The Concept of Autonomy and the Independent Director of Public Corporations

Daniele Marchesani

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http://dx.doi.org/https://doi.org/10.15779/Z38RW1W

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Daniele Marchesanit

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INTRODUCTION

William T. Allen once wrote: "A commonly used word—seemingly specific and concrete when used in everyday speech—may mask troubling ambiguities that upon close examination are seen to derive not simply from casual use but from more fundamental epistemological problems."¹ The word "independent" in the context of corporate boards of directors is an example of the "deceptive dependability of language" to which Chancellor Allen referred.² This Article will discuss the cause of, and the remedy to, this word's ambiguities.

In the last twenty years, the American corporate governance system has come to see Independent Directors as an effective tool for safeguarding the interests of shareholders and other corporate constituencies.³ State case law, federal legislation, and stock exchange listing rules rely especially on directors without ties to the company and its executives to serve as watchdogs of management. The 2002 corporate governance reforms, which followed the Enron and WorldCom scandals, are based on such great confidence in the positive role of Independent Directors that today it seems fair to say that "independent" has almost become synonymous with "trustworthy."⁴

During the same period, many legal, financial, and managerial studies recognized that there are several flaws in such an equation. Common definitions of Independence fail to consider all of the ties that affect directors' independent judgment. The absence of ties, moreover, does not alone guarantee that directors discharge their duties effectively; a trustworthy director needs to

¹. Katz v. Oak Indus., Inc., 508 A.2d 873, 875 (Del. Ch. 1986) (where the former Delaware Chancellor was referring to the term "coercion").
². Id.
³. To avoid any confusion, I will use "Independence," "Independent," and "Independent Director" to refer to the special status of certain corporate directors, and "independence" and "independent" to refer to the psychological personal attribute. Under common definitions, a director may be: (i) "Independent" when the director has no relationship with the company and its management other than his directorship; (ii) "inside" when the director is an employee of the company; or (iii) "affiliated" (or "gray") when the director has a relationship with the company such as being the company's lawyer, banker, or consultant. Common definitions also use denominations such as "non-employee," "outside," and "non-interested."
⁴. By "trustworthy," I intend that the Independent Directors can be trusted to effectively carry out their responsibilities.
possess personal characteristics other than mere independence. Finally, the organizational structure of an entity may itself prevent directors from properly performing their roles, whether by generating obstacles or by failing to provide directors with adequate opportunities for action. The latest series of reforms has strengthened the traditional definition of Independence and has introduced some structural changes. The new rules, however, 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.

In this Article, I intend to make a twofold contribution. First, I will suggest a new framework for the analysis of this matter: the very definition of Independence should be modified so that only individuals with both the personal attributes and the institutional resources necessary to be effective would receive the responsibilities and legal status that currently pertain to Independent Directors. Such an approach is consistent with studies of the philosophy of psychology distinguishing “independence,” defined as freedom from external coercion or influence, from the more inclusive concept of “autonomy,” which also requires that a person be free from a wider range of constraints, and that he have adequate opportunities to act. Only autonomous individuals are capable of both formulating and pursuing their own goals. Independence is a condition necessary but not sufficient for such a purpose. A person free from another’s influence may still fail to make or to carry out his plans because he lacks the strength of will, competence, or other necessary qualities. Alternatively, his environment might not provide him with adequate resources.

In light of these categories, current rules of corporate governance clearly rely upon a definition of independence to identify a director as if he were autonomous (i.e., a director who formulates and pursues his objectives, thus effectively carrying out his responsibilities). Such dissonance is not merely semantic but has important practical consequences. The presence of Independent Directors on company boards has become an indicator of good governance. Moreover, special legal effects attach to certain decisions made by directors that qualify as Independent. In both regards, current definitions of Independence do not justify such reliance and should be modified; they should include all of the requirements necessary to identify individuals who will indeed act autonomously and therefore be trustworthy.

The second focus of this Article is to identify the conditions necessary for a director to be truly autonomous, and then to elaborate a set of structural and procedural arrangements that could realize such conditions. In addition to solutions generally discussed by scholars and practitioners, I will advance two
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proposals.\(^5\) The first is to create within each corporation a support staff: a group of professionals selected by, and working for, the Independent Directors. It is based on an idea originally proposed during the 1970s. Organizational Design concepts could be used to provide the staff with the tools necessary to effectively support the work of the directors, especially with regard to accessing relevant information within the corporation.

The second proposal addresses how to identify those individuals who possess the motivation and active posture necessary to serve effectively as Independent Directors. Equity ownership has been traditionally proposed as the answer to this problem, but has produced uncertain results. Consistent with modern philosophical views that consider autonomy as an exercise-concept, I shall suggest that directors should be qualified as Independent only after having given proof that they possess the personal qualities that are necessary for a director to be effective. In practical terms, this would translate into a procedure to evaluate and confirm newly elected directors as Independent. Each would be permanently awarded such a status only after a positive finding, made by the existing Independent Directors, that he has demonstrated activeness and independence as a member of the board. The director's use of the set of powers and resources as suggested by this Article will provide a reasonably objective basis to make such a determination.

Courts would be able to adopt the approach proposed in this Article even without an amendment of the relevant statutory rules. Failure to meet the suggested requirements of autonomy, which are not mandatory under current rules, would not in itself give rise to fiduciary liability. Instead, courts could consider these requirements factual elements relevant to the determination of Independence and deny special legal effects to the actions of directors who do not meet them.

This Article is ultimately an attempt to present a coherent and comprehensive theory of the Independent Director of public companies, one that will foster a better understanding of the dynamics and weaknesses of the current system and provide effective solutions to the existing problems. While I believe that no definitive improvement can occur without a true change in board culture, the suggested approach and solutions could nonetheless contribute toward eliminating a significant weakness within the present governance system.

I. THE DIFFERENT ROLES OF THE BOARD OF DIRECTORS

Under modern corporate governance, the CEO and the other executives manage the corporation: boards of directors do not direct the day-to-day

\(^5\) See infra Part V.
operations of large companies. Ordinarily, it is the CEO who decides the company's strategy and oversees its implementation. He sets the budget, hires and fires the top executives, and represents the company publicly. Directors are instead entrusted with different roles, which have been classified into at least three major categories.

The first function is to monitor the company's management on behalf of the shareholders. To this end, the board selects the CEO and other senior executives, determines their compensation, and reviews their transactions with the company. The board has also been increasingly entrusted with overseeing general compliance with the law in a number of areas, such as auditing, accounting, financial reporting, and disclosures.

Second, directors perform a service stratégic role. The board supports management in the evaluation and development of the chief objectives and strategies of the corporation. In certain instances, such as when the company issues stock or pays dividends as well as in the case of mergers and other changes of corporate structure, the board is directly responsible for making the relevant decisions.

The board also performs a resource-gathering role. The board acts as a bridge between the corporation and the various actors of its social environment. In particular, directors exchange information and otherwise interact with the company's various stakeholders, the government, and the legal and financial communities to acquire and maintain legitimacy as well as the necessary support within these communities.

The American corporate governance system has adopted the so-called monitoring model, which emphasizes the board's monitoring role. Accordingly, the 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.


8. See Langevoort, supra note 7, at 801-02.

9. Id. at 802-03.

10. Id. at 802.

11. Id. at 801; see also Lynne L. Dallas, The Multiple Roles of Corporate Boards of Directors, 40 SAN DIEGO L. REV. 781, 805-07 (2003) (including these activities within what professor Dallas refers to as the relational role of the board).

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corporate reforms have confirmed this tendency by focusing on means that improve board monitoring. These include an audit committee responsible for the oversight of auditing and internal accounting controls, as well as a compensation committee which sets and reviews executive compensation.13

The monitoring model assigns a crucial role to Independent Directors. The underlying rationale is that these directors, being free from ties to the corporation and its management, are in a better position to monitor the CEO and the other executives and, when necessary, to take action to protect the interests of the corporation or its shareholders.14 Along with the diffusion of the monitoring model, corporate governance rules have given increasing importance to the role of Independent Directors. As a result, "a cornerstone of so much of corporate law today is the monitoring model, and more specifically, the outside director." 15

II. INDEPENDENT AS SYNONYMOUS WITH TRUSTWORTHY

The importance of Independent Directors to the monitoring model of the board is reflected in modern state jurisprudence, federal legislation, Securities and Exchange Commission (S.E.C.) regulations, and stock exchange listing rules. In certain situations, the decisions of Independent Directors receive special deference, and their presence on the board is generally believed to ensure good governance.

Delaware courts give special significance to decisions made by directors deemed Independent under applicable judicial definitions. In derivative litigation, before initiating an action a shareholder must first demand that the board of directors bring suit on behalf of the corporation.16 If the shareholder


14. [Independence] provides a director with the distance and objectivity necessary to examine management action in the most effective manner. . . . Insofar as management is concerned, director independence brings accountability and responsibility. Responsibility to a watchful intermediary will likely spur thoughtful decisionmaking and reflection on management’s part. These results will not occur unless the intermediary is in fact independent of the examined party, thus making board independence a critical component of modern governance theory. Elson, supra note 12, at 497-98 (footnotes omitted); see also ROBERT A.G. MONKS & NELL MINOW, CORPORATE GOVERNANCE 202-03 (1995); James D. Cox, The Paradoxical Corporate and Securities Law Implications of Counsel Serving on the Client’s Board, 80 WASH. U. L.Q. 541, 547-49 (2004).
15. See Cox, supra note 14, at 549.
16. See Beam v. Stewart, 845 A.2d 1040, 1048 (Del. 2004); Kaplan v. Peat, Marwick, Mitchell & Co., 540 A.2d 726, 730 (Del. 1988) ("Pre-suit demand under Chancery Court Rule 23.1, is an objective burden which must be met in order for the shareholder to have capacity to sue on behalf of the corporation.").
alleges sufficient facts to create a reasonable doubt that the majority of the directors are Independent, he is entitled to proceed with the litigation without making any demand, as this would be considered futile. Courts determine whether a director is Independent on a case-by-case basis depending on the factual circumstances of the case. When a shareholder makes a pursuit demand, instead of deciding on its own whether to comply, the board may delegate to a special committee of Independent Directors the task of evaluating the appropriate course of action. Even when no demand is made because it is deemed excused as futile, the board may still appoint such a committee to decide whether to seek dismissal of the derivative action.

Director Independence is also relevant in interested transactions. These include transactions between a director and his corporation, or transactions between the corporation and another corporation in which the director has a financial interest. Section 144 of the Delaware General Corporation Law provides a safe harbor for interested transactions approved by a majority of Independent Directors who do not have a personal interest at stake. Delaware courts have taken considerably different positions on the effect of the approval. It may result in the application of the business judgment rule to the interested transaction. Other courts have instead held that the fairness standard applies, but the approval has the effect of shifting the burden of proof.

18. [A court] must review the complaint on a case-by-case basis to determine whether it states with particularity facts indicating that a relationship—whether it preceded or followed board membership—is so close that the director's independence may reasonably be doubted. This doubt might arise either because of financial ties, family affinity, a particularly close or intimate personal or business affinity or because of evidence that in the past the relationship caused the director to act non-independently vis-à-vis an interested director.
20. See Zapata Corp. v. Maldonado, 430 A.2d 779, 785-89 (Del. 1981). The Delaware Supreme Court has declined to decide "whether the substantive standard of independence in a [Special Litigation Committee] case differs from that in a presuit demand case." Beam, 845 A.2d at 1055.
21. See DEL. CODE ANN. tit. 8, § 144 (2003). Section 144 "deals with the... problem of the conditions under which a corporate contract can be rendered 'un-voidable' solely by reason of a director interest" but does not say what standard of review applies to the transaction. Cinerama, Inc. v. Technicolor, Inc. 663 A.2d 1134, 1154 (Del. Ch. 1994), aff'd, 663 A.2d 1156 (Del. 1995).
22. See EDWARD BRODSKY & M. PATRICIA ADAMSKI, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES AND LIABILITIES § 3:8 (2004); see also Robert J. Brown, Jr., The Irrelevance of State Corporate Law in the Governance of Public Companies, 38 U. RICH. L. REV. 317, 342 (2004) (noting that court decisions on interested transactions have "sharply restricted the reach of the duty of loyalty").
23. See Puma v. Marriott, 283 A.2d 693 (Del. Ch. 1971); cf. Oberly v. Kirby, 592 A.2d 445, 465 n.14 (Del. 1991) (supporting, although in dictum, this position). The business judgment rule "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." Emerald Partners v. Berlin, 787 A.2d 85, 90 (Del. 2001) (quoting Aronson v. Lewis, 473 A.2d at 812).
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to the plaintiff.24

In a takeover context, in deciding whether to apply the protection of the business judgment rule to defensive measures adopted by the board of the target corporation, courts give great weight to the approval of such measures by a board comprised of a majority of outside Independent Directors.25 "An 'outside' director has been defined as a non-employee and non-management director . . . . Independence 'means that a director's decision is based on the corporate merits of the subject before the board rather than on extraneous considerations or influences.'"26

As for federal laws and regulations, the Internal Revenue Code allows public corporations to benefit from an exception to a $1,000,000 limit upon corporate tax deductions for compensation paid to their executives. The exception applies to salaries that are "performance based" and that are approved by a committee composed of two or more outside directors.27 The Securities Exchange Act of 1933 also exempts from insider trading restrictions a transfer of securities from a company to one of its officers or directors if the transfer is approved by a board committee composed of two or more "non-employee" directors.28 Although mutual funds present governance issues different from those of traditional corporations, it is important to mention the funds' rules as they relate to Independent Directors. The Investment Company Act of 1940 requires that at least 40% of investment company directors be

24. The entire fairness standard always applies in transactions involving self-dealing by a controlling shareholder; "the burden, however, may be shifted from the defendants to the plaintiff through the use of a well functioning committee of independent directors." Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997) (citing Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994)); see also Krasner v. Moffett, 826 A.2d 277, 286 (Del. 2003) ("The independence of the special committee involves a fact-intensive inquiry that varies from case to case.").


27. See 26 C.F.R. § 1.162-27 (2004). A director qualifies as an "outside director" if he:
   (A) Is not a current employee of the . . . corporation;
   (B) Is not a former employee of the . . . corporation who receives compensation for prior services . . . during the taxable year;
   (C) Has not been an officer of the . . . corporation; and
   (D) Does not receive remuneration from the . . . corporation, either directly or indirectly, in any capacity other than as a director.

28. See 17 C.F.R. § 240.16b-3 (2004). A "non-employee" director:
   (A) Is not currently an officer . . . of the [corporation] or a parent or subsidiary of the [corporation], or otherwise currently employed by the [corporation] or a parent or subsidiary of the [corporation];
   (B) Does not receive compensation, either directly or indirectly, from the [corporation] or a parent or subsidiary of the [corporation], for services rendered as a consultant or in any capacity other than as a director . . .
   (C) Does not possess an interest in any other transaction for which disclosure would be required . . . and
   (D) Is not engaged in a business relationship for which disclosure would be required . . . .

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"non-interested" persons. Moreover, as a condition for benefiting from certain exemptions, S.E.C. rules require that funds comply with specific governance standards, some of which concern Independent Directors. A special status is also reserved for Independent Directors within the banking industry. For instance, as a result of the 1991 amendments to the Federal Deposit Insurance Act, the Federal Deposit Insurance Corporation adopted rules providing that insured depository institutions establish an audit committee composed solely of "outside directors who are independent of management of the institution . . . ."

Following the 2002 corporate governance reforms, companies are increasingly required to have a substantial presence of Independent Directors on their boards. Rule 301 of the Sarbanes-Oxley Act of 2002 mandated that the S.E.C. adopt rules requiring national stock exchanges to include in their listing requirements certain obligations for company audit committees, and in particular requiring that such committees be composed only of Independent Directors. The S.E.C. set forth the minimum requirements for Independence.


33. In order to be considered to be independent . . . a member of an audit committee of a listed issuer that is not an investment company may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee:

(A) Accept directly or indirectly any consulting, advisory, or other compensatory fee from the issuer or any subsidiary thereof . . . or

(B) Be an affiliated person of the issuer or any subsidiary thereof . . . . In order to be considered to be independent . . . a member of an audit committee of a listed issuer that is an investment company may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee:

(A) Accept directly or indirectly any consulting, advisory, or other compensatory fee from the issuer or any subsidiary thereof . . . or

(B) Be an "interested person" of the issuer as defined in . . . 15 U.S.C. 80a-2(a)(19).

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The New York Stock Exchange (NYSE) and NASDAQ have both adopted new listing rules requiring companies to have a majority of Independent Directors on their boards. Both sets of listing rules set forth definitions of Independence. Companies listed on the NYSE must have a nominating/corporate governance committee and a compensation committee comprised of Independent Directors. The new NASDAQ rules require that a majority of Independent Directors, or a committee comprised of Independent Directors, decide or recommend the CEO's and executive officers' compensation as well as select or recommend director nominees.

It now seems fair to say that "after the 2002 reforms, it is unquestionable that Delaware, the Exchanges, and the federal government each have policies that express the belief that genuinely independent directors who owe their allegiances entirely to their corporation and its stockholders are valuable to investors." The above overview shows how corporate governance rules treat Independent Directors as the individuals upon whom shareholders and other corporate constituencies can rely to ensure that corporations are properly managed. As I will now discuss, however, independence alone does not justify this special trust in the positive role of Independent Directors.

III. A DIFFERENT VIEW OF INDEPENDENT DIRECTORS

Corporate governance rules have increasingly enlarged the role of Independent Directors. However, many commentators have argued that Independent Directors are not in the position to adequately discharge their duties because of deficiencies in their personal attributes and in the structural

34. See NASDAQ Marketplace Rule 4350(c), IM-4350-4 ("Independent directors... play an important role in assuring investor confidence. Through the exercise of independent judgment, they act on behalf of investors to maximize shareholder value in the companies they oversee and guard against conflicts of interest. Requiring that the board be comprised of a majority of independent directors empowers such directors to carry out more effectively these responsibilities."); N.Y.S.E. Listed Co. Manual § 303A.01 (The Commentary notes that "[e]ffective boards of directors exercise independent judgment in carrying out their responsibilities. Requiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest.").

35. See NASDAQ Marketplace Rule 4200 ("Independent director means a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship, which, in the opinion of the company’s board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director."); N.Y.S.E. Listed Co. Manual § 303A.02(a) ("No director qualifies as ‘independent’ unless the board of directors affirmatively determines that the director has no material relationship with the listed company... ") Both rules identify a number of specific relationships that prevent a director from being qualified as Independent.


37. See NASDAQ Marketplace Rule 4350(c).


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features of the corporation.  

Before examining these positions, it is worth noting that these ideas find some support in many empirical studies’ inability to discover a clear correspondence between the presence of Independent Directors on the board and a firm’s performance. There are, however, some caveats to be made in interpreting the results of such studies. First, the studies generally adopt unsophisticated definitions of Independence, and definitions often differ from one study to another. Additional problems arise because almost all of the variables used are endogenous or because the empirical results can often be interpreted as either equilibrium or out-of-equilibrium phenomena. Overall, it is still unclear what consideration should be accorded to these empirical studies. Nevertheless, their results are consistent with the idea that Independence alone is not sufficient to guarantee good director performance.

A. Directors’ Personal Attributes

Most definitions of independence do not consider all of the ties that may exist between a director and the company or its managers. In particular, indirect economic relationships as well as personal and social connections affect the ability of directors to act independently. Indeed, many corporate governance guidelines and codes of best practice have supported the adoption of stricter definitions of Independence. Enron represents a good example of what may


41. See Sanjai Bhagat & Bernard Black, The Uncertain Relationship between Board Composition and Firm Performance, 54 BUS. LAW. 921, 952 (1999); Lynne L. Dallas, The Relational Board: Three Theories of Corporate Boards of Directors, 22 J. CORP. L. 1, 18 (1996); Fisch, supra note 13, at 278-79 (“Defining independence appropriately for purposes of these studies is particularly difficult. Many studies rely on relatively superficial criteria in classifying directors as independent . . . .”); Langevoort, supra note 7, at 798-99; Lin, supra note 39, at 922.

42. See Hermlalin & Weissbach, supra note 40, at 8 (“The . . . problems of joint endogeneity . . . plague these studies. For instance, firm performance is both a result of the actions of previous directors and itself a factor that potentially influences the choice of subsequent directors.”).

43. See Brudney, supra note 39, at 612-13; Charles M. Elson, Director Compensation and the Management-Captured Board—The History of a Symptom and a Cure, 50 SMU L. REV. 127, 161 (1996); Gilson & Kraakman, supra note 39, at 875.

44. See HOLLY J. GREGORY, COMPARISON OF CORPORATE GOVERNANCE GUIDELINES AND CODES
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happen when directors have indirect economic links with the company. The 2002 reforms and recent Delaware decisions have addressed this issue by recognizing the relevance of family, professional, or financial ties that endanger a director's independence of judgment. 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. Specifically, a director may not have the experience and knowledge necessary for the job. State laws generally do not provide mandatory director qualifications, and few are the cases in which corporations fill the gap. The 2002 reforms have not taken any steps in this regard. The new NYSE listing rules only require that companies adopt and disclose corporate governance guidelines addressing director qualification standards and director orientation and continuing education. An exception exists within the context of audit committees. The Sarbanes-Oxley Act requires that corporations disclose in annual reports whether any of the Independent Directors serving on the audit committee is a financial expert. If none is present, the report must explain why. The new listing rules do require that, at the very least, all of the committee members are financially literate.

Another issue arises from many directors' inability to devote sufficient time to their position because they either have full-time jobs or serve on other

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46. See Chandler & Strine, supra note 32, at 967-71.
47. The NYSE listing rules require a positive showing of any relationship affecting director Independence. The commentary to the rule, however, does not mention personal friendships as one of the examples of the relationships that should be disclosed. See N.Y.S.E. Listed Co. Manual § 303A.02; Developments in the Law—Corporations and Society, 117 HARV. L. REV. 2181, 2198 (2004); cf. Beam v. Stewart, 845 A.2d 1040, 1051-52 (Del. 2000): Mere allegations that [the directors] move in the same business and social circles, or a characterization that they are close friends, is not enough to negate independence for demand excusal purposes. That is not to say that personal friendship is always irrelevant to the independence calculus. But for presuit demand purposes, friendship must be accompanied by substantially more in the nature of serious allegations that would lead to a reasonable doubt as to a director's independence.
48. See Gilson & Kraakman, supra note 39, at 875; Lin, supra note 39, at 903.
corporate boards. To remedy this problem, some corporate governance guidelines and codes of best practice suggest a requirement that directors have sufficient time for their duties or a limit on the number of boards on which they may sit. Furthermore, board meetings are so infrequent that the directors do not have sufficient opportunities to make a valuable contribution to the management of the corporation.

Nothing guarantees, moreover, that Independent Directors will have sufficient incentive to actively monitor the company's management even when they are in the position to do so. Instead, the following factors suggest Independent Directors will lack such an incentive. First, as part of the vast phenomenon of cross-directorships, many directors are also managers of other companies. As such, they have no incentive to make waves within the board of another company whose managers serve on the board of their company. Second, the phenomenon of groupthink within the boardroom poses an additional obstacle to the directors' willingness to confront the management. Third, interpersonal board dynamics tend to create a nonconfrontational environment where dissent is strongly discouraged.

The traditional argument to the contrary is that the market for directors creates the incentive to monitor the company's management: allegedly, directors will try to foster their reputation to maintain their office and to be elected to additional boards. Commentators, however, generally reject this argument and claim that lack of motivation typically limits the effectiveness of Independent Directors.

54. See LORSCH & MACIVER, supra note 49, at 178; MONKS & MINOW, supra note 12, at 189-90; Brudney, supra note 39, at 609; Gilson & Kraakman, supra note 39, at 875; see also The Role of the Board of Directors in Enron's Collapse: Hearing Before the Permanent Subcomm. on Investigations of the Senate Comm. on Governmental Affairs, 107th Cong. (2002) (statement of Herbert S. Winokur, Jr.) (discussing the limited role of directors within a large corporation and the part-time nature of their job).
56. See Lipton & Lorsch, supra note 39, at 64-65. According to the 2003 Corporate Board Member study, the mean number of meetings per year is 5.6. CORP. BOARD MEMBER, WHAT DIRECTORS THINK STUDY 2003 3 (2003).
57. See MONKS & MINOW, supra note 12, at 188-89.
58. See Elson, supra note 43, at 159, 161-62 ("While such board composition may lead to affable board gatherings, the oversight function may be severely compromised. . . . [C]onflict with a manager who is also a member of one's own board may lead to future retribution of one's own turf, thus reducing the incentive to act."); cf. Gilson & Kraakman, supra note 39, at 875.
61. See WILLIAM G. BOWEN, INSIDE THE BOARDROOM 48 (1994) (noting with regard to Independent Directors that "[c]ourage and the will to act are often the attributes in scarcest supply"); see
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Additionally, fiduciary duties and personal liability rules fail to create a sufficient incentive to act in the best interest of the corporation. In particular, the standard of care that governs the directors' duty to monitor, the business judgment rule, the possibility of limited monetary damages for breach of the standard of care, and the availability of insurance coverage all make it unlikely that a director's exposure to liability will provide a serious incentive to act.

In monitoring management and company operations, directors have a general obligation of care. Technically, courts will not apply the business judgment rule to the directors' failure to act unless a conscious decision not to act has been made. Conversely, directors violate their fiduciary duties if they do not exercise "the amount of care that ordinarily careful and prudent men would use in similar circumstances." Directors fail to meet this standard not only if they ignore a red flag, but also if they do not "attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists."

This standard of care does not seem to provide sufficient incentive to monitor, especially if the following factors are taken into consideration. First, it has generally been common practice for corporations to maintain a minimum reporting system, which will likely allow directors to meet their duty of care in this regard without taking any further action. Second, directors will not be held responsible if they reasonably rely on the opinions and information provided to them by the management. Third, directors have no duty to actively inquire into a matter that is not connected to a specific event. In addition, in the late 1980s, Delaware law was amended to allow stockholders to exonerate directors from damage liability arising out of violations of their fiduciary duty of care. Such limitations clearly weaken any motivational effect of state fiduciary rules. Even though Sarbanes-Oxley's rules on audit committees may result in an increase of director liability for breach of either federal law or the duty of care

also Bebchuk et al., supra note 39, at 771 (in the context of compensation committees); Brudney, supra note 39, at 613; Elson, supra note 43, at 159; Gilson & Kraakman, supra note 39, at 873-76.
62. See Langevoot, supra note 7, at 818-23; Lynn A. Stout, On the Proper Motives of Corporate Directors (Or, Why You Don't Want to Invite Homo Economicus to Join Your Board), 28 DEL. J. CORP. 1, 5-8 (2003).
64. See Aronson v. Lewis, 473 A.2d 805, 813 (Del. Ch. 1984); In re Caremark Int'l Inc. Derivative Lit., 698 A.2d 959, 967 (Del. Ch. 1996).
67. Delaware corporate law shields directors from liability in their reliance on inside or outside sources of information; however, the law requires that such reliance be reasonable. See DEL. CODE ANN. tit. 8, § 141(e) (2003).
68. § 102(b)(7).
under state law, directors’ overall exposure to liability for breach of their duty of care will continue to be very limited.

The business judgment rule tends to shield directors from personal liability in relation to their business decisions. Although the rule is a cornerstone of American corporate law because it allows boards to make business decisions without always being second-guessed by courts, the rule provides directors with many opportunities to fail to act in the best interest of the corporation without breaching their fiduciary duties. The business judgment rule generally applies to directors’ actions, such as the approval of executive compensation, and to the actions of special litigation committees. With respect to director responses to takeover attempts, Delaware case law sets forth more specific guidelines. In the case of the director’s duty to maintain an internal control system, courts, by incorporating such guidelines into fiduciary duty, have created some incentive to actually follow such practices in order to avoid the risk of personal liability.

B. Structural Constraints

Structural concerns further impair the effectiveness of Independent Directors. First, commentators have pointed out that the traditional involvement of the CEO in the selection of director candidates raises serious doubts as to


70. See supra note 23; see also Brudney, supra note 39, at 614-15 ("The duty of care as implemented by the business judgment rule imposes minuscule likelihood of liability of independent directors."); Meese, supra note 60, at 1675 ("[T]he business judgment rule... insulates directors from much judicial oversight that could, conceivably, encourage directors to act in shareholder interest.").

71. See Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 VA. L. REV. 247, 306-07 (1999) (listing a few situations where the directors may approve a transaction without losing the protection of the business judgment rule even though the transaction is not in the best interest of the corporation).

72. See Brehm v. Eisner, 746 A.2d 244, 263-264 (Del. 2000); Bebchuk et al., supra note 39; Brudney, supra note 39, at 610-16. Bebchuck et al. discuss the failures of Independent Directors in the context of special committees. The authors point out the deleterious effects of, among others, lack of economic incentive, board group dynamics, and CEO influence on the selection of directors. Brudney notes how in this context directors will face many obstacles because of their adversarial role. Their desire to monitor improper self-dealing will be tempered by the necessity to maintain good relationships with the management with whom directors must work. In addition to social ties, lack of incentives to intervene would limit outside directors’ ability to prevent improper transactions.


74. See Kenneth B. Davis, Jr., Once More, the Business Judgment Rule, 2000 WIS. L. REV. 573, 582-86 (2000) (maintaining that one of the conditions necessary for creating more precise standards of conduct for directors, as in the context of internal control systems and defenses against takeover attempts, is that they apply to "a context in which monitoring, oversight, or the exercise of independent judgment by the corporation’s outside directors is especially critical").
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whether board members are in the position to effectively monitor the CEO. 75 In this respect, the new NYSE and NASDAQ listing rules have restricted, at least in theory, the selection of candidates for the position of director to the competences of Independent Directors. 76

Second, a CEO who also serves as the chairman of the board will be able to control, at least partially, the body that is supposed to monitor his actions. 77 The chairman of the board has control over the agenda, the information that supports it, and the schedule of meetings. Combining the role of CEO and chairman makes it less likely that directors will be in the position to monitor effectively and, if necessary, to challenge the CEO. Possible solutions for this problem include the appointment of an Independent Director as chairman and the designation of an Independent Lead Director to chair meetings of Independent Directors, as well as to serve as a liaison between the Independent Directors and the executives. 78 The new NYSE and NASDAQ listing rules require that Independent Directors meet regularly outside of the presence of management. 79 These meetings clearly promote a more open discussion among Independent Directors, who have the opportunity to express their views and concerns outside of the presence of the CEO.

More generally, when the board relies only on the information provided by the CEO, its ability to monitor the management effectively is impaired. 80 Particularly important is the access that directors have to lower management. 81

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76. See supra notes 36-37 and accompanying text.

77. See Bowen, supra note 61, at 86 (recognizing that a single CEO-chairman “deprive[s] the board of an important protection against abuses of power.”); Lorsch & MacIver, supra note 49, at 82-83; Monks & Minow, supra note 12, at 179-80 (noting that “when the chairman of the board is also the CEO, it makes management accountable to a body led by management.”); William R. Ide, Post-Enron Corporate Governance Opportunities: Creating a Culture of Greater Board Collaboration and Oversight, 54 Mercer L. Rev. 829, 840 (2003); Lin, supra note 39, at 914.

78. See Bowen, supra note 61, at 89-93; Gregory, supra note 44, at 15-18; Lipton & Lorsch, supra note 39, at 70-71. According to the 2003 Corporate Board Member study, 57.3% of the boards with CEO as chairman had a lead director. See Corp. Board Member, supra note 56, at 3.

79. See NASDAQ Marketplace Rule 4350(c); N.Y.S.E. Listed Co. Manual § 303A.03.

80. See In re Caremark Int’l Inc. Derivative Lit., 698 A.2d 959, 970 (Del. Ch. 1996) (“relevant and timely information is an essential predicate for satisfaction of the board’s supervisory and monitoring role...”); Lawrence L. Mitchell, Structural Holes, CEOs, and the Missing Link In Corporate Governance (George Washington Univ. Law Sch., Pub. Law Research Paper No. 77, 2003), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=467980 (discussing how structural deficiencies may allow the management to control and manipulate the information available to the board); Monks & Minow, supra note 12, at 174-75; Lin, supra note 39, at 914; Ide, supra note 77, at 838; see also Cox, supra note 32 (Professor Cox analyzes the issue in the context of special litigation committees and determination of fairness in merger transactions, using the information provided by legal counsel to the directors. He underlines the importance that the committee’s counsel be truly independent.).

81. Unless a subordinate manager has independent network ties to one or more of the independent
In this respect, the 2002 reforms failed to address the existing issues. The new obligations regarding certification of financial reporting by external auditors are important in this context, because the work of the auditors will guarantee, at least to a certain extent, the reliability of the information that the board receives. Nevertheless, no adequate action has been taken to ensure the overall quality and completeness of the information provided to the board.

As even the most recent definitions of Independence focus exclusively on the lack of ties between the directors and the company or its management, the 2002 reforms have generally failed to give adequate consideration to the additional personal characteristics and structural conditions necessary for a director to be an effective monitor of management. It therefore appears that the job of fully realizing the beneficial role of the Independent Directors is far from finished.

IV. AUTONOMY v. INDEPENDENCE

A. The Concept of Autonomy in Contemporary Philosophy

Independence is traditionally defined as freedom from the control or influence of others. Although common dictionaries report the two words as synonyms, contemporary studies of philosophy have distinguished the concept of “independence” from the more inclusive concept of “autonomy,” which encompasses both freedom from interference and a positive aspect of self-governing. Independence is therefore viewed as a condition necessary but not sufficient for autonomy. Because “the notion of autonomy is utilized in various contexts in ways that suggest it names a cluster of disparate concepts,” I will...
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first clarify the concept of autonomy upon which this Article will rely.87

One account of personal autonomy focuses on the internal psychological processes of the individual and seems, therefore, to be of little help in legal analysis. This theory is based on the works of Harry Frankfurt and Gerald Dworkin, who elaborate a distinction between first-order desires (those upon which a person acts) and second-order evaluation of first-order desires.88 According to Dworkin, to be autonomous, a person must be able to reflect critically on his own first-order desires as well as to have some capacity to alter them.89 The higher-order evaluation, furthermore, must satisfy “conditions of procedural independence” in that it must not be influenced by external factors to the point where it cannot be considered the person’s own.90 As long as a person chooses his first-order desires freely, he is autonomous; even a person who lives under the control of others will be considered autonomous if living in such a way is the result of his own act of volition.

A second conception of autonomy considers not only individual volitional choices, but also the ability of the individual to act on such choices, as affected by the characteristics of both the person and the environment in which he acts. Because of its broader scope, this Article will rely on this account of autonomy as a helpful conceptual tool in the analysis of the role of Independent Directors within the corporate governance system. This conception of autonomy, embraced by Robert Young as well as others (some with minor variations), considers “autonomous” a person who not only formulates his life plan in accordance with his own values and desires, but also carries through with it. “Autonomous” identifies a person who chooses a course of action in a non-coerced and conscious manner, who has the capacity and opportunity to pursue such a course of action free from constraints, and who actually pursues it.91 As a consequence, “to be autonomous is not merely to have a capacity, nor the

87. John Christman, Introduction, in THE INNER CITADEL: ESSAYS ON INDIVIDUAL AUTONOMY 3 (John Christman ed., 1989). For example, Joel Feinberg illustrated how the word “autonomy” may refer to four different concepts: the capacity to govern oneself, the condition of governing, the character ideal, which stems from the concept of autonomy as a condition, and the right to be autonomous. Joel Feinberg, Autonomy, in THE INNER CITADEL: ESSAYS ON INDIVIDUAL AUTONOMY 4.
88. See DWORKIN, supra note 86 (using the example of a person who has a first-order desire to smoke but at the same time a second-order wish not to have such desire); Harry G. Frankfur, Freedom of the Will and the Concept of a Person, in THE INNER CITADEL: ESSAYS ON INDIVIDUAL AUTONOMY 63.
89. See DWORKIN, supra note 86, at 15-18.
90. Id. at 18 (listing manipulation, hypnotic suggestion, and coercion as examples of causes of lack of procedural independence).
91. See KUPFER, supra note 86; YOUNG, supra note 86, at 37 (“The autonomous person orders his (or her) life according to a plan or conception which fully expresses his own will.”); Oshana, supra note 86, at 99-126. Cf. DIANA T. MEYERS, SELF, SOCIETY AND PERSONAL CHOICE (Columbia University Press 1989) (considering “autonomous” a person who has autonomy competency, i.e., a repertory of skills necessary for self-governance, not impaired by either internal or external factors); RAZ, supra note 86, at 372 (for whom the necessary conditions of autonomy are mental abilities, independence as freedom from influence of others, and an adequate range of options).
opportunity to exercise a capacity. Autonomy is an exercise-concept . . . "92

To achieve autonomy, a person needs to be free from constraints and to have the positive qualities necessary to formulate and pursue his own goals. These positive qualities include self-awareness and rationality. Self-awareness permits a person to be immune from manipulation by others. Rationality is needed to make the valid judgments necessary to successfully devise and carry out one's goals. This theory also calls for the absence of what Joel Feinberg classified as external and internal (positive and negative) constraints;93 an autonomous person will be free from either type.94 Internal constraints include weakness of will, deficiencies in talent or skills, neurosis, or addiction. External constraints are lack of opportunities and resources, and subjection to the control or influence from others (i.e., lack of independence).95 Clearly, independence, defined as freedom from others' influence, is just one of the preconditions of autonomy. A person will be able to both elaborate and pursue his objectives only when all of the conditions for autonomy are satisfied.

One final elaboration of the concept of autonomy seems noteworthy for our purposes. Lawrence Haworth has addressed the issue of how the environment of social institutions, including the family, the church, and also large corporations, affects personal autonomy.96 He concludes that institutions are neutral with respect to autonomy; that is, depending upon their structure, they may either be receptive to autonomy or limit it. Haworth does not identify a specific structure which would enhance autonomy.97 However, he acknowledges that "[a] fuller account of domains for autonomy would identify the elements of a social structure that affect development of people's capacity for autonomy and their motivation to exercise that developed capacity . . . ."98

Upon examination of the concept of autonomy as it relates to Independent

92. YOUNG, supra note 86, at 49. The view that a person is autonomous only if he actually exercises his ability to be autonomous is shared by KUPFER, supra note 86, at 28-29; MEYERS, supra note 91, at 87; RAZ, supra note 86, at 371-73; Oshana, supra note 86, at 100-02. But see LINDLEY, supra note 86, at 68-69 (distinguishing between being autonomous, as possessing "certain intellectual and practical capabilities" from actually exercising autonomy).

93. See JOEL FEINBERG, SOCIAL PHILOSOPHY 13 (1973). Kupfer, Young and Oshana all adopt the categories of internal and external constraints. See KUPFER, supra note 86; YOUNG, supra note 86; Oshana, supra note 86. Meyers analyzes the internal and external factors that may prevent a person with competency autonomy from being autonomous. See MEYERS, supra note 91, at 89.

94. Young recognizes that whether one approaches the conditions to autonomy in terms of absence of constraints or presence of positive qualities is not crucial, being "often a matter of perspectives . . . ." YOUNG, supra note 86, at 35. For example, strength of will could be considered as a positive requirement for autonomy, and weakness of will could be an internal obstacle to it.

95. In this regard, Oshana focuses on the necessity that a person's social-relational conditions provide an adequate opportunity to be autonomous. A person "must find herself within a set of relations with others that enable her to pursue her goals in a context of social and psychological security." Marina Oshana, Personal Autonomy and Society, 29 J. SOC. PHIL. 81, 94 (1998).

96. HAWORTH, supra note 86.

97. Haworth only discusses traits of the institution that affect autonomy, such as flexibility, accessibility, and controllability. Id. at 113-19.

98. Id. at 119 (citation omitted).
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Directors in the next section, it becomes clear that the identification of the structural conditions of autonomy is indeed one of the objects of this Article.

B. Autonomy, Independence, and Corporate Governance

The corporate governance system has embraced the notion that the presence of Independent Directors on company boards is important to achieving good governance. Statutory rules and case law, moreover, give special deference to certain decisions made by Independent Directors in a number of different contexts. This approach stems from the idea that a director's independence ensures that he will properly discharge his duties, and in particular, that he will be an effective monitor of management. Accordingly, the definition of Independence serves to identify persons who are truly free from constraint or influence by the corporation and its management.

Such reliance, however, is unjustified. In light of the conceptual categories discussed above, independence alone is not sufficient for a director to effectively carry out his responsibilities. To formulate and achieve his objectives, an individual needs to have certain additional personal characteristics, and he must act within a context that provides him with the opportunity to exercise autonomy. Thus, the current definition of Independent Director is misleading because it purports to identify someone who will be an effective and therefore trustworthy director, but the requirements of the definition are inadequate for this purpose. This shortcoming is very dangerous because the governance system mistakenly relies upon individuals to have qualities of autonomy by virtue of meeting the definition of independence. Since Independent Directors are often the primary means of protecting shareholders' interests, it follows that in many situations the shareholders in fact have little or no protection.

Governance rules should instead adopt a definition of Independent Director that contains all of the requirements necessary to identify what "Independent Director" is intended to signify: an autonomous director. 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. It should also account for structural and procedural elements that may affect the director's ability to act. Only a person who satisfies all of the conditions for autonomy will be reliable as a director who will set his own objectives and effectively pursue them to satisfy his obligations under the law. This conclusion is

99. See supra, Part II.
100. It seems appropriate to clarify that when we apply the theory of autonomy to the actions of corporate directors, we recognize that corporate law sets the values upon which directors act as well as the ultimate goals that they try to achieve. Within those limits, however, the system relies on them as actors that operate autonomously in formulating their own intermediate goals and take appropriate
consistent with the views that question the positive role of Independent Directors because of their lack of motivation, competence, and time, as well as because of structural barriers. As discussed in Part VI, the suggested definition of Independent Director relies on many of the requirements that scholars and practitioners have indicated as necessary for making a director trustworthy.

Before attempting to identify the conditions of autonomy, I would like to make one additional remark. Only Independent Directors should be required to possess the suggested qualifications. This approach finds its roots in recognizing that the structure of each company’s board varies depending on the role with which the directors are entrusted. Although the monitoring role may be dominant, the board must also carry out strategic and resource-gathering duties. “[B]oards are expected to perform multiple roles, with the effective performance of these roles requiring different types of directors. Some boards perform some roles better than others, depending on their composition.” The proposed definitions target individuals who will efficiently perform the monitoring role. Not all of the requirements should be imposed on the entire board.

C. The Conditions of Autonomy

As it has long been recognized, Independent Directors should be free from ties that may impair their freedom of action and should possess personal attributes necessary to discharge their duties effectively. In particular, they ought to be motivated, competent, and able to devote the necessary time to their office.

More is needed, however: the environment in which Independent Directors operate should provide them with adequate resources and opportunities. First, the directors should have access to complete and accurate information, which actions accordingly.

101. See Fisch, supra note 13, at 284 (“Ideal board structure . . . depends on board function. . . . [C]ompanies can have very different needs from their boards of directors, and . . . a universal model board may be incapable of meeting those needs.”) (footnote omitted).

102. Dallas, supra note 11, at 815.

103. This suggests that a director who does not possess all of the requirements necessary to be autonomous may still be capable of effectively performing roles other than monitoring. For example, to provide strategic support to the board, a director who is also the CEO of another company may not need to have access to company information to the same extent as an Independent Director. Where the CEO has an honest interest in utilizing the director’s advice, he would provide the director with all of the information he needs. If the CEO failed to submit a certain strategy to the board’s attention or tried to manipulate the director by taking advantage of his informational advantage, the Independent Directors would be able to intervene and address the problem, as they would have access to all of the necessary information to monitor the CEO. Furthermore, for resource-gathering purposes a company could benefit from having on its board a prominent public figure, although he may devote only limited time to his work as a director.

104. The ties may be economic as well as personal, such as friendships and relevant social ties. Indeed any relationship that could reasonably result in an improper restraint of a director’s actions should be taken into consideration. Cf. supra Part III.A.
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they should receive in a timely manner and in a workable form. They should be able to request and receive specific data as well as follow-up information. Their sources should not be limited to the top management, because CEO control over informational routes undermines the directors’ ability to receive complete and accurate data, thus giving the CEO a position of dominance over the board.\textsuperscript{105} Instead, the directors should be able to access relevant information from different sources at all hierarchical levels, within and outside the corporation.\textsuperscript{106}

Second, Independent Directors should have the resources to elaborate and formulate proposals about the information received. It is unreasonable to believe that one individual, devoting a limited amount of time to this activity, can properly perform such tasks in conjunction with the operations of a large public company. Instead, directors should have access to all financial, human, and institutional resources they may need.

Third, directors should have the necessary opportunities and powers to operate. They must be able to articulate their positions not only during board meetings, but also in preparation thereof, and propose actions they deem necessary.\textsuperscript{107} To this end, they should be able to access the rest of the board before meetings and should actively participate in preparing meeting schedules and agendas. Furthermore, the composition and voting procedures of the board should put them in the position to determine the outcome of deliberations.

Fourth, directors’ ability to act should not be impaired by indirect constraints arising from within the corporation. If the CEO, or other executives, have the power to affect directors’ status within the corporation, directors are not in the position to freely take advantage of any power and opportunities provided to them. Management should not have any influence over the nomination of directors, their remuneration, or any other sources of direct or indirect power over them.

Finally, there is a necessary corollary to the above conditions: Independent

\textsuperscript{105} See Mitchell, supra note 80; GREGORY, supra note 44, at 39-40; see also Ide, supra note 77, at 838-39 (suggesting that the heads of each corporate division/department meet regularly with the board or its committees), 867 (suggesting that the board have access to the various “service” functions of the corporation such as finance/accounting, legal, regulatory/compliance, and human resources, and that reporting be directed upstream to the head of the respective function that should then report to the board); Lipton & Lorsch, supra note 39, at 71-72. Interestingly, the words that Young uses with regard to autonomous individuals aptly describe the approach corporate directors should take. See YOUNG, supra note 86, at 12. “[T]hose who draw invalid inferences or make use of incomplete or partially reliable information are likely to suffer in their overall autonomy . . . . Autonomous persons, then, do not accept what they are told without any reason, or with too little reason to regard the testimony as reliable.” Moreover, “where there is antecedent ground for doubting the impartiality of a particular investigation or source of information, autonomous persons must quite literally make up their own minds in light of the total available evidence.” Id at 13.


\textsuperscript{107} See id. at 108.
Directors should be able to control their position within the institutional environment. By this, I mean that they should determine the company-specific arrangements concerning their roles and powers. Within the limits of mandatory rules, each company will choose and adapt governance structures and procedures to fit its specific needs. This gives each corporation a certain degree of discretion, which extends to the arrangements concerning the Independent Directors. The Independent Directors themselves should control the exercise of such discretion. They should be in charge of implementing the structural and procedural solutions that satisfy the conditions of autonomy such as access to resources, salaries, manners of interaction with other directors, and access to information inside and outside the corporation. Without this specific power, even an organizational layout that might in principle foster directors' ability to act could be ineffective in practice.

V. REALIZING THE CONDITIONS OF AUTONOMY

A. Directors' Personal Attributes

I will first address elements pertaining to the individual serving as a director, regardless of his position within the corporation. Nonetheless, one should be mindful that the personal attributes of the Independent Directors are necessarily affected by the structural settings in which they operate. At the same time, an individual's capabilities may overcome structural barriers within a corporation. These two aspects of the directorial function are deeply intertwined and should not be considered as if one were independent from the other.

An Independent Director should have no personal or economic relationships that could impair his ability to act. In this regard, I believe that relevant ties are not only those 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. In addition to identifying a number of specific types of connections that would normally endanger the director's independence of judgment, the existing Independent Directors should affirmatively determine that a candidate director has no other relationship that, regardless of its nature, could have such an effect. This open-ended approach allows all ties to be taken into consideration, including personal friendships and social links that might have a material influence.

A very important concern is to identify directors who possess the necessary motivation to discharge their duties effectively. The solution traditionally

108. Cf. HAWORTH, supra note 86, at 113-19 (suggesting that one of the conditions of an institutional autonomous task environment is controllability, the ability to control that environment).

109. This is the approach adopted in the NYSE and NASDAQ listing rules. See supra note 35.
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proposed in this respect is compensating the director in part with company stock. The director’s long-term financial interest in the company allegedly gives him the incentive to actively monitor management.\textsuperscript{110} Empirical studies suggest that stock ownership improves director-monitoring ability.\textsuperscript{111} To render this solution more effective, additional requirements can be added. Directors should not be able to sell the stock until a number of months after leaving the company.\textsuperscript{112} Moreover, they should not be permitted to use derivative transactions to eliminate or reduce the risk of price fluctuations.\textsuperscript{113}

Remunerating directors with corporation equity has become common practice. This solution alone, however, has not guaranteed that directors are adequately active and motivated in performing their duties. After elaborating the structural and procedural arrangements that should provide Independent Directors with the necessary resources and opportunities for action, in Part V.D I suggest a procedural solution that addresses the problem of director motivation and active participation.

Independent 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, and whether he is also a member of a particular committee.\textsuperscript{114} In this case as well, existing Independent Directors

\textsuperscript{110} See R. Franklin Balotti et al., Equity Ownership and the Duty of Care: Convergence, Revolution, or Evolution?, 55 BUS. LAW. 661 (2000) (providing a review of judicial decisions giving consideration to director substantial stock ownership and proposing an equity-based presumption of care within the context of directors’ fiduciary duties); Elson, supra note 43, at 165-66; Langevoort, supra note 7, at 806; see also NACD, REPORT OF THE NACD BEST PRACTICES COUNCIL: COPING WITH FRAUD AND OTHER ILLEGAL ACTIVITY 16 (1998).

\textsuperscript{111} Sanjai Bhagat et al., Director Ownership, Corporate Performance, and Management Turnover, 54 BUS. LAW. 885, 918-19 (1999).

\textsuperscript{112} See RICHARD C. BRENTON, RESTORING TRUST, REPORT TO THE HON. JED S. RAKOFF ON CORPORATE GOVERNANCE FOR THE FUTURE OF MCI, INC. 79 (2003), available at http://www.nysd.uscourts.gov/rulings/02cv4963_082603.pdf; GREGORY, supra note 44, at 27-28; LORSCH & MACIVER, supra note 49, at 176-77 (suggesting that directors be remunerated with stock options that vest “the fifth to ninth year out”) (footnote omitted); MONKS & MINOW, supra note 14, at 216 (suggesting “the use of awards of restricted stock vesting 12 to 36 months after the director retires from the board” because directors could “attempt to engineer a short-term increase in the stock price at the sacrifice of long-term viability for the company … “)); Elson, supra note 43, at 131,134. Elson argues that in order to make outside directors “substantial shareholders” and create an incentive for them to “examine questionable management initiatives with the vigorous, independent, and challenging eye of an owner,” outside directors should be compensated with company stock that they cannot sell during the term of their office.


\textsuperscript{114} See JAY A. CONGER ET AL., CORPORATE BOARDS: STRATEGIES FOR ADDING VALUE AT THE TOP 39-43 (2001); GREGORY, supra note 44, at 9-10; cf BRENTON, supra note 112, at 40-41 (suggesting a skill set that each director should possess).
should be required to make a positive determination that the candidate possesses the necessary competence. To ensure that a director dedicates sufficient time to his responsibilities, there should be a maximum number of boards on which the director may sit, which would vary depending on whether a director also has a full time job or other commitments. Serving on a special committee should count as an additional commitment.

B. The Independent Director Staff

1. The Central Role of the Independent Director Staff

I believe that the autonomous action of Independent Directors would greatly benefit from the support of a staff of their own. The staff (to which I will refer as the Independent Director Staff or IDS) should be composed of a group of professionals working under the exclusive control of the Independent Directors and not subject to the authority of the CEO. This idea is not new; however, not only has it long been forgotten within the context of traditional corporations, but more importantly it has never been developed to its full potential. By applying Organizational Design concepts, I will propose an IDS that would enhance the structural autonomy of Independent Directors and mitigate the shortcomings related to their competence, their motivation, and the time that they dedicate to their duties.

Among the benefits that establishment of the IDS would bring about, the most important would be the flow of information generated between the

115. Directors, once elected, should also be required to participate in education and training programs. These programs allow directors to acquire specific knowledge about the industry in which the company is active and to become familiar with the corporation as well as with their own role and legal obligations. See BRENTON, supra note 112, at 36; GREGORY, supra note 44, at 13-14.

116. According to the 2003 Corporate Board Member study, the mean of hours spent on board matters, including meeting attendance, preparation time and travel is 19.2 per month. CORP. BOARD MEMBER, supra note 56, at 3; see also BRENTON, supra note 112, at 63-64; CONGER ET AL., supra note 114, at 45-46; GREGORY, supra note 44, at 28; LORSCH & MACIVER, supra note 49, at 192 (suggesting instead that "directors stipulate...that they will have adequate time to serve"); E. Norman Veasey, An Economic Rationale for Judicial Decisionmaking in Corporate Law, 53 BUS. LAW. 681, 699 (1998) ("The directors should limit to a reasonable number the major boards on which they serve. What is a reasonable number depends on the extent to which each director is able to carry out his responsibilities to each board in a professional manner.") (citation omitted).

117. The idea was first advanced by Arthur J. Goldberg, Debate on Outside Directors, N.Y. TIMES, Oct. 29, 1972, at F1. It was then taken up by Professor Harvey Goldschmid and by Ralph Nader and Christopher Stone. See Symposium, The Greening of the Board Room: Reflections on Corporate Responsibility, 10 COLUM. J.L. & SOC. PROBS. 15, 27-28 (1973) (statement of Harvey Goldschmid); RALPH NADER ET AL., TAMING THE GIANT CORPORATION 121 (1976); CHRISTOPHER D. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR 148-49 (1975). Recently, the S.E.C., as a condition for benefiting from certain exemptions, has required mutual funds to authorize their Independent Directors to hire their own staff. See supra note 30 and accompanying text.

different organizational units of the corporation and the Independent Directors. Each company should establish an IDS along an independent hierarchical line separate from the company’s management and other employees. The IDS would be under the exclusive control of the Independent Directors but would work in collaboration with the rest of the corporation. This would allow Independent Directors to create and have access to channels of communication throughout the corporation at different organizational levels. To this end, the IDS should be able to access any unit within the different divisions of the corporation to obtain whatever information the Independent Directors may need. While it should be the general obligation of all units to provide the IDS with the necessary support, the IDS should not have the authority to enforce such obligations or compel others to comply with its demands for collaboration. At the same time, the IDS should notify the CEO of any such request, and the CEO should not have to worry about Independent Directors acting behind his back. Maintaining trust between the CEO and the directors is an essential ingredient of a successful corporate board.

For these informational routes to work, it is necessary to elaborate a structural design that not only ensures the cooperation of the various units, but does so without interfering with the CEO’s authority over his subordinates. For this purpose, I draw on Organizational Design studies on linkages between separate, but interdependent, organizational units. To facilitate the exchange of information, organizations can utilize lateral linkage devices such as liaison positions, indirect hierarchical solutions, task forces, standing committees, integrating managers, and matrix structures. These organizational tools can be utilized to elaborate a solution applicable to the IDS.

In light of the suggested structural position of the IDS, I suggest the use of a set of integrating mechanisms consisting of liaison roles, a hierarchical solution, and in limited cases, task forces. Within the hierarchical structure of

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119. Justice Goldberg, supra note 117, suggested in his original formulation of the idea that the staff be “assured of full and complete cooperation from management and from lower-level employees in filling requests for information.” An unlimited right to collaboration, however, is not advisable. In practice, it would result in altering the hierarchical line existing within the corporation by subjecting all units to the direct control of the IDS and the indirect control of the Independent Directors, even if only for purposes of information gathering. Such a solution would probably undermine the CEO’s de facto control over management.

120. Organizational Design has analyzed the problem of ensuring collaboration between units that need to exchange information to perform their work, but are not in a direct hierarchical relationship which gives any of them the authority to compel the other to collaborate. See, e.g., Jay R. Galbraith, Organization Design: An Information Processing View, in ORGANIZATIONS BY DESIGN: THEORY AND PRACTICE 496 (Mariani Jelinek et. al eds., 1981); HENRY MINTZBERG, THE STRUCTURING OF ORGANIZATIONS 162-63 (1979); NADLER ET AL., supra note 118, at 96.

a corporation, the IDS would be vertically linked to the Independent Directors. All of the other units would be located within a structure, with the CEO at the top. The Independent Directors and the CEO both serve on the board of directors, which has ultimate control over the entire corporate structure. It is not advisable that the board directly interfere with the hierarchical lines that link the CEO with the rest of the corporation. The IDS on one side, and any of the other organizational units on the other, should be located on different hierarchical lines, which, while they might eventually converge at the top, are mutually independent at lower levels.

The primary means of enhancing the flow of information is establishing liaison positions within the IDS and in each of the other organizational units. As a general matter, the individuals working in such roles organize and facilitate collaboration between units, including the exchange of information, without having the authority to impose their decisions on their counterparts. The establishment of such a formal position carries with it a number of benefits. First, the direct linkage between the source of information and the recipient improves the timeliness of the information and decreases the likelihood of its distortion. Avoiding going up and down the hierarchical line facilitates communication. This linkage device is inexpensive because it requires only the part-time attention of a few persons without any need of an additional organizational structure. When the liaison role is assigned to individuals with a lower status in the organization, those individuals find themselves in a better position to absorb frictions and maintain good working relations between the higher-level members of the different hierarchical lines. Finally, the establishment of open channels of communication between the liaison individuals facilitates the development of personal relationships, which in turn increases frankness and openness in communication.

The establishment of liaison positions alone, however, will not always guarantee the necessary flow of information. Two principal factors might contribute to a failure to collaborate. A liaison individual, or his unit, may be incapable of providing adequate assistance. Alternatively, management may

122. See NADLER, supra note 118, at 96 ("[Liaison roles] serve as sources of information and expertise and as contacts and advisers on work involving their respective groups. In essence, they serve as information conduits deep within the organization. . . . The Liaison role is not usually a full-time responsibility but rather is done in conjunction with other activities."") (illustration omitted); see also MINTZBERG, supra note 120, at 162-63.


124. DANIEL ROBEY, DESIGNING ORGANIZATIONS 244 (2d ed. 1986); see also Galbraith, supra note 120, at 501 ("Liaison men are typical examples of specialized roles designed to facilitate communication between two independent departments and to bypass the long lines of communication involved in upward referral. Liaison roles arise at lower and middle levels of management.").

125. NADLER ET AL., supra note 118, at 102.

126. ROBEY, supra note 124, at 244.

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discourage him or his unit from providing full support to the IDS. The failure to collaborate may come about in two different forms. First, the information transmitted upon request for collaboration may be incomplete or incorrect. Second, the unit might squarely withhold information unknown to the IDS.

To remedy these failures, corporations should supplement the liaison roles with a procedure that relies on the hierarchical links of the different units. A common solution to integration problems is to report them up along the hierarchical chain until they reach the organizational unit that can resolve the conflict. If the unit’s failure to collaborate is due to lack of professional skills, the problem would probably be solved with the input of the manager in charge of the unit division, avoiding any need to go further up the line. The real problem arises when a unit withholds information for "political" reasons. In this case, reporting the problem to the top management, which was probably the cause of the failure to collaborate in the first place, would probably not be the proper solution. Instead, the conflict should be referred to the top of the corporate hierarchical structure and should therefore be presented to the board of directors.

Bringing the issue before the board creates a risk of undermining the authority of the CEO and management in general. I believe, nonetheless, that in practice this procedure would be effective and would intrude upon the CEO's power relationships to an acceptable extent. Both the Independent Directors and management would work hard to solve the conflict in order to prevent it from reaching the board. Both parties would naturally be aware of the damaging effect that such a confrontation could have upon the working relations within the board. In addition, the failure to solve the problem would probably reflect negatively on the professional skills of the individuals handling the conflict on both sides at a lower level, who would therefore have an additional incentive to solve it. The CEO, moreover, might have good reason to withhold full collaboration and thus might be able to convince the directors to accept his decision, possibly even before the matter reaches the board. Ordinarily, this procedure would preserve the effectiveness of the corporation’s hierarchical structure. The only individual with the authority to give lower management and other employees a direct order to collaborate would remain the CEO. Neither the Independent Directors—directly or through the IDS—nor the board, would have such power.

It is still possible that the board would compel the CEO to order his subordinates to cooperate fully. That, however, would happen only if the CEO were not able to convince the board of the wisdom of his point of view, and both parties were not willing to back down from their positions, even at the risk.

128. See NADLER ET AL., supra note 118, at 95-96; Galbraith, supra note 121, at 110.
of disrupting working relations and undermining the authority of the CEO. This would happen only in extreme cases, in which a drastic intervention on the part of the board would not only be acceptable, but also advisable.

The above procedure would not work where Independent Directors and the IDS were not aware of the existence of relevant information. However, they would have the ability to create channels of communication that could directly reach any of the corporate divisions at different hierarchical levels and could thus gain access to all of the necessary information. Although the top management could firmly control those channels, its ability to successfully keep information concealed from the Independent Directors would be dramatically diminished because of the numerous informational routes and because of the personnel working within them.

In exceptional cases, such as corporate reorganizations or acquisitions, as well as during financial and operational crises, a member of the IDS could join the task force set up by management to work on the matter, and allow Independent Directors to have direct access to pertinent information. Through the IDS, the Independent Directors would obtain first-hand information in a timely manner, and be in the position to properly evaluate the appropriate actions under the circumstances.

2. The Multiple Benefits of the Independent Director Staff

The suggested establishment of the IDS would provide the Independent Directors with the informational strength necessary for autonomous action. The IDS could also aid the Independent Directors in many other respects. The IDS could serve as an institutionalized memory of the governance issues specific to each corporation. Both the specific personnel and the office as an organizational unit could be an important means of preservation and transmission of previous experience to new Independent Directors. Veteran members of the IDS would assist new directors in elaborating proposals for those governance arrangements that, as we will discuss in Part V.E, should be within the control of the Independent Directors.

The IDS would be able to elaborate on the information that the Independent Directors receive directly from management. The IDS would also make sure that the information was presented in workable form and received in a timely manner before board meetings. It could also request follow-ups and clarifications and allow directors to communicate and exchange information among themselves well in advance of meetings. The IDS, moreover, would assist Independent Directors in performing any additional tasks that are part of their duties, and facilitate control over the implementation of board

129. On the role of task-forces as a lateral linking device, see MINTZBERG, supra note 120, at 163-64; Galbraith, supra note 120, at 501-02.
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decisions. The IDS would also limit the directors' deficiencies related to personal attributes. The Independent Directors would greatly benefit from the competence and experience of the professionals on their staff. The IDS would also relieve the directors of part of their workload, easing the problems created by lack of time availability. Finally, the establishment of the IDS would indirectly cause directors to be more active and involved in the corporation's affairs. The IDS, in fact, would require input and direction from the Independent Directors; this would create a constantly open channel of communication between the directors and the corporation, leading directors to be more heavily engaged in their institutional roles.

Creating the IDS would have one additional important effect on the work of the Independent Directors: the formation of an evidentiary trace having important repercussions on the courts' application of fiduciary standards. What is now a job performed exclusively by one individual, albeit within the context of the entire board or one of its committees, would be performed with the assistance of a team of people. Consequently, evaluative and decisional processes that are now confined within the sometimes inscrutable mind of the director would be "externalized" and developed along the lines of interaction between the directors and the professionals supporting their work. In many instances, the ability to observe the processes behind directorial action, or failure to act, would make it possible to express a much more informed judgment on its appropriateness. Without reaching the substance of the decisions, the duty of care could expand to include additional specific obligations in regard to the mechanics of such processes. The duty of good faith could also be at issue in situations where the directors unreasonably disregard information from the IDS.

C. The Latest Structural and Procedural Solutions

Some additional structural and procedural solutions seem necessary to provide Independent Directors with sufficient powers and opportunities to act. As commentators have discussed these solutions at length, I will only give them cursory attention. First, as currently required by NASDAQ and NYSE listing rules, boards should be composed of a majority of Independent Directors. Such an arrangement gives the latter the necessary decision-

130. See STONE, supra note 117, at 148-49.
131. The IDS could also include a corporate governance expert, who would give the directors support in dealing with the various issues related to their role and obligations.
133. See NASDAQ Marketplace Rule 4350(c); N.Y.S.E. Listed Co. Manual § 303A.01. On the
making power. Furthermore, Independent Directors should regularly hold separate meetings apart from management and inside directors.\textsuperscript{134} These meetings should be regularly scheduled so that they will not be perceived as unusual or threatening.

Independent Directors should also exercise greater control over board meetings. They should participate in developing the schedule and the agenda for the meetings, as well as have some control over the information provided in support thereto.\textsuperscript{135} I do not believe that any particular structure, such as the designation of a leading Independent Director or the appointment of an Independent Director as chairman, should be preferred.\textsuperscript{136} Rather, companies should be free to find the solution that best fits their needs.\textsuperscript{137} Independent Directors should also have the ability to hire outside experts and have access to independent counsel.\textsuperscript{138}

Finally, in order to prevent informal constraints on Independent Directors’ actions, decisions regarding their nomination and compensation must be strictly reserved to a committee composed exclusively of other Independent Directors. The CEO or any other member of the management should not have any control or influence over such decisions.

\textbf{D. Independent Director Confirmation}

Lack of motivation and active involvement remains one of the open issues in the work of Independent Directors. Equity ownership, the solution traditionally advanced in this respect, does not constitute the definitive answer to this problem.\textsuperscript{139} In this section, I elaborate a procedural device consisting of a confirmation process of newly elected directors, which I believe has the potential to provide an effective tool for identifying motivated and active

benefits of having a majority of independent directors on the board, see Chhaochharia & Grinstein, \textit{supra} note 38, at 9; \textit{Developments in the Law—Corporations and Society, supra} note 47, at 2195.

134. \textit{See Brenton, supra} note 112, at 35; \textit{Gregory, supra} note 44, at 33-34; Veasey, \textit{supra} note 116, at 699. According to the 2003 Corporate Board Member study, 50% of the companies that participated in the study held meetings quarterly and 7.8% never held meetings at all. \textit{Corp. Board Member, supra} note 56, at 2.

135. \textit{Gregory, supra} note 44, at 41-42.

136. \textit{See, e.g., id.} at 15-16 (noting codes of best practices leave the adoption of such solutions to the discretion of each corporation). \textit{See also Bowen, supra} note 61, at 87; \textit{Brenton, supra} note 112, at 49-51.

137. I believe that a minimum number of meetings per year should be mandated regardless of director Independence. Frequent meetings seem to be necessary for any director to be effective. \textit{See Lipton & Lorsch, supra} note 39, at 69-70.

138. \textit{See Gregory, supra} note 44, at 57-58; \textit{see also} Cox, \textit{supra} note 32, at 1090 (maintaining that, whenever an Independent Director has to decide a conflict of interest situation involving management or the controlling shareholders, those advising the directors should also obey independence standards); Greg Rogers, \textit{How the Outside Can Help the Inside, 13 Bus. L. Today} 51 (2004); \textit{cf. 17 C.F.R. \S \textsuperscript{240.10A(b)(4)} (providing public companies audit committees with the authority to hire “independent counsel and other advisers” as they deem necessary to discharge their responsibilities).}

139. \textit{See Stout, supra} note 62, at 3-5.
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directors.
The philosophical conception of autonomy adopted by this Article considers "autonomous" individuals who not only have the capacity and the opportunity to exercise such capacity, but who also actually exercise it.\textsuperscript{140} Thus, the most effective test to assess whether an individual should be considered autonomous is to see whether he acts in such a manner. With regard to a corporate director, such a determination should be made on the basis of the person's actual conduct on the board. In practice, corporations could achieve this result by adopting a procedure requiring each director elected as Independent to undergo an evaluation process at the end of his first or second year in office. At such time, the current Independent Directors would determine whether the new director has proven himself to be sufficiently active and independent. The evaluation should be strictly limited to the autonomous quality of the director's work,\textsuperscript{141} the substance of his decisions should not be at issue. Only upon a positive finding could he be confirmed as an Independent Director.

At first sight, this procedure closely resembles current evaluations of directors in their individual capacity.\textsuperscript{142} Thus far, such processes have largely failed to keep ineffective directors off the board.\textsuperscript{143} Upon closer examination, however, it becomes clear that the suggested procedure is immune to the many shortcomings of current evaluations. Furthermore, it has the potential to become an effective procedural tool for improving the performance of Independent Directors while creating a positive dynamic within the board.

Many different factors prevent current director evaluations from being a widespread and successful means of preventing the reelection of ineffective directors.\textsuperscript{144} First, generally all of the directors are evaluated at the end of each year, or near the end of their term. The frequency and the generality of the evaluations increase the likelihood that directors will wrongly perceive evaluation as a routine procedure or formality bearing little importance.\textsuperscript{145}

\textsuperscript{140} See supra notes 91-92 and accompanying text.
\textsuperscript{141} In this context, by independent I mean that the director's decisions are made on the basis of an evaluation process that is not entirely dependent upon the input and information received from the CEO.
\textsuperscript{142} On director evaluations, see TOOTH & BOOTH, supra note 50, at A-12; Ide, supra note 77, at 859; Katherine M. Sullivan & Holly J. Gregory, Message to Boards: Assess Yourself, 1053 PRACTICING L. INST., CORP. L. AND PRAC. COURSE HANDBOOK SERIES 155, 163 (1998).
\textsuperscript{143} Statistics indicate that only 24% of U.S. boards have ever asked a director to resign for poor performance. See KORN/FERRY INTERNATIONAL, ANNUAL BOARD OF DIRECTORS STUDY 23 (2001); Jeffrey A. Sonnenfeld, What Makes Great Boards Great, 108 HARV. BUS. REV. 106, 113 (2002) ("I can't think of a single work group whose performance gets assessed less rigorously than corporate boards.").
\textsuperscript{144} Only 19% of boards in the U.S. are evaluated individually. See KORN/FERRY INTERNATIONAL, supra note 143, at 23.
\textsuperscript{145} See CARTER B. COLIN & JAY W. LORSCH, BACK TO THE DRAWING BOARD 127 (2003) (discussing how the excessive frequency of the evaluations reduces their effectiveness).
Next, the process generally aims at assessing whether each of the board members is effective as a director overall, and whether his presence is beneficial to the work of the board. This evaluation generally relies upon the personal perceptions of the other directors. The broad scope and the subjective basis of this process make it more difficult to reach a conclusion that a director is clearly ineffective and should not be reconfirmed to the board.

Third, the fact that all of the directors evaluate each other creates a dynamic that does not foster open and truthful assessment. Each director must judge the work of his peers, with whom he has often been serving on the board for several years. Directors, furthermore, may be disinclined to give frank and open evaluations to avoid preventing the development of trust and collaboration among directors and thereby damaging the board's working environment. Studies of groupthink show in fact that these evaluations have a negative impact on intra-group relations. More importantly, I believe that few people would give a negative evaluation, which could lead to the non-reelection of a director, knowing they could be the next to suffer the same fate the following year.

A final shortcoming is that the only meaningful sanction that can follow a negative evaluation is that the director concerned will not be selected to be a candidate for reelection. The harshness of this sanction makes it unlikely in practice that the other directors will be willing to espouse it. As a result, negative evaluations will likely only lead to a warning, which, although it might create some incentive to do better the following year, would nonetheless ultimately have little effect on removing inadequate or incompetent directors.

The proposed confirmation procedure not only appears generally immune from the problems described, but also has the potential to create a productive dynamic within the boardroom. First, only individuals recently elected to serve as Independent Directors would be subject to evaluation during their first or second year in office. The suggested process would take place less


147. Cf. CONGER ET AL., supra note 114, at 111-12 (for the proposition that universal evaluation criteria fail to recognize the value of the different manners in which a director may contribute to the work of the board).

148. See id. at 124 ("Every time we work with a board, we are told it is difficult to remove a director who is not pulling his weight. No one wants to be critical of a longtime colleague.... [D]irectors do not like to sit in judgment of their peers....").

149. See NAT'L ASS'N OF CORPORATE DIRS., REPORT OF THE NACD BLUE RIBBON COMMISSION ON DIRECTOR PROFESSIONALISM 18 (2001). On the damaging effect of peer evaluations to director cohesion within the board, see CONGER ET AL., supra note 114, at 111-2; WILLIAM A. DIMMA, EXCELLENCE IN THE BOARDROOM 55 (2002). See also Langevoort, supra note 7, at 810-11 (discussing the importance of collegiality in creating a better environment for productive work with respect to board of directors).

150. See O'Connor, supra note 59, at 1301-03 ("Literature on small group decision making, however, warns against such self-evaluations because it can undo the peerage of the group.").

151. A negative evaluation after the first year should not be determinative. If a director is not
frequently, and the directors would have to focus on the performance of only one or a few individuals. It would thus be likely that the directors would be more engaged in the confirmation process.

Second, the evaluation would be very specific: it would address only whether a director has proven to be active and independent. These are the attributes that, together with the others discussed throughout this Article, are necessary to make a director autonomous and therefore trustworthy. The existing Independent Directors would have the opportunity to assess what use the new director makes of all of his prerogatives. Confirmed directors could in fact observe the new director’s attendance and behavior within the board, on special committees, and during Independent Directors’ separate meetings. In particular, they could look at whether he carefully scrutinizes the proposals advanced by the CEO, and whether he requests or, when appropriate, proposes alternatives. The Independent Directors could also monitor the new director’s use of the power to seek information within the corporation, to access outside consultants and independent counsel, and to make requests regarding the schedule and agenda of board meetings. Finally, they could evaluate what use he makes of the IDS and how he interacts with it. All of these are reasonably verifiable elements that could form the basis of a sufficiently objective evaluation.

Next, this procedure would not impair the collaborative atmosphere within the board. Only the directors recently elected to serve as Independent would be subject to the confirmation process; it would not be a peer evaluation because the new director would have a status different from that of the other directors. Upon confirmation, a new member of the board would become a full-fledged Independent Director. If not confirmed as Independent but still reelected, he would probably not harbor any resentment because he would ultimately still be on the board.

Finally, a negative evaluation of the new director’s activeness and independence would not necessarily result in his failure to be selected for reelection. He could simply be denied the qualification as Independent. A director who is not truly an insider, but who is not qualified to be Independent either, could still be very helpful to the work of the board.\footnote{152}{See supra note 103.} The other directors could decide that an individual not confirmed as Independent should nonetheless continue serving on the board because, for example, of his ability to perform the strategic or relational role. The possibility to administer a less extreme sanction following a negative evaluation will make it more likely that the current Independent Directors would make proper use of the confirmation

\textsuperscript{152} See supra note 103.
procedure.

I believe that this solution could be very effective in practice. The existing Independent Directors would have a strong interest in confirming as their peers only individuals that are active and independent. They would indeed benefit from the new director’s active participation in managing the increasing Independent Director workload and in monitoring the CEO. Furthermore, the confirmation process would remind both old and new Independent Directors of their duty to be active and independent. In addition, the Independent Directors would feel partly responsible for ensuring that the new colleague adequately performs his directorial role. On the other hand, the possibility of an evaluation that may potentially lead to a meaningful sanction would provide the new director with a serious incentive to be proactive.

Although the procedure would subject the directors to scrutiny only during their first or second year, I believe that it would be effective beyond such a period of time. An individual, once proven to be an active and independent member of the board, will presumably continue working in the same manner throughout his permanence on the board. If a director substantially altered his behavior after having been confirmed, he would run a serious risk of not being selected as a candidate for reelection or of being reelected as a non-Independent Director. The new director’s work, moreover, would have a lasting beneficial effect on the work of the Independent Directors in two respects. First, the director would contribute to setting the proper tone on the board with respect to activeness and independence. Second, to be confirmed, he would make proper use of the powers and opportunities for action provided to him. By doing so, the director would draw the other Independent Directors’ attention to the procedural and structural tools available to be active and independent and make it more likely that they would take advantage of them. In turn, more widespread director activeness and independence would make it more common and therefore easier for directors to question, and disagree with, the CEO.

One may contend that this procedure would be completely ineffective where many or all of the Independent Directors already in office were, or over time became, passive and subordinated to the CEO and had no interest in properly evaluating any new board member. The very purpose of the suggested process, however, is to prevent a board from evolving in such a direction; this is indeed the kind of situation that would be less likely to occur after implementation of the confirmation process. Where the initial set of Independent Directors properly discharged their duties, the confirmation procedure would make it more likely that subsequent directors would be active and independent as well.


154. On the importance of legitimizing dissent within the boardroom, see COLIN & LORSCH, supra note 145, at 174.
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I recognize that the new procedure would give the current Independent Directors the power to pressure the new director in relation to substantive issues under the examination of the board. I think, however, that in practice this would rarely be the case. Under ordinary circumstances, the procedure would provide new directors with an incentive to be active and independent, as well as serve as a road map for their work. A director lacking such qualities would either be denied qualification as Independent or would not be reelected to the board. It could happen, however, that on a matter unrelated to the confirmation, a serious conflict would arise between the new director and the existing Independent Directors, and the latter would try to put pressure on the former. In such a case, the new director could easily keep a record of his activity on the board and access the court system to redress any improper use of the confirmation procedure.\textsuperscript{155}

To summarize, the suggested approach provides for an up-front evaluation of a candidate director's qualifications and independence.\textsuperscript{156} Upon a positive finding, a director could then be elected to the board, but subject to confirmation as Independent by the Independent Directors already in office.\textsuperscript{157} I believe that, pending confirmation, the director should serve as Independent and be considered as such for the purpose of reaching a majority of Independent Directors on the board. The director, however, should not participate as Independent in approval of specific acts or transactions when such qualification triggers special legal effects, as in the case of derivative litigation.

\textit{E. Control Over the Institutional Environment}

One final requirement necessary to realizing the conditions for autonomous action concerns the power to determine the specific governance arrangements of each particular company. As a general matter, corporations should have as much flexibility as possible in devising their organizational features; each corporation should be able to adapt governance structures to its specific needs. By doing so, companies would also play an active and creative role in

\textsuperscript{155.} A breach of the duty of good faith on the part of the Independent Directors could be alleged where they denied confirmation to an active and independent new director. A finding that the director actively engaged in his directorial role by making use of his prerogatives and by reaching his decision upon accessing sources of information not limited to management would be sufficient for reversal of the confirmation decision, regardless of the substance of the directors' actions.

\textsuperscript{156.} See supra Part V.A.

\textsuperscript{157.} I recognize that there may be special circumstances where the entire board would have to be replaced and it would not be possible to complete the confirmation process before declaring the new directors Independent. This, however, would be an extraordinary occurrence that should not impinge on the validity of the procedure under ordinary circumstances. Moreover, alternative solutions could be elaborated for these types of situations such as electing, as confirmed Independent Directors, individuals already confirmed as Independent on the board of one or more other corporations.
developing effective solutions to common governance issues.

The exercise of such discretion, however, should be under the control of the Independent Directors when it comes to the specific arrangements concerning their action within the corporation. Otherwise, the management or the inside directors could undermine the work of the Independent Directors by limiting their access to necessary powers and resources. Within the framework suggested, Independent Directors should control the specific arrangements regarding, for example, separate meetings, budget, and IDS organization.158 As long as Independent Directors compose a majority of the board of directors, the board itself will remain the appropriate body to decide these matters. Within that context, the directors and the CEO will be able to confront problems and to develop the solutions that best fit the particular needs of the corporation. Nonetheless, the board’s voting procedures should ensure that the CEO does not obtain control over the Independent Directors by co-opting one or more of them.159

VI. A NEW JUDICIAL DEFINITION OF INDEPENDENCE

Having identified and elaborated upon the elements that should be incorporated into the definition of Independent Director, it remains to discuss the role played by courts in this regard. In every situation in which they assign specific legal effects to the status of Independent Director, courts should follow the approach suggested in this Article.160 Before giving special deference to the actions of certain directors, courts should evaluate whether they satisfy all of the conditions that justify such deference. Directors should therefore not be qualified as Independent unless they meet all of the requirements related to autonomy with respect to the specific action at issue in each case.

The validity of this approach is not undermined by the recent refusal of the Supreme Court of Delaware to consider good corporate governance practices when evaluating director liability.161 The court held that the failure to maintain certain practices such as separate Independent Director meetings cannot lead to a court’s determination of liability, as such practices are not mandatory under state law.162 I suggest a different approach. Courts would not assess director

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158. Cf. 17 C.F.R. § 240.10A-3(b)(5) (2004) (requiring public companies to provide audit committees with appropriate funding, as determined by the same audit committees).
159. A possible solution would be to provide that the approval of board deliberations regarding arrangements concerning Independent Directors require not only a majority of votes, but also the vote of the majority of the Independent Directors.
160. See Lin, supra note 39, at 963. Lin suggests that courts should not treat all outside directors as equally effective, but “to the extent that the concept of director ‘independence’ is the law’s shorthand way of determining whether outside directors are capable of acting as effective monitors of management, the courts should consider the factors… that may bear on directors’ incentive and abilities.”
161. See Brehm v. Eisner, 746 A.2d 244, 256 & n.29 (Del. 2000).
162. See id.; cf. Veasey, supra note 116, at 699-700 (suggesting seven aspirational norms, but
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liability based on whether a company implements certain governance practices. Instead, the requirements of the improved definition of Independence would constitute factual elements that affect the determination of whether a director is Independent under case law. Such a change in perspective could take place without amending state statutory law.

In deciding on director Independence, courts should not only determine whether a director is independent, but also whether he possesses all of the other characteristics necessary for autonomous action. For example, courts should look at whether the director has the necessary competence, whether the method for his selection and compensation ensures that he has the necessary motivation, and whether the company’s governance structure provides him with the necessary resources and opportunities for action. These factual elements should be considered equal to elements that courts already consider, such as whether a director has economic or family ties with the company or the CEO. Accordingly, courts should deny the status of Independent to directors who do not meet all of the relevant requirements in any situation where such status carries with it special legal effects, such as in derivative litigation.

Courts are obviously not in the position to require corporations to implement immediately the suggested structural and procedural solutions as a condition for recognizing directors as Independent. A more comprehensive definition of Independent Director, however, would give courts greater leverage in promoting the realization of the conditions of autonomous action within corporate boards.

CONCLUSION

The corporate governance system has long relied on Independent Directors as monitors of the company’s management on the assumption that, being free from compromising ties, they effectively protect the interest of the corporation and its shareholders. Notwithstanding the crucial role assigned to Independent Directors, the complexity of their function and the multiplicity of the issues arising from this role have not been fully recognized. As a result, two problems have long been left without an adequate solution: how to identify those individuals who will indeed act as effective monitors of management, and how to provide them with the resources necessary to adequately perform their job.

The concept of autonomy provides a useful conceptual tool to sort out such complexity and address issues related to Independent Directors—both existing issues and issues that will inevitably arise as Independent Directors become increasingly important. In particular, the suggested approach would support the adoption of a more comprehensive judicial evaluation of the status of recognizing that “[t]hey do not necessarily drive liability considerations...”).
Independent Director. At the same time, the specific structural and procedural solutions formulated in this Article have the potential to provide an effective answer to the problems that appear most compelling: the lack of active involvement and lack of information and resources.