THE FALLACY OF DIRECTOR INDEPENDENCE

YARON NILI*

Director independence has become a key cornerstone of the contemporary corporate governance landscape. Over the past few decades, the composition of public firms' boards of directors in the United States has changed dramatically, shifting towards an increased reliance on directors labeled as "independent." Courts, regulators, and investors have come to increasingly rely on these independent directors and have made their presence on boards a priority.

However, despite the increased attention, the current system of selecting, anointing, and ensuring director independence is laden with gaps. This Essay highlights three key issues with the current independence framework. First, the current designation and disclosure framework for director independence is inadequate, providing companies with too much discretion and leaving shareholders with insufficient information. Second, the current structure of boards further complicates the ability of directors to act independently. Third, key board leaders such as the independent chair and the lead independent directors who have been lauded as the standard-bearer for independence, may in fact lack true independence or lack the effective powers to carry out their roles. As these gaps in the director independence framework continue to emerge, this Essay cautions against a deferential reliance on the director independence framework.

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* Assistant Professor of Law, University of Wisconsin Law School and Co-Director of Academic Research, John L. Weinberg Center for Corporate Governance. I am grateful for the thoughtful comments of the participants in *The New Realism in Business Law and Economics* conference. Gabrielle Kiefer and Daniel Schwartz provided valuable research assistance.

INTRODUCTION

After founding VerticalNet—a business-to-businesses tech provider—with a former classmate,[1] Michael Hagan set his sights across the parking lot on Nutrisystem, Inc.—a home delivery weight loss company whose stock had recently plummeted from sixteen dollars per share to two dollars per share.[2] Upon hearing of Nutrisystem's potential sale, Hagen gathered an investor group,[3] and together they purchased 58.4 percent of the company at 65 cents per share.[4] Hagan immediately began implementing changes, and as Nutrisystem's new Chairman and Chief Executive Officer (CEO) helped the company's value to grow nearly thirty times over,[5] earning it the Forbes Magazine's title of Best Small Public Company in 2006.[6] In May 2008, when Nutrisystem's profits leveled out, Hagan stepped down as Chairman and CEO.[7] However, four years later, with Nutrisystem revenues again plunging, Nutrisystem asked Hagan to rejoin the board of directors.[8] Surprisingly, despite his recent tenure as CEO, Hagan was named the company's *lead independent director*,[9] ostensibly to function as an "objective" check on insiders. His ironic stint as lead independent director did not last long, however, as the company once again named him Chairman of the Board three months later.[10]

While Hagan's classification as lead independent director after his service as the company's CEO less than five years earlier may seem peculiar, it is far from an anomaly, and it illustrates the flaws of the current

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1. Peter Key, *VerticalNet Seeks To Raise $30 mil.*, BIZJOURNALS.COM (Dec. 14, 1998, 12:00 AM), https://www.bizjournals.com/philadelphia/stories/1998/12/14/story2.html [https://perma.cc/FS2V-4HCB].

2. David Whelan, *Before... and After*, FORBES (Oct. 14, 2006, 9:20 AM), https://www.forbes.com/free_forbes/2006/1030/170_2.html [https://perma.cc/D9H7-QX78].

3. *Id.*

4. *Id.*

5. *See Our Team at Hawk Capital Partners*, HAWK CAP. PARTNERS, http://hawkcapital.com/ourteam.html [https://perma.cc/3W7J-4LSD].

6. *The Have-Mores!: The Next Tycoons*, PHILLYMAG.COM (June 9, 2008, 2:10 AM), https://www.phillymag.com/news/2008/06/09/the-have-mores-the-next-tycoons/2/ [https://perma.cc/AGU5-TXRZ].

7. *Michael Hagan Returns to Nutrisystem Board of Directors*, BUSINESSWIRE (Feb. 16, 2012, 4:05 PM), https://www.businesswire.com/news/home/20120216006642/en/Michael-Hagan-Returns-Nutrisystem-Board-Directors [https://perma.cc/2LS9-PLYX].

8. *Id.*

9. *Id.*

10. Crissa Shoemaker DeBree, *Nutrisystem To Part Ways With CEO*, THE INTELLIGENCER (Apr. 6, 2012, 12:01 AM), https://www.theintell.com/article/20120406/BUSINESS/304069580 [https://perma.cc/82QE-RMXT].

independent director system. Indeed, as has been well documented, the composition of United States public firms' boards of directors has seen a dramatic shift.[11] Boardrooms once controlled by company executives have been almost entirely replaced by independent directors, often leaving the CEO as the lone executive in the room.[12]

Though originally market-driven, recent corporate scandals and the corresponding regulatory reforms, including the Sarbanes-Oxley Act (SOX) and the Dodd-Frank Act (Dodd-Frank),[13] have intensified this shift. These regulatory reforms' focus on director independence has garnered attention from investors, academics, and courts. Shareholders, on heightened alert following the fatal carelessness of Enron and WorldCom, have shown continued interest in corporate board members' abilities to effectively scrutinize management.[14] Similarly, many academics have long pushed for boards that are more independent.[15] In addition to shareholders, regulatory bodies, and academics, Delaware courts have also shown an increased interest in and reliance on independent directors, beginning with their use of independence assessments when analyzing shareholder derivative actions to "encourage companies to appoint independent directors and assign them a meaningful role."[16]

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11. *See* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1473 (2007); Kobi Kastiel & Yaron Nili, *"Captured Boards": The Rise of "Super Directors" and the Case for A Board Suite*, 2017 WIS. L. REV. 19, 26 [hereinafter *Captured Boards*].

12. While only a majority of the board is required to be independent in order to comply with the regulatory requirements, independent directors, as currently defined, now make up eighty-four percent of all board members in the S&P 500. *See, e.g.*, SPENCER STUART, BOARD INDEX SURVEY 15 (2014); SHEARMAN & STERLING LLP, 10TH ANNUAL SURVEY: CORPORATE GOVERNANCE OF THE LARGEST US PUBLIC COMPANIES 5 (2012); Rajeev Kumar, *2014 Corporate Governance Review*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 30, 2014), https://corpgov.law.harvard.edu/2014/10/30/2014-corporate-governance-review/ [https://perma.cc/2E5C-E6C7].

13. *See* Gordon, *supra* note 11, at 1472–76.

14. Edward S. Adams, *Corporate Governance After Enron and Global Crossing: Comparative Lessons for Cross-National Improvement,* 78 IND. L.J. 723, 732, 775–77 (2003). *See generally* David A. Westbrook, *Corporation Law After Enron: The Possibility of a Capitalist Imagination,* 92 GEO. L.J. 61 (2003).

15. *See generally* Gordon, *supra* note 11 (describing the role of boards of directors in mitigating agency problems); Michelle M. Harner, *Corporate Control and the Need for Meaningful Board Accountability*, 94 MINN. L. REV. 541, 583–84 (2010) (focusing on boards' broader duties in the context of a controlling shareholder).

16. Lucian A. Bebchuk & Assaf Hamdani*, Independent Directors and Controlling Shareholders,* 165 U. PA. L. REV. 1271, 1281 (2017); *see also Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994) (stating that "approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden" in entire fairness review from the interested party to the challenging party).

Given the increased reliance and attention on independent directors, definitions of "director independence" have become increasingly important. Companies must maintain a certain percentage of independent directors if listed on the exchanges,[17] and they often tout their independent directors in communications with investors.[18] However, as this Essay further elaborates, despite independent directors' growing prominence on corporate boards,[19] there is little one can discern from a mere designation of "independence" by companies. As Usha Rodrigues cautioned, this in effect can lead to the "fetishization of independence."[20] This Essay ties together several significant inadequacies in the current independent director framework[21] and argues that the current system may not only undermine the credibility of director independence but may also render it counterproductive altogether.

The Essay proceeds as follows. Part I provides a brief overview of the growing focus on independent directors by regulators, academics, Delaware courts, and investors. Part II outlines three key insufficiencies in the current framework: disclosures and self-designation, structural limitations in the current board design, and inadequate leadership authority. Finally, the Essay concludes that regulators, scholars, and investors should adopt a level of skepticism about the current system of director independence and its ability to achieve both accountability in the boardroom and protection for minority shareholders. This sets the framework for a more candid discussion regarding the substantive value of independent directors.

17. N.Y.S.E. Listed Company Manual, §§ 303A.01, 303A.04 (2009), 303A.05 (2103), 303A.06 (2009); NASDAQ Stock Mkt. LLC Rules §§ 5605(b)(1), 5605(c)(2), 5605(d)(2), 5605(e) (2019). *See also Developments in the Law—Corporations and Society*, 117 HARV. L. REV. 2169, 2187 (2004) ("The revised listing standards of both the NYSE [New York Stock Exchange] and NASDAQ . . . require (with a few exceptions) that listed-company boards have a majority of independent directors. . . .").

18. Patty M. DeGaetano, *The Shareholder Direct Access Teeter-Totter: Will Increased Shareholder Voice in the Director Nomination Process Protect Investors?*, 41 CAL. W. L. REV. 361, 385–87 (2005).

19. *See, e.g.*, Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 453 (2008) ("Independence means independence from the corporation, period."); E. Norman Veasey, *Should Corporation Law Inform Aspirations for Good Corporate Governance Practices—or Vice Versa?*, 149 U. PA. L. REV. 2179, 2180–82 (2001).

20. Rodrigues, *supra* note 19, at 453.

21. *See infra* Section II.

I. THE RISE OF THE INDEPENDENT DIRECTOR

A. Background

Corporate boards are entrusted with several important governance roles.[22] Yet, while early twentieth century boards served mainly an advisory role, boards today have taken on a much larger role in monitoring management.[23] This shift has led to increased scrutiny regarding the proper composition of the board, and consequently, the composition of U.S public firms' boards has changed dramatically.[24] This shift has also caused a change in directors' most valued skills: while directors were once valued for their networking and business advice, they are now valued for their perceived ability to effectively scrutinize management.[25] Accordingly, a strong presence of directors deemed to be "independent" from those controlling the firm's day-to-day operations has become essential,[26] and directors designated as independent have gained an increasing number of corporate board seats, replacing non-independent directors (company employees commonly referred to as "insiders").[27] In fact, the percent of company insiders serving on boards of S&P 500 companies has fallen from nearly forty-nine percent in the 1950s[28] to approximately fifteen percent in 2019.[29]

To further increase the perception of independence and better comply with regulatory requirements, companies without independent chairs have

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22. Melvin Aron Eisenberg, *Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants*, 63 CALIF. L. REV. 375, 376 (1975).

23. *See* MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 139–41 (1976) (discussing the practices of the corporate board); Stephen M. Bainbridge & M. Todd Henderson, *Boards-R-Us: Conceptualizing Corporate Boards*, 66 STAN. L. REV. 1051, 1053 (2014) ("State law now requires boards to mediate the relationship between ownership and control of the corporation.").

24. *See, e.g.*, Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. L. 921, 921–24 (1999) (discussing the role of the corporate board and management).

25. Yaron Nili, *Out of Sight, Out of Mind: The Case for Improving Director Independence Disclosure*, 43 J. CORP. L. 35, 44 (2017) [hereinafter Nili, *Out of Sight, Out of Mind*].

26. *See generally* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301 (1983) (discussing the agency problem posed as a result of the structure of U.S. firms).

27. Nili, *Out of Sight, Out of Mind*, *supra* note 25.

28. *See* Gordon, *supra* note 11, at 1473 n.9; Urska Velikonja, *The Political Economy of Board Independence*, 92 N.C. L. REV. 855, 865 (2014); *See Captured Boards*, *supra* note 11, at 26.

29. EY CENTER FOR BOARD MATTERS, CORPORATE GOVERNANCE BY THE NUMBERS (2019), https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/cbm/ey-cgbtn-quarterly-print-version-march-2019.pdf [https://perma.cc/WS8Z-8ZQ4].

been encouraged to appoint a lead independent director. Among these regulatory requirements is the New York Stock Exchange's requirement that the non-management directors of a company hold regularly scheduled executive sessions.[30] This, in part, has led appointing a lead independent director to become a best practice for companies that maintain a combined CEO-chairperson role.[31] Despite companies conferring their lead independent director with explicit responsibilities and powers[32] as well as the upward trend in companies with independent boards, the true utility of the lead independent director role has not been adequately addressed.[33]

The combination of the market-driven transformation of corporate boards and increased regulatory requirements has made director independence a cornerstone of modern corporate law.[34] Directors deemed "independent" are entrusted with objectively and impartially monitoring management to ensure that the interests of shareholders are well served. Translating the notion of independence into practice, however, is far from a simple task, and while regulators and stock exchanges have tackled this elusive target in different ways, their attempts have, for the most part, come up short. Regardless, regulating director independence is seen as paramount to empowering investors to make informed decisions about where to invest and how to vote.

While academic discourse has long encouraged and lauded the movement toward more independent boards,[35] some have acknowledged that this shift comes at a cost, noting the negative impact director independence may have on the board's *advisory* role and the company's overall performance.[36] Yet, the current independence system has the potential to impact the board's ability to effectively execute

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30. N.Y.S.E. Listed Company Manual, § 303A.03 (2009) (explaining that while no mandatory number of meetings is required, in practice such meetings take place regularly).

31. *See Captured Boards*, *supra* note 11, at 51; Marion Plouhinec, *The Role of the Lead Independent Director*, HARV. L. SCH. F. ON CORP. GOVERNANCE (November 25, 2018), https://corpgov.law.harvard.edu/2018/11/25/the-role-of-the-lead-independent-director/ [https://perma.cc/6MZY-NKA2].

32. *Id.*

33. *See* Yaron Nili, *Board Gatekeepers' Independence* (Working Paper 2020) [hereinafter Nili, *Board Gatekeepers' Independence*).

34. *See, e.g.*, Daniele Marchesani, *The Concept of Autonomy and the Independent Director of Public Corporations*, 2 BERKELEY BUS. L.J. 315, 320–21 (2005); Arthur Levitt, Chairman, SEC, Remarks Before the Conference on the Rise and Effectiveness of New Corporate Governance Standards (Dec. 12, 2000), https://www.sec.gov/news/speech/spch449.htm [https://perma.cc/82JC-SJKZ].

35. *See* Gordon, *supra* note 11, at 1540.

36. Yaron Nili, *The "New Insiders": Rethinking Independent Directors' Tenure*, 68 HASTINGS L.J. 97, 99–102 (2016) [hereinafter Nili, *New Insiders*].

its *monitoring* role. While social science[37] and corporate governance literature[38] have shown that a close-knit board can be beneficial for board performance, others have suggested that these benefits can also decrease independence and directors' ability to assess another directors' work impartially.[39]

Some academics have also addressed the regulatory changes in the last decade,[40] touting them as an effective means of producing a more independent board that is capable of effectively monitoring insiders' decisions.[41] However, recent scholarship has begun to identify several structural inadequacies. For example, Professors Hill and McDonnell noted that directors, many of whom drew their appointment from their connections to management, are often motivated by the "pernicious golden rule"—deferring to the directors whose deference they would want if they were officers.[42] This collegiality, combined with the personal and professional relationships between directors and officers, pushes directors to make decisions that favor management, even if doing so is not in the corporation's best interest.[43] These unaddressed structural constraints camouflage directors' motivations, which may not align with their fiduciary duties, but are not classically self-serving to the extent that they trigger judicial scrutiny.[44]

More broadly, several scholars have questioned the ex-ante approach for determining director independence.[45] These scholars argue this system creates a false notion that independence is absolute and that Delaware's

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37. *See* James D. Westphal & Edward J. Zajac, *Defections from the Inner Circle: Social Exchange, Reciprocity, and the Diffusion of Board Independence in U.S. Corporations*, 42 ADMIN. SCI. Q. 161, 163–64 (1997).

38. John F. Olson & Michael T. Adams, *Composing a Balanced and Effective Board to Meet New Governance Mandates*, 59 BUS. LAW. 421, 445–46 (2004).

39. *See* Karen A. Jehn & Priti Pradhan Shah, *Interpersonal Relationships and Task Performance: An Examination of Mediating Processes in Friendship and Acquaintance Groups*, 72 J. PERSONALITY & SOC. PSYCHOL. 775, 778 (1997); Janine Nahapiet & Sumantra Ghoshal, *Social Capital, Intellectual Capital, and the Organizational Advantage*, 23 ACAD. MGMT. REV. 242, 245 (1998); Reed E. Nelson, *The Strength of Strong Ties: Social Networks and Intergroup Conflict in Organizations*, 32 ACAD. MGMT. J. 377, 380 (1989). *See generally* Jerry Goodstein & Warren Boeker, *Turbulence at the Top: A New Perspective on Governance Structure Changes and Strategic Change*, 34 ACAD. MGMT. J. 306 (1991) (finding that the longer the members of a board of directors have worked together, the more likely they are to resist change).

40. *See infra* Section I.B.

41. *See* Gordon, *supra* note 11, at 1539 ("The effect of the reforms on the board's role is to make the role of the independent director more important than ever.").

42. Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith, and Structural Bias*, 32 J. CORP. L. 833, 838 (2007).

43. *Id.*

44. *Id.*

45. *See* Rodrigues, *supra* note 19, at 453 ("Independence means independence from the corporation, period."); Veasey, *supra* note 19.

situational approach to independence—which analyzes independence at any given point in time—is a more accurate approach.[46] Delaware's approach, further discussed below, recognizes that as conflicts arise in different contexts, the focus of concern—the influence from which we wish to insulate directors—varies as well.[47] This analysis of Delaware law may be particularly warranted, since Delaware's increased reliance on director independence is what sparked the increased discourse on board independence.[48]

B. Regulators' Focus on Independent Directors

The collapse of Enron and WorldCom vividly demonstrated weaknesses in the corporate governance systems and alerted regulators of the need for greater board regulation to ensure effective and impartial monitoring of management.[49] In response, both private and public regulatory players took strong action to secure board accountability. The federal government began by overhauling the regulatory requirements for public corporations with the SOX[50] and the Dodd-Frank.[51] Motivated by the belief that true inside directors encounter greater barriers to effectively monitor corporate officers, and that independent directors are better equipped to detect fraud, protect shareholders' interests, and monitor managerial abuse of authority, these regulatory and private reforms forced the U.S. exchanges to enhance their director independence requirements.[52]

For example, under SOX, the board's audit committee must consist entirely of independent directors, who in order to qualify cannot accept "any consulting, advisory, or other compensatory fee" from the company on whose board they sit.[53] Similarly, Dodd-Frank requires the national exchanges to adopt new listing standards that address the issues of compensation committee independence, its authority to retain and be directly responsible for the consultants and advisers it retains, its analysis of the independence of compensation consultants and advisers, and the

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46. *See generally* Rodrigues, *supra* note 19; *see also* Veasey, *supra* note 19, at 2180. Jeffrey Gordon defended independence in Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1469 (2007).

47. Rodrigues, *supra* note 19, at 452–53.

48. Yaron Nili, *Successor CEOs*, 99 B.U. L. REV. 787, 799 (2019) [hereinafter Nili, *Successor CEOs*].

49. Gordon, *supra* note 11, at 1535–36.

50. Nili, *New Insiders*, *supra* note 36, at 108.

51. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. §§ 5301–5641 (2010).

52. *See* Gordon, *supra* note 11, at 1540; *see also* William W. Bratton & Michael L. Wachter, *Tracking Berle's Footsteps: The Trail of* The Modern Corporation's *Last Chapter*, 33 SEATTLE U. L. REV. 849, 866 (2010).

53. *See* 17 C.F.R. § 240.10A-3 (2019).

disclosure of any conflicts of interest concerning compensation consultants.[54]

In addition, the NYSE and NASDAQ impose listing standards that require firms to populate their boards and committees with independent directors.[55] These standards require that both a majority of the board members of public companies be independent of management, and that the audit, compensation, and nominating committees be composed entirely of independent directors.[56] They also contain guidelines—often perceived as requirements—for determining whether a director is independent.[57] For example, companies may not list directors as independent if they were former employees of the company, received compensation outside of directors' fees over a certain threshold, had ties to the company's auditor, or had business or compensation interlocks with the company above a certain threshold.[58] The guidelines further indicate that "[n]o director qualifies as 'independent' unless the board of directors affirmatively determines that the director has no material relationship with the listed company."[59] However, since the board determines whether a "material

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54. Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and Rule 240.10C-1 of the Securities Exchange Act of 1934 direct the national securities exchanges to adopt new listing standards applicable to compensation committees and compensation advisers. *See* 17 C.F.R. § 240.10C-1 (2019).

55. For example, SOX mandated the creation of an audit committee of the board that has greater powers and many more responsibilities than ever before, such as working with external auditors of internal controls. *See Considering Director Independence*, COVINGTON & BURLING LLP (July 12, 2007), https://www.cov.com/~/media/files/corporate/publications/2007/07/823.pdf [https://perma.cc/LP8Q-6LA4] [hereinafter *Considering Director Independence*]. The NYSE and NASDAQ requirements largely track those of the SEC Item 407 of Regulation S-K. Yaron Nili, *Horizontal Directors*, 114 NW. L. REV. (forthcoming 2020). This mandate requires company to identify each director or nominee that the company considers independent. 17 C.F.R. § 229.407(a) (2019). Companies usually satisfy the Item 407 requirements by including the disclosures within their annual proxy statement or annual 10-K. Companies must also disclose individual independence standards as well as each director that is a member of the compensation, nominating or audit committee that is not independent. *Id.*

56. N.Y.S.E. Listed Company Manual, §§ 303A.01, 303A.04 (2009), 303A.05 (2013), 303A.06 (2009); NASDAQ Stock Mkt. Rules §§ 5605(b)(1), 5605(c)(2), 5605(d)(2), and 5605(e) (2019). *See also Developments in the Law—Corporations and Society*, 117 HARV. L. REV. 2169, 2187, 2194 (2004) ("The revised listing standards of both the NYSE [New York Stock Exchange] and NASDAQ . . . require (with few exceptions) that listed-company boards have a majority of independent directors. . . .").

57. Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3, 9 (2000) (explaining how the rules are considered by most to be "bright line"); *see also* N.Y.S.E. Listed Company Manual, § 303A.01–02 (2009).

58. Nili, *Out of Sight, Out of Mind*, *supra* note 25, at 39–40.

59. N.Y.S.E. Listed Company Manual, § 303A.02 (2009).

relationship" exists, it has considerable discretion when classifying directors as "independent."[60]

C. Courts and Independent Directors

The term "independent directors" arose against a backdrop of state laws that required director independence in specific situations, such as the approval of interested transactions, in derivative suits, and in litigation committees.[61] Delaware law, for instance, specifically requires independent directors' approval of related party transactions in order for the business judgment rule to apply.[62] In examining independence, Delaware courts undergo a case-by-case factual inquiry, specifically examining "whether the director's decision is based on the corporate merits of the subject before the board, rather than extraneous considerations or influences"[63] or whether a director is, for any substantial reason,[64] incapable of making a decision "with only the best interests of the corporation in mind."[65] This in turn, could, and indeed has, led to different, perhaps inconsistent, outcomes in particular cases depending on procedural issues such as the burden of proof, the specific facts of the case,

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60. Nili, *Out of Sight, Out of Mind*, *supra* note 25, at 40. A nice illustration is the case of Penny Pritzker—one of America's richest and most powerful businesswomen—who was an independent director of Hyatt Hotels until her status changed. *See* John R. Emshwiller & Alexandra Berzon, *Hyatt Director Gets a Status Makeover*, WALL ST. J. (Aug. 24, 2010), http://online.wsj.com/article/SB10001424052748703649004575437713243128. *See* Gary Larkin, *Just What is an Independent Director Anyway?*, THE CONF. BOARD (Sept. 10, 2010), http://tcbblogs.org/governance/2010/09/10/just-what-is-an-independent-director-anyway/ [https://perma.cc/3RDH-LLAN] (offering a more detailed critique).

61. Nili, *New Insiders*, *supra* note 50, at 115.

62. Nicolle Stracar, *Applying a New Regulatory Framework to Interested Transactions by Minority Shareholders*, 20 U. PA. J. BUS. L. 993 (2018).

63. *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1049 (Del. 2004); *see* Maureen S. Brundage & Oliver C. Brahmst, *Director Independence: Alive and Well Under Delaware Law*, *in* GLOBAL CORPORATE GOVERNANCE GUIDE 2004: BEST PRACTICE IN THE BOARDROOM 116–20 (2004); Rodrigues, *supra* note 19, at 469.

64. One factor that courts consider when determining whether or not a director is independent is a director's interlocks—connections the director has through other boards the director directly serves. However, this factor should be expanded to include a director's network—connections beyond interlocks, including indirect connections with other companies and boards. *See* Jeremy McClane & Yaron Nili, *Social Governance*, 12 (working paper, 2020).

65. *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 938 (Del. Ch. 2003) (defining independence such that "a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences" (quoting *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984))).

and the availability of admissible facts.[66] Unlike the regulatory bodies, Delaware courts have avoided any "bright-line" prerequisites for independence and have included social ties as a potential disqualifying factor.[67]

Most importantly, Delaware law suggests that while a director may be independent on some issues, they may not be for others.[68] Delaware rejects corporate governance advocates' attempts to reduce independence to a determinative "status" and does not bind itself to ex-ante designations or safe harbor rules.[69] Instead, Delaware looks at the particular conflict arising in the relevant transaction and utilizes a situational approach.[70] The focused attention that Delaware gives to its corporate code and case law, coupled with its high volume of corporate law cases, indicates that

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66. For instance, in the *Oracle* case it was determined that personal connections rose to the level of impeding independence, while in the *Martha Stewart* case the opposite was held. *See id.* at 920. Similarly, the *In re MFW Shareholders Litigation* court stated that:

> Even in the context of personal, rather than financial, relationships, the materiality requirement does not mean that the test cannot be met. For example, it is sometimes blithely written that "mere allegations of personal friendship" do not cut it. More properly, this statement would read "mere allegations of mere friendship" do not qualify. If the friendship was one where the parties had served as each other's maids of honor, had been each other's college roommates, shared a beach house with their families each summer for a decade, and are as thick as blood relations, that context would be different from parties who occasionally had dinner over the years, go to some of the same parties and gatherings annually, and call themselves "friends."

67 A.3d at 509 n.37

67. *See* Lisa M. Fairfax, *Sarbanes-Oxley, Corporate Federalism, and the Declining Significance of Federal Reforms on State Director Independence Standards*, 31 OHIO N.U. L. REV. 381, 402 (2005) (discussing the *Oracle* and *Beam* cases in the context of Delaware courts' willingness to consider social and professional ties in the independence inquiry); *see also Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040 (Del. 2004) (focusing on social and professional ties); *In re Oracle*, 824 A.2d at 938 (holding that the independence analysis should pay heed to personal and social relationships among directors, and finding that such relationships negated directors' independence).

68. Under Delaware law, there is a presumption that directors are independent. *In re Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984). To show that a director is not independent, a plaintiff "must show that the directors are 'beholden' to the [controlling party] or so under [the controller's] influence that [the director's] discretion would be sterilized." *See Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993) (citing *Aronson*, 473 A.2d at 815). Thus, Delaware law has treated the issue of independence as an ad hoc factual issue, examining "whether the director's decision is based on the corporate merits of the subject before the board, rather than extraneous considerations or influences." *Beam ex rel. Martha Stewart*, 845 A.2d at 1049–52 (Del. 2004); *see also In re Oracle Corp.*, 824 A.2d at 920 (discussing whether a director is, for any substantial reason, incapable of making a decision "with only the best interests of the corporation in mind").

69. Rodrigues, *supra* note 19, at 483.

70. *Id.* at 476.

Delaware's law "can be taken as a fair representative of state law, at least if a state were to prioritize its corporate law."[71] Yet, the ad hoc approach taken by Delaware courts is not without its costs. Cases have been decided inconsistently,[72] and a designation is vetted only if litigation is brought by a plaintiff.[73]

D. Investors' Focus on Independent Directors

Finally, investors have an interest in director independence.[74] As institutional investors' market share of large public companies has risen, so too has their interest in governance matters such as tenure.[75] In a 2015 survey of leading institutional investors, sixty-two percent of the surveyed investors indicated that they read the director independence section of the proxy statement and rely on it to make voting decisions; this was the second most read section after the pay for performance section (sixty-four percent).[76] In addition, fifty-nine percent of investors indicated that they read and rely on the director nominee descriptions, their quality, qualifications, and skills section of the proxy statement for voting.[77] Indeed, activist investors, led by several prominent hedge funds, have achieved an increasingly important and active role in corporate America, effectuating changes in governance matters to address the public's calls for change.[78] Even at the individual investor level, scholars have noted the possibility that a lack of confidence in corporate governance expressly guides individual investment choices.[79] Some have further noted that this may mislead investors to think that independent boards correlate with shrewd investment.[80]

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71. *Id.* at 464–65; *See also* E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1414 (2005).

72. McClane & Yaron Nili, *supra* note 64.

73. *See* Nili, *Out of Sight, Out of Mind*, *supra* note 25, at 46.

74. *Id.*

75. Nili, *New Insiders*, *supra* note 36, at 150.

76. David F. Larcker et al., *2015 Investor Survey: Deconstructing Proxy Statements—What Matters to Investors*, 8 (2015), https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survyey-2015-deconstructing-proxy-statements_0.pdf [https://perma.cc/WJ9A-UP45].

77. *Id.*

78. Nili, *New Insiders*, *supra* note 36, at 155 ("By adopting voting policies that reflect the impact tenure has on independence they could push the majority of institutional investors to act on their concerns."); *Captured Boards*, *supra* note 11, at 31.

79. Laura Kabler, *Money in the Game: Executing a Governance-Based Hedge Fund Strategy*, 12 STAN. J.L. BUS. & FIN. 121, 123 (2006) ("[I]nvestors might choose an entirely passive strategy by investing in index funds and then hope to recoup any damage from governance failures after the fact in the inevitable shareholder litigation that will seek to recover the damage done by governance failures after the fact.").

80. Rodrigues, *supra* note 19, at 494.

II. THE FALLACY OF DIRECTOR INDEPENDENCE

Despite the growing focus on director independence, the current system falls short in three key areas. First, the designation of independent status is just that—a designation, over which companies have virtually unfettered discretion to define and design their standards. Second, independence designations largely ignore broader structural issues, including the effects that tenure and "information capture" may have on a director's ability to truly fulfil her duties as an objective decision-maker, even if such director is "objectively" independent. Third, board leadership figures, who have been portrayed as guardians of the board's independence, may fall well short of these aspirations through a combination of both designation and structural issues. This section addresses each of these key concerns and provides a novel analysis of the third.

A. Unchecked Designations and Disclosures

The current approach to director independence—one that is focused on a set of criteria and subsequent certification by the board of directors—is, as the existing literature has posited, an empty approach.[81] As I have previously discussed in detail, the current framework can be summed up as being *too much*, *too little*, *too late*, and *too soft*.[82] First, it provides companies with *too much* discretion—boards self-determine which directors are "independent," subjecting their decisions to behavioral bias.[83] Second, it provides investors with *too little* information—most companies provide the minimum amount of information required under Item 407 and the stock exchange rules.[84] Third, a board's designation of a director as independent is often *too late*—the analysis is done ex-ante.[85] Finally, the current framework is *too soft*—boards' designations of independent directors are uncontested and are enforced only when ramifications extend beyond director independence.[86]

81. *See* Nili, *Out of Sight, Out of Mind*, *supra* note 25.

82. *Id.*

83. *Id.* at 64.

84. *Id.*

85. *Id.* at 63.

86. In fact, less than one third of sampled companies developed their own independence standards that exceeded the listing requirements under its stock exchange. *Id.* at 67. An example is the action against Mark Thompson. In effect, the Commission sanctioned Thompson for not being independent. The agency did it by finding that the failure to disclose his relationship with E&Y resulted in disclosure violations under the proxy rules and periodic reporting requirements. J. Robert Brown, *Director Independence and SEC Enforcement* (Part 2), RACE TO THE BOTTOM (Aug. 11, 2008, 12:00PM) http://prosoxblog.squarespace.com/the-sec-governance/director-independence-and-sec-enforcement-part-2.html [https://perma.cc/E6RM-65YT].

The failures within this framework highlight an additional issue with independence designations—that of director interlocks, especially among companies within the same industry. Many directors have become full-time directors, splitting their time between multiple companies because of the appeal of director positions.[87] Given that management controls the nomination process, directors who seek to maintain board positions within the same industry may be less likely to counter management for fear of losing their position.[88] This means that despite the company designating them as independent, they may be reliant entirely upon management to maintain their source of income, which raises questions as to whether they can truly fulfill the duties of an independent director. Companies, however, have not yet acknowledged this issue, instead choosing to designate these directors as independent.

B. Structural Limitations

The design of corporate boards, in and of itself, leads to concerns regarding the ability of independent directors to carry out their roles. In particular, two structural limitations could play a significant role in hindering the current independent director system: directors' long tenure and the board's "information capture." The analysis below on director tenure calls into question directors' independence over time. The analysis on "information capture" underscores the structural disadvantages of independent directors in their ability to exercise their independent judgments, due to the manner in which directors are provided (or in some cases, not provided) information.

1. TENURE

As boards continue to operate under the current designation framework, extended director tenure exacerbates the current problems. Having the significant human capital, social ties, and reputation invested in the corporation that long-term directors have culminated over time might compromise independent directors' willingness to act independently or hold insiders accountable.[89] Even without preexisting ties, long tenure could result in the cultivation of newly formed relationships with management to the point where a once independent director could become an insider. This intra-board structural bias could

87. Aida Sijamic Wahid & Kyle T. Welch, *Does the Market Value Professional Directors?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 26, 2017), https://corpgov.law.harvard.edu/2017/03/26/does-the-market-value-professional-directors/ [https://perma.cc/6W8V-MSCF].

88. Yaron Nili, *Horizontal Directors*, 114 N.W. L. REV. 1179 (2020).

89. Nili, *New Insiders*, *supra* note 36, at 131–32.

potentially compromise directors' ability to act independently of their social ties, or at the very least, such close ties might cloud directors' ability to detect wrongdoing.[90]

Furthermore, as directors serve on a board for longer periods, they typically accumulate an increasing portion of the company's equity, some of which they can only sell when they leave the board.[91] "While courts and regulators treat financial ties with a company as an important factor in assessing director independence, they do not consider director fees as part of such financial ties."[92] However, true financial dependency cannot be limited to considerations outside of director fees. "Several recent studies find that the probability of accounting fraud, though small, nevertheless increases with the amount of stock-based compensation given to directors and increases as well with the fraction of total compensation that is stock-based."[93] As these studies demonstrate, possessing an increased financial stake in the corporation puts "independent" directors' willingness to act independently at risk if such action could significantly damage the value of their equity. Nonetheless, there has been a tread towards equity-based compensation for directors.[94]

Director tenure further exacerbates the independence concerns raised by equity-based compensation. Equity compensation that is correlated with performance can be counter-productive: directors may be incentivized not to disclose information or to selectively disclose information to shareholders in order to maximize the upside of their equity interest.[95] As a director's equity stake increases throughout their tenure, so too does their incentive to carry out their role—conveying information to all shareholders regardless of its beneficial or detrimental nature—in a manner that most benefits them.[96]

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90. This is well documented with directors that have personal ties to management and naturally extends to directors that have personal ties to other directors. *See e.g.*, James D. Westphal, *Collaboration in the Boardroom: Behavioral and Performance Consequences of CEO-Board Social Ties*, 42 ACAD. MGMT. J. 7, 7 (1999).

91. For a review of director compensation trends and the increased use of restricted stock, see Steve Pakela & John Sinkular, *Trends in Board of Director Compensation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 13, 2015), https://corpgov.law.harvard.edu/2015/04/13/trends-in-board-of-director-compensation/ [https://perma.cc/49ED-XL5U].

92. Nili, *New Insiders*, *supra* note 36, at 120.

93. Gordon, *supra* note 11, at 1536–37.

94. Nili, *New Insiders*, *supra* note 36, at 141.

95. *See* Robert K. Herdman, Chief Accountant, Sec. & Exch. Comm'n, Making Audit Committees More Effective, Speech by SEC staff (Mar. 7, 2002), https://www.sec.gov/news/speech/spch543.htm [https://perma.cc/59QB-ESUD].

96. Nili, *New Insiders*, *supra* note 36, at 141.

Moreover, the director election process, whereby management effectively controls nominations, contributes to directors' tenure.[97] The current reelection process places directors at a crossroad: they can be deferential to management, or they can act against management and potentially risk re-election.[98] Directors that choose the former, being deferential to management, negate their "intended" role. Further, the current election process prolongs director tenure: many director elections are uncontested, making re-election easier, thereby prolonging the director's tenure.

2. INFORMATION CAPTURE

A second structural limitation in the current system is "information capture"—the need for directors to access and synthesize information in order for them to execute their role.[99] There are three factors that play into this phenomenon. First, directors lack direct access to company information. Directors are often "part-time employees" who sit on outside boards.[100] Accordingly, they often lack the time, resources, and industry-specific knowledge necessary for them convey relevant information to shareholders.[101] This deficit forces independent directors to rely on the interpretations, opinions, and conclusions of other directors and executives (especially the CEO)[102] who are company insiders.[103] Second, directors often receive their information immediately prior to a board meeting. Since most companies only have a few board meetings each year,[104] each meeting calls for a packed agenda, demanding that the director review and

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97. Although shareholder approval is required, often the approval threshold is low. For a review of the issues with current director voting, see Letter from Edward J. Durkin, Dir. of Corp. Affairs, United Bhd. of Carpenters, to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (May 20, 2011), www.sec.gov/rules/petitions/2011/petn4-630.pdf [https://perma.cc/62X9-QFYD]; *see also* Jay Cai et al., *A Paper Tiger? An Empirical Analysis of Majority Voting*, 21 J. CORP. FIN. 119 (2013) (questioning the impact of current majority voting policies).

98. Nili, *New Insiders*, *supra* note 36, at 122.

99. *See Captured Boards*, *supra* note 11, at 23. *See also* Ann C. Mulé & Charles M. Elson, *A New Kind of Captured Board*, DIRECTOR EVALUATION, First Quarter 2014, at 27, 27–29.

100. *Captured Boards*, *supra* note 11, at 23.

101. *Id.*

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

103. *Id.*

104. Nicola Faith Sharpe, *The Cosmetic Independence of Corporate Boards*, 34 SEATTLE U. L. REV. 1435, 1453 (2011).

analyze a significant amount of information that is often outside of their area of expertise[105] on short notice.[106]

Third, directors lack sufficient access to information. On the one hand, this prohibits them from verifying the information that management provides them through their own inquiry.[107] In fact, a survey from 2007 found that only ten percent of directors were able to access the corporation's information independently through an online board portal.[108] On the other hand, it raises concerns for situations in which management does not provide the director with information at all, ultimately eliminating the director's access to information altogether. These three factors, independently and in combination, raise doubts as to whether independent directors, who often lack sufficient access to information and rely on the information provided to them by management, are able to sufficiently carry out the task entrusted to them: providing unfiltered information to shareholders.

C. Limitations of Key Board "Gatekeepers"

A third issue with the current director independence landscape moves from the general designation issues and structural limitation of the board to a specific concern regarding the designation of key figures in the boardroom as independent. As companies respond to the increased demand for director independence, they are increasingly designating independent chairs in lieu of the CEO serving as both the chair and CEO. In instances where the chair is not deemed independent, companies often elect to designate independent leadership through the appointment of a lead independent director.[109] However, as further detailed below, the reliance on key board members to serve as "gatekeepers" is subject to similar designation and structural concerns as portrayed above.

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105. *See Captured Boards*, *supra* note 11, at 28–29.

106. *Id.* at 28. *See also* THE KORN/FERRY INST., 33RD ANNUAL BOARD OF DIRECTORS STUDY 23 (2006), https://www.kornferry.com/content/dam/kornferry/docs/article-migration/33rd%20Annual%20Board%20of%20Directors%20Study%20.pdf [https://perma.cc/P8ZY-4MX9]. The Korn/Ferry survey found that directors spent an average of seventeen hours a month on board business. *Id.* The seventeen hours included "review and preparation time, meeting attendance, and travel." *Id.*

107. In a survey "independent directors were found to be less satisfied with the financial, operational and strategic information they received than their non-independent counterparts." *See* Thomas et al., *supra* note 102, at 72.

108. *Id.*

109. Twenty percent of the SP 500 companies never require an LID and twenty-four percent always require an LID. Thirty-two percent require an LID when the chair is not independent. *See Board Gatekeepers' Independence*, *supra* note 33.

1. INDEPENDENT CHAIRS

Today, most large public companies have separated the roles of CEO and chair of the board, and many have chosen to nominate an independent director as chair. This, however, is a new development in corporate governance, as the vast majority of U.S. corporations had a dual CEO-chair position as late as the end of the financial crisis.[110] Recently, however, investors have heightened the pressure on firms to separate the positions and install an independent chair.[111] Indeed, in 2019, fifty-three percent of S&P 500 boards split the chair and the CEO positions, compared with thirty-seven percent a decade ago.[112] Moreover, today thirty-four percent of S&P 500 boards have an independent chair, more than double the sixteen percent in 2009.

Yet, the inadequacies of the delegation and designation system that were described above, are also applicable to the case of "independent" chairs. For instance, in some cases, the CEO-chairs relinquish their role as CEO but stay on as the chair (in what I termed elsewhere as "successor CEOs"), often with the designation of "independent" chair despite their prior role.[113] Though the push to separate the roles is largely based on a desire to improve board independence vis-à-vis management,[114] it becomes an empty exercise. This phenomena undercuts board independence for two reasons. First, having a former CEO on the board in conjunction with the current CEO may subvert any power given to the rest of the independent directors, including an appointed lead independent

110. Aiyesha Dey et al., *CEO and Board Chair Roles: To Split or Not To Split?*, 17 J. CORP. FIN 1595, 1595 (2011).

111. *See, e.g.*, *Proxy Firms Recommend JPMorgan Shareholders Vote Against Pay Plan*, REUTERS BUS. NEWS (May 6, 2015, 11:58 AM), https://www.reuters.com/article/us-jpmorgan-pay/proxy-firms-recommend-jpmorgan-shareholders-vote-against-pay-plan-idUSKBN0NR1XY20150506 [https://perma.cc/PL9U-ZJTP] (reporting that proxy advisory firm ISS recommended stripping JPMorgan Chase CEO Jamie Diamond from his chairmanship); John Laide, *Issue Focus: Separate Chairman and CEO*, SHARK REPELLENT (Sept. 18, 2015), https://www.sharkrepellent.net/pub/rs_20150918.html [https://perma.cc/LLB6-SXHB] (reporting that shareholder activists have continuously lobbied companies to appoint an independent chairman); *see also* Matteo Tonello, *Separation of Chair and CEO Roles*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 1, 2011), https://corpgov.law.harvard.edu/2011/09/01/separation-of-chair-and-ceo-roles/#2b [https://perma.cc/CZ23-D4JB].

112. *2019 Spencer Stuart U.S. Board Index*, SPENCER STUART 22 (2019), https://www.spencerstuart.com/research-and-insight/ssbi-2019-board-composition-part-3 [https://perma.cc/MV3P-HUUU].

113. *See* Nili, *Successor CEOs*, *supra* note 48.

114. *Id.* at 796, 805.

director, if any.[115] Second, because the ex-CEO, now chair, is not technically an "insider," companies may refrain from appointing a lead independent director at all, instead viewing the ex-CEO as sufficiently independent, despite her enduring ties to the company.[116] Importantly, companies with successor CEOs as chairs maintain higher rates of being cited for lack of independence than other companies. For example, twenty-four of the 217 S&P 1500 companies in 2016 with Successor CEOs reported their chair as independent despite being a former CEO of the company.[117] This again highlights the problems with company autonomy over independence designations.

2. Lead Independent Directors

In an attempt to combat some of these issues, the lead director role has grown in both popularity and power, as more and more firms elect to designate a lead independent director and tailor the position's responsibilities to the unique needs of the firm.[118] Proxy advisors, ISS and Glass Lewis, have successfully advocated for the lead independent director structure and recommend granting these directors specific powers.[119] These directors, however, may have less power than one might hope. In fact, as I highlight elsewhere, they may have essentially become "lead" in title only.[120]

First, similar to the concerns surrounding chair independence, lead independent directors suffer from similar designation discretion. Therefore, the same concerns that plagued independent director designations generally apply to lead independent directors as well, only now as it pertains to a key figure in the boardroom. Indeed, as Figure 1 below depicts, a survey of 100 companies in the S&P 500 found that many lead independent directors are relatively long tenured, both as directors and as lead independent directors. If long tenure reduces independence, this finding may be even more important in the context of lead independent directors.

115. *Id.* at 820; *see*, *e.g.*, *Corporate Governance Guidelines*, BANK OF N.Y. MELON (Dec. 9, 2019), https://www.bnymellon.com/us/en/who-we-are/corporate-governance/corporate-governance-guidelines.jsp [https://perma.cc/SZZ6-XRQK].

116. Nili, *Successor CEOs*, *supra* note 48, at 820.

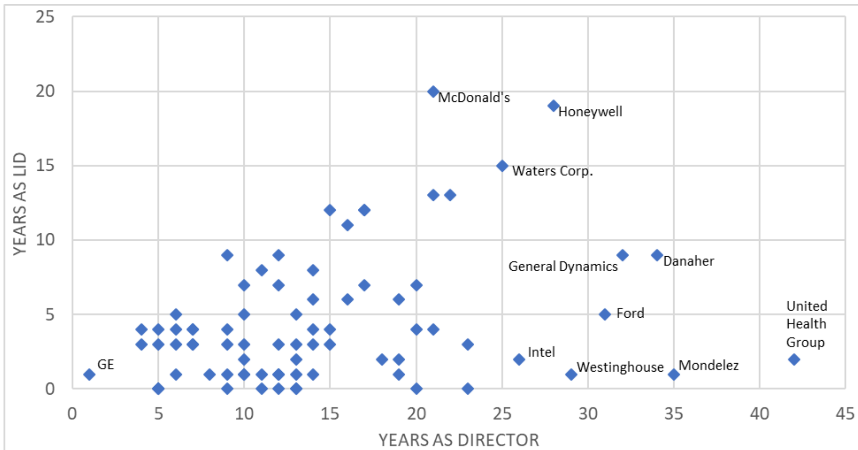
117. *Id.* at 828.

118. *Id.* at 801.

119. Amy Lee Rosen, *Support for Independent Chairmen Waning, Proxy Firm Finds*, CQ. ROLL CALL WASH. CORP. GOVERNANCE BRIEFING (June 20, 2016), 2016 WL 3382203; Holly Gregory, *Board Leadership and the Role of the Independent Lead Director*, Practical Law (Mar. 1, 2018) Westlaw W-013-3518.

120. *See* Nili, *Board Gatekeepers' Independence*, *supra* note 33.

Figure 1: Lead Independent Directors Tenure



Second, even when a lead independent director is truly independent, there are concerns regarding their true ability to serve as gatekeepers.

The following example illustrates this subjectivity in lead independent director designations: in 2016, Tim Cook, the CEO of Apple, became the lead independent director of Nike's board.[121] However, Cook's classification as "independent" is puzzling. Nike and Apple have long been partners dating back to 2006 when the two companies joined forces and released the Nike+ iPod.[122] This alliance was furthered by the launch of the Apple Watch Nike+, which some feel was "Nike's reward" for discontinuing their Nike FuelBand—a similar product which arguably would have placed the two companies in competition.[123] This alliance raises doubts as to whether Nike's undisclosed procedure for designating a director as "independent," let alone the lead independent director, is effective, at least when it comes to Tim Cook. Nike, like the majority of

121. Nike, Inc., 2019 Proxy Statement (Form Def 14A) 10, 21 (July 23, 2019).

122. Natalie Kerris, *Nike and Apple Team Up to Launch Nike+iPod*, APPLE (May 23, 2006), https://www.apple.com/newsroom/2006/05/23Nike-and-Apple-Team-Up-to-Launch-Nike-iPod/ [https://perma.cc/59S2-LFJ5]; *Apple & Nike Launch the Perfect Running Partner, Apple Watch Nike+*, APPLE (Sept. 7, 2016) https://www.apple.com/gr/newsroom/2016/09/07Apple-Nike-Launch-the-Perfect-Running-Partner-Apple-Watch-Nike-/ [https://perma.cc/8HXX-XJT6]; Mark Sullivan, *Apple Watch Sales Were Way Up Over the Holidays, Slice Data Shows*, FAST COMPANY (Jan. 6, 2017) https://www.fastcompany.com/3067040/apple-watch-sales-were-way-up-over-the-holidays-slice-data-shows [https://perma.cc/Z9VN-FHSW].

123. Mark Sullivan, *Apple Watch Nike+ May Be Nike's Reward for Letting FuelBand Die*, FAST COMPANY (Sept. 7, 2016), https://www.fastcompany.com/3063539/apple-watch-nike-may-be-nikes-reward-for-letting-fuelband-die [https://perma.cc/LJZ8-E3YF].

its peers, does not disclose its standard for determining independence, nor does it imposed heightened requirements for the role of lead independent director, allowing the "independence" designations of directors like Cook to go unchecked.

Structurally, lead independent directors are likely to suffer from the same unchecked designation, tenure, and informational capture limitations as other independent directors.[124] Most companies' lead independent director structure perpetuates the lack of necessary disclosures rather than addresses it. For example, because companies choose when to designate a lead independent director, some choose only to do so when the CEO and chair are the same person,[125] while others only do so when the chair is an insider.[126] This essentially allows the company to choose when the heightened monitoring that a lead independent director theoretically provides is necessary. Similarly, very few companies set term limits for their lead independent directors.[127] Finally, while a minority of companies allow lead independent directors to communicate with management regarding the board's request for information, there remains a prevailing lack of unfiltered access to company information, which is a necessity to effectively monitor management.

Even when a lead independent director is truly independent, concerns arise with the level of influence afforded to her. While many companies follow proxy advisor guidelines for delineating lead independent director duties, data suggests these powers are often qualified by limiting language that subjugates lead independent directors' power.[128] ISS has advocated that several key duties be granted to lead independent directors, including: serving as liaison between the chairman and the independent directors; approving information sent to the board; approving meeting agendas for the board; approving meeting schedules to assure that there is sufficient time for discussion of all agenda items; the ability to call meetings of the independent directors; and, if requested by major shareholders, availability for consultation and direct communication.[129] While each of these powers is highly prevalent among companies, these powers are often qualified by limiting language that suppresses lead independent directors power.[130] For

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124. Thomas, *supra* note 102, at 72.

125. *Corporate Governance Guidelines*, *supra* note 115.

126. *See, e.g.*, *Corporate Governance Principles*, BEST BUY CO., INC. (2019), http://s2.q4cdn.com/785564492/files/doc_downloads/Gov_docs/2019/09/13/Corp-Gov-Principles-Sept-2019.pdf [https://perma.cc/FDK3-7E9U].

127. *See* Nili, *Board Gatekeepers' Independence*, *supra* note 33.

128. *Id.*

129. Carol Bowie, *ISS 2015 Independent Chair Policy FAQs*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 26, 2015), https://corpgov.law.harvard.edu/2015/01/26/iss-2015-independent-chair-policy-faqs/ [https://perma.cc/N2CH-J7TL].

130. Full statistics on the weakening of ISS recommended powers forthcoming. *See* Nili, *Board Gatekeepers' Independence*, *supra* note 33.

example, "approving information sent to the board," becomes "approves, in consultation with the Chairman of the Board and other members of senior management and to the extent practicable, the information to be provided to the Board;"[131] and "approving meeting agendas for the board" becomes "advising the Chairman on the agenda for Board meetings."[132] This limiting language hamstrings the effectiveness of the lead independent director structure and introduces the possibility that lead independent directors are more symbolic than functional.

The current inadequacy of the lead independent structure bears out anecdotally. Returning to the example of Tim Cook, the lead independent director for Nike, it is worth noting that Apple's Compensation Committee includes Nike as one of its "peer companies,"[133] meaning Apple "reviews compensation practices and program design" to use as a benchmark for setting its own management compensation.[134] Interestingly enough, Cook is the chair of Nike's compensation committee,[135] meaning he has say on Nike's management compensation—a factor Apple's compensation committee will consider when deciding to set Cook's own salary as Apple's CEO. Thus, in theory, Cook has the power to influence Apple's compensation committee by raising compensation at Nike. The "long-standing partnership" between the companies, combined with Cook's ability to influence his own compensation via his role on Nike's compensation committee, raises substantial doubt as to his ability to be a truly independent monitoring check. The current lead independent director framework, however, does nothing to account for this misalignment.

CONCLUSION

Director independence has become a cornerstone of modern corporate governance in the United States. Investors have placed the characterization of "independent director" on a pedestal, companies taut their boards as independent, and regulators and stock exchanges have required the presence of independent directors on public companies'

131. *Corporate Governance Guidelines*, WALGREENS BOOT ALLIANCE 3 (Jan. 25, 2019), https://s1.q4cdn.com/343380161/files/doc_downloads/governance_guidelines/WBA-Corporate-Governance-Guidelines-(2019-01).pdf [https://perma.cc/RXK2-4ZCX].

132. *Corporate Governance Guidelines*, FORD MOTOR COMPANY (Mar. 2015) https://corporate.ford.com/content/dam/corporate/en/company/corporate-governance/Company_Governance_Corporate_Governance_Principles.pdf [https://perma.cc/G6N3-8VGD].

133. Apple, Inc., Proxy Statement (Form Def 14A) 33 (Dec. 27, 2017).

134. *Id.* at 34.

135. John Kell & Jonathan Vanian, *Tim Cook Becomes Nike's Lead Independent Director*, FORTUNE (June 30, 2016), https://fortune.com/2016/06/30/apple-ceo-tim-cook-nike/. [https://perma.cc/8TW6-TH58].

boards. Yet, as this essay outlined, in reality, a combination of structural inadequacies and a discretionary definition raise significant concerns regarding the current framework's ability to match what investors and regulators strive for and expect from independent directors—proper monitoring of boards.

More concerning is that the current use of independence as a designation for directors and boards may actually camouflage significant issues that boards may face by relying on a designation that holds little meaning. To borrow Professor Rodrigues' cautionary words from 2008, we may fetishize the notion of director independence by making the designation of a director as independent the end in itself, instead of the means to achieve better governance in the boardroom.[136]

It is therefore necessary to start considering the possibility that regulators and companies may be doing a disservice to shareholders by cultivating a false sense of trust in the independence of their board of directors. Indeed, the mere use of the term "independent" may be untenable in the context of corporate governance. Instead, regulators and investors must clearly identify the goals that have led to the infusion of independent directors—the monitoring of mangers and other directors—and tailor a more realistic and concrete framework to ensure its success. This revised framework must not merely focus on naming a director as independent, but rather must focus on the tools, qualities, and information available to a director to ensure that such director acts in an independent and informed manner.

Future work must tackle this elusive concept. Corporations have outsized impact not only on their investors but also on our society as a whole. Directors play a key role both in governing the corporation and in representing shareholders' interests. Ensuring a *functionally* independent board rather than the current declaratory designation is a crucial step in ensuring that corporations are accountable to their investors.

136. *See* Rodrigues, *supra* note 19, at 453.