. Treatise Law Corp § 9:14 ("[T]he statutory mandate that corporations shall be managed by their boards of directors or under the supervision of their boards of directors is weakened if directors can be removed at the whim of the shareholders.").

252. This is because the new reforms will set a competency threshold and more transparent vetting process for all elected directors. *See infra* Part II.B.1.

253. *See infra* Part II.B.3.

254. The SEC, the self-proclaimed "Investor's Advocate," states that its mission is "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." The SEC explains that it depends on informed and diligent investors to report alleged failure of corporations to comply with federal securities regulations. Thus individual investors have access to a sophisticated advocate for their interests. *See The Investor's Advocate*, SEC.GOV, www.sec.gov/about/whatwedo.shtml (last visited Feb. 25, 2014).

255. *See supra* Part I.A.1.a.

to a board.[256] The corporate board might remain a self-perpetuating institution under this new scheme.[257] Nevertheless, standardizing the selection process and requiring the board to justify its nominees will allow shareholders to be confident that qualified individuals are safeguarding their investments; at the very least the increased transparency would allow shareholders to make an informed choice not to invest or to withdraw their investments.

a. Board Selection of Nominees

The first change must occur in the process by which boards select nominees for election.[258] A board, through its position as a fiduciary of

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256. Some scholars propose to resolve the issue of board insularity by allowing shareholder proxy access. *E.g.*, *Access to the Ballot*, *supra* note 108, 43-44; Lisa M. Fairfax, *The Model Business Corporation Act at Sixty: Shareholders and Their Influence*, 74 LAW & CONT. PROB. 19, 28 (2011) (noting "the important weight that shareholders have placed on the proxy-access issue"); McDonnell, *supra* note 56, at 116 (concluding that for shareholder proxy access, "the optimal default rule would provide for relatively generous proxy access, and the optimal altering rule would allow shareholders to opt out of the default rule in any direction they choose"); *see generally* Hermalin & Weisbach, *supra* note 121, at 8, 17 (explaining how "cross-sectional analysis of boards is limited because of endogeneity issues"). Others align with the SEC in favor of requiring independent boards. *E.g.*, Marchesani, *supra* note 78, at 326-27 (advocating for a more definite framework to determine independence, but limiting the inquiry of directorial competence to independent directors and also failing to recognize that an individual's qualities that permit that status change over time and the current election scheme will not remedy the costs of this system). Meanwhile, other scholars focus on solidifying director insulation from shareholder oversight. *E.g.*, Grant, *supra* note 120 (recognizing that the independence definition does not account for "organizational behavior factors[,]" but attempting to resolve this by focusing solely on the compensation committee and requiring continued professional education and rotation of directors).

257. *See supra* Part I.A.1.a.

258. The incumbent board's absolute control over director elections is an intrinsic characteristic of boards that allows them to persist as self-perpetuating entities. *See supra* Part I.A. Most existing reforms propose either to grant shareholders direct access to a corporation's proxy material, or to leave the director nominations wholly to the discretion of a group of "independent" board members. *See supra* Part I.C.2. It is well established that shareholders' votes on the proposed slate are pretty much a formality. *See supra* Part I.A. Further, it is well established that the asymmetry of information as between directors and shareholders put shareholders at a disadvantage and preclude shareholders from making optimal contributions. *See* Forbes & Milliken, *supra* note 107; *see also infra* notes 331-336 and accompanying text. Also, the goal of the board is

the corporation, exercises its business judgment when it informs shareholders of whom it believes would be best suited to serve as directors.[259] Thus, as long as directors can articulate a reasonable justification for selecting a nominee, they are essentially insulated from the threat of interference.[260]

A mandatory rule requiring every corporate board to have a selection committee (the "Committee") may increase transparency and limit a board's ability to entrench unqualified directors.[261] The regulation will require the Committee to conform to the following requirements: (1) the Committee must be comprised entirely of

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to oversee the corporation for overall shareholder wealth maximization. *See supra* Introduction, Section B. If majority shareholders are allowed to become de facto board members and dictate who will fill board positions, then minority shareholders probably will not receive the best return on their investments, and not only will the majority shareholders be taking over the board's responsibilities, but the board will be unable to ensure that the interests of all of the corporation's shareholders are promoted equally. Consequently, it is essential to strike a balance between board insularity and the involvement of shareholders participating in electing the board.

259. In *McMullin v. Beran*, the Delaware Supreme Court defined the board's responsibility, in fulfilling its fiduciary duty, as requiring the board to "first, conduct a critical assessment of (the relevant proposal) . . . and second, [to] make an independent determination whether that transaction maximized value for all shareholders." McMullin v. Beran, 765 A.2d 910, 920 (Del. 2000); *see id.* at 918 ("The statutory duties and common law fiduciary responsibilities that directors of a Delaware corporation are required to discharge depends upon the specific context that gives occasion to the board's exercise of its business judgment.").

260. *See supra* Part I.C.2.a. Although the NYSE and NASDAQ require listed corporations to have nominating committees wholly comprised of independent directors, they fail to regulate or standardize the definition of what constitutes a qualified director. Merely requiring boards to disclose what they determined were qualifying factors without establishing any parameters or specifying what such designations must entail would not prevent a board from stipulating that a qualified director would be anyone who went to the same country club as an incumbent director. *See also supra* notes 195-207 and accompanying text.

261. *See infra* Part II.B.1.b (conceding that directors will probably still be able to entrench themselves in their positions once they have been elected onto the board, but drawing attention to the fact that assuming compliance with the new regulation for board composition, any entrenched directors will not be unqualified). This is distinguishable from a nominating committee, because under the current system, the nominating committee nominally has complete control over determining the slate. Here, the Committee will be responsible for vetting the candidates and selecting those whom the entire board will consider whether to nominate.

directors; (2) the number of directors on the Committee must not be less than two, but may not otherwise exceed 15% of the entire board; (3) the Committee must first select a director to serve as Committee representative at the selection meeting (the "Meeting");[262] (4) the Committee must take into consideration suggestions from the corporation's top-level managers, its shareholders,[263] and the remainder of the board, all of whom must fill out a form naming prospective nominees and listing their qualifications for consideration;[264] (5) the Committee must finalize the list of candidates it will include on a ballot,

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262. Some corporations currently have staggered boards. *See* DEL. CODE ANN. tit. 8, § 141(d) (2014) (allowing corporations to stagger board elections every two or three years). Under this reform, a corporation must assess the eligibility of every director, every year. Thus, publicly held corporations will no longer be allowed to classify their boards.

263. This regulation does not confer upon shareholders direct proxy access. Rather, it guarantees shareholders the opportunity to have their nominations considered. It is important not to conflate protection of the shareholder's right to submit a candidate for consideration for a nomination with the right to access the proxy material directly and wield nominating power for two main reasons. First, informational asymmetries exist between shareholders and directors, and shareholders are at the disadvantage. Second, although the threat is de minimis, directors at least have the potential to incur personal liability as a result of their decisions. Conversely, if shareholders possessed direct proxy access, they would be able to be involved making decisions that would affect the corporation without any possibility of being held accountable for their actions. *See* Sharfman, *supra* note 59, at 402, 408; *see generally* Hamermesh, *supra* note 23, at 117, 156 (arguing that pursuant to their statutory right "to present proper business" at shareholder meetings, shareholders have a statutory right to nominate directors that "can be circumscribed through private ordering only in limited ways, to promote an orderly electoral process" and identifying "pitfalls and steps that drafters of corporate statutes and governance documents might consider in light of uncertainties about the nature and scope of the shareholder's right to nominate directors").

264. The Committee would not be required to entertain suggestions made by non-shareholder constituents of the corporation. Although the nominations will be submitted anonymously, every person eligible to submit a nomination will receive a randomized voter ID number. Nominations will be submitted electronically. Only qualified candidates will be considered. See *infra* Part II.B.1.a, for a discussion of qualifying characteristics. *Compare* Nicola Faith Sharpe, *Rethinking Board Function in the Wake of the 2008 Financial Crisis*, 5. BUS. & TECH. L. 99, 109 (2010) (explaining that most corporate boards are comprised of directors who are "not qualified to assess the strategic viability of the corporations they direct"), *with* Murphy, *supra* note 26, at 168 ("Since all directors are "hand picked" by the same process, they join the board as colleagues of other "very smart, highly influential and experienced people" who have met the same demanding criteria of selection.").

on which the board will vote at the Meeting; and (6) the Committee must prepare a voting packet (the "Packet") that will include an informational sheet for each candidate, listing the candidate's qualifications for serving on the board.[265] Additionally, the Packet must include a list of those nominees suggested for consideration that the Committee did not include on the final ballot but otherwise would be eligible candidates.[266]

The ballot will provide at least two, but no more than the number of directors who served on the Committee, blank spaces for write-ins of nominees listed in the Packet. If a candidate from the supplemental list receives a majority of votes at the Meeting, the final slate will include candidates nominated via this write-in process.[267] Thus, regardless of the protocol proscribed by each corporation's bylaws, ballots would not necessarily present more candidates than would be included on the final slate, lessening the threat of entrenchment.[268]

This mandatory reform of the selection process will permit corporations to determine the eligibility factors that the Committee will list in each Packet.[269] Under this regulation, a corporation might also require its Committee to include a list of nominees the Committee did not include on the ballot with an explanation of why the Committee did

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265. It is also important to note that the nominations are anonymous, so the Packet and information that the Committee produces will not distinguish candidates nominated by shareholders from those nominated by corporate officials. *See infra* Part II.B.1.a, for a discussion of qualifying characteristics. *Contra* Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY L.J. 435, 495 (2012) (indicating who nominated whom and making clear who was responsible for the corresponding content in the proxy materials).

266. *See infra* Part II.B.1.b, for a discussion of qualifying characteristics (allowing the Committee to balance the factors affecting a candidate's qualification and permitting a finding of "incompetent" despite not having one of the pre-determined disqualifying characteristics).

267. This will ensure a Committee does not have the final say on which incumbent directors are considered for re-election, should they meet the qualification standards discussed. *See infra* Part II.B.1.b.i. This will also prevent a Committee from being able to decide unilaterally that the remainder of the board will not have the option to consider alternative legitimate candidates. Also, this departs from the traditional plurality voting rules. *See, e.g.*, DEL. CODE ANN. tit. 8, § 216(3) (2014) ("Directors shall be elected by a plurality of the votes of the shares."); *see also supra* note 90.

268. *Access to the Ballot*, *supra* note 108, at 45 (explaining that when the directors nominated by the company run unopposed, their election is guaranteed).

269. *See infra* Part II.B.2.

not include those contenders.[270] Further, the corporation's bylaws will specify the voting method that the board will employ during the Meeting.[271] The corporation will require that the directors either rank all candidates on the ballot according to preference or select only the number of nominees that will appear on the final slate without classifying individual preference.[272] Allowing each corporation to decide the technical voting method will adequately balance the SEC's interest in restricting the boards' control over director elections with the corporations' need for flexibility in structuring their individual systems of governance.[273]

Although a Committee consisting entirely of directors is potentially problematic because the Committee members would most likely include themselves on the proposed ballot, the Committee only suggests the candidates for the board to consider for *selection* as nominees.[274] Further, the second requirement limits the amount of incumbent directors involved in constructing the ballot, whereas the entire board will vote on the final slate independently and anonymously.[275] Thus, the Committee would not have the final say over whom the board included on the final slate.[276]

After the Committee submits the ballot and Packet to the board, a Meeting will be held where the directors have time to read the Packet

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270. A requirement for the Committee to justify its decisions by articulating an unbiased explanation for its judgment of each candidate would force the Committee to eliminate overt influence of members' personal preferences and instead base their assessments on logical factors. Thus, if a well-intentioned Committee were driven by inherent subconscious biases, it would be forced to justify its decisions to the remainder of the board—and potentially shareholders—and establish that it reached decisions based on objective criteria. *See supra* notes 128-130 and accompanying text.

271. *Cf.* DEL. CODE ANN. tit. 8, § 216(3) (2014) ("In the absence of such specification in the certificate of incorporation or bylaws . . . Directors shall be elected by a plurality of the votes[.]").

272. *Id.*

273. Bebchuk & Hirst, *supra* note 83, at 334 ("A central argument . . . is that, even assuming that [proxy] access is beneficial for many public companies, the optimal approach is to retain no-access as the default arrangement and let the provision of shareholder access evolve through the adoption of an access arrangement on a company-by-company basis.").

274. *See generally supra* Part I.A.1, for a discussion of how incumbent boards dominate director elections and have reciprocal interests in perpetuating their status as directors.

275. *See supra* note 265 and accompanying text.

276. *See supra* notes 267-268 and accompanying text.

and ask the Committee representative to clarify anything regarding the eligibility of candidates.[277] After, the directors will independently deliberate and anonymously submit their ballots.[278] Directors will not be able to speak with one another or leave the Meeting until they cast their votes.[279]

If the results of a board's vote at the Meeting are inconclusive (e.g., in the event of a tie), the board will have a second Meeting.[280] During the second Meeting, the Committee representative will present a closed ballot with the candidates whose statuses were inconclusive after the initial vote.[281] The Committee representative will not inform the rest of the board, including the Committee, of the candidates who received the majority of votes at the first Meeting.[282] Prior to the second Meeting, the Committee representative will complete additional research on the remaining candidates to help the rest of the board make a more informed vote.[283] At the second Meeting, after distributing the closed ballot, the Committee representative will present to the board the results of the research, and the Committee representative will objectively elaborate on

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277. *Cf.* Marchesani, *supra* note 78, at 340-41.

278. Corporations might choose to assign the directors numerical identifiers to preserve the integrity of the process; the paper trail would ensure transparency, and the ability to match each director with his or her ballot would not only allow the board to take corrective measures in case of singular error, e.g., discarding a defective ballot or allowing a director to clarify an ambiguous marking, but also disincentivize sabotage.

279. To encourage the board to consider each candidate, depending on the size of the board and the number of nominees in the Packet, the Committee representative will specify a minimum amount of time that must pass before a director may submit a complete ballot and leave the Meeting.

280. *But see infra* note 346 and accompanying text.

281. A candidate's status would be inconclusive if he or she did receive either a majority of votes or an overwhelming minority. The percentage at which a candidate's status constitutes an overwhelming minority will depend on the context. This would differ from the current method of allowing the incumbent board to deliberate separately after a slate is not passed. *See supra* note 91 and accompanying text.

282. This will provide a check against collusion and help minimize the impact of strategic and self-interested decision-making. *See supra* Part I.A.

283. Murphy, *supra* note 26, at 170 ("Despite the fact that directors are generally highly qualified individuals, the flood of information with which they must work likely leaves them never feeling completely informed. Directors are often inundated with pages of information prior to board meetings. Given time constraints, director [sic] are unusually unable to process this information.").

the qualifications of the remaining candidates.[284] Finally, the rest of the board, with the exception of the Committee representative, will vote.[285] The resulting slate will be comprised of one nominee for each seat on the board; however, the official shareholder ballot will also contain blank spaces where shareholders will have the opportunity to "write in" a candidate that was identified in a proxy contest.[286]

b. Board's Responsibility to Inform Shareholders

Although each nominee runs independently for a position on the board, the SEC's regulation of the proxy materials that corporations must include with their slates does not afford sufficient protection for the few checks on board entrenchment the shareholders are actually qualified to employ.[287] Thus, the next element of the current director election process that must change is the information made available to the shareholders regarding the final slate.[288]

Once the board decides on the final slate, it must disclose the information contained in the Packet at the Meeting about each nominee on the final ballot.[289]

c. Proxy Contests

Over time, each corporation will establish a baseline from which the board could anticipate the cost of producing and disseminating the proxy material necessary to inform its shareholders about nominees on

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284. *See infra* Part II.B.2.
285. *Cf.* Marchesani, *supra* note 78, at 340-41.
286. *See infra* Part II.B.1.c.
287. Specifically, shareholders are qualified to make informed votes and to launch proxy contests.
288. Although pursuant to SOX, corporations must disclose information about their election process and policies, these requirements are largely ineffective. *See supra* notes 193, 244.
289. This proxy material will be comprised of information including the factors underlying the determination that a nominee is qualified to serve on the board, how much stock a prospective nominee holds in the company, and any of the nominee's significant business relationships or past involvement with other director nominees, top-level managers, or majority shareholders in the corporation. *See infra* Part II.B.2.

the slate.[290] Under this reform, if a shareholder launches a proxy contest, then the corporation will compensate the contest's winner - either the insurgent or a rebuttal on behalf of the incumbent board—for the baseline amount.[291] Further, the corporation will provide the shareholder with a copy of the Packet that was distributed at the Meeting.[292]

Any disgruntled shareholder may launch a proxy contest,[293] and eligibility will not be contingent upon satisfying an ownership threshold. However, the corporation will only compensate a disgruntled shareholder for proxy materials distributed if the insurgent had submitted a timely suggestion to the Committee.[294] If the insurgent elected not to participate in the selection process from the start, then the corporation would not compensate the shareholder for costs incurred regardless of the outcome. This would encourage shareholders to take advantage of the opportunity to have the board consider their suggestions, and it would discourage shareholders waiting to see if they are satisfied with the outcome before raising a complaint and becoming involved in the process.

Additionally, the corporation will not compensate the board for additional costs incurred in a proxy contest.[295] Although directors are "elected" to their positions, directorial elections are not elections in the typical political sense.[296] Standards of corporate governance should not

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290. Upon receiving notice that an insurgent intended to launch a proxy contest, the board must inform the shareholder of the baseline expenses for distribution in absence of the threat of a proxy contest.

291. Because the anticipated expenses would be derived from those required to fund an established system, the winner will be eligible for compensation at a rate exceeding the baseline amount, pending evaluation of receipts that such increase was necessary.

292. The board would only distribute the background information of those candidates included on the slate, so by giving the insurgent a copy of the Packet with information on each candidate considered, the shareholder might be persuaded by the additional information and decide not to pursue the contest.

293. *See supra* notes 86-88 and accompanying text.

294. Although nominations are anonymous, an eligible voter would have the same voter ID for the duration of that year's vote.

295. There are already safeguards that ensure that if insurgents sue directors, directors would not suffer undue financial harm (e.g., indemnification and insurance provisions). *See supra* Part I.C.2.

296. Some scholars emphasize the similarities between democratic political elections and director elections. Harris, *supra* note 49, at 225 ("Corporate elections are similar, in many ways, to political elections."); Kang, *supra* note 60, at 1329 (likening

validate, and they certainly should not facilitate, conduct that would turn the process for selecting a fiduciary into a socio-political campaign.[297] As such, if a director wants to launch a rebuttal to an insurgent's contest as an independent shareholder, the director may do so, provided he or she does not use any company resources accessed by virtue of his or her position on the board.[298] Further, if a director launches a rebuttal campaign and wins, the director will only be compensated the amount of the pre-determined baseline cost for proxy publication.[299]

d. Slate Ratification

The final change to the electoral process will occur at its final stage - slate ratification.[300] The new standard will abandon the current default,[301] which requires a plurality vote to ratify a proposed slate with the option to require a majority vote and instead will require a majority vote with the option of allowing a plurality to suffice.[302] Under the majority vote standard, if an insufficient number of directors receive the

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the way "shareholders respond to the informational signal from counter-endorsements against management's position by trusted sources" to voters in a political election). However, director elections are more analogous to the appointment of trustees rather than the appointment of a political official. *See supra* note 28 and accompanying text.

297. Sharfman, *supra* note 59, at 412-13 ("[L]arge public companies are economic, not political, institutions which first and foremost need to respond to the accountability provided 'by the market for stock (and the managers' need to raise capital), the market for goods, and the market for managers' services.'") (quoting Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J. L. & ECON. 395, 397 (1983)) (footnote omitted).

298. *See supra* Part I.A.1.b.

299. *Contra* Murphy, *supra* note 26, at 137 (explaining that ordinarily, management enjoys "virtually unlimited access to funds to promote its candidates while . . . other shareholders [are afforded] only a 'slim possibility of reimbursement if they should triumph over shareholder inertia and concerted management opposition to win a seat on the board'").

300. *See supra* note 255 and accompanying text.

301. Plurality voting is the traditional voting standard for director elections. Under this standard, the directors who receive the most votes are elected to the board. Velikonja, *supra* note 168, at 877 (explaining that under this default, because "[m]ost directors run unopposed, so a director could be elected if she received a single vote in her favor").

302. *See* Sjostrom, *supra* note 55, at 217.

majority vote to fill the board's positions, a second vote will take place.[303]

2. Board Composition

Boards must be able to operate with a measure of autonomy.[304] Fortunately, many shareholders do not want to be responsible for monitoring directors, and the shareholders that do want to participate actively in monitoring directors are not necessarily competent monitors.[305] Therefore, directors should only be those individuals who are actually qualified to perform the requisite directorial duties.[306] In order for the proposed changes to the director election process to have optimal impact, directors must no longer be categorized as independent, inside, or outside.[307] Instead, board members should be assessed by their potential to succeed as directors.[308]

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303. The board will offer a new slate, half of which will include new nominees selected pursuant to the new process, and half of which will include the highest-ranking half of the directors on the original slate who did not receive a majority of the votes.

304. *See supra* Part II.A.

305. Specifically, if a shareholder desires to become more involved with the management of the corporation, then that shareholder has other avenues by which he or she might fulfill this wish—i.e., become a director. *See* J.W. Verret, *Defending Against Shareholder Proxy Access: Delaware's Future Reviewing Company Defenses in the Era of Dodd-Frank*, 36 J. CORP. L. 391, 398 (2011) (explaining that "rational apathy" accounts for the fact that many shareholders neither vote, nor inform themselves about the voting process because shareholders accurately anticipate "a low proportionate benefit or their slim odds of affecting the outcome"); *see also supra* notes 15, 110-115 and accompanying text. *Contra Insulating Boards*, *supra* note 42, at 1643.

306. *See, e.g.*, David A. Drexler et al., 1-13 Delaware Corporation Law and Practice § 13.01[12][b] (LexisNexis 2013) § 13.01[6] (clarifying that valid qualifications could be general, like a maximum age, or they could be specific, like "a requirement of American citizenship for directors of a corporation engaged in the defense industry"); Corporate Laws Committee, ABA Section of Business Law, Changes in the Model Business Corporation Act-Proposed Amendments to § 8.02 Relating to Qualifications for Directors and Nominees for Directors, 68 BUS. LAW. 781, 783 (2013) (listing eligibility requirements that would be permissible under § 8.02 including qualifications "based on residence, shareholdings, age, length of service, experience, expertise and professional licenses or certifications").

307. *See supra* notes 195-207 and accompanying text; *cf.* Nicola Faith Sharpe, *Process Over Structure: An Organizational Behavior Approach to Improving Corporate Boards*, 85 S. CAL. L. REV. 261, 264 (2012) [hereinafter *Process Over Structure*] (acknowledging that "[h]istory has shown that the scholarly and regulatory

a. Who Can Be Nominated

Theoretically, any individual presented on the corporation's election slate may serve as a director upon shareholder ratification of the slate;[309] however, because the shareholder vote is insignificant, the Committee must be constrained by its ability to justify its basis for selecting each nominee.[310] Current requirements focusing on the so-called "independent" status of a director are indeterminate.[311] Thus, while the board must fully disclose to the shareholders any and all pre-existing personal ties that a nominee has to the corporation, the qualification inquiry must focus on a nominee's objective potential to fulfill directorial duties.[312]

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focus on board composition and structure is a dangerously incomplete solution to the problems that have caused this century's corporate failures" and concluding that "how boards engage in management monitoring should be the focus of corporate regulatory reform, more so than who sits on the board or how boards are structured). *Contra* Donald C. Clarke, *Three Concepts of the Independent Director*, 32 DEL. J. CORP. L. 73 (2007) (acknowledging that the ambiguity of an independent designation leads to inconsistent rules, yet finding that the problem may be addressed by remaining cognizant of the critical differences among non-management directors categorized as independent, outside, or disinterested).

308. It is important to note that all corporations have different needs that would benefit from different types of directors. Therefore, it is important to ascertain a baseline requirement that is more stringent than that imposed under SOX and Dodd-Frank, but not too exacting. *See, e.g.*, Marchesani, *supra* note 78, at 335 ("The definition should require that a director be free from compromising ties and have the motivation, skills, and other characteristics necessary for him to be effective.").

309. Additional nominees may be included in the proxy material pursuant to a successful proxy contest. *See supra* Part II.B.1.d. Specifically, any person permissibly on the slate must have undergone the qualification assessment prior to the vote.

310. *See supra* Part II.B.2. Complying with these requirements would not require exercise of business judgment, but instead would be reviewable under a reasonable diligence standard. BLACK'S LAW DICTIONARY 553 (10th ed. 2014) ("A fair degree of diligence expected from someone of ordinary prudence under circumstances like those at issue.").

311. *See supra* notes 195-207 and accompanying text.

312. Thus, individuals selected solely on the basis of their social status would not be able to pre-qualify as candidates. The Packet would disclose any ties either to the corporation or to other directors on the current and prospective board. Pertinent personal ties include a financial stake or previous working relationship with any current director or manager, prior involvement with other entities that provide similar services as the corporation, or pre-existing social ties to majority shareholders, current directors, or managers. *See* Marchesani, *supra* note 78, at 338 ("[R]elevant ties are not only those

The board of directors of a publicly held corporation ideally consists of individuals with experience in business management, knowledge of the industry, competence in risk assessment, a propensity for strategic planning, and most importantly, the ability to remain objective.[313] Relevant considerations that would account for a candidate's eligibility might be any characteristic that manifested any of these ideals.[314] Each nominee must have relevant experience or a skill to contribute that would lend itself to helping the board fulfill its duty to oversee management of the corporation for shareholder wealth maximization.[315] Thus, the nominees included on the slate at the annual director election must be objectively qualified to serve on the board and satisfy objective thresholds predetermined in corporate instruments.[316]

b. Who Cannot Be Nominated

While there will be a comprehensive assessment of each nominee for qualification to be elected, some factors will preclude those who might otherwise qualify from being nominated. Relevant circumstances

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with the company and its management, but also those with the other directors; any significant relationship with any of these subjects might in fact have an improper influence on an Independent member of the board.").

313. Current federal regulations that impact board composition focus on the concept of an "independent" director. This is problematic because the federal government's concept of independence conflates a relational connection with the ability to remain objective. *See, e.g.*, Rodrigues, *supra* note 198, at 1067-68 ("Federal intervention, by enshrining the independent board for the public corporation has created an entity suitable for but one purpose, dealing with managerial conflict."); *see also supra* notes 195-207 and accompanying text.

314. *See e.g.*, Marchesani, *supra* note 78, at 318 (emphasizing personal characteristics of a potential director like "motivation, competence, and time availability").

315. *See* Bainbridge & Henderson, *supra* note 18, at 1082-83 (describing the types of qualities corporations look for in directors depending on the situation).

316. A prospective director does not need to embody all qualities, the individual just must satisfy overall requirements. *See* Marchesani, *supra* note 78, at 338-39 ("A very important concern is to identify directors who possess the necessary motivation to discharge their duties effectively. . . . [Directors] should also meet a minimum level of skills and industry-specific experience as well as devote sufficient time to their duties as board members. While each director should also have specific additional knowledge, such a requirement will vary depending on the competencies that the other directors bring to the board[.]").

that might result in a candidate's automatic disqualification include an insurmountable conflict of interest or anything that would prevent an individual from maintaining an objective perspective when fulfilling the expected directorial duties.[317]

The Committee will determine whether a nominee possesses these disqualifying characteristics before the Meeting, and the Committee representative will confirm such a finding before the presentation of the final slate to the shareholders. This ensures that candidates are not improperly excluded and that candidates nominated via write-in do not violate this requirement.[318]

A corporation's CEO will not be allowed to sit on its board of directors concurrently.[319] Excluding CEOs from board service will allow directors to evaluate the CEO without fear of retribution.[320] Further, the

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317. Examples of people who might not be suitable to serve on a board due to insurmountable conflicts of interest are CEOs of other companies, officers of the corporation, and "special interest" directors. *See* Bainbridge & Henderson, *supra* note 18, at 1114 ("[I]nstitutional investors occasionally nominate board members in order to influence governance of a particular firm.").

318. Besides through the official selection process, candidates may appear on the slate as the result of a proxy contest. *See supra* note 306 and accompanying text.

319. This does not preclude every member of the corporation's top management from being elected to serve as a director. Because there is no statutory requirement for management positions, a corporation might hire an individual to manage an aspect of the corporation that would present a conflict of interest to the same extent as a CEO. For example, a corporation might want someone serving as the Chief Legal Officer (the "CLO") or Chief Financial Officer (the "CFO") concurrently to serve on the board. Although the interests of the CLO and CFO might diverge differently from those of directors who, independent from board participation, do not have the authority to participate directly in the day-to-day management of the corporation, their involvement does not pose the same threat as the CEO's. Nor does this preclude anyone who is a CEO from serving as a director on the board of another corporation. *Contra* Rodrigues, *supra* note 198, at 1055 (advocating for the disqualification of "full-time employees from board membership altogether, thus relegating CEOs to an observer status that permits them to attend most meetings but not to vote"). This is distinguishable from current requirements under the NYSE and NASDAQ listing standards that independent directors meet separate from management—and the rest of the board—periodically. *See* NYSE Manual, *supra* note 77, at § 303A.03; NASDAQ Marketplace Rule 4350(c), *available at* https://www.sec.gov/rules/other/nasdaqllcf1a4_5/nasdaqllcamendrules4000.pdf.

320. Harley E. Ryan Jr. & Roy A. Wiggins III, *Who Is in Whose Pocket? Director Compensation, Board Independence, and Barriers to Effective Monitoring*, 73 J. FIN. ECON. 497, 509 (2004) (explaining that as CEO's power increases, the CEO will use this power for personal gain).

board may still consult with the CEO and allow the CEO's recommendations to influence its decisions. However, without the CEO's direct involvement, the board may more freely decide to act either without conferring with the CEO or contrary to the CEO's suggestion.[321]

Although the CEO will not sit on the board, directors will obtain information about the company from monthly reports and by meeting either with the CEO or the CEO's designated liaison.[322] Specifically, as a result of the exclusion of CEOs from board service, corporations will need to include in their articles of incorporation or bylaws a requirement for the CEO to report the status of the corporation to the board, such as requiring the CEO to attend the monthly board meeting.[323] Corporations may amend their bylaws to broaden CEO involvement, but these amendments may not allow the CEO to vote on issues before the board.[324] Additionally, the directors must ensure that the CEO is not apprised of the voting process beyond the end result.[325] Thus, while the Committee might consider the CEO's suggested candidates for nomination more exhaustively, the CEO will neither take part in any official Committee deliberation nor know who served on the Committee and what transpired during a Meeting until the board presents the final slate to the shareholders.[326]

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321. Murphy, *supra* note 26, at 181 ("A line of business administration scholars have long regarded the CEO's power to nominate or influence the nomination of directors as an important source of the CEO's power on the board.").

322. Karmel, *supra* note 131, at 790 ("Independent directors are completely beholden to management for information. This dependence on insiders may give a CEO more power than was the case when a board included insiders.").

323. Further, the corporation's bylaws might require each manager personally to submit a monthly report to the board to ensure the board makes fully informed decisions. *See generally* Frederick Tung, *The Puzzle of Independent Directors: New Learning*, 91 B.U. L. REV. 1175, 1177 (2011) ("Outside directors will always suffer informational disadvantages relative to insiders, and this disadvantage will be greater in firms where outsiders have greater difficulty acquiring information about the firm.").

324. *See supra* note 319 and accompanying text.

325. This will ensure the directors are not unduly influenced by the CEO, whom they share a reciprocal desire to maintain the status quo. Dent, *supra* note 49, at 1248 ("Boards strive to entrench themselves and the CEO.").

326. This would discourage campaigning. *See supra* note 296 and accompanying text, for a discussion of how director elections are not political elections.

3. Reconceptualizing Shareholder Rights, and the Question of Director Removal

The proposed reforms define the ways in which shareholders must be allowed to participate in the election of directors.[327] Allowing shareholders to participate in a meaningful way limited to the director election process would inspire confidence in their boards' ability to carry out their primary purpose without compromising the shareholders' reliance on the expectation that they have entrusted their investment to a qualified fiduciary.[328]

The people investing in the stock of a corporation do not necessarily know about the specific laws for the different states in which the corporation is incorporated.[329] Although people ideally should investigate what they spend their money on before investing, in reality, when people take the time to research potential investments, they are more concerned with the mission and reputation of a corporation than with the state laws that might distinguish it from a similarly situated company.[330]

Furthermore, when people decide to invest, they generally consider the reputation of the corporation, the expected financial return, and other subjective factors.[331] Ultimately, if they choose to become a passive investor in a corporation, they entrust the management of their investment to sophisticated people that are qualified to run the

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327. *See supra* Part II.B.1-2.

328. See *supra* notes 15, 110-115, 244-247 and accompanying text, for a discussion of the reasons for limiting shareholder involvement beyond this level. *Cf.* Velikonja, *supra* note 168, at 877 ("Shareholders express their preferences in two other ways: by casting votes in director elections and by influencing nominating committees that select board nominees.").

329. Bainbridge, *supra* note 62, at 623 (2006) ("[S]hareholders lack incentives to gather the information necessary to actively participate in decisionmaking. . . . Given the length and complexity of corporate disclosure documents, the opportunity cost entailed in making informed decisions is both high and apparent.").

330. *See supra* note 15 and accompanying text.

331. Jacob E. Hasler, *Contracting For Good: How Benefit Corporations Empower Investors and Redefine Shareholder Value*, 100 VA. L. REV. 1279, 1322 (2014) (explaining that "shareholders are presumed to exchange capital for a promise that directors will maximize the value of their investment[;]" however, "an interest among certain shareholders to invest in publicly traded companies that further social missions exists"); *see supra* notes 131-133 and accompanying text.

business.[332] Moreover, they do not invest in a publicly held corporation because they desire to collaborate with all of the other shareholders.[333] Unless a company's mission statement provided to the contrary, people who decide to invest do so without the expectation that any person, by virtue of his or her ownership or interest in a share of the corporation, will be able to make decisions that impact their financial returns.[334] The only qualification for purchasing a share of a corporation on a publicly listed stock exchange is the ability to pay for the stock.[335] It follows that strangers who similarly invest in a corporation do not expect them to have decision-making authority over the corporation.[336]

The new electoral process will guarantee shareholders the opportunity to make their preferences known and to meaningfully participate in the election of directors on two occasions.[337] First, they can have their election suggestions considered without having to mount a proxy contest.[338] Second, they will have a fair chance to launch a proxy contest during which they can present to the rest of the

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332. Bernard S. Sharfman, *What's Wrong With Shareholder Empowerment?*, 37 J. CORP. L. 903, 906-07 (2012) [hereinafter *What's Wrong*] (articulating the "disparities between management and shareholders in terms of information, skill in decision making, and interests" and concluding "that the private ordering of corporate governance arrangements, where decision making is shifted from the board and its executive officers to shareholders, should be a rare occurrence, and moreover, should be presumed harmful to corporate governance unless proven otherwise").

333. Sharfman, *supra* note 59, at 405 (acknowledging "most shareholders' natural lack of interest in the corporate governance of those many companies they invest in").

334. *See generally* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 759 (2005) (describing the "collection action problems" that prevent shareholders "from becoming informed or acting based on social and moral sanctions").

335. *See generally Market Centers: Buying and Selling Stock*, U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/answers/market.htm (last visited Jan. 30, 2015) (listing the process involved in executing a trade to buy or sell stock).

336. *What's Wrong*, *supra* note 332, at 905 (rejecting arguments for shareholder empowerment in publicly held corporations and explaining that "it is imperative that the board and its executive officers have the authority to make the vast majority of decisions or delegate decision-making authority without shareholder approval. Such a shareholder approval process would simply freeze up the corporation and ultimately lead to its failure"). *Contra*. *Increasing Shareholder Power*, *supra* note 16, at 868 (advocating for shareholder power to initiate structural changes).

337. *See supra* Part II.B.1.c.

338. *See id*.

corporation's shareholders their nominees and the background information on which the board based its decision if the board did not include the shareholder's nomination on the final slate.[339] Additionally, shareholders will be able to make more informed decisions concerning how they will vote on a slate because they will have access to comprehensive background material about each nominee.[340]

Implementing procedural safeguards to prevent boards' complete control over the election process will allow shareholders to be more confident in the ability of their boards to effectuate their primary purpose;[341] however, the SEC's regulations should not extend beyond this procedural check.[342] This is because once a board is elected, it must be able to do its job.[343] Thus, requiring boards not only to adhere to a prescriptive process designed to ensure transparency in the selection process, but also to conduct yearly evaluations of incumbent directors, will mitigate factors that compromise the ability of boards to remain objective without infringing on the freedom of corporations.[344]

Accordingly, while it is clear that reducing board insularity would increase director accountability, the manner by which boards are formally constrained must be narrowly tailored to address the disparity between corporate governance practices that favor incentivizing individuals to serve as directors over preserving the cardinal purpose of the board.[345] Curtailing board insularity to incentivize directors "to avoid shirking, empire building, and other departures from shareholder interests that are costly" by expressly encouraging shareholder engagement and facilitating activist intervention would not only increase the vulnerability of directors to opportunistic, collusive, and paternalistic influences, but also obstruct the transparency afforded by the knowledge of exactly who is involved in determining company policy and

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339. *See id*.

340. *Compare* disclosure requirements under the stock exchanges, *supra* note 202, *with* Part II.B.

341. *See supra* Introduction, Section B.

342. *Contra* Fisch, *supra* note 265, at 495.

343. *See supra* Part I.B; *see generally Managing Expectations*, *supra* note 147, at 448 (questioning "whether the oversight doctrine offers false hope, creating expectations that directors cannot realistically fulfill").

344. *E.g.*, Sharfman, *supra* note 59, at 398 ("[A] one-size-fits-all approach to corporate governance is much reviled."); *see also supra* Part II.B.1.a.

345. *See supra* Introduction, Section B.

overseeing the management of the corporation.[346] Therefore, modifications to the election process will increase the likelihood that only trustworthy and competent individuals will be elected and that incumbent directors are actually vulnerable to replacement.

Although shareholders are traditionally conceived of as having the right to evaluate directors and convey their assessments through their involvement at shareholder meetings and decisions in annual elections, these rights are widely recognized as nominal.[347] Campaigns promoting shareholder empowerment ensued; however, particularly in light of the current economic climate, adopting a governance structure that would allow shareholders to overtake the fundamental responsibilities of the board would destabilize corporate America further.[348]

Instead, granting shareholders the right to participate in the nomination and election process without increasing their ability to remove directors would not only incentivize directors and shareholders to take the nomination and selection process seriously because each elected director would serve at least an entire term, but also allow directors to exercise their business judgment free from outside

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346. In *The Myth That Insulating Boards Serves Long-Term Value*, Professor Bebchuk argues that the ability of shareholders to intervene and engage with companies would, in the long-term, benefit not only companies but also shareholders and the general economy. *See Insulating Boards*, *supra* note 42, at 1643-44 (conceding that he neither argues nor believes "the optimal level of board insulation is zero"). Nevertheless, this conclusion is only speculative, because modern boards of publicly held corporations remain very insulated. Bebchuk implores policymakers and institutional investors to "going forward, reject the arguments for limiting the rights and involvement of shareholders that are regularly made in the name of long-term value." *Insulating Boards*, *supra* note 42, at 1687. *Contra* William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 661-62 (2010) (rejecting the reasoning that justifies support for policies increasing shareholder power and regulatory reform on the basis that the failure of the management of corporations to assess risk is what lead to the current financial crisis).

347. *See supra* Introduction, Section C.

348. *Compare Insulating Boards*, *supra* note 42, *with* Bainbridge & Henderson, *supra* note 18. *See also* Cohen & Schleyer, *supra* note 90, at 106 (explaining that shareholder proposals seeking to have their rights increased "have been common in recent years and a number of public companies have reacted by providing shareholders with these rights (subject to limitations), although concerns about their potential impact as a takeover mechanism have limited their appeal to many companies and shareholder groups").

pressure.[349] So long as the director fulfills his or her directorial duties, working to maximize shareholder wealth, the director's position would be secure for at least a year.[350] Thus, although it would remain difficult to remove a director in between elections, boards would no longer be completely unrestrained self-perpetuating entities.[351]

III. ALTERNATIVE SOLUTIONS (AND WHY THEY FAIL)

Part III of this Note explains why existing proposals to reform regulation of boards fail. The responsibilities of the modern corporate board far exceed fulfillment of its primary purpose.[352] Furthermore, the continual imposition of additional obligations understandably tends to distract boards from achieving their intended goal.[353] Specifically, the

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349. *See supra* Part I.B.

350. *See generally* Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors,* 58 U. CHI. L. REV. 187, 224-48 (1991) [hereinafter *Quinquennial Election*] (describing how insulating directors from short-term pressures will ultimately allow them to fulfill their responsibility and best serve the long-term interests of the corporation and explaining an ideal model would insulate directors and managers "for substantial enough periods to permit them to develop their future plans, while at the same time creating a periodic forum in which the directors would be totally uninsulated and subject to recall by the stockholders").

351. *See supra* Part I.A.

352. *Cf.* Rodrigues, *supra* note 198, at 1053 (articulating that, "we ask public company boards to do too much with too little . . . [:] the dominant regulatory philosophy pushes corporations towards the unattainable Platonic Ideal and then takes boards to task when they fall short"). State corporate statutes are generally unrestrictive and afford investors considerable flexibility in determining the structure of their corporations. In fact, although there is a recognized "Platonic Ideal board," comprised of directors who are intelligent, active, and engaged, there are no legal requirements that specify qualitative characteristics of directors. *See* Rodrigues, *supra* note 198, at 1087, 1087 n.179; *see also* Velikonja, *supra* note 168, at 903 (explaining that the concept of board independence has different meanings for different people, and independent directors are generally conceptualized as people without ties to the corporation or management who are "superior to all other dependent groups with clear interests: managers, shareholders, employees, public interest groups, and creditors"). In fact, the only substantive positive requirement of a board is to have a director on the audit committee who is a financial expert. Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7265. *But see id.* (providing for disclosure "whether or not, *and if not, the reasons therefor*, the audit committee of that issuer is comprised of at least [one] member who is a financial expert") (emphasis added).

353. *See supra* Part I.C.2.

traditional duties of the board are generally default rules derived from state statutes, and directors are afforded broad discretion under state law to tailor the way by carry out their responsibilities.[354]

When the federal government directs how all boards must operate when overseeing the management of the corporation, it not only fails to achieve its intended goal through its ambiguous instructions,[355] but also imposes universal reforms, the application of which may unnecessarily disrupt the structure of a successfully functioning corporation.[356]

The balance of a well-structured company is disturbed by mandates to alter the way in which the board carries out its duties because whereas a board's failure to comply with a mandatory rule risks intervention by the federal government, it is difficult to prove that a board failed to comply with its duties imposed under state law.[357] *Some* of the formerly discretionary duties of the board become mandatory due to federal intervention; as such, the importance of the fulfillment of their duties overtakes the boards' attention to obligations subject to state law because only this regulated activity may be monitored effectively.[358] This created a false perception of increased transparency and accountability because the boards' responsibilities in overseeing the corporation's compliance with new federal regulations are more readily

354. *See supra* notes 216-221 and accompanying text; *see also* Rodrigues, *supra* note 198, at 1054 ("State corporate law by its nature necessitates such flexibility, given the fact that the same basic corporate code serves the needs of both tiny 'mom and pop' corporations and Fortune 50 behemoths.").

355. *See supra* Part I.C.2.b.ii.

356. See *supra* notes 6, 191 and accompanying text, for a discussion of how the federal government generally enacts legislation in response to isolated incidents. *Cf. Process Over Structure*, *supra* note 307, at 311 (concluding that "[c]urrent attempts to fix corporate boards are doomed to failure").

357. *See supra* Part I.C.2.

358. For example, while the board is tasked with overseeing the management of the corporation on behalf of the shareholders, independent directors, who arguably should not have any specific duties derived from their position besides working to carry out the board's duties, have been tasked "to oversee compliance with legal and regulatory requirements and catch wrongdoing, to evaluate an auditor's conflicts of interest and supervise its work, to set the standards of social responsibility of the company, and monitor performance and compliance with those standards." Velikonja, *supra* note 168, at 905.

traceable.[359] Consequently, confusion arose over the primary purpose of the board and resulted in a primacy debate over what policies corporate governance should promote to ensure the board's ultimate purpose is achieved.[360]

Conclusions conceived of through the prism of the authors' subjective beliefs of the purpose of the board inspire ideological debates that polarize proponents of conflicting viewpoints in a primacy debate;[361] their proposed reforms are all aimed toward resolving a different issue.[362] Thus, rather than having any actual effect on corporate governance, solutions proposed by proponents arguing within their

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359. *See supra* notes 244-247 and accompanying text; *see also* Fisch & Gentile, *supra* note 29, at 541 (recognizing the costs of creating and maintaining committees on how the board functions overall and explaining that "[i]ssuers have long expressed concern that, as the burdens associated with being a director increase, their success in attracting and retaining qualified directors decreases").

360. *See Micro-Symposium on Competing Theories of Corporate Governance*, 62 UCLA L. REV. DISCOURSE 66 (2014) for a discussion of the competing theories of corporate governance that form the primacy debate; *see also* Sprague & Lyttle, *supra* note 8 (shareholder primacy); *Director Primacy*, *supra* note 101 (director primacy); Blair & Stout, *supra* note 34 (team production); Georgiev, *supra* note 239, at 71-78 (2014) (investor primacy); Rodrigues, *supra* note 198 (conflict primacy); *Quinquennial Election*, *supra* note 350 (quinquennial election model); *A Critical Look*, *supra* note 100 (self-perpetuating board theory).

361. Andrew Ross Sorkin, *An Unusual Boardroom Battle, in Academia*, DEALBOOK (Jan. 5, 2015, 9:42 PM), http://dealbook.nytimes.com/2015/01/05/an-unusual-boardroom-battle-in-academia/?_r=0 (illuminating the eruption of "a nasty, often personal battle among elite professors, regulators and white-shoe lawyers" regarding proponents of different - apparently adversarial - opinions on the effectiveness of classified boards and the appropriateness of the publications of the opposing view-holder with regard to the dispute).

362. *See, e.g.*, Fogel & Geier, *supra* note 8, at 66-68 (proposing reforms that would position "oversight shareholders" on corporate boards to situate shareholders in their rightful position as "[t]he most effective check and balance on management"); Howard, *supra* note 125, at 426 (proposing "regulations that would insulate corporate directors' informal decisionmaking processes from being hindered by groupthink"); *see* Rodrigues, *supra* note 198, at 1052-53 (articulating the "Platonic Ideal" model of the corporate board and explaining how reform efforts for the past thirty years have focused on achieving that goal); Velikonja, *supra* note 168, at 904 ("Independent directors are viewed differently by various constituencies: investors view them as advocates for shareholder wealth maximization; employees view them as advocates for institutional stability; financial creditors view them as a voice of reason against excessive risk-taking; environmentalists view them as stewards of our environment; and still other interests view them as representatives of the public interest.").

respective primacy frameworks are largely discounted.[363] In fact, the proponents of different viewpoints often concede that their proposed solutions are impractical,[364] incomplete,[365] unrealistic,[366] or unworkable.[367] Others propose changes that would only further distract

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363. *See, e.g.*, *Director Primacy*, *supra* note 101, at 597-98 (describing Professors Blair's and Stout's mediating hierarch theory of boards as inapplicable to established publicly held corporations or alternatively "inapt"); Ian B. Lee, *Efficiency and Ethics in the Debate About Shareholder Primacy*, 31 DEL. J. CORP. L. 533, 536 (2006) (identifying the first of the Article's two principal aims as arguing "that Blair, Stout, and [Einer] Elhauge do not succeed in demonstrating the superiority of their alternative approaches from an efficiency perspective"); Stout, *supra* note 100, at 791, 808 (explaining that "calls for greater 'shareholder democracy' appeal to laymen, the business media, and even many business experts not because they are based on evidence, but because they have a strong emotional allure[,]" and cautioning that without empirical evidence to support this conclusion, it would be reckless to accept the argument "that giving shareholders greater control over corporate directors would be a good idea"). *But see* Grant, *supra* note 120, at 764-65 (purporting to "contribute[] to the existing scholarly literature by developing and modernizing reforms that practitioners considered in connection with Sarbanes-Oxley . . . [and] Dodd-Frank").

364. *See, e.g.*, Grant, *supra* note 120, at 799, 807 (confoundingly "[s]etting practical concerns aside" by contradicting her earlier recognition that nominal independence fails to account for organizational behaviors that can perpetuate conflicts of interests that arise from having "captured boards" before offering what Professor Bernice Grant ultimately designates a "creative yet practical approach to indirectly achieve the goal of enhancing the *independent* judgment of the compensation committee members") (emphasis added).

365. Allan C. Hutchinson, *Hurly-Berle–Corporate Governance, Commercial Profits, and Democratic Deficits*, 34 SEATTLE U. L. REV. 1219, 1219, 1249 (2011) (rejecting the shareholder primacy norm and "the traditional evaluative focus of economic success" in favor of "a more inclusive and democratic standard of social well-being" but leaving unanswered the questions of how to "determin[e] for the purposes of corporate governance which groups are to classify as members, by what means their interests are to be ascertained, how to ensure that those interests are adequately represented, and on what basis those often competing interests are to be weighed and balanced").

366. Simultaneously criticizing the expectations of the federal government and corporate reformers for their "unrealistic" expectations for the board, Professor Usha Rodrigues prefaces her proposal for a "fully independent board" to "reconstitut[e] and refram[e] the board of directors" by stating that she is "skeptical that we can define our way to 'true' independence[.]" Rodrigues, *supra* note 198, at 1053, 1055.

367. *See, e.g.*, Rodrigues, *supra* note 198, at 1089 (describing her solution "in general terms" but "deferring the implementation question for another day[.]"); Sprague & Lyttle, *supra* note 8, at 41-42 (opening Article by describing how the current

boards from fulfilling their primary purpose.[368]

Although the primacy debate expressly deals with board function, not insularity, the proposed changes to the board ultimately speak to the problems exacerbated by unrestrained board insularity.[369] The proposed methods fail because the constituents of the debate disagree at a

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financial crisis supports the conclusion that corporate governance needs to be reformed, but conceding that the it is doubtful that their proposed solution will on its own prevent the next financial crisis).

368. For example, in *Groupthink and Corporate Governance Reform: Changing the Formal and Informal Decisionmaking Process of Corporate Boards*, Andrew Howard suggests that corporate boards should allow proxy access not only to institutional investors but also to creditors. Howard, *supra* note 125, at 452-53. Howard explains that this reform would facilitate competitive elections by reducing the cost of running a proxy contest. Although Howard offers restrictions, such as requiring a 5% ownership share for at least two years and limiting the number of nominations accepted from institutional investors and creditors to no more than one-quarter of the board, this reform fails for two reasons. First, this reform would permit institutional investors and creditors "the right to nominate directors straight onto the corporation's proxy statement for an annual or special shareholders' meeting" without restricting the pool of candidates for nomination. *Id.* at 452. Second, the extension of electoral voting rights to any institutional investor but not all shareholders creates an even greater risk of clashing interests where the interests of a sophisticated organized constituency will be pursued at the expense of an individual shareholder seeking to profit from a long-term investment. Similarly, while creditors have an interest in the survival of the corporation, their interest in the corporation's profitability will never exceed the amount of debt owed. *See* Velikonja, *supra* note 168, at 860-61 (arguing that "[i]nstitutional investors and corporate managers value director independence because it displaces more meaningful reform . . . that might limit rent-seeking or force firms to internalize fully the costs of their activities," and that " excessively risky strategies transfer wealth to shareholders at the expense of creditors and employees"); *see also* Bainbridge & Henderson, *supra* note 18, at 1068, 1081-82 (suggesting corporations provide compensation incentives to professional directors to align their interests with the shareholders and to change the legal requirement of a board being comprised of "natural persons," but failing to acknowledge the issue of unconstrained board activity and the extent to which directors are able to bond together and act without any meaningful oversight, insulated from the threat of any personal liability); Samuel R. Foreman, *Bored Boards: The Directorial Disengagement Dilemma*, 50 WASHBURN L.J. 147 (2010) (advocating for professional directors).

369. Rodrigues, *supra* note 198, at 1055 (identifying an issue posed by a "disconnect between the theoretical power and actual impotence of the public board"). *Contra A Critical Look*, *supra* note 100, at 1272 (arguing that the board "with certain limitations" should be made "a de jure self-perpetuating body").

fundamental level.[370] For example, contrary to the history of corporate governance and the stated purpose of the public corporation,[371] some scholars are convinced that shareholders should control the corporation or that the primary purpose of the board is not to maximize shareholder profit.[372]

Recently, the SEC announced its decision to review Rule 14a-8(i)(9) and declared that for the 2015 proxy season, it would not issue any rulings on shareholder proposals excluded under this section of the Rule.[373] Rule 14a-8(i) addresses when a corporation may exclude a shareholder proposal from its proxy statements despite the shareholder's compliance with the procedural requirements for director elections and

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370. Professors Lucian Bebchuk and Stephen Bainbridge, proponents of shareholder primacy and director primacy, respectively, agree the ultimate purpose of the board is to work to maximize shareholder wealth; however, while Bebchuk lobbies for shareholder empowerment and director accountability to shareholders, who Bebchuk believes ultimately control the corporation, Bainbridge asserts that "[*s*]*trong* limits on shareholder control . . . *essential*." *Micro-Symposium on Competing Theories of Corporate Governance*, *supra* note 360, at 70 (emphasis added). *But see* Hutchinson, *supra* note 365, at 1250 (avoiding adopting any particular theory within the primacy debate (although explicitly rejecting the shareholder primacy norm) and instead advocating for a more democratic approach by focusing on "limits on limited liability; a broadening of directors' fiduciary duties; the increased representativeness of the board; and the enactment of substantive regulatory standard").

371. *See supra* Introduction, Section A.

372. *See, e.g.*, Blair & Stout, *supra* note 34, at 282-83 (conceiving of the public corporation as a "mediating hierarchy," where this is board primacy, but directors as disinterested trustees, representing the interests of all, not just the shareholders); Elhauge *supra* note 334, at 733, 738 (explaining that despite the canonical law and economics view of the duty to maximize profits for shareholders, "[c]orporate managers have never had an enforceable legal duty to maximize corporate profits. Rather, they have always had some legal discretion (implicit or explicit) to sacrifice corporate profits in the public interest"); Sydney Ember, *Morning Agenda: Seeking More Say on Directors*, DEALBOOK (Nov. 6, 2014, 7:26AM), http://dealbook.nytimes.com/2014/11/06/morning-agenda-seeking-more-say-on-directors/ (describing efforts of a group of institutional shareholders, led by New York City Comptroller Scott M. Stringer to increase boardroom accountability by submitting proxy proposals to public corporations "to allow *investors* to hire and fire directors directly") (emphasis added).

373. Gretchen Morgenson, *S.E.C. Reversal May Clear Way for Shareholders to Challenge Companies*, N.Y. TIMES (Jan. 19, 2015),www.nytimes.com/2015/01/20/business/sec-reversal-may-clear-way-for-shareholders-to-challenge-companies.html?_r=0.

provides a succession of thirteen circumstances under which a corporation may justify its decision to exclude a shareholder proposal.[374] A corporation may invoke the ninth substantive basis for excluding an otherwise legitimate shareholder proposal from a its proxy statement based on the content of the shareholder proposal if points of "the proposal directly conflict[] with one of the company's own proposals to be submitted to shareholders at the same meeting."[375] However, as of January 16, Rule 14a-8(i)(9) has been suspended.[376]

On December 1, 2014, the SEC's Division of Corporation Finance (the "Division") approved Whole Foods Market, Inc.'s decision to exclude a shareholder proposal that would have permitted shareholders who owned at least 3% of the common stock for three years to nominate directors.[377] Pursuant to Rule 14a-8(i)(9), Whole Foods had filed a no-action letter with the SEC justifying exclusion of the proposal "because the Proponent's Proposal directly conflicts with a proposal to be submitted by the Company in the 2015 Proxy Materials[.]"[378] The shareholder, James McRitchie, submitted two letters on December 23 and 30 appealing the SEC's decision and requesting that it either reconsider or review its decision on the basis that (1) Whole Foods did not appear to have legitimately planned to submit its own proposal directly in conflict with the shareholder's, (2) this obfuscated the purpose of the rule, which "was not intended to allow companies to simply avoid shareholder proposals by substituting their own proposal on the same subject[,]" and (3) including the shareholder's proposal as well as Whole Foods' alleged proposal "would not lead to inconsistent and ambiguous results[.]"[379] On January 16, the SEC notified McRitchie that upon further consideration, Chair Mary Jo White directed the

374. *Id.*

375. 17 C.F.R. § 240.14a-8(i)(9) (2011).

376. Morgenson**,** *supra* note 373.

377. *Id.*

378. James McRitchie, *Appeal of No-Action on Proxy Access at Whole Foods Markets*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Jan. 13, 2015, 9:11 AM), http://blogs.law.harvard.edu/corpgov/2015/01/13/appeal-of-no-action-on-proxy-access-at-whole-foods-markets/.

379. *Id.*; *see* Andrew Ackerman & Joann S. Lublin, Whole Foods Dispute Prompts SEC Review of Corporate Ballots, WSJ (Jan. 19, 2015), www.wsj.com/articles/in-reversal-sec-wont-allow-whole-foods-to-exclude-nonbinding-shareholder-proposal-1421450999 ("The SEC's December decision allowing Whole Foods to ignore the shareholder proposal prompted more than 20 companies to seek permission to exclude similar corporate governance proposals.").

Division to review the basis for exclusion under Rule 14a-8(i)(9), and accordingly, "[t]he Division would not express any views under [that] rule . . . for the current proxy season."[380] And thus, the Division reversed its no-action order because in light of its decision not to express views on this type of exclusion, it could not express a view concerning Whole Foods' decision to exclude the proposal here.[381]

Reactions to the decision to suspend Rule 14a-8(i)(9) for the year have been mixed.[382] Proponents of shareholder proxy access have called for shareholders to unite against the potential for boards to abuse the knowledge that enforcement action for exclusion of proposals on the basis of "conflicting" content is unlikely.[383] For example, McRitchie published an article advising shareholders to adopt a no-tolerance policy against decisions to exclude proposals based on Rule 14a-8(i)(9) until the review is completed.[384] Conversely, Whole Foods has not commented on the decision beyond confirming that it is reviewing the SEC's statement.[385] Likewise, the opposition to increased shareholder proxy access has implored proxy adviser firms and institutional investors to refrain from commenting on the issue until the SEC makes

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380. Letter from David R. Fredrickson, Chief Counsel, U.S. Securities and Exchange Commission, to James McRitchie (Jan. 16, 2015) (http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2015/jamesmcritchiecheveddenrecon011615-14a8.pdf). For official statement, see Public Statement from Chair Mary Jo White Directing Staff to Review Commission Rule for Excluding Conflicting Proxy Proposals (Jan. 16, 2015) (http://www.sec.gov/news/statement/statement-on-conflicting-proxy-proposals.html#.VNP2vZ3F81I).

381. *Id.*

382. *See* R. Douglas Harmon, *SEC Reverses Course on Proxy Exclusions for Certain Shareholder Proposals*, JDSUPRA (Jan. 21, 2015), http://www.jdsupra.com/legalnews/sec-reverses-course-on-proxy-exclusions-49528/ (discussing possible short-term and long-term significance of the Division's official review of the Rule).

383. James McRitchie, *SEC Withdraws No-Action: Rule 14a-8(i)(9)*, CORPGOV.NET (Jan. 19, 2015), http://corpgov.net/2015/01/sec-withdraws-no-action-from-whole-foods-rule-14a-8i9-suspended/ ("[I]f they omit a duly submitted proxy proposal based on their own interpretation of the subdivision now under review by the SEC, their directors should face a vote of no confidence.").

384. *See id*.

385. Ross Kerber & Tanvi Mehta, *SEC steps back after challenge on Whole Foods proxy access*, REUTERS (Jan. 20, 2015), www.reuters.com/article/2015/01/20/whole-foods-mrkt-sec-idUSL1N0UZ0PS20150120.

its final determination.[386] Ultimately, whatever the SEC announces to be the proper scope and application of this Rule has the potential to result in an increase in litigation.[387]

In light of the failure of the existing federal regulations and proposed solutions to resolve the ambiguity of the purpose and responsibilities of the board, it is important to shift away from the "primacy" debate.[388] Instead, corporate reformers should focus on determining what checks and balances are necessary to ensure that boards fulfill their duties without continual interruption, but with a more legitimate incentive to concentrate interests.[389]

CONCLUSION

Stringent laws or policies that would heavily monitor boards would discourage anyone from wanting to serve on them.[390] Although the primary purpose of the board is to oversee the management of the corporation for shareholder wealth maximization, modern legal,

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386. Dow Jones Business News, *Proxy Adviser Warns Companies on Shareholder Ballots*, NASDAQ (Jan. 23, 2015), http://www.nasdaq.com/article/proxy-adviser-warns-companies-on-shareholder-ballots-20150123-00677 ("Business groups like the Business Roundtable had urged proxy advisers firms to stay out of the fight while the Securities and Exchange Commission reviews its rules.").

387. *See* Broc Romanek, *Proxy Access Punt: Top 5 Things People Are Asking*, THECORPORATECOUNSEL.NET (Jan. 19, 2015), www.thecorporatecounsel.net/blog/2015/01/proxy-access-punt-top-5-things-people-are-asking.html (listing five options and their potential consequences for corporation's that have counterproposals in conflict with a shareholder proposal and noting the potential reach of the SEC's new position beyond proxy access proposals); *see also* Marianne Hill, *Taming the Corporate Beast*, DOLLARS&SENSE (July/August 2014), www.dollarsandsense.org/archives/2014/0714hill.html (recalling the litigation resulting from the SEC's attempt to implement a Rule "facilitating shareholders' ability to have their proposed nominees for a corporation's board of directors included in proxy materials"); *supra* note 200, for a discussion of the SEC's failed attempt to ensure shareholder proxy access through Rule 14a-11.

388. *E.g.*, Hutchinson, *supra* note 365, at 1245, 1249 (adopting a democratic view of corporate governance similar to Blair and Stouts' team production theory whereby "profit maximization . . . will simply no longer be the exclusive or predominant goal among many other social ambitions" and shareholders "would become simply different kinds of members who would include owners, directors, managers, workers, customers, suppliers, lenders, neighbors, community, etc.").

389. *See supra* Parts I.C.2 and II.B.

390. *See supra* Part II.A.

economic, and political policies have both expressly and implicitly imposed upon boards additional responsibilities they were not traditionally expected to undertake.[391] Given the nature of a publicly held corporation and the passive role of shareholders, there needs to be some federal regulations that require boards to take affirmative measures to remain objective when acting in their role as part of the fiduciary of the shares of the corporation.[392]

Further, directors are necessarily concerned with their corporation operating within the law because being found to have violated the law would harm stock value.[393] Nevertheless, an affirmative duty to monitor the corporation's compliance with regulations, absent a similar expressly imposed obligation to ensure boards fulfill their responsibilities in light of their primary duty, might tacitly encourage boards to shift their focus from shareholder wealth maximization to general oversight for compliance.[394] Because the regulations establish clear expectations of corporations, the board can and probably should create a separate corporate group of qualified individuals to work in

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391. *See supra* notes 237, 358 and accompanying text; Rodrigues, *supra* note 198, at 1052 ("With every financial crisis or scandal comes the cry 'Where were the boards?' and a call for boards to 'do more'").

392. *See supra* Part II.B.

393. *See supra* Introduction, and Part I.C.1, for descriptions of the social network of boards and directors' diverging interests; Scarlett, *supra* note 110, at 46 (suggesting that "market forces [may] curb decision-maker discretion and encourage voluntary information disclosure on actions and related outcomes").

394. For example, under § 205 of the Sarbanes-Oxley Act of 2002, which is entitled "Standards of Professional Conduct for Attorneys Appearing and Practicing before the Commission in the Representation of an Issuer," the board of directors may create a qualified legal compliance committee, comprised of at least one member of the audit committee and at least two other independent directors, responsible for addressing reports of any possible material violation "by the issuer or by any officer, director, employee, or agent of the issuer[.]" 17 C.F.R. §§ 205.2(k), 205.3(c)(1) (2014). *Cf.* Velikonja, *supra* note 168, at 909 (explaining how in response to the Foreign Corrupt Practices Act of 1977, the NYSE "required listed companies to maintain a fully independent audit committee to implement and oversee internal control systems" without "articulating clearly 'for whose benefit [internal controls' exists, and to what end'" and arguing that, in fact, "[u]sing the corporate board of directors to police corruption and bribery is curious because bribe-paying harms a firm's competitors, not investors"). *See supra* Part I.C.2.b.

conjunction with management to whom the board could delegate the responsibility to oversee the corporation's compliance.[395]

Eliminating designations such as "independent," "outside," or "inside," in favor of focusing on an individual's overall traits, which would, in their totality, qualify a person to serve on a board, will eliminate concerns of absolute unconstrained director control and instead contribute to the management and oversight of the corporation for shareholder wealth maximization.[396] And thus, it is essential to shift away from an assessment that focuses on a single characteristic of a candidate at the time of election.[397]

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395. However, this separate group will be distinct from the board. The board's duty, first and foremost, will be to oversee the management of the corporation to maximize the value of the common stock. The group will be another component of the corporate operations that the board oversees, but it will not be another committee or subsidiary of the board. *Contra* Murphy, *supra* note 26, at 189 (proposing for a dual-purpose board).

396. *See supra* notes 195-207 and accompanying text.

397. *But see supra* Part II.B.2.b, for a discussion of some singular disqualifying characteristics.