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BUSINESS DECISIONS BY THE NEW BOARD: BEHAVIORAL SCIENCE AND CORPORATE LAW†

Robert J. Haft*‡

Not long ago, the boards of directors of large American corporations¹ generally rubber-stamped the decisions of top management.² As lower-rank officers or business associates of the corporation, most directors were beholden to one "director," the chief executive officer. The board rendered friendly advice to the chief executive and fired him if he performed very poorly.³ Almost invariably, however, the chief executive dominated the old board. This pattern of subservience has recently begun to give way. "Independent" or nonmanagement directors now constitute a majority of the typical board of the 1,300 largest corporations in the United States.⁴ Along with this independence has come an unmistakable trend toward increasing the

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1. This Article deals with only the very largest American corporations. The cut very roughly includes companies with over \$150 million in assets or \$1 billion in annual sales, with publicly traded common stock. This comprises, in the corporate statistical data later cited, no less than the "Fortune 500," nor more than the 1,300 largest corporations. Most of the analysis in this Article is premised on the existence of a board consisting of a majority of independent directors, which these companies have recently achieved, and part of the analysis is based upon corporate organizations with virtually autonomous divisions, usually a function of operations which are very large in size and complex. The other large- and medium-sized publicly held corporations may not have a majority of independent directors or autonomous divisions in the foreseeable future.

2. One president has said, "We get a little advice from the outside board members, but the management runs the company. The board rubber-stamps the action of the management, and the board members are there to mollify the outside stockholders." Mace, *The President and the Board of Directors*, HARV. BUS. REV., Mar.-Apr. 1972, at 37, 39. Accord, R. GORDON, BUSINESS LEADERSHIP IN THE LARGE CORPORATION 131 (1945) ("For the majority of the corporations studied, the available evidence strongly suggests that ratification of management proposals by the board is largely a formality."). But see *End of the Directors' Rubber Stamp*, BUS. WEEK, Sept. 10, 1979, at 72 (noting a greater willingness by directors to challenge management policies).

3. See M. MACE, DIRECTORS: MYTH AND REALITY 15 (1971); Mace, *supra* note 2, at 37-41; Mace, *Directors: Myth and Reality — Ten Years Later*, 32 RUTGERS L. REV. 293, 303-04 (1979).

4. HEIDRICK & STRUGGLES, INC., THE CHANGING BOARD 1980 UPDATE 2 (1980) [hereinafter cited as HEIDRICK & STRUGGLES 1980]. This study seems to exclude from the definition of independent directors not only full-time corporate officers, but also their family members, retired corporate officers, lawyers and commercial or investment bankers doing business with

role of the new board in corporate governance.⁵

Although some evidence suggests that recent innovations designed to strengthen the board's role⁶ have been more cosmetic

the corporation. Other studies citing higher percentages of outside directors do not seem to make this distinction.

The most recent survey, conducted by the Securities and Exchange Commission, finds that the boards of the largest companies (over \$150 million in assets) consist of very slightly under a majority (48.5%) of "independent" directors, under the most stringent of definitions. Securities Exchange Act Release No. 17518, 21 SEC DOCKET 1551, 1558, at Table 2 (Feb. 17, 1981) [hereinafter cited as SEC 1980 Study]. This stricter definition of independent directors excludes: present employees of the company and its affiliates, former employees, relatives of executive officers, creditors, suppliers, customers, retained attorneys, investment bankers, and control persons.

5. This trend is being accelerated at the instance of traditionally powerful forces on the corporate scene: the New York Stock Exchange, the Business Roundtable, and the American Bar Association. See Andrews, *The Roundtable Statement on Boards of Directors*, HARV. BUS. REV., Sept.-Oct. 1978, at 24, 30; *Corporate Director's Guidebook*, 33 BUS. LAW. 1591, 1625 (1978) (ABA encourages nonmanagement director majorities to effectuate independent decision-making) [hereinafter cited as *Guidebook*]. But see Hetherington, *When the Sleeper Wakes: Reflections on Corporate Governance and Shareholder Rights*, 8 HOFSTRA L. REV. 183 (1979); Kripke, *The SEC, Corporate Governance, and the Real Issues*, 36 BUS. LAW. 173 (1981); Letts, *Corporate Governance: A Different Slant*, 35 BUS. LAW. 1505 (1980). In 1978, the New York Stock Exchange required all its listed companies to create an audit committee composed of independent directors.

6. Most of the largest corporations have audit committees of the board, with the power to delve deeply into the company's records, methods, and practices. See note 15 *infra*. The board's role is also expanding as a result of the creation of compensation committees, composed of independent directors. Such committees, which exist in most of the largest corporations, fix the terms of top management compensation. KORN/FERRY INTERNATIONAL, BOARD OF DIRECTORS SEVENTH ANNUAL STUDY 3 (1980) [hereinafter cited as KORN/FERRY 1980]. About 80% of the largest corporations have a compensation committee. SEC 1980 study, *supra* note 4, at Table 11. Over 88% of companies listed on the New York Stock Exchange have one. *Id.* About 72% of the members of this committee in the largest companies are "independent" under the most stringent definition. *Id.* at Table 16. In addition, over 45% of the 1,300 largest corporations have a director nominating committee. HEIDRICK & STRUGGLES 1980, *supra* note 4, at 3. About 45.5% of responding companies from the 1000 largest industrial companies and 300 leading nonindustrial corporations have a nominating committee making the initial decision approving board prospects. This is a recent and significant change. Now, the initial decision in approving board prospects is made by the directors, not the chief executive, in 58% of the 1300 largest companies, either through the nominating committee (45.5%) or by all directors as a group (12.7%). *Id.* Over 75% of the very largest corporations (at least \$2 billion in sales) make the initial decision in the nominating committee (69.2%) or the decision is made by all directors (6.4%). *Id.* The initial decision is made by the chief executive in 26.6% of all 1300 companies and in 16.7% of the very largest companies. *Id.*

A more recent survey indicates that about 40% of the largest companies (over \$150 million in assets) have a nominating committee. SEC 1980 Study, *supra* note 4, at Table 18. Almost 49% of the largest companies which are listed on the New York Stock Exchange have one. *Id.* About two-thirds of the members of this committee in the largest companies are "independent" under the most stringent definition. *Id.* Almost all (97.4%) nominating committees "select or recommend nominees" for the board, but only 12.7% "evaluate incumbent directors." *Id.* at Table 21. See KORN/FERRY INTERNATIONAL, BOARD OF DIRECTORS EIGHTH ANNUAL STUDY 4 (1981) [hereinafter cited as KORN/FERRY 1981] (52% of the responding 576 large corporations have a nominating committee and another 8% are considering establishing one).

Most of the largest corporations have board audit committees empowered to delve deeply into the company's records, methods and practices. Boulton, *The Evolving Board: A Look at the Board's Changing Roles and Information Needs*, 3 ACAD. MGT. REV. 827, 828 (1978) (discussing effects of increasingly active audit committees). Over 95% of the largest companies (over \$150 million in assets) have an audit committee, including virtually all companies listed

than real,⁷ it is clear that the new board will become an important locus of corporate power in the near future. Substantive effects usually lag behind structural changes, and these changes are all relatively recent. In fact, 1980 may have been the watershed year. Nearly half (48.5%) of the directors of companies with over \$150 million in assets were persons "independent" of management in a rigorous sense. These "independent" directors were not present or former officers, employees, relatives of officers, creditors, suppliers, customers, retained attorneys, investment bankers, or control stockholders of the company.⁸ In other words, the new breed of director has no economic stake in the company, other than the relatively modest compensation associated with the directorship. And since 1980, the board, and not the chief executive, has made the initial decision approving nominees for election as directors in almost seventy percent of the very largest corporations (\$2 billion sales) and in over fifty-eight percent of the 1,300 largest companies.⁹ Nearly eighty percent of the 1,300 largest companies recently stated that the board will exert more influence,¹⁰ and the momentum generated by recent pressures to reform corporate governance will undoubtedly continue.

The board that is emerging in the large corporations to fill this more influential role is a peer group — a collegial body of equals in the critical sense that one (the chief executive) does not wield special power over the others. The independent directors will naturally give weight to the chief executive's views, based on the latter's special knowledge and experience, but this is qualitatively different than the domination of the old board by the chief executive. This new equality among board members will be reinforced by the rough equality in socioeconomic status that has always existed on boards of direc-

on the New York Stock Exchange. SEC 1980 Study, *supra* note 4, at Table 11. About 82% of the members of this committee in the largest companies are "independent" under the most stringent definition. *Id.* at Table 17. Of these committees, about 75.4% review the adequacy of the corporation's internal controls, but only 9% direct internal corporate investigations. *Id.* at Table 20. See Burns, *On the Rationale of the Corporate System*, in *THE CORPORATE SOCIETY* 121, 174 (R. Marris ed. 1974).

7. See Solomon, *Restructuring the Corporate Board of Directors: Fond Hope — Faint Promise?*, 76 MICH. L. REV. 581, 590-601 (1978).

8. SEC 1980 Study, *supra* note 4, at Table 2.

9. HEIDRICK & STRUGGLES 1980, *supra* note 4, at 3.

10. In a recent survey, nearly 80% of the 1300 largest companies believe boards will exert more influence on corporate governance in the future. HEIDRICK & STRUGGLES 1980, *supra* note 4, at 1. Certain business commentators envision boards of directors playing a much more significant role in strategic planning for the company. See, e.g., Wommack, *The Board's Most Important Function*, HARV. BUS. REV., Sept.-Oct. 1979, at 48.

tors.¹¹ To discharge its new responsibilities, the new board will be more active, primarily through committees of the board, than the old board. Already the board and its committees are meeting more often. Directors are working harder, both in terms of preparatory homework and time spent at meetings,¹² and are receiving greater compensation.¹³ This trend toward more work and higher compensation will likely continue, and boards may shrink in size to become optimal work groups (with the shirkers or those with too many directorships resigning), or boards may divide progressively more work among their various committees.¹⁴

It is unclear, however, whether the board's functions will increase beyond "monitoring" the performance of management, proffering advice to the chief executive when requested, and considering management's business proposals. Commentators agree that today the board does no more than this. Although time and informational constraints will continue to prevent the board from managing or actually supervising the corporation's business, its new-found independence should result in more careful and skeptical consideration of management's business proposals than in the past. And the independent directors will demand, and receive, more information relevant to important corporate matters.¹⁵

These emerging trends are consistent with the view, currently supported by the commentators and the corporate establishment, that directors should be "monitors."¹⁶ They are also consistent with viewing directors as "deciders." This Article's thesis is that, by rea-

11. KORN/FERRY 1981, *supra* note 6, at 3, Table 3. The independent directors are drawn from the upper ranks of other companies, academia, the bar, commercial and investment banking, and the government.

12. The boards of the largest companies (over \$150 million in assets) meet 8.6 times per year. SEC 1980 Study, *supra* note 4, at Tables 2 & 8. About one-third have 9 to 12 board meetings per year. *Id.* at 1553. In addition, the audit, compensation, and nominating committees of these companies meet, respectively, 3.2, 3.3, and 2.2 times per year. *Id.* at Table 12. Further, the SEC observes that "there is evidence that some boards are becoming more active." *Id.* See KORN/FERRY 1981, *supra* note 6, at 8. See generally ARTHUR YOUNG EXECUTIVE RESOURCE CONSULTANTS, THE NEW DIRECTOR 28-29 (1981) [hereinafter cited as THE NEW DIRECTOR] (board meetings may be decreasing from an average of 10 to 14 meetings per year in 1967 to six to eight meetings in 1979, but the use of committees is increasing significantly).

13. KORN/FERRY 1981, *supra* note 6, at 5-8 (aggregate and average fees have increased, but fee per hour of work has decreased); SEC 1980 Study, *supra* note 4, at 1533.

14. HEIDRICK & STRUGGLES, INC., THE CHANGING BOARD 4 (1977) [hereinafter cited as HEIDRICK & STRUGGLES 1977]. But see KORN/FERRY 1981, *supra* note 6, at 3 ("For the seventh consecutive year, the average number of directors . . . is 13.").

15. Boulton, *supra* note 6, at 835; HEIDRICK & STRUGGLES 1977, *supra* note 14, at 10.

16. SEC, STAFF REPORT ON CORPORATE ACCOUNTABILITY, *printed for the use of SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS*, 96th Cong., 2d Sess. 549-53 (1980) [hereinafter cited as STAFF REPORT].

son of its recently secured independence from management domination, the boards of directors of large American corporations are now in a unique position to make business decisions of the highest quality,¹⁷ and that corporate law should respond to this potential appropriately. On the basis of findings in the behavioral sciences, this Article urges a limited rethinking of the role of the chief executive and the board of directors before the model of directors as "monitors" of the chief executive's performance is frozen in place. Already armed with information supposedly received as monitors, the independent director group can best employ its limited time by doing what corporate law used to command (and still strongly suggests): making business decisions.

There is growing recognition by the corporate establishment in America that its priorities should be reordered to achieve profit maximization in the long-term rather than in the short-term. The recent stress on financial wizardry and short-term profit may well shift to an emphasis on manufacturing superior products at prices competitive with other nations and on making long-term investments for real productivity gains.¹⁸ The new board is uniquely equipped to make

17. "High-quality decisions" is not a loaded phrase for some hidden social or political agenda. This Article simply assumes that an objective standard of excellence exists for business decisions and focuses upon the traditionally important decisions of corporate life: markets, acquisitions, major corporate goals, and strategic planning, all for profit maximization. One could apply the approach just as consistently to social responsibility or any other goal, provided the peer decision-making group agrees upon the relevant common values and objectives.

18. Reginald H. Jones, the recently retired chairman of General Electric and Chairman of the Business Council, took this position in a recent interview in the *Washington Post*:

The biggest problem in American business today, Jones said, is the sharp decline in the quality of U.S.-produced goods, a factor he attributes largely to a "management-malaise" that he says has permeated corporate suites in recent years and inhibited executives from taking steps to stay ahead.

The only hope for correcting it: Revamp the thinking in corporate boardrooms, Jones says, so directors and stockholders recognize they sometimes must forgo short-term profits to make the kinds of needed investments that will "enhance the long-range opportunities of the corporation."

"What we have today," Jones says, "is a bunch of money managers who are under tremendous pressure from Wall Street to have every quarter a little bit better than the last, and I'm not sure it's realistic." If you're going to make long-term improvements, he asserts, profits occasionally may have to slip.

Jones complains bitterly that this profits-at-any-price quest has brought on a spate of illnesses in American business — not only the decline in quality, but a falloff in productivity, a slump in corporate investment and a lag in research and development.

How do you turn that around? "To me, that puts the onus squarely on the board of directors," Jones says. Corporate directors must "encourage management to make investments that will enhance" longer-range opportunities — even if they mean some diminution of profitability in the short run.

In Corporate Leadership, An Era Ends at G.E. Co., Wash. Post, Mar. 29, 1981, § H, at 1, col. 1, 7, col. 3. See also Hayes & Abernathy, *Managing our way to economic decline*, HARV. BUS. REV., July-Aug. 1980, at 67.

these decisions. Neither time nor informational constraints should foreclose such decisions from board purview. The difference between directors as monitors or deciders is one of degree or emphasis. But like gender, the difference could become dramatic.

In Part I, this Article summarizes the empirical research that compares the decision-making capabilities of peer groups such as the new board with those of individuals and other groups. All other things being equal, the new board will make better decisions than the individuals and groups within the corporation who have a more direct stake in its short-term profitability. Part II suggests some legal responses to these findings. It argues primarily that the law should encourage truly independent directors to serve and act not merely as "monitors," but rather as "deciders." To promote these ends, courts can accord more certain, and probably greater, legal protection to business decisions reached by the truly independent board than does current law. This can be effected by the courts under the business judgment rule. Part II concludes with a brief discussion of certain legal rules and corporate governance "reform" proposals that may create inequalities of power among the directors, and thus undermine quality decision-making.

A number of other factors, discussed in Part III, may also affect the quality of peer group decision-making. For example, the behavioral sciences, particularly the small group literature, suggest that "cohesiveness," friendship, and trust among group members — as well as common values and objectives — promote better group performance. The first section of Part III thus considers various governance proposals that threaten group cohesiveness. It then examines the extent to which corporate law should distinguish among directors for liability purposes, and urges that courts refrain from individualizing the scope of directorial duty unless a particular director's conduct is fraudulent or illegal.

The second section of Part III analyzes other conditions that promote high quality decisions. Small group researchers suggest that the proper group size for optimal decision-making is five, supporting the typical thirteen-person board that divides decision-making tasks among smaller committees. Other behavioral scientists have found that a "consensus" decision rule results in better group decisions than does a majority rule. Corporate law should respond appropriately.

Part III's final section confirms that peer group decision-making is not a panacea. Unless counteracted, the natural group pressures promoting conformity and a rush to decide will undermine quality

decisions. The empirical findings suggest certain procedural steps that the new board can take to ameliorate "groupthink" tendencies. Certain of these procedures — *e.g.*, separating the roles of chief executive and chairperson of the board or assigning a different director at each meeting to serve as a formal devil's advocate — have received substantial evidential support. The courts can provide incentives to adopt one or more of these procedures by affording additional legal protections to the decisions of an independent board that has such a procedure in place.

Part IV takes up the thorniest subject — the proper allocation of decision-making between the chief executive and the new board in the large corporation. Social psychologists have found that peer groups make better decisions than do individuals, whose limited cognitive capacities lead to more systematic errors in decision-making than was previously supposed. These findings suggest that the board should make more of the decisions currently made by the individual chief executive. Time constraints demand that most major decisions be made by the chief executive, either alone or in consultation with subordinates. But, the Article argues, the board, and not the chief executive, should formulate long-term and strategic plans,¹⁹ make decisions affecting the entire organization, and choose between stark alternatives. Peer group decision-making by the new board will be better in such cases than decisions by the chief executive.

Recognizing that these changes may not occur without some judicial prodding, Part IV suggests several legal approaches to the division of decision-making between the chief executive and the new board. By extending the protection of the business judgment rule, courts can encourage the board to decide more and delegate less to the chief executive. Similarly, by denying business judgment protection and revitalizing agency principles, they can discourage the chief executive from making business decisions that should be left to the board.

At the same time, corporate law should eliminate any suggestion that independent directors must conduct their own investigations into corporate activities. "Monitoring," in the investigative sense, should be the duty of the chief executive and responsible senior executives, not the new board. The courts should utilize agency princi-

19. See Shanklin & Ryans, *Inside/Outside Director Information Needs: A Survey*, DIRECTORS & BOARDS, Winter 1981, at 22-25; Wommack, *supra* note 10, at 48 (board's "most important function is to approve or send back . . . management's recommendations about the future direction of the corporation"). Cf. HEIDRICK & STRUGGLES 1977, *supra* note 14, at 11 (noting that two-thirds of the board chairmen surveyed considered input on long-term planning to be the board's most important function).

ples or the business judgment rule to encourage the chief executive to pierce the pervasive informational blockages in the huge organization, and report to the board the information that is critical to its decisions. In the process, the chief executive will also acquire more accurate information in the decision areas that the board has explicitly delegated to him.

I. THE FINDINGS OF THE BEHAVIORAL SCIENCES

A. *Can the Behavioral Sciences Supply "Empirical" Findings?*

Many persons perceive the behavioral sciences, particularly psychology and social psychology, as "soft" — too general and vague to be put to practical use, and too new to be given weight in daily affairs.²⁰ They are naturally skeptical of "empirical" findings that are based on laboratory experiments conducted by a professor, with his or her students as subjects. Two methodological problems may justify this natural skepticism. First, it is not clear that college students are representative of the population at large.²¹ Second, these findings may be distorted by the "experimenter expectancy effect," which occurs when the professor unconsciously gets his students to do what he wants them to do and then reports their actions as empirical findings.²²

Behavioral scientists, however, are increasingly using the methodologies of the natural sciences to measure the variables in human behavior. Many of the findings summarized in this Article were first made in controlled laboratory studies and later confirmed by field observations in natural settings.²³ Recent experimental designs have also sought to eliminate the experimenter expectancy effect. And, as some recent findings in cognitive psychology suggest, it is our much-prized individual intuition that may be "soft" and unreliable.²⁴

20. See Miller, *Hard Realities and Soft Social Science*, PUB. INTEREST., Spring 1980, at 67.

21. Miner, *A Comparative Analysis of Three Diverse Group Decision Making Approaches*, 22 ACAD. MGT. J. 81, 90 (1979) (quoting McNemar, *Opinion Attitude Methodology*, 43 PSYCH. BULL. 289, 333 (1946)) ("the existing science of human behavior is largely the science of the behavior of [college] sophomores").

A classic and incisive analysis of directors' behavior under various legal rules was provided by Professor Alfred F. Conard, and, happily, without reliance on findings concerning college sophomores. See Conard, *A Behavioral Analysis of Directors' Liability for Negligence*, 1972 DUKE L.J. 895.

22. R. ROSENTHAL, EXPERIMENTER EFFECTS IN BEHAVIORAL RESEARCH 127-40 (1966). See Krattenmaker & Powe, *Televised Violence: First Amendment Principles and Social Science Theory*, 64 VA. L. REV. 1123, 1153-54 (1978).

23. Cf. M. SHAW, GROUP DYNAMICS 428-36 (3d ed. 1981) (noting that field observations have confirmed a number of laboratory findings concerning group behavior).

24. See notes 208-22 *infra* and accompanying text.

A vast body of literature exists on group decision-making. Well-known psychologists, political scientists, social psychologists, economists, sociologists, and others have contributed to the field. The empirical evidence strongly supports the proposition that, all other things being equal, decisions made by a peer group are qualitatively better than those of an individual or of a group of nonpeers.

B. *Peer Groups Make Better Decisions Than Do Individuals*

The evidence shows that peer groups produce better solutions to problems than do individuals working alone. With some dissent, the evidence also supports the proposition that peer groups perform better than the best individual in the group. This is the "assembly bonus effect." Intellectual synergy apparently occurs in peer groups.

The types of problems used in the many experiments vary greatly.²⁵ The studies are, however, sufficiently similar to indicate that group superiority obtains when the contributions of several individuals can be combined, when decisions require the creation of ideas and recall of information, and when group members are permitted to correct individual errors.²⁶ Theories advanced to explain group superiority include the influence and ability of the best or most confident group member and the greater individual interest in the problem that participation in group decision-making arouses.²⁷ Groups also correct errors of fact or of judgment that are randomly distributed among their members.²⁸ Obviously, groups expend more person-hours than individuals,²⁹ but the potential benefits from high-quality decisions at the top level of the largest corporations overwhelmingly outweigh the extent to which costs of director-group decisions exceed the costs of decisions by individual chief executives.³⁰

The earliest studies involved simple tasks with one correct solution, and groups clearly outperformed individuals.³¹ Later, in 1959,

25. See M. SHAW, *supra* note 23, at 60-64.

26. *Id.* at 78.

27. *Id.* at 64.

28. See *id.* at 57-62, 77-78.

29. *Id.* at 78.

30. The "costs" referred to are the dollar costs of the corporation and the opportunity costs of the directors. If opportunity costs become too high because too much work is demanded from them, the directors will simply quit. Thus, the corporation faces an upper limit on the amount of decision-making it can demand from the new board.

31. For example, Thorndike in 1938 found that, in experiments involving 56 Barnard students, groups were superior to individuals in problems involving sentence completion, limericks, and crossword puzzles. Thorndike concluded that groups are superior when dealing with materials "permitting a greater range of response." Thorndike, *On What Type of Task*

Barnlund reported evidence of group superiority in logical problem solving.³² He compared the performances of individuals working alone and as members of decision groups, recording and analyzing the discussions of over 170 college students making 829 decisions. Only two of the twenty-nine groups failed to outperform their own best member. In both of these groups, an individual had received an almost perfect initial score. Barnlund concluded that the superior group results reflected the dynamics of the group itself, which led to greater concentration on the problem, more enthusiasm, stimulation of more careful thinking, consideration of a wider range of ideas, and critical testing of ideas through discussion.³³

More recent experimental designs evince a high degree of scientific sophistication and use advanced statistical techniques to evaluate both the design and the results. For example, Felsenthal and Fuchs presented individuals and groups with a complex problem involving over twenty variables and having only one correct answer. The results corroborate the proposition that groups are superior to individuals in complex problem solving.³⁴ Other recent experiments reported by Hall and Watson³⁵ and by Nemiroff³⁶ evaluated complex decisions made under conditions of high uncertainty — the context of most major business decisions. Both used the National Aeronautics and Space Administration's Moon Survival Problem. Subjects ranked fifteen items of equipment in order of their importance for survival, making fifteen interdependent judgments. All subjects first ranked the fifteen items on their own, and then joined groups. The experimenters instructed certain groups to tolerate di-

Will a Group do Well?, 33 J. ABNORMAL & SOC. PSYCH. 409, 413 (1938). Similarly, Taylor and Faust in 1952 found that groups performed significantly better than individuals in playing the game of Twenty Questions. Taylor & Faust, *Twenty Questions: Efficiency in Problem Solving as a Function of Size of Group*, 44 J. EXPERIMENTAL PSYCH. 360, 367 (1952). They found superiority in terms of fewer questions posed, fewer number of failures, and shorter elapsed time to solution. In the experiment, 105 psychology students participated. Thirty small groups were compared to fifteen individuals over a period of five days of testing. *Id.* at 361. The game is an example of a problem involving broad and imaginative search leading to one specific solution.

32. Barnlund, *A Comparative Study of Individual, Majority, and Group Judgment*, 58 J. ABNORMAL & SOC. PSYCH. 55, 56 (1959).

33. *Id.* at 59-60.

34. Felsenthal & Fuchs, *Experimental Evaluation of Five Designs of Redundant Organizational Systems*, 21 AD. SCI. Q. 474, 485 (1976) (reporting on experiments involving 1,674 third-year college students).

35. Hall & Watson, *The Effects of a Normative Intervention on Group Decision-Making Performance*, 23 HUMAN REL. 299 (1970) (reporting on experiments involving 148 businesspersons attending various management seminars).

36. P. Nemiroff, *Group Decision-Making Performance as Influenced by Consensus and Self-Orientation* (Oct. 1973) (unpublished graduate paper on file with the *Michigan Law Review*).

verse opinions and attempt to reach a consensus. Other groups were given no instructions. Hall and Watson's sixteen instructed groups outperformed their most proficient member, while the sixteen uninstructed groups performed as well as their most proficient member and better than the average individual in the group.³⁷ Nemiroff replicated Hall and Watson's experiment, and obtained nearly the same results.³⁸

Empirical studies have consistently indicated that peer groups outperform individuals in complex problem solving. Only one major summary registered a partial dissent. Olmstead and Hare agree that groups generate more correct solutions, make fewer errors, detect errors more quickly than individuals and are "usually better at solving problems than the average individual" in the group. They concluded, however, that groups are "seldom better than the best individual."³⁹

In all important aspects, the peer group superiority findings apply to the new board. Independent directors now comprise the majority of a collegial body of equals at the apex of the corporate hierarchy. These independent directors, unlike the chief executive and the various vice presidents and middle-level managers, have no direct stake in the year-to-year fluctuations in the corporation's profits. Their annual directors' compensation is not geared to short-term results. In the very largest corporations, directors typically receive flat annual compensation plus a fixed per-meeting fee, resulting in noncontingent compensation ranging from \$18,000 to \$22,000 per annum.⁴⁰ Compensation at this level does not give the typical independent director a significant economic stake in the company because these highly qualified persons could earn more for the directorial time and effort expended (and with lesser potential liability) in their principal or related occupations.⁴¹ The potential for

37. Hall & Watson, *supra* note 35, at 300-01.

38. P. Nemiroff, *supra* note 36, at 8, 22.

39. M. OLMSTED & A. HARE, *THE SMALL GROUP* 86 (2d ed. 1978). They further state: [R]esearch has revealed no unambiguous rules for constructing creative groups. . . . Executives responsible for establishing the methods of decision-making and problem-solving for their organizations may be able to acquire insights and wisdom from small-group research, but as yet there is a dearth of applicable and at the same time adequately grounded and reliable findings.
Id. at 86.

40. KORN/FERRY 1981, *supra* note 6, at 14. The SEC 1980 Study, *supra* note 4, at Tables 8, 9, 10 & 12, indicates a lower range of compensation, but the KORN/FERRY data is not on a basis comparable to the SEC data.

41. The "hourly rate" averages \$119. KORN/FERRY 1981, *supra* note 6, at 8.

high-quality decision-making in the large corporation thus exists in the new board.

C. Other Decision-Making Groups: Uneven Decision Quality

The new board is in a unique position to make decisions guided solely by the qualitative standard of excellence in furthering corporate goals. In contrast to the new board, the chief executive, other high officers, and middle-level managers of the largest corporations earn extremely large salaries, and many receive contingent compensation of hundreds of thousands of dollars (and more for some chief executives) based upon the bottom-line profit in the particular year. Given such high individual stakes, the vice-presidents group, the managers of the various autonomous divisions of the large corporation, and some other decision-making peer groups below them tend to make decisions based more upon individual security and advancement than upon qualitative excellence.⁴² Short-term solutions, coalition bargaining among divisional managers, "political" acceptability, "muddling through," "satisficing," and "log rolling" are endemic to decision-making by these peer groups because of their large and direct stakes in the short-term operations of the organization.⁴³ Whether their particular decisions also meet objective criteria of excellence depends primarily on chance. The previously summarized findings of peer group superiority do not apply to these groups.

Until recently, the chief executive, the various vice presidents, retained counsel, and others beholden to the chief executive comprised

42. See generally P. DRUCKER, *THE PRACTICE OF MANAGEMENT* 147-75 (1954); Hayes, *The Real Story on Group Executives*, *DIRECTORS & BOARDS*, Fall 1980, at 11, 11-16; Vance, *Shared Chief Executive Authority: Chaos or Collegiality?*, *DIRECTORS & BOARDS*, Fall 1980, at 5 (chief executive authority sharing by a small group in major companies is on the rise again). But see *Greyhound Taps Batastini as President, Revives Executive Office After 5 1/2 Years*, *Wall St. J.*, Nov. 21, 1980, at 8, col. 2 (reporting on the formation of a chief executive "group," but not peers).

43. See, e.g., R. CYERT & J. MARCH, *A BEHAVIORAL THEORY OF THE FIRM* (1963); D. KATZ & R. KAHN, *THE SOCIAL PSYCHOLOGY OF ORGANIZATIONS* (2d ed. 1978); J. MARCH & H. SIMON, *ORGANIZATIONS* 47-52 (1958); J. STEINBRUNER, *THE CYBERNETIC THEORY OF DECISION* 62, 74-75 (1974); Carter, *The Behavioral Theory of the Firm and Top-Level Corporate Decisions*, 16 *AD. SCI. Q.* 413, 421 (1971); Gamson, *A Theory of Coalition Formation*, in *SMALL GROUPS* 562 (A. Hare, E. Borgatta & R. Bales eds. rev. ed. 1965); Johnson, *Conflict Avoidance Through Acceptable Decisions*, 27 *HUMAN REL.* 71, 81 (1974) (top management makes the "second best decision" in order to increase certainty and reduce interpersonal friction); Mayhew & Levinger, *On the Emergence of Oligarchy in Human Interaction*, 81 *AM. J. SOC.* 1017, 1040-41 (1976); Pfeffer, *Power and Resource Allocation in Organizations*, in *PSYCHOLOGICAL FOUNDATIONS OF ORGANIZATIONAL BEHAVIOR* 278, 281-82 (B. Staw ed. 1977); Suedfeld, *Characteristics of Decision Making as a Function of the Environment*, in *MANAGERIAL CONTROL AND ORGANIZATIONAL DEMOCRACY* 203, 209 (1978); Zaleznik, *Power and Politics in Organizational Life*, *HARV. BUS. REV.*, May-June 1970, at 47.

a majority of the directors of most of the largest companies. The chief executive dominated the board, whose decision-making qualitatively resembled individual decision-making by the chief executive. Similarly, "group" decision-making sessions in large corporations today often do not involve peer groups because the participants rarely occupy the same positions in the hierarchy. As Richard Hoffman has stated:

The social systems in which the group is embedded impinge on its functioning. The authority relationships deriving from the formal organization structure seem most powerful. People with higher organizational ranks tend to participate more actively and to exercise undue influence in the group. These tendencies are, unfortunately, unrelated to the likelihood of their having the appropriate resources to solve the problem under consideration. The traditional stereotype that leaders control the decision process is held even by college students, with harmful effects on the problem-solving effectiveness of groups in our laboratory studies. The typical organizational reward system promotes this dependence on the leader's influence.⁴⁴

Argyris and Schon make the same point in a different way when they observe that "[top management] sessions are rarely classifiable as problem-solving sessions."⁴⁵

The limited evidence available also indicates that subordinates distort information when reporting to their superiors. Unless the subordinates trust their superior, they may say what they think the superior wants to hear.⁴⁶ The superior-subordinate relationship may similarly prejudice group "voting" on decisions. The pressure upon the subordinates in a group to conform to what they anticipate their superiors want is very strong.⁴⁷ Its pervasive presence in the corporate sector cannot be doubted, given the rewards that conformity of-

44. Hoffman, *Applying Experimental Research on Group Problem Solving to Organizations*, 15 J. APPLIED BEHAVIORAL SCI. 375, 380 (1979) (citations omitted).

45. *Id.* at 375 (citations omitted).

46. See O. WILLIAMSON, *MARKETS AND HIERARCHIES* 122-23 (1975); A. ZANDER, *GROUPS AT WORK* 28 (1977); Hoffman, *supra* note 44, at 387; Newman & Sussman, *Controlling the Sycophant: Policies and Techniques of Corporation Presidents*, ADV. MGT. J., Aug. 1978, at 14-15. Cf. Driscoll, *Trust and Participation in Organizational Decision Making as Predictors of Satisfaction*, 21 ACAD. MGT. J. 44, 44 (1978) (trust is defined as "the belief that decision makers will produce outcomes favorable to the person's interests without any influence by the person"). An experienced chief executive or other superior will "discount" or "counter-bias" information from subordinates. A good chief executive usually knows when the marketing executives are exaggerating projected sales or when they are doing the opposite (so as to claim credit at year-end for "increased" sales). However, a counter-biasing chief executive probably will not learn the true state of facts. He may not, for example, learn the sales figure that the marketing executives or even the sales people on the spot really believe will be achieved. See Jablin & Sussman, *Sycophancy in the Boardroom: Causes and Controls*, DIRECTORS & BOARDS, Winter 1980, at 40, 45. In contrast, communication in a peer group is very efficient. O. WILLIAMSON, *supra*, at 46-47.

47. See note 46 *supra*.

fers and the authoritarian-hierarchical traditions in most large corporations.⁴⁸ The quality of decisions made by such nonpeer groups is probably quite uneven, determined primarily by the quality of the individual superior's decision.

II. THE ROLE OF CORPORATE LAW IN PROMOTING PEER GROUP DECISION-MAKING

The behavioral sciences point to the new board as the best hope for high-quality major decisions in the large corporation. The courts can and should encourage the trend toward independent and more active boards by providing nearly absolute protection under the business judgment rule for the decisions made by a board or committee composed of a majority of independent directors. All business decisions by the independent directors should be insulated from attack in shareholder's derivative suits, save for (1) utterly gross mistakes of judgment that were patently obvious at the time of decision and resulted in very substantial and tangible damage to the corporation, and (2) those limited categories of decisions that directly and personally affect the fate of their codirectors, such as the decision to terminate a shareholder suit against codirectors.⁴⁹ Articulation of the rule in these terms (except for the second proviso) would afford greater and more certain legal protection to the decisions of independent directors than present case law. And, there appears to be a process-of-decision proviso to the business judgment rule, requiring due care or ordinary diligence by the directors. As argued later, this proviso should be eliminated or strongly diluted.⁵⁰

A rule that clearly articulated almost absolute protection for business decisions made by the new board might well increase, well beyond a bare majority, the number of independent directors on the new board. It may also encourage the chief executive to pass to the board certain important decisions that the chief executive previously made alone or in nonpeer group settings. Since the findings of the behavioral sciences indicate that, all other things being equal, peer

48. See M. SHAW, *supra* note 23, at 399; A. ZALEZNIK & M. KETS DE VRIES, *POWER AND THE CORPORATE MIND* 254 (1975); Argyris, *The CEO's Behavior: Key to Organizational Development*, HARV. BUS. REV., Mar.-Apr. 1973, at 55, 56.

49. The co-director exception raises wholly different behavioral issues because the cohesive peer group is asked to judge the conduct of one of its members. The derivative suit dismissal rule is the subject of many recent articles, most of which question the objectivity of judgments by directors of their codirectors. See Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261 (1981), and the articles cited therein at 263 n.13.

50. See text at notes 171-200 *infra*.

groups outperform both individuals, who may have severely limited cognitive capacities,⁵¹ and nonpeer groups, whose decisions are uneven in quality, these by-products will be beneficial.

A. *The Business Judgment Rule*

The business judgment rule supposedly protects directors from liability for their mistaken business decisions, absent fraud or self-dealing. A commentator has summarized the rule as follows:

Whether or not there is a specific statutory standard courts have widely applied the business-judgment rule to shield directors against allegations of ordinary negligence absent specific wrongful action by them. A court, it is said, will not substitute its judgment for that of directors when they act reasonably and in good faith. In the absence of self-dealing, therefore, if a decision of a board of directors can be attributed to "any rational business purpose," a court will not hold a director liable for honest errors or mistakes of judgment.⁵²

A number of policies underlie this rule, including encouraging qualified persons to serve as directors, minimizing judicial interference to permit private business enterprises to function at maximum efficiency, freeing directors to take business risks without inordinate caution, and avoiding the imposition of unfair liabilities by judges and juries who lack competence to evaluate complex business decisions and gain their wisdom by hindsight.⁵³ A tenet of free enterprise — the market can efficiently punish corporations for the negative outcomes of honest but erroneous decisions — also supports this rule.

Although judicial articulations of the rule appear clear and certain, commentators disagree about the scope of a process-of-decision proviso and the actual standard applied by courts to the business decision itself.⁵⁴ One group sees little court intervention, except for

51. See notes 208-22 *infra* and accompanying text.

52. Caplin, *Outside Directors and Their Responsibilities: A Program for the Exercise of Due Care*, 1 J. CORP. L. 57, 59-60 (1975) (footnotes omitted).

53. See, e.g., *Auerbach v. Bennett*, 47 N.Y.2d 619, 630-31, 393 N.E.2d 994, 1002, 419 N.Y.S.2d 920, 926 (1979).

54. One commentator has noted that the statutory expression of a standard of conduct is less significant than its subsequent application by the judiciary. Lewis, *The Business Judgment Rule and Corporate Directors' Liability for Mismanagement*, 22 BAYLOR L. REV. 157, 162 (1970). The courts disagree on what the standard of conduct is because "duty" is a potentially dynamic concept offering an opportunity for judicial sensitivity to practices as they develop. See Mundheim, *A Time to Learn*, in COMMENTARIES ON CORPORATE STRUCTURE AND GOVERNANCE 179, 181 (D. Schwartz ed. 1979) [hereinafter cited as COMMENTARIES]. Certain commentators argue that the duty of care which the courts impose on a director under the business judgment rule is a much lower standard than that of an ordinary prudent person. See Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 680-81 (1974); Kaplan, *Fair Treatment of Shareholders*, in COMMENTARIES, *supra*, at 215, 221-22. Critics further point out that this lower standard may be a product of courts too often limiting their

the most extreme cases. Professor Bishop has articulated this view:

The search for cases in which directors of industrial corporations have been held liable in derivative suits for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack.

. . . .

. . . All in all, I remain very skeptical of the proposition that directors of industrial corporations run any substantial risk of liability for ordinary negligence.⁵⁵

Samuel Arsht, on the other hand, recently concluded that the potential for court intervention is high and that the rule does not bar liability for ordinary negligence.⁵⁶ The leading corporate texts and most decided cases also talk of directorial liability for ordinary negligence.⁵⁷ Cases actually holding directors liable for want of ordinary care are few or nonexistent,⁵⁸ but most derivative suits against directors are settled before judgment. The threatened ordinary care standard may be a principal reason for such settlements.

One can reasonably conclude that a capable and independent director today makes business decisions only with some trepidation. Whether that director will confront the relatively safe insanity standard ("any rational business purpose"), or a gross negligence (recklessness) standard, or an "ordinary negligence" standard for business decisions or the process leading up to them is uncertain.

inquiry to the question of whether fraud or conflict of interest is present. *See, e.g.,* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971). Other commentators assert that ordinary negligence is the standard, and, further, that a duty of inquiry is a prerequisite to the use of the business judgment rule. *See, e.g.,* 3A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1040 (1975 & Supp. 1980); Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 100 (1979); *Guidebook*, *supra* note 5, at 1602. *Cf.* Cary & Harris, *Standards of Conduct Under Common Law, Present Day Statutes and the Model Act*, 27 BUS. LAW. 61, 70 (Spec. Issue Feb. 1972) ("I believe that the distinction between the business judgment rule and the negligence rule . . . which is already somewhat obscure, will largely vanish.").

55. Bishop, *Sitting Ducks and Decoy Ducks: New Trends in Indemnification of Corporate Directors and Officers*, 77 YALE L. J. 1078, 1099-101 (1968).

56. Arsht argues that the cases in which the business judgment defense was denied as a result of gross negligence are consistent with those cases using a "mere negligence" standard of care. Arsht, *supra* note 54, at 100-11; Arsht & Hinsey, *Codified Standard — Safe Harbor But Charted Channel: A Response*, 35 BUS. LAW ix, xiv (1980).

57. FLETCHER, *supra* note 54, § 1029, at 12 ("[I]t is now the general rule that want of ordinary care creates liability.") (footnote omitted); H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS § 234, at 453-55 (2d ed. 1970); N. LATTIN, THE LAW OF CORPORATIONS § 78, at 274 (2d ed. 1971); *Cf.* H. BALLANTINE, BALLANTINE ON CORPORATIONS § 63, at 158-59 (rev. ed. 1946) ("The degree of negligence depends upon what degree of care and diligence is due and owing, whether slight, ordinary or great.").

58. Professor Bishop found only four cases of apparent negligence uncomplicated by self-dealing, none of which, he concluded, carried "real conviction." Bishop, *supra* note 55, at 1099-100.

B. *Truly Independent Directors Should Be Given
Incentives To Serve*

The courts can use the ambiguities in the business judgment rule to promote decision-making by independent directors: the "any rational" basis test or a gross negligence "plus more" standard — clearly articulated — would apply to business decisions reached by a board or committee with a majority of truly independent directors, while the standard applicable to the management-dominated board, and possibly to the nonindependent directors on the new board, could properly remain unsettled.

The principle supporting such manipulation of an ambiguous legal rule can be traced to the seminal case of *Barnes v. Andrews*, in which Judge Learned Hand stated: "No men of sense would take the office, if the law imposed upon them a guaranty of the general success of their companies as a penalty for any negligence."⁵⁹ This incentive-to-serve rationale, articulated in 1924 in *Barnes*, had little meaning then for most directors of large companies. Their incentive to serve was the pure profit motive, either as highly paid managers of the company or as persons doing business with it. The incentive rationale was as hollow to them as it is for nonindependent directors, who serve for the same reasons today. Courts need not grant nearly absolute protection for decisional outcomes to these individuals.

In contrast, truly independent persons would respond to greater and more certain protection under the business judgment rule by more readily accepting invitations to serve as directors. Although the "real" reasons that independent directors serve today are unclear, the pat answers — money, power, perquisites, and prestige — are unsatisfactory. Generally, the individuals who have accepted (and will in the future accept) the role have already reached the socioeconomic apex, with all the accoutrements. That their "margin" for acceptance is their desire for still more of these goods is unpersuasive,⁶⁰ especially if one considers the increasing demands on independent directors to work harder, and their positive responses thereto.⁶¹ It seems unlikely, therefore, that independent directors

59. 298 F. 614, 617 (S.D.N.Y. 1924). "If the test of negligence which is applicable in the field of torts or in the Estate field were similarly applicable in the business or banking field, it would *realistically* be very difficult if not almost impossible to secure the services of *able and experienced* corporate directors." *Smith v. Brown-Borhek Co.*, 414 Pa. 325, 333, 200 A.2d 398, 401 (1964) (emphasis in original).

60. See generally C. ALDERFER, *EXISTENCE, RELATEDNESS AND GROWTH* (1972); A. MASLOW, *MOTIVATION AND PERSONALITY* (2d ed. 1970); D. MCCLELLAND, *THE ACHIEVEMENT MOTIVE* (1976); D. MCCLELLAND, *THE ACHIEVING SOCIETY* (1961).

61. See text at notes 12-14 *supra*.

view the job as a mere sinecure to be favorably added in the "margin" favoring acceptance.

Some of the pat answers may figure into the mix, but "high-achievement" independent directors may accept the role principally to satisfy their individual need for new and challenging experiences⁶² in a pleasant interpersonal atmosphere. If this speculation or anything close to it is the true margin of decision today, then stringent liability rules for truly independent directors could tilt the margin against choosing to serve.⁶³

The incentive to serve rationale, then, affords a principled basis for distinguishing between the civil liability standards applicable to truly independent directors and the other directors. Or, the courts could apply the same highly protective standard to all directors, but distinguish the respective burdens of proof.⁶⁴ Whether the courts should make any distinction depends upon other factors, some of which will be discussed later in connection with group cohesiveness.⁶⁵ To promote director independence, it may be best to leave the negative implication of strong protection for the independent directors an open question. Courts should understand, however, that testing the business decisions of nonindependent directors against an ordinary negligence standard may undermine other policies behind the business judgment rule.

Recent decisions under the business judgment rule consistently support, and can be read as strong judicial encouragement of, the

62. See note 60 *supra*; HEIDRICK & STRUGGLES 1977, *supra* note 14, at 8 ("two thirds of recently elected outside directors surveyed . . . in another study report that the opportunity to contribute was the reason they joined boards"). Mace reported that chief executives joined the boards of other companies to learn, and compare the experiences with those in their own companies. M. MACE, *supra* note 3, at 109. Chief executives and retired chief executives are the two largest sources of outside directors. KORN/FERRY 1981, *supra* note 6, at 1. The retired senior executives are undoubtedly motivated by a strong desire to "relive" challenging experiences and to compare them with those at their former company. For the former high government officials, the members of academia and the bar, the board experience can easily be visualized as "new and challenging."

63. Coffee & Schwartz, *supra* note 49, at 317 (footnote omitted), propose a statutory damage "ceiling keyed to the financial circumstances of the individual defendant and applicable only to cases involving exclusively violations of the duty of due care." The ceiling is a maximum of "the highest Annual Gross Income of such person during the five calendar years preceding" the verdict, and in some cases, the total director's fees received. *Id.* at 335. A ceiling would be quite helpful in preserving the thin margin of decision, but both the ceiling and the standard ("due care") proposed may be pegged too high for the target population. The chief executive of another company is the prime source of independent directors. That chief executive may change the margin of decision if the threat involves one year's past income (which may be a million dollars or more) and a stigmatizing finding that he or she is a negligent businessperson.

64. See note 70 *infra*.

65. See notes 101-05 *infra* and accompanying text.

trend toward independent directors. In the corporate takeover area, *Panter v. Marshall Field & Co.*⁶⁶ and *Crouse-Hinds Co. v. InterNorth, Inc.*⁶⁷ are significant. Both cases protected the decision of the board to resist a takeover by another corporation under the business judgment rule. In *Panter*, the Seventh Circuit stated:

We also note that a majority of the directors of Field's were "independent": they derived no income from Field's other than normal directors' fees and the equivalent of an employee discount on merchandise. The presumption of good faith the business judgment rule affords is heightened when the majority of the board consists of independent outside directors.⁶⁸

In *Crouse-Hinds*, the Second Circuit held that a director's "interest" in remaining a director, standing alone, is insufficient to rebut the presumption under the business judgment rule that directors have acted properly and in good faith.⁶⁹ The truly independent director will meet the *Crouse-Hinds* test because, by definition, he does not have significant pecuniary interests in the corporation. Other cases in the takeover area indicate that corporate officers and other persons who have direct pecuniary interests in the corporation (such as its retained attorney) face higher burdens of proof or more stringent liability standards than other directors when the board's decision is challenged.⁷⁰

Another recent line of cases involves the power of independent directors to dismiss stockholder derivative suits brought against their codirectors.⁷¹ Although the subject is beyond the scope of this Article, one can at least recognize the great, and often absolute, protection that independent directors can provide management directors under the business judgment rule. These cases thus create strong incentives for management to invite independents to join the board.

C. Preserving Equality Among the Directors

Members of the peer groups that the behavioral sciences rank best for decision-making must maintain their equality *inter se*. The

66. 646 F.2d 271 (7th Cir.), *cert. denied*, 50 U.S.L.W. 3443 (U.S. Dec. 1, 1981).

67. 634 F.2d 690 (2d Cir. 1980).

68. 646 F.2d at 294.

69. 634 F.2d at 702.

70. *See, e.g.,* *Cheff v. Mathes*, 199 A.2d 548 (Del. 1964) (directors who had no personal financial interest in preventing a minority shareholder from gaining control had a lighter burden of proof in justifying a corporate purchase of the minority shareholder's stock than those directors who had a financial interest); *Bennett v. Propp*, 41 Del. Ch. 14, 187 A.2d 405 (1962) (Chairman-President held liable; other directors not liable; but Chairman-President failed to advise board of facts in a timely fashion).

71. *See* Coffee & Schwartz, *supra* note 49.

chief executive no longer dominates the independent board; all directors deal with each other from positions of equal power and influence — peers, in the truest sense. However, equality is fragile. Seemingly small tinkering may upset the fine balance.

A stark example would be granting directors the power to remove a codirector from office with or without cause, but most boards have no such power.⁷² A more subtle threat to peerage was recently advocated in a Securities and Exchange Commission ("SEC") staff report that would increase the functions of the new board's nominating committee. Most of the largest corporations have a committee of the board, composed of a majority of independent directors, which recommends nominees for election as directors to fill vacancies created by resignation, death, and other causes. The courts should consider such a nominating committee favorably when asked to protect directors from liability because it furthers the goal of making directors independent of management. However, the new board should reject the proposal in the SEC staff report that this committee also evaluate "the performance of incumbent directors in determining whether to recommend them for re-election."⁷³

The power of certain directors to evaluate the other directors may reduce the quality of decision-making because it will "unpeer" the director group. Oliver Williamson has pointed out that experience-rating and monitoring by certain individuals creates a hierarchy rather than a peer group. He has also argued that peer groups punish individual malingerers in one way or another, rendering formal evaluation unnecessary.⁷⁴ Recent corporate data tend indirectly to support Williamson. In 1980, 12.7% of nominating committees had responsibility for evaluating incumbent directors. This percentage represents a thirty-two percent decrease in the number of nominating committees performing this function the year before.⁷⁵

If the board limits its evaluation to wholly superficial factors, such as frequency of attendance at meetings, it may not undermine equality. However, even this superficial function has now been taken over by the federal proxy rules. Under those rules, the annual proxy statement sent to shareholders must disclose the name of each

72. Delaware has wisely stated that conferring such a power on co-directors would be a "dangerous precedent." See *Bruch v. National Guar. Credit Corp.*, 13 Del. Ch. 180, 186-90, 116 A. 738, 741-42 (1922).

73. STAFF REPORT, *supra* note 16, at 526-27.

74. O. WILLIAMSON, *supra* note 46, at 46, 49, 53.

75. SEC 1980 Study, *supra* note 4, at 1554.

director attending fewer than seventy-five percent of the meetings of the board and assigned committees.⁷⁶

The last potential vestige of subtle management influence over the truly independent director — and a potential threat to peerage — derives from the probability that the chief executive still initially selects the new independent director nominees.⁷⁷ But it is also likely that the independent nominees now selected are persons friendly or known to both the independents and the chief executive.⁷⁸ A recent survey found that an independent committee and not the chief executive now makes the “initial decisions in approving a prospective director,”⁷⁹ but the survey did not ask who made the initial suggestion.

The proposition that even the independent directors with no business or familial ties to management are nevertheless especially loyal or beholden to the chief executive because the chief executive was responsible for their nomination is unrealistic. As previously argued,⁸⁰ the independent director today serves by a slight “margin” of decision, not by a margin that commands special obedience or loyalty to the procurer. Finally, one should remember that a time lag separates structural and substantive change. The independent nominating committee is a recent structural change, and the recent data suggest that it is having a substantive effect. Soon structure will transform to substance. Those who have argued to the contrary rely on data rendered stale by more recent events.⁸¹

76. Securities Exchange Act Release No. 15384, 16 SEC DOCKET 348 (Dec. 6, 1978).

77. See THE NEW DIRECTOR, *supra* note 12, at 14 (“Most of the new directors (56%) were selected for a board on the basis of prior contact with management. . .”).

78. Of companies with sales volumes over \$1 billion, 70% use the nominating committee, consisting of one inside and four outside directors, to locate outside directors for the new board. KORN/FERRY 1981, *supra* note 6, at 8, 22. In response to the survey question “How are outside directors located for the board?” the same Korn/Ferry report states the responses as follows: “Recommendation and known to chairman — 77.6%; Recommendation and known to board members — 77.3%.” *Id.* at 22. The fair inference from this is that the new nominees are known to both the chief executive and one or more independent directors.

79. HEIDRICK & STRUGGLES 1980, *supra* note 4, at 3.

80. See text accompanying notes 60-63 *supra*. But see THE NEW DIRECTOR, *supra* note 12, at 14-15.

81. See Coffee & Schwartz, *supra* note 49, at 284 & nn.124, 125. Professors Coffee and Schwartz and others rely, in part, on the 1971 Heidrick & Struggles Profile of the Board of Directors which found that 37% of “the organizations participating reported having fired a director.” HEIDRICK & STRUGGLES, INC., PROFILE OF THE BOARD OF DIRECTORS 11 (1971). Because the 1971 Heidrick & Struggles questionnaire was sent to the chief executive of the participating corporations, commentators interpreting the above-quoted phrase concluded that the chief executive (rather than the board as a group) had removed the director. See Coffee & Schwartz, *supra* note 49, at 283 n.125; Note, *The Business Judgment Rule in Derivative Suits Against Directors*, 65 CORNELL L. REV. 600, 620 n.103 (1980). Neither the quotation nor the question posed by Heidrick & Struggles (“has a director of your company ever been ‘fired?’”) supports the commentators’ conclusion. See Letter from Heidrick and Struggles, Inc. to Pro-

III. PROMOTING HIGH-QUALITY DECISION-MAKING IN PEER GROUPS

Many of the country's largest corporate entities have recently begun to move toward peer group decision-making. By judiciously manipulating corporate law, the courts can further this trend. But all peer groups are not alike, and not every current corporate governance proposal is conducive to good decision-making. In this respect, the behavioral sciences can offer considerable guidance to legislatures, courts, and the new boards.

A. *Group Cohesiveness and the New Board*

Group composition is an important factor in the quality of decision-making. As behavioral scientists confirm, an individual's performance varies depending upon the other individuals in the group.⁸² The degree to which members of a group are attracted to each other and to the group, and the morale of the group is called "cohesiveness." There is no direct evidence tying the degree of cohesiveness to an objective standard of excellence in decision-making, but Shaw has summarized the indirect evidence:

[H]igh-cohesive groups are more effective than low-cohesive groups in achieving their goals. The cohesive group does whatever it tries to do better than the noncohesive group.

. . . .
. . . It follows that group problem solving should be facilitated by group cohesiveness. Despite some negative findings . . . the empirical

fessor Robert J. Haft (July 14, 1981) (on file with the *Michigan Law Review*). The 1977 Heidrick & Struggles Profile posed the same question and reports that the proportion of "boards" who have terminated a directorship by some means "has increased slightly since 1971." HEIDRICK & STRUGGLES 1977, *supra* note 14, at 12.

The distribution of "lackluster" directors in the population may well be a constant, without bespeaking anything on the relative power today of the chief executive *versus* the new board over the independent directors. Other and more recent Heidrick & Struggles data is more significant. In their 1977 Profile, the chief executive was "[t]he initial decision maker regarding a prospective director" in 42.9% of companies with annual sales of \$1 billion or more, all directors as a group in 29% and the nominating committee in 14% of these companies. HEIDRICK & STRUGGLES 1977, *supra* note 14, at 8. Their "1980 Update" indicates that a strong shift occurred between the 1977 and 1980 reports. The "initial decision-maker in approving board prospects" is now the nominating committee in 69% of companies with annual sales of \$2 billion or more, all directors as a group in 6.4% and the chief executive in 16.7% of these companies. In companies with sales between \$1 billion and \$1.9 billion, the corresponding figures were 43.5%, 10.9% and 34.8%. HEIDRICK & STRUGGLES 1980, *supra* note 4, at 3.

In all fairness to those who rely on the 1971 Heidrick & Struggles statistics, it must be recognized that they use that data in an entirely different context, and one which has been excepted from this author's proposals: the dismissal by directors of derivative suits against co-directors (usually management). Behaviorally, it is much easier for the independents to criticize the chief executive for a business proposal now before the board than to permit a large damage suit against him or her to go forward.

82. See M. SHAW, *supra* note 23, at 211-13.

evidence generally supports this expectation.⁸³

Underlying cohesiveness is friendship. Groups of close friends solve problems more efficiently than do various friend-stranger groupings. Increased ease of communication is probably a major factor,⁸⁴ as well as the readiness of individuals to be influenced by, to trust, and to respond positively to the actions of friends.⁸⁵ In fact, interpersonal trust has been confirmed as an essential precondition to effective group problem solving.⁸⁶

Boards of directors can be very cohesive groups. Conflict among group members decreases cohesiveness when the dispute concerns principles; "however, when the group members agree on principles but are in disagreement over matters that assume adherence to those principles, the conflict enhances cohesiveness."⁸⁷ The members of both the new and old boards have common objectives and values and agree on the principles applicable to the largest private aggregations of economic power because they are drawn from the very same socioeconomic group. And "membership in a persistently high status group" also promotes cohesiveness⁸⁸ — a finding particularly applicable to the boards of our largest corporations. Certain governance and liability proposals, however, may undermine the board's cohesiveness, and reduce the quality of its decisions.

1. *Constituency Directors*

The empirical findings support the nearly universal rejection of the idea of appointing directors to "represent" different corporate

83. *Id.* at 225, 395 (citations omitted). See A. HARE, *HANDBOOK OF SMALL GROUP RESEARCH* 340 (2d ed. 1976). However, Hare points out that friends can also agree to malingering: "A slowdown may also occur if the group members conspire to lower the output. The efforts of the group to impose a slowdown will be more effective if the group members are highly congenial." *Id.* at 209 (citation omitted).

84. A. HARE, *supra* note 83, at 209. See Donahue, Hawes & Mabee, *Testing a Structural-Functional Model of Group Decision Making Using Markov Analysis*, 7 *HUMAN COMMUNICATIONS RESEARCH* 133-46 (1981).

85. See M. OLMSTED & A. HARE, *supra* note 39, at 68-70; M. SHAW, *supra* note 23, at 215. For an example of a study showing that compatibility among group members leads to more rapid problem solving, see Reddy & Byrnes, *Effects of Interpersonal Group Composition on the Problem-Solving Behavior of Middle Managers*, 56 *J. APPLIED PSYCH.* 516, 517 (1972).

86. Zand, *Trust and Managerial Problem Solving*, 17 *AD. SCI. Q.* 229, 238 (1972). An excellent review of the empirical evidence concerning trust in experimental and natural groups and in organizations is contained in Golembiewski & McConkie, *The Centrality of Interpersonal Trust in Group Processes*, in *THEORIES OF GROUP PROCESSES* 131, 156-78 (C. Cooper ed. 1975). Trust and distrust are "spirally reinforced," i.e., trust leads to ever more trust, and distrust leads to ever more distrust. *Id.* at 139, 175.

87. M. SHAW, *supra* note 23, at 215. See Sole, Marton & Hornstein, *Opinion Similarity and Helping: Three Field Experiments Investigating the Bases of Promotive Tension*, 11 *J. EXPERIMENTAL SOC. PSYCH.* 1 (1975).

88. M. OLMSTED & A. HARE, *supra* note 39, at 113.

"constituencies," such as employees or consumers.⁸⁹ Alvin Zander cited empirical evidence that "an adversary relationship among members" derogates from the quality of decision-making. Each member tries to persuade the representatives of other constituencies, but does not accept their influence: "The oral contributions are no more useful than no comments at all."⁹⁰ Barnlund, who analyzed group superiority, found that two factors accounted for a majority of the group errors in his experiments. One factor was that groups faced with intense disagreement either compromised on a third solution or the "less aggressive members" surrendered to the other faction. "Apparently disagreement stimulates thought up to a point; beyond that point, groups may lack the patience and skill to exploit it."⁹¹ In a more recent empirical study comparing the quality of decisions by groups with "representatives" with decisions of other groups, the representative groups made lower quality decisions.⁹² But if the various constituencies must "accept" the group decision, then representatives must be included in the group, adversely affecting decision "quality."⁹³

2. Cumulative Voting

Cumulative voting for directors also leads to directors as representatives, in this case, of different shareholder constituencies. Shareholders with large holdings are given the opportunity to gain representation on the board in proportion to their holdings.⁹⁴ Seventeen states currently mandate cumulative voting, and about thirty states permit it.⁹⁵ Although forceful arguments have been made for and against cumulative voting,⁹⁶ the cohesiveness findings suggest that shareholder representatives, like other constituency representatives, would detract from quality decision-making.

89. See STAFF REPORT, note 16 *supra*, at 459-68.

90. A. ZANDER, *supra* note 46, at 78.

91. Barnlund, *supra* note 32, at 59.

92. Stumpf, Freedman & Zand, *Judgmental Decisions: A Study of Interactions Among Group Membership, Group Functioning, and the Decision Situation*, 22 ACAD. MGT. J. 765, 769 (1979).

93. *Id.* But the constituency form of decision-making is precisely the type engaged in by the various corporate coalitions and organizational subunits below the board and the chief executive in maintaining operations. See note 43 *supra*.

94. W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 258-59 (5th ed. unabr. 1980).

95. *Id.* at 260.

96. *Id.*

3. *Recent SEC Proxy Amendments*

The SEC has recently amended the federal proxy rules to facilitate voting on each director individually.⁹⁷ Now shareholders have the opportunity not to vote for a particular director while voting in favor of the rest of the slate of nominees. A shareholder can still conform to the traditional practice of voting the entire director slate either up or down,⁹⁸ but prior to the amendment the typical form of proxy provided by companies impeded shareholders who wanted to cast a vote for or against an individual director. Another recent amendment requires public disclosure of the votes cast by shareholders concerning an individual director who was elected but received five percent or more negative or withheld votes.⁹⁹ Although these amendments may further "shareholder democracy" in the election of directors of very large corporations — a dubious proposition — they may be counterproductive to the cohesiveness of the new board by making the performance of individual directors an electoral issue. The SEC received many negative comments on this rule:

Many commentators believed that rulemaking in the area of corporate accountability should focus on strengthening the independent role of the board, as well as the structure of the board and its committee system, rather than unduly politicizing the corporate electoral process through a provision for individual voting. Others commented that when shareholders vote for directors, they are voting for or against the board as a cohesive managing body and have little interest in individual nominees.¹⁰⁰

The SEC did not directly respond to these perceptive comments. It has failed in these instances correctly to resolve the tensions between certain outdated notions of shareholder democracy in the very large corporation and conditions conducive to high-quality decisions by the new board.

4. *Liability Distinctions Among Directors*

Some cases have drawn liability or burden of proof distinctions among directors. In the case of decision-making by the board and true group tasks undertaken by the new board, such as the review of a securities registration statement or proxy statement, the standard of

97. Rule 14a-4(b)(2), 17 C.F.R. § 240.14-4(b)(2) (1980). See Securities Exchange Act Release No. 16356, 18 SEC DOCKET 997, 998-1000 (Nov. 23, 1979).

98. Voting "down" an entire slate occurs in a proxy fight between two factions or in a takeover struggle in which each side proposes its own full board slate.

99. Schedule 14A, Item 6(g)(1), 17 C.F.R. § 240.14A-101 (1980). See 18 SEC DOCKET, *supra* note 97, at 999.

100. 18 SEC DOCKET, *supra* note 97, at 999.

liability should be uniform as to all directors.¹⁰¹ The courts should promote group cohesiveness and discourage individual strategic behavior. Individualized definitions of due care and directorial duty are inconsistent with this goal. The obvious exceptions are instances in which a director, usually from management, has practiced fraud upon the group itself, by failing to disclose facts that he knows are important to the group task and unknown to the others, and instances in which a particular director has a personal interest in conflict with the group activity. The "actual fraud" exception recognizes that act most destructive of group cohesiveness — disloyalty to the group itself. In the typical conflict of interest case, the law already requires the interested director to disclose the conflict and withdraw from that specific group decision.¹⁰²

Some cases have distinguished directors who are inside officers from directors who are not.¹⁰³ To the extent that the courts believed the insiders knew the damning facts but did not tell the outsiders, the distinction approximates the disloyalty to the group exception. Unless a particular director had actual knowledge, however, no distinctions based on supposed inequalities of access to information or of relevant expertise among the directors *as such*¹⁰⁴ should be made. The famous Delaware case of *Graham v. Allis-Chalmers Mfg. Co.*¹⁰⁵ refused to draw any liability distinctions among directors for group conduct — either the group was liable or not. The court held the board not liable on the ground that the board had no duty to investi-

101. In twenty-eight states, common law defines the duty of care of directors. Twenty-two states have statutory definitions. The common law jurisdictions obviously can make the standard uniform, through judicial decisions. So can the statutory jurisdictions because most provide a uniform and objective standard, absent actual individual knowledge of impropriety ("good faith"). Although the language of the uniform standard varies from statute to statute, most are similar to section 35 of the Model Business Corporation Act: "[W]ith such care as an ordinarily prudent person in a like position would use under similar circumstances." *Guidebook*, *supra* note 5, at 1631. But see *id.* at 1601, in which the ABA committee "recognizes that the special background and qualifications of a particular director . . . may place greater responsibility on that director."

102. See W. CARY & M. EISENBERG, *supra* note 94, at 565-86, 600-06. A few states still adhere to the old view that a transaction between a director and the corporation is voidable even if fair. *Id.* at 583-84; N. LATTIN, *supra* note 57, § 80, at 291 n.67. See Bulbulia & Pinto, *Statutory Responses to Interested Directors' Transactions: A Watering Down of Fiduciary Standards?*, 53 NOTRE DAME LAW. 201, 204-05 (1977); Buxbaum, *Conflict-of-Interest Statutes and the Need for a Demand on Directors in Derivative Actions*, 68 CALIF. L. REV. 1122 (1980).

103. See *Bates v. Dresser*, 251 U.S. 524, 529-30 (1920); W. CARY & M. EISENBERG, *supra* note 94, at 535-36.

104. If management as such should have informational duties to the new board, the courts should handle the problem directly. The last part of the Article proposes that this duty be placed on key management as such, and that the informational duties imposed by present law on directors as such be removed or strongly diluted. See notes 244-57 *infra* and accompanying text.

105. 41 Del. Ch. 78, 188 A.2d 125 (Del. 1963).

gate whether the employees were engaged in illegal acts, absent some tangible warning signs to the board. The case has been criticized on the basis of its narrow view of board duties, but its group approach to the issue is not counterproductive of cohesiveness.

Certain liability distinctions among directors may be justified by policies that outweigh the promotion of high-quality decisions through group cohesiveness. For example, the incentive to serve rationally, which, as previously argued, should provide the truly independent directors with an almost absolute business judgment defense, leaves open the possibility of denying these benefits to management directors. Such a distinction would serve the currently more important goal of encouraging the selection of truly independent directors for the boards of the very largest corporations. And the findings that peer groups make better decisions than do individuals and nonpeer groups are more extensive and clear than the findings that link the cohesiveness of the group with the quality of its performance. Put to choices, therefore, the courts should continue to distinguish among directors based upon true independence to promote collegial decision-making among equals, though group cohesiveness may thereby diminish. No substantial behavioral case, however, can be made for distinctions among the independent directors, absent the unlikely event of actual fraud or clearly illegal action by one of these directors.

The federal courts have imposed civil damage liability upon directors under provisions of the federal securities laws, such as rules 10b-5 and 14a-9 of the 1934 Act and section 11 of the 1933 Act. The federal cases have overanalyzed the behavior of individual directors, and, in so doing, have failed or been unwilling to recognize that board activities are essentially group activities, not the sum total of individual acts. To the extent that legal rules place different pressures on different members of a group with the same group goal, group cohesiveness may diminish. And when the stakes of a decision are different for different individuals in the group, coalitions may form or individual strategic behavior detrimental to high-quality decisions may occur.¹⁰⁶

106. The economic stakes of business decisions are different for the inside senior executives on the board than for the independent directors. A perceptive and experienced group of independent directors will properly "discount" the self-interest of the insiders when making business decisions. But the independent directors cannot "discount" for the relative accuracy or inaccuracy of the information upon which the decision is based. "[T]he amount, quality, and structure of the information that reaches the board is almost wholly within the control of the corporation's executives. . . . [T]his kind of power over information flow is virtually equivalent to power over decision." Eisenberg, *Legal Models of Management Structure in the*

For example, section 11 of the 1933 Act imposes huge liabilities on every director who fails to exercise due diligence concerning the accuracy of the registration statement used to sell securities. Its language weakly suggests, but clearly does not compel, an interpretation requiring the court to evaluate the diligence of each individual director, rather than the diligence exercised by the board as a whole.¹⁰⁷ Yet, in the only two cases that examined directors' duties under section 11, both courts stressed the liability of the particular director based on his particular actions and inactions and his particular background and experience.¹⁰⁸ Although each court held all of the directors liable, neither court analyzed the director group's failure reasonably to reach its one clear group goal — an accurate registration statement. A registration statement is a group effort, involving the directors, lawyers, accountants, officers, and others. The implicit suggestion of both cases — that someday, one director may be held liable and another exonerated — may be counterproductive both to the overall quality of board decision-making and to group preparation of an accurate registration statement.

The SEC has reinforced this individualized approach to the board in various public reports relating to the bankruptcies of certain corporations. For example, in its reports on *Stirling Homex*, *Penn Central*, and *National Telephone*, the SEC strongly criticized the actions and inactions of particular directors.¹⁰⁹ These directors were understandably unable to overcome the board's norms. The hope that one director will courageously rise above the group is unrealistic, particularly in a cohesive group.

Modern Corporation: Officers, Directors and Accountants, 63 CALIF. L. REV. 375, 380 (1975) (footnote omitted).

107. Section 11 provides in relevant part:

[N]o person . . . shall be liable . . . who shall sustain the burden of proof . . . that . . . he had, after reasonable investigation, reasonable ground to believe and did believe . . . that [the registration statement was accurate]

In determining . . . what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

15 U.S.C. §§ 77K(b)(3)(A), 77K(c) (1976).

108. *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971); *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968).

109. Securities Exchange Act Release No. 11,516, 7 SEC DOCKET 298 (July 2, 1975) (*Stirling Homex Corp.*); SEC STAFF REPORT, THE FINANCIAL COLLAPSE OF THE PENN CENTRAL COMPANY, *printed for the use of* SPECIAL SUBCOMM. ON INVESTIGATIONS OF THE HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 93d Cong., 2d. Sess. 151-72 (1972); Securities Exchange Act Release No. 14380, 13 SEC DOCKET 1393 (Jan. 16, 1978) (*National Telephone Co., Inc.*).

5. *Continuity of Board Membership*

Continuity of association among group members, like that among friends, promotes group cohesiveness, and thus promotes high-quality group decisions as well.¹¹⁰ With very high cohesiveness, however, a counterproductive tendency toward conformity of opinion develops — “groupthink.”¹¹¹ The old board was probably too cohesive and in-bred,¹¹² dominated as it was by the company’s executives who worked together on a daily basis under the leadership of the chief executive. The new board may well strike a fine balance between incest and indifference among group members. It meets almost monthly as a full board, and each director also meets about six times a year in small committee groupings; more meetings and more group work appear to be the trend.¹¹³ Add to this the likelihood that the independents have other social connections with each other, and the board has the makings of a cohesive group that avoids the evils of groupthink.

As in the case of cumulative voting, tensions exist between certain notions of “shareholder democracy” and quality decisions by the new board. All states require the election of some directors annually, thus introducing at least the possibility of constant turnover in the boardroom. However, continuity of the director group in the large corporation persisted in the past, primarily because of manage-

110. A. HARE, *supra* note 83, at 330-32, 340.

111. See M. SHAW, *supra* note 23, at 218-22. See, e.g., Cartwright & Zander, *Pressures to Uniformity in Groups: Introduction*, in GROUP DYNAMICS 139, 147 (D. Cartwright & A. Zander eds. 3d ed. 1968). Irving Janis wrote: “I use the term ‘groupthink’ as a quick and easy way to refer to a mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members’ strivings for unanimity override their motivation to realistically appraise alternative courses of actions.” I. JANIS, VICTIMS OF GROUPTHINK 9 (1972).

112. Group cohesiveness promotes the development of attitudes among members of in-group superiority (“group egocentrism”) as contrasted with other groups. See, e.g., I. JANIS, *supra* note 111, at 197, 203-04 (“shared illusion of invulnerability”); Myers & Bach, *Group Discussion Effects on Conflict Behavior and Self-Justification*, 38 PSYCH. REP. 135, 135 (1976) (competition with other groups enhances these attitudes).

An empirical study suggests that in terms of economic measures of performance, the proportion of outside directors is of no significance. J. PENNINGS, INTERLOCKING DIRECTORATES 154-55 (1980). In fact,

[f]irms that have permitted a greater influx of outside directors have a slight tendency to lower performance levels, but the relationships are insignificant for most of the effectiveness indicators From the results . . . it appears that boards dominated by insiders benefit from their cohesiveness rather than suffer from groupthink. However, . . . the coefficients are extraordinarily small

Id.

113. Boards of companies with annual sales of between \$1 billion and \$5 billion meet between eight and ten times per year. Each committee meets at least twice during the year, with many meeting an average of four to six times per year. KORN/FERRY 1981, *supra* note 6, at 12, 19.

ment's control of the proxy machinery and its domination of the board. The nominating committee of the new board has largely replaced the chief executive as the keeper of proxy machinery. Thus, the new board's independent directors will preserve continuity of board membership.

Continuity can be structurally furthered by providing for the classification of directors, with staggered terms of two or more years for each director. Each year only a number, but fewer than a majority, of the directors are up for election. Most states permit this by statute.¹¹⁴ Although subject to potential abuse in limited circumstances,¹¹⁵ classification promotes cohesion and continuity and may be especially helpful during the present "shake-out" or transition period for the new board.¹¹⁶

B. Other Conditions for High-Quality Decisions

This Article has presented evidence that, all other things being equal, peer groups make higher quality decisions than do individuals or nonpeer groups, and that group cohesiveness is an important factor in quality decision-making. Obviously many variables affect group decision-making.¹¹⁷ But two matters receive particular em-

114. A. FREY, J. CHOPER, N. LEECH & C. MORRIS, *CASES AND MATERIALS ON CORPORATIONS* 417 (2d ed. 1977).

115. *Id.*

116. *Id.* Although highly unlikely, it would follow that if the portion of directors up for election in the very largest corporations are defeated, the entire "cohesive" board should then resign. "The largest industrials do not use this device as frequently [as smaller industrials]. In fact, the proportion of premier size industrials staggering terms has declined from 13.9 percent to 11.2 percent over the past five years." HEIDRICK & STRUGGLES 1977, *supra* note 14, at 11. Cf. Schotland, *Conclusions and Recommendations*, in ABUSE ON WALL STREET 565, 576 (1980) (Twentieth Century Fund Report) (The unaffiliated directors of pension funds and other non-profit institutions should have "terms at least as long as (and preferably longer than) the terms of other directors; otherwise, unaffiliated directors may be tempted to sacrifice their independence to retain their directorships.").

117. The variables researched include noise, member proximity, seating arrangements, and other factors which affect communication networks. See A. HARE, *supra* note 83, at 260-77, 343-44; M. SHAW, *supra* note 23, at 118-66, 392-93. Research has also been done on the effects of type of task, leadership behavior and individual personality on group problem solving. See A. HARE, *supra* note 83, at 330-56; M. SHAW, *supra* note 23, at 315-89. The Article does not discuss these variables because each either is unlikely to affect board decision-making or, as in the case of individual personality, is far too complex for researchers to have even established base principles at this time.

Should group composition be homogeneous or heterogeneous? One aspect of this question, focusing on individual abilities, is flat and obvious; other aspects, dealing with race and with gender, are explosive. Groups composed of members having diverse but relevant abilities perform more effectively than groups composed of members having similar abilities. M. SHAW, *supra* note 23, at 259. Heterogeneity with respect to personality characteristics also appears to facilitate group problem solving. See *id.* at 395; Hoffman, *Homogeneity of Member Personality and its Effect on Group Problem-Solving*, 58 J. ABNORMAL & SOC. PSYCH. 27, 31 (1959) (experimental "results imply that a multiplicity of perceptions of a problem are productive of creative solutions"); Hoffman, Harburg & Maier, *Differences and Disagreement as Factors in Creative*

phasis in the behavioral literature. First, is there an optimal group

Group Problem Solving, 64 J. ABNORMAL & SOC. PSYCH. 206 (1962); Hoffman & Maier, *Quality and Acceptance of Problem Solutions by Members of Homogeneous and Heterogeneous Groups*, 62 J. ABNORMAL & SOC. PSYCH. 401 (1961); Pelz, *Some Social Factors Related to Performance in a Research Organization*, 1 AD. SCI. Q. 310 (1956) (performance of research scientists benefited from frequent association with colleagues having a variety of values, experiences and disciplines). The evidence becomes equivocal and inadequate past this obvious point. Shaw states:

Although there are some negative results, the bulk of the evidence suggests that groups that are compatible with respect to needs and personality characteristics are able to . . . achieve their goals more effectively than groups whose members are incompatible with respect to needs and personality characteristics.

M. SHAW, *supra* note 23, at 258. See Schutz, *What Makes Groups Productive?*, 6 HUMAN REL. 429, 454-55 (1955) (compatible groups utilize their resources more effectively than other groups). However, Shaw points out that compatibility is a vague concept and that the tools for measuring it are crude. See M. SHAW, *supra* note 23, at 260.

Shaw refers to only one study that questions whether mixed-sex groups are more effective than homogeneous groups. That study, reported in 1978, involved a management task requiring the group to decide the correct placement of six trainees. Each group had a leader and two followers. Group performance was measured by the time required to complete the task. Heterogeneous groups performed better than homogeneous groups with both male and female leaders. Shaw suggests that this study may have limited relevance because the differences may have been the result of the differential behavior of leaders in mixed-sex and same-sex groups. M. SHAW, *supra* note 23, at 246, 259.

In the past decade, a number of studies attempted to measure the efficiency of racially mixed groups and racially homogeneous groups. None of these studies involved measurement of the quality of decision-making by the different groups. Efficiency was measured by the relative time required to complete simple tasks. In some of the studies, the racially mixed groups took more time to complete these tasks. The only reliable finding is that the racial composition of the group influenced the feelings and behaviors of group members, with some evidence that the tension created in the racially mixed groups inhibited effective group interaction. *Id.* at 249-51. The evidence is not only extremely limited, but the differences, in the words of Shaw, "may or may not adversely affect group performance." *Id.* at 260. Further, both the gender and race research consisted of laboratory experiments with college students and field observations of blue-collar workers conducted some years ago. This would appear to have little or no relevance to the manner in which the composition of the board of directors affects the quality of decision-making.

Some commentators have expressed their concern that a board contain a diversity of points of view and a sensitivity to different issues and different shareholder interests. However, most commentators supporting director diversity do not support constituency directorships. See STAFF REPORT, *supra* note 16, at 459-68.

Variety is the spice of directorial decisions. The SEC Staff Report states:

Ralph Lazarus representing the Business Roundtable noted: "You don't want a monolithic board; you want a board that's made up of different backgrounds." The Business Roundtable Statement on "The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation" also endorses the importance of seeking directors from outside the business community. Similarly, another commentator noted: "With a requisite degree of independence, all members of the board will feel a compulsion to take initiatives and espouse special causes from time to time, and not always the same cause. This is true of all who are worthy of board membership, regardless of sex, race, religious background, or other distinction. Indeed, there is a positive advantage in having board members with diverse experiences and backgrounds, who are capable of relating them to the corporate interest. The character of the individual is what is really paramount."

Id. at 467 (emphasis in original; footnotes omitted) (quoting C. BROWN, PUTTING THE CORPORATE BOARD TO WORK 117 (1976)). The Heidrick and Struggles survey of the 1300 largest corporations reported: "[N]early three-quarters of the organizations report no members of a racial or ethnic minority as board members, and 68 percent of the companies have no women directors." HEIDRICK & STRUGGLES, INC., THE CHANGING BOARD 1979 UPDATE 4 (1979).

size for decision-making? Second, which decision rule is preferable — consensus or majority rule?

1. *Group Size*

The size of the group obviously influences its performance.¹¹⁸ The range of resources available to the group increases with group size, as does the probability that the group will contain at least one member capable of performing the task. But relatively fewer group members then participate, forming subgroups as a result.¹¹⁹ Thelen suggested the "principle of least group size": just large enough to include individuals with all the relevant skills for problem solution.¹²⁰ Bales reported that the optimum group size in his group decision experiments was five.¹²¹ Slater found five to be the optimum size when individual member "satisfaction" with the intellectual task of the group is an important criterion.¹²² Subjective satisfaction with

118. See Steiner, *Models for Inferring Relationships Between Group Size and Potential Group Productivity*, 11 BEHAVIORAL SCI. 273 (1966).

119. M. SHAW, *supra* note 23, at 168-69. See Bales, *The Equilibrium Problem in Small Groups*, in WORKING PAPERS IN THE THEORY OF ACTION 111, 131-32 (1953).

120. See Thelen, *Group Dynamics in Instruction: Principle of Least Group Size*, 57 SCHOOL REV. 139 (1949), cited in M. SHAW, *supra* note 23, at 243.

121. See Bales, *In Conference*, HARV. BUS. REV., Mar.-Apr. 1954, at 44, 48. (reporting results of experiments at the Harvard Laboratory of Social Relations).

122. See A. HARE, *supra* note 83, at 229; Slater, *Contrasting Correlates of Group Size*, 21 SOCIOMETRY 129 (1958).

The Supreme Court has indirectly dealt with the question of "optimal" group size in a different context: jury size. In *Williams v. Florida*, 399 U.S. 78 (1970), it held that a six-member jury satisfies the constitutional guarantee of a jury in a state criminal trial. The Court relied on empirical studies and theoretical writings. 399 U.S. at 101 nn.48 & 49. A new set of studies was cited in the later opinions concerning jury size. See *Colgrove v. Battin*, 413 U.S. 149, 158-60 & n.15 (1973); *Ballew v. Georgia*, 435 U.S. 223, 231-39 & nn.10-32, 243-44 nn.34-37 & 39-41 (1978) (plurality opinion) (Blackmun, J.). *Ballew* held that a five-member jury did not satisfy the constitutional requirement in a state criminal trial. See generally Lermack, *No Right Number? Social Science Research and the Jury-Size Cases*, 54 N.Y.U. L. REV. 951, 963 (1979) (Justice Blackmun did not differentiate between empirical and nonempirical work and the studies he cited do not support his conclusions); Nagel, *Value Reinforcement as a Key to Policy Research Utilization*, in THE USE — NONUSE — MISUSE OF APPLIED SOCIAL RESEARCH IN THE COURTS 106, 106-09 (1980) (criticizing Justice Blackmun's "selective" use and citation of the author's research model for Type I errors — convicting the innocent — and Type II errors — not convicting the guilty); Kaye, *And Then There Were Twelve: Statistical Reasoning, the Supreme Court, and the Size of the Jury*, 68 CALIF. L. REV. 1004, 1019-20 (1980).

Justice Blackmun in *Ballew* states: "When individual and group decisionmaking were compared, it was seen that groups performed better because prejudices of individuals were frequently counterbalanced, and objectivity resulted. Groups also exhibited increased motivation and self-criticism." 435 U.S. at 233. Justice Blackmun cited Barnlund in support of the statement. 435 U.S. at 233 n.15 (citing Lempert, *Uncovering "Nondiscernible" Differences: Empirical Research and the Jury Size Cases*, 73 MICH. L. REV. 644, 687-88 (1975) (citing Barnlund, *supra* note 32, at 58-59)). These findings have not been challenged, to the author's knowledge, in the still-raging debate among scholars on the jury size issue. The optimum jury size issue implicates other values besides accuracy and quality, such as the value of having a representative cross-section of the community on a state criminal jury. One might logically

the task is an incentive that a board should offer to attract independent directors.

The growing use of committees to make certain board decisions will promote high-quality decision-making. The average size of a board committee in the large corporation is five.¹²³ The various state statutes permitting full delegation of the board's powers to a committee and the uniform acceptance by the courts of committee decisions as the equivalent of board decisions are likewise consistent with the goal of high-quality group decisions.

2. *Decision by Consensus*

The decision rule employed by a group affects the quality of its decisions. The empirical evidence strongly suggests that a consensus decision rule leads to higher quality decisions than majority rule. Studies by Hall and Watson and by Nemiroff found that groups that decided by consensus made higher quality decisions in the NASA Moon Survival Problem.¹²⁴ The instructions to the "consensus" groups did not require unanimous concurrence on each aspect of the complex problem, but suggested that the group not limit discussion solely to that sufficient to reach a simple majority vote. Other groups operated on the majority vote principle. The researchers attributed the superior results of the consensus groups to the fact that the consensus rule forced the groups to recognize and deal with differences of opinion rather than to deny or ignore them. Nemiroff concluded rather firmly that consensus is the best decision rule for a peer group.¹²⁵

urge this "value" in the corporate context, *see, e.g.*, note 89 *supra* (discussing "constituency" directors), but it has no bearing on qualitative excellence in business decisions.

Consideration has recently been given to group decision-making by appellate courts. *See* Jones, *Multitude of Counsellors: Appellate Adjudication as Group Decision-Making*, 54 TULANE L. REV. 541, 553-55 (1980).

123. *See* KORN/FERRY 1981, *supra* note 6, at 12.

124. *See* notes 35-36 *supra*.

125. *See* Nemiroff, *supra* note 36, at 2. *See also* Robertson, *Small Group Decision Making: The Uncertain Role of Information in Reducing Uncertainty*, 2 POL. BEHAVIOR 163, 163 (1980) (a consensus rule will increase search activity, but if the result is informational overload, the group will be uncertain about its decisions). Mathematical models have been devised and computer simulations used to compare decision outcomes under simple majority rules and other decision rules. *See* A. HARE, *supra* note 83, at 344-54. If majority rule is binding, coalitions may develop in the group. The opportunities for a combination of two or more minorities in opposition to a leading proposal must then be explored. Many theoretical and empirical articles analyze the formation and maintenance of coalitions. *See, e.g.*, Komorita & Chertkoff, *A Bargaining Theory of Coalition Formation*, 80 (No. 3) PSYCHOLOGICAL REV. 149 (1973). Many are based on various "game" theories, which make behavioral assumptions as to how persons "should" act — *i.e.*, rationally and with individual optimization in mind. These studies as well as the bargaining theories are beyond the scope of this Article.

Decision by consensus is a long standing rule in the non-Western world, particularly in villages and small groups.¹²⁶ Japanese managers decide by consensus in large business organizations.¹²⁷ No votes are taken, but all views are considered until a solution can be found that incorporates the concerns of all members. Hare conducted a field study of the Quakers, who have used the consensus method for over 300 years. He found the method effective when the group is highly cohesive and shares "common values."¹²⁸ Since the new board, like the old, agrees on common values, the empirical evidence supports the use of a consensus decision rule, and not a majority rule, to achieve high-quality decisions.¹²⁹

However, a legal requirement that the board reach its decisions by consensus would be counterproductive. Such a requirement might cause boards to reach compromise solutions rather than find solutions of the highest quality, or to embrace all points of view by leaving final decisions intentionally vague.¹³⁰ When the board states its decision in vague terms, it passes the real decision to the officers who implement it, in effect delegating decision-making to the chief executive.¹³¹ Furthermore, the imposition of a consensus rule on the average thirteen-person board in the large corporation might make *bona fide* decision-making practically impossible. Based on the available evidence on peer-group decisions, optimum group size, and consensus decisions, however, the courts should accord the greatest

126. A. HARE, *supra* note 83, at 345.

127. See Drucker, *What We Can Learn From Japanese Management*, HARV. BUS. REV., Mar.-Apr. 1971, at 110, 111-13. *But cf.* Pascale, *Communication and Decision Making Across Cultures: Japanese and American Comparisons*, 91 AD. SCI. Q. 91 (1978) (Managers of Japanese firms were not found to utilize a consultative decision-making process more extensively than American managers do, which finding did not contradict Drucker's point that Japanese managers spend more time than Americans defining the issues before supplying the answer). See generally W. MONROE & E. SAKAKIBARA, *THE JAPANESE INDUSTRIAL SOCIETY* 13 (1977); *Japanese Management Style Wins Converts*, INDUS. WEEK, April 16, 1979, at 19; *Japanese Managers Tell How Their System Works*, FORTUNE, Nov. 1977, at 126; Ueda & Craighead, *Patience in Human Relations: Key to Doing Business in Japan*, MGT. REV., Oct. 1978, at 57.

128. A. HARE, *supra* note 83, at 345.

129. This data has been collected by behavioral scientists observing people in groups. The mathematical models and computer simulations may in the future point in a different direction, but their assumptions with respect to human behavior and their applications of power and game theories will have to be more closely examined. This body of literature has distinctive relevance to business organizations. It requires further consideration. For example, the studies of coalitions in small groups are relevant to the problems of close corporations and partnerships.

130. See G. ALLISON, *ESSENCE OF DECISION* 178 (1971); R. MACK, *PLANNING ON UNCERTAINTY* 130 (1971) ("Uncertainty can make coalitions possible which clarity would disrupt.").

131. See Note, *Decisionmaking Models and the Control of Corporate Crime*, 85 YALE L.J. 1091, 1104 (1976). See generally Hoffman, *The Beginnings of a Hierarchical Model of Group Problem-Solving*, in *THE GROUP PROBLEM-SOLVING PROCESS* 157 (1979).

possible deference to a consensus business decision by a five-person independent committee.¹³²

C. *Conditions That Impede High-Quality Group Decisions*

Janis tells the story of Alfred Sloan, the former chairman of General Motors, who reportedly announced at a meeting:

Gentlemen, I take it we are all in complete agreement on the decision here. . . . Then I propose we postpone further discussion of this matter until our next meeting to give ourselves time to develop disagreement and perhaps gain some understanding of what the decision is all about.¹³³

In seeking to determine the causes of incorrect group decisions, Barnlund recognized the malevolent group dynamics that Sloan tried to avoid: "[G]roup members agreed immediately and unanimously upon the wrong answer to a problem. Further study of the issue was then considered unnecessary and wasteful. . . . Agreement [became] the criterion of correctness."¹³⁴ A recent case history of a company's faulty acquisition of another business on the strong recommendation of the chief executive reveals similar decision-making problems. Although the company's board had prestigious and conscientious independent directors and had received advance information, the directors did not realize that other directors shared their negative opinions or that senior management, except for the chief executive, opposed the acquisition, and they did not wish to provoke conflict with the new chief executive.¹³⁵

The studies of group behavior have identified two principal causes of faulty group decisions — group pressure toward conformity of opinion and unexpressed and subtle group dynamics that speed up the decision process. After evaluating the behavioral science evidence, this section discusses various techniques for counteracting harmful dynamics and the appropriate judicial incentives to adopt these techniques.

1. *Conformity Pressures*

We have all experienced the pressures toward conformity in a group. Groups do not encourage dissent. This is intuitively obvious, and as the social scientists are wont to do, they replicated the obvi-

132. See note 49 *supra* and accompanying text.

133. I. JANIS, *supra* note 111, at 218-19.

134. Barnlund, *supra* note 32, at 59.

135. Levy, *Reforming Board Reform*, HARV. BUS. REV., Jan.-Feb. 1981, at 166.

ous in many experimental studies during the 1950s.¹³⁶ Janis coined the word "groupthink" to dramatize the point,¹³⁷ and the famous experiments of Solomon Asch,¹³⁸ a Gestalt psychologist, engendered hundreds of experiments and articles on the subject of conformity. Asch had his subjects look at lines of different lengths. Each individual merely had to state that one line was longer than the others. The experimenter's confederates unanimously gave the wrong answer, and nearly thirty-seven percent of the experimental subjects conformed with the confederates. Later experiments by others demonstrated that conformity pressures increased with the use of complex problems involving subjective judgments and with the increasing attractiveness of the group to the individual subjects.¹³⁹

Of the many empirically identified variables that influenced conformity to the majority, the most powerful variable was the degree of ambiguity and uncertainty in the problem. The greater the ambiguity and uncertainty, the greater the conformity of the individual to majority judgment. Asch's experiment represents the least ambiguous situation — judging which line is longer than the others. Sherif's experiments involved the movement of light under very ambiguous conditions (the "autokinetic effect"); approximately eight out of every ten persons yielded to unanimous group decisions.¹⁴⁰ Other experiments have confirmed that the degree of conformity corresponds closely to the degree of ambiguity involved.¹⁴¹

Pressures toward conformity thus appear greatest in the very areas where the board of directors operates. Analysis of the information upon which major business decisions are to be based, of the choices considered, and of the potential consequences of the decision is complex, ambiguous, and uncertain. And, findings suggest that conformity is greater in ongoing than in temporary groups.¹⁴²

136. For a summary of these studies, see A. HARE, *supra* note 83, at 19-59; M. OLMSTED & A. HARE, *supra* note 39, at 114; M. SHAW, *supra* note 23, at 280-93. For a general discussion of the field, see Cartwright & Zander, *Pressures to Uniformity in Groups: Introduction*, in GROUP DYNAMICS 139 (3d ed. 1968).

137. See note 111 *supra*.

138. See Asch, *Effects of Group Pressure Upon the Modification and Distortion of Judgments*, in READINGS IN SOCIAL PSYCHOLOGY 2 (rev. ed. 1952); Asch, *Opinions and Social Pressure*, SCI. AM., Nov. 1955, at 31.

139. See, e.g., Brehm & Mann, *Effect of Importance of Freedom and Attraction to Group Members on Influence Produced by Group Pressure*, 31 J. PERSONALITY & SOC. PSYCH. 816 (1975).

140. M. SHERIF & C. SHERIF, AN OUTLINE OF SOCIAL PSYCHOLOGY 554-55 (rev. ed. 1956).

141. See M. SHAW, *supra* note 23, at 282-83. See also Emerson, *Deviation and Rejection: An Experimental Replication*, 19 AM. SOC. REV. 688 (1954) (testing theory that conformity is related to cohesiveness).

142. See M. SHAW, *supra* note 23, at 285-86. In the more successful groups, there is a

These experiments, however, may overstate the effect of conformity. Asch's classic experiment was the basis for all later conformity research. Asch presented subjects with the unanimous (but false) judgment of the experimenter's confederates. When one confederate answered correctly or merely stated that he was unable to make a judgment, conformity decreased from thirty-three percent to less than six percent.¹⁴³ And, Asch's experimental conditions do not represent the context in which peer groups make decisions. Asch did not permit any interaction or discussion among the members.¹⁴⁴ In group discussions, each individual can account for the various positions taken by the other members and can anticipate a satisfactory interpretation of his or her potential dissent by the others. In Asch's experiment, "the assault on the [subject's] judgment reaches an intensity virtually unparalleled outside the laboratory."¹⁴⁵ The subject could neither account for why everybody else was wrong, nor expect the others to interpret his or her potential dissent satisfactorily. Most studies of conformity have been designed to explore the negative consequences of conformity — the loss of individuality, the restriction of creativity and the reduction of the group to the level of mediocrity.¹⁴⁶ In *Victims of Groupthink*, Janis emphasized these negative aspects in his dissection of the Bay of Pigs decision by President Kennedy and his advisors. Most of the pioneers who shaped this negative cast conducted their experiments during the height of the McCarthy era. Current empirical studies do not support the existence of blind adherence to the majority only for the sake of agreement. In the most recent summary, Shaw stated:

[U]ndesirable consequences undoubtedly would follow from a blind, unreasoning "follow the crowd" type of conformity. Fortunately, there is no evidence that behaving in accordance with group norms *necessarily*, or even usually, results from such unthinking compliance. In many, perhaps most, instances, there are good and sufficient reasons for conforming to group norms.¹⁴⁷

2. The Group's Dynamics

The more significant problem in group decision-making is the

tendency toward increased conformity. See Kidd & Campbell, *Conformity to Groups as a Function of Group Success*, 51 J. ABNORMAL & SOC. PSYCH. 390 (1955).

143. See M. SHAW, *supra* note 23, at 284.

144. See A. HARE, *supra* note 83, at 23-24.

145. Ross, Bierbrauer & Hoffman, *The Role of Attribution Processes in Conformity and Dissent: Revisiting the Asch Situation*, 31 AM. PSYCH. 148, 150 (1976).

146. M. SHAW, *supra* note 23, at 289.

147. *Id.* (emphasis in original).

pressure toward convergence of opinion, not unthinking conformity, that occurs at some point during the decision-making process. A large body of the recent group research indicates that groups tend to become "solution-minded"; their goals of efficiency, success, and satisfaction speed up the decision-making process. The danger is that the group will reach a unanimous, but incorrect, decision very early in the process.¹⁴⁸

Contrary to folklore, the researchers find that the real difficulty is in trying to slow groups down rather than trying to speed them up. They use various terms to describe the dynamics of making the decision very shortly after the majority opinion begins to appear — "the emerging consensus," "majority congruence," "group convergence," and "passing the adoption threshold."¹⁴⁹ In essence, members of the group initially attack the problem in an open-minded and searching manner, but when they sense which way the wind is blowing, they proceed quickly to a decision.

Hoffman concluded that the first solution to pass what he calls the "adoption threshold" wins and prevents others from emerging.¹⁵⁰ At some point, the emergence of a majority becomes apparent to all, and dissent turns to ambiguity and then to unity, with little or no dissent. Group discussion and analysis serve continuously to anchor the developing consensus. Bales, Bormann, and Fisher have each confirmed the existence of this phenomenon.¹⁵¹ Coupled with the

148. See Barnlund, *supra* note 32, at 59.

149. See, e.g., I. JANIS, *supra* note 111, at 11, 198-206, 218-19 (strong concurrence-seeking tendency); A. KOWITZ & T. KNUDSON, DECISION MAKING IN SMALL GROUPS 171-72 (1980) (premature consensus); Hoffman, Friend & Bond, *Problem Differences and the Process of Adopting Group Solutions*, in THE GROUP PROBLEM SOLVING PROCESS 48, 64-65 (1979) (passing the adoption threshold).

150. See Hoffman, Friend & Bond, *supra* note 149, at 64-65. See generally Hoffman, *Applications to the Functioning of Problem-Solving Groups*, in THE GROUP PROBLEM SOLVING PROCESS 184-87 (1979). "[T]he adoption of [the ultimate] solution could be predicted at a relatively early stage of the problem-solving discussion." Hoffman & Maier, *Valence in the Adoption of Solutions by Problem-Solving Groups: II. Quality and Acceptance as Goals of Leaders and Members*, in THE GROUP PROBLEM SOLVING PROCESS 33, 33 (1979).

151. See E. BORMANN, DISCUSSION AND GROUP METHODS 282-83 (2d ed. 1975) (groups do not proceed rationally in problem solving except to justify solution); Bales, *In Conference*, HARV. BUS. REV., Mar.-Apr. 1954, at 44, 49 (recommends reversing the order of formal parliamentary procedure for group problem solving by having the group deal in the following order with: (1) what are pertinent facts? (2) how do group members feel about such facts? (3) what shall be done in reference to problem?). Fisher, *Decision Emergence: Phases in Group Decision-Making*, 37 SPEECH MON. 53, 58-65 (1970) (discusses four stages of group decision-making). Some of the studies have literally dissected, minute by minute, the group decision-making process. For example, one study found that 22% of the time devoted to a problem involved the initiation and development of one idea, 25% to the clarification of that idea and 25% to confirmation of the idea; in other words, 72% of the group effort was aimed at anchoring the first solution as the group solution. Larson, *Speech Communication Research on Small Groups*, 20 SPEECH TEACHER 89, 99 (1971). Another study found that the group attention span per substantive "theme" is only 76 seconds. Berg, *A Descriptive Analysis of the Distribution and*

group's disposition to finish the task — its "solution-mindedness" — convergence or congruence may lead to decisions based on inadequate information and an inadequate search for alternatives. Groups adopt only as many criteria as are needed to solve the problem,¹⁵² and the group's discussion centers around the first apparently reasonable solution. If enough cues reveal that a solution is acceptable, it becomes the group decision.

In their experiments with the NASA Moon Survival Problem,¹⁵³ Hall and Watson and Nemiroff found that the use of "intervention techniques" to slow down "majority congruence" led to higher quality decision-making in certain groups than in groups in which the usual group dynamics were at work. Hall and Watson, for example, instructed certain groups of businesspersons to avoid taking an early majority vote, to encourage differences of opinion, and to seek to reach a "consensus." These "instructed" groups performed significantly better than the most proficient member of their group and significantly better than the uninstructed groups. These studies demonstrate that procedures aimed at slowing down the group dynamics and protecting the minority significantly improve the quality of group decision-making.

3. *Techniques for Slowing Down the Group's Dynamics*

Experimenters have used many techniques to avoid the group's rush to decision and to lessen conformity pressures.¹⁵⁴ Four techniques have received empirical support: (1) anonymous voting at various stages of the decision process; (2) formalizing the role of devil's advocate, and rotating the job at each meeting; (3) using a "discussion leader" whose position on the issue is not known to the group, instead of using a high-profile leader whose position is or quickly becomes known to all; and (4) if the decision can wait, implementing a "second round review."

Duration of Themes Discussed by Task-Oriented, Small Groups, 34 SPEECH MON. 172, 174 (1967).

152. See Hoffman, Bond & Falk, *Valence for Criteria: A Preliminary Exploration*, in THE GROUP PROBLEM SOLVING PROCESS (1979).

153. See notes 35-36 *supra*.

154. "Brainstorming" became a much used technique in the 1960's, thanks to its active promotion by advertiser Osborn. Rules designed to facilitate creativity are imposed on the group. Individuals are not allowed to criticize ideas suggested by other, but can only build upon them or suggest other ideas. The experimental results have been equivocal. However, at least some of the apparent superiority of brainstorming groups may have resulted merely from the use of a decision-deferral technique, or from the superiority of participants. See A. HARE, *supra* note 83, at 319; Parnes, *Effects of Extended Effort in Creative Problem Solving*, 52 J. EDUC. PSYCH. 117 (1961).

a. *Anonymous voting by directors.* Behavioral scientists have tested empirically various forms of anonymous voting and have found that such voting leads to higher quality group decisions than disclosed voting. Anonymous voting obviously reduces conformity pressures. And the various anonymous voting procedures structure group decision-making, and thus counteract the rush to decide, although other structured or staged processes might also produce that effect.

One structured process for anonymous voting — called the Nominal Group Technique — was devised by Van de Ven and Delbecq.¹⁵⁵ A complex problem is posed to the group. Each individual is then given time to formulate an approach and possible solution without communicating it to the others. Then a structured round-robin presentation by each member is made, one idea at a time. Each idea is immediately summarized on a blackboard. The group discusses the listed ideas to clarify and to evaluate them. This proceeds for one or more rounds. Finally, members vote by secret ballot and the majority decision becomes binding.

A computer age technique called the "Delphi Process," pioneered by Dalkey and Hammer, is the ultimate technique for preserving anonymity.¹⁵⁶ However, the new board cannot use it in its stark form because the individuals comprising the "group" never meet face-to-face. A very complex problem is posed. Members communicate anonymously, either in writing or by computer. After each member's first input is recorded and available to all, members make second inputs, anonymously communicating questions and explanations in the process. This procedure continues until the group reaches a consensus or a predetermined number of rounds have occurred.

The researchers have tested these and other structured decision procedures with anonymous voting. Although differing on various

155. See Van de Ven & Delbecq, *The Effectiveness of Nominal Delphi and Interacting Group Decision Making Processes*, 17 ACAD. MGT. J. 605 (1974). For other similar studies, see Felsenthal & Fuchs, *supra* note 34; Green, *An Empirical Analysis of Nominal and Interacting Groups*, 18 ACAD. MGT. J. 63 (1975) (contradicts Van de Ven and Delbecq on superiority of nominal over interacting groups); Stumpf, Freedman & Zand, *Judgmental Decisions: A Study of Interactions Among Group Membership, Group Functioning, and the Decision Situation*, 22 ACAD. MGT. J. 765, 779-80 (1979) (summarizes the conflicting evidence, and suggests, on the basis of a later experiment reported in the article, that when "the decision requires quality and originality, interacting groups are likely to recommend less effective decisions" than nominal groups); Stumpf, Zand & Freedman, *Designing Groups for Judgmental Decisions*, 4 ACAD. MGT. REV. 589 (1979).

156. Dalkey & Hammer, *An Experimental Application of the Delphi Method to the Use of Experts*, 9 MGT. SCI. 458 (1963). See Felsenthal & Fuchs, *supra* note 34; Reed, *On the Dynamics of Group Decision-making in High Places*, DIRECTORS & BOARDS, Winter 1978, at 49.

other points, they have concluded that the anonymity aspect of the various techniques leads to higher-quality group decisions.

The courts, therefore, should allow the new board to experiment with secret voting. Present liability rules applicable to the individual directors may leave some room for anonymous voting, at least for all "votes" prior to the "official" final decision that is duly recorded in the minutes. Indeed, current law might permit experimentation with anonymous voting on the formal final decision. The anonymous dissenting directors later faced with a lawsuit based on the majority's actions might well object to such a procedure. But it is not even clear today whether a formal dissenting vote, without resignation or steps taken to prevent damage from the majority decision, will insulate a dissenter from liability.¹⁵⁷ In any event, such stark situations are rare in the boardroom, and the uniform use of the secret ballot by the new board appears, on balance, worthy of serious consideration.¹⁵⁸

b. *The chief executive as chairperson?* Another approach that the researchers have empirically confirmed as effective in upgrading the quality of group decisions is the "discussion leader" technique.¹⁵⁹ One person, designated the discussion leader, cannot express his or her own views, but must stimulate participation by all, encourage questions, and protect any emerging minority. Janis and Mann strongly recommend the technique, stating that it allows the group "the opportunity to develop an atmosphere of open inquiry and to

157. Fletcher states: "To protest is not alone sufficient to excuse a director. If he does no more than protest he is liable as much as if he had acquiesced in the transaction. But protests followed by affirmative action will suffice." 3A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1058 (1975) (footnotes omitted). See *DePinto v. Provident Security Life Ins. Co.*, 374 F.2d 37, 44 (9th Cir.), cert. denied, 389 U.S. 822 (1967) (director who resigned just before corporation was looted held liable for negligence; had he learned of the fraudulent looting plan in time (as he should have), then "armed with such information, it would have been [the director's] duty to decline [the] request that he resign as a director. Continuing as a director . . . would have enabled [him] actively to oppose the proposal before the board and, if necessary, draw the matter to the attention of stockholders . . . and . . . of state regulatory officials."); Joyce, *Director of Corporations*, DIRECTORS & BOARDS 51, Summer 1979, at 53-54. Cf. *Heit v. Bixby*, 276 F. Supp. 217 (E.D. Mo. 1967) (lack of protest by a director made him liable as collaborator with other directors); *Walker v. Man*, 142 Misc. 277, 281-82, 253 N.Y.S. 458, 465 (Sup. Ct. 1931) (failure by director to protest or correct an illegal transaction equivalent to acquiescence for liability purposes).

158. One company that makes it easier for directors to ask questions is Massachusetts Mutual Life Insurance Company. There the directors put questions in writing anonymously prior to the meeting. See Scheibla, *Heat on Directors: A Revolution is Occurring in the Boardroom*, BARRON'S, July 30, 1979, at 4, 27.

159. See Maier & Solem, *The Contribution of a Discussion Leader to the Quality of Group Thinking: The Effective Use of Minority Opinions*, 5 HUMAN REL. 277 (1952).

explore impartially a wide range of policy alternatives."¹⁶⁰ An announcement of the leader's position colors the decisions of both the group and the leader. After persons have publicly committed themselves to a choice, they are likely to evaluate contrary communications in a biased manner.¹⁶¹

This empirical evidence suggests that the chief executive, who usually places items on the board's agenda and is committed to a specific course of action, should not also serve as chairperson of the board. Acting solely as a director, the chief executive can expect the board to give due weight to his views in any event. However, only seven percent of the very largest companies and twenty-five percent of 1,300 large companies have seen fit to separate the roles of chief executive and chairperson.¹⁶²

c. *Directors as rotating devil's advocates.* The new board should also consider formalizing the position of devil's advocate.¹⁶³ Janis¹⁶⁴ strongly recommends assigning the role of devil's advocate to members of the group on a rotating basis.¹⁶⁵ As envisioned by Janis, the group leader will have to give each member "an unambiguous assignment to present his arguments as cleverly and convincingly as he can, like a good lawyer, challenging the testimony of those advocating the majority position."¹⁶⁶ A recent empirical study indicated that the devil's advocate technique slows convergence by the majority and may generate more alternative solutions.¹⁶⁷

Directors may be loath to adopt or implement enthusiastically the devil's advocate procedure because it exposes them to greater risks of liability: if a directorial decision is later challenged in court, information developed by the devil's advocate would become the plaintiff's starting point. But strengthening the business judgment

160. I. JANIS & L. MANN, *DECISION MAKING* 399 (1977) (quoting I. JANIS, *supra* note 111, at 211).

161. *See id.* at 182.

162. *See* KORN/FERRY 1980, *supra* note 6, at 3.

163. *See* I. JANIS, *supra* note 111, at 218-19; I. JANIS & L. MANN, *supra* note 160, at 397-98; J. STEINBRUNER, *supra* note 43, at 338-39. Both Janis and Steinbruner have made detailed historical studies of high-level governmental decision-making.

164. *See* I. JANIS, *supra* note 111, at 218-19; J. STEINBRUNER, *supra* note 43, at 338-39, also mentions the technique.

165. *See* I. JANIS, *supra* note 111, at 216. Janis and Mann note that the board must provide the rotating devil's advocate with sufficient resources and staff in advance of the meeting in order to perform this role effectively. *See* I. JANIS & L. MANN, *supra* note 160, at 398.

166. I. JANIS, *supra* note 111, at 215.

167. *See* Herbert & Estes, *Improving Executive Decisions by Formalizing Dissent: The Corporate Devil's Advocate*, 2 ACAD. MGT. REV. 662, 666 (1977).

defense for independent directors, as this Article recommends, should at least partially allay such fears.

d. *The second-round review.* When time permits, the board can postpone a decision until its next meeting. Alfred Sloan did just that, and Janis recommends the procedure.¹⁶⁸ Postponement is an intuitively sound way to reduce pressures toward conformity and the rush to decide, and the procedure has also received some empirical confirmation.¹⁶⁹ Although the group literature suggests many other techniques for slowing down the decision-making process,¹⁷⁰ this writer has not found empirical support for them.

4. *The Courts Should Encourage the Use of "Stop-and-Think" Procedures by the Board*

Although we know very little about the decision-making processes used by the typical board of a large corporation, there is little reason to suppose that a group of directors is exempt from the conformity pressures found in the many groups observed in the laboratory and in the field by behavioral scientists. Because businesspersons typically attempt to get jobs done as quickly and efficiently as possible, there is also no reason to suppose that the new board is any less solution-minded than other groups.¹⁷¹ Finally, there is little reason to expect that the new board — a group composed of very busy individuals, highly-compensated for their other main activities — will readily adopt time consuming procedures aimed at reducing the pressures toward conformity and quick decisions at board meetings. Consequently, the courts should provide positive legal incentives to encourage the new board to adopt one or more of the empirically confirmed "stop-and-think" procedures.

Corporate law strongly emphasizes the board's decision-making process. After reviewing the Delaware decisions, for example, Arsht concluded:

The business judgment rule was not conceived as a defense that, once asserted, precluded judicial inquiry into the procedures and methodologies followed by the directors in making their challenged decision. . . . [I]n each case the business judgment rule [expressed by the court] was a starting point for inquiry into the directors' decisionmaking

168. See I. JANIS, *supra* note 111, at 218-19.

169. See B. BASS, *ORGANIZATIONAL PSYCHOLOGY* 388-92 (1965).

170. See notes 167-68 *supra*. See generally I. JANIS & L. MANN, *supra* note 160; A. KOWITZ & T. KNUDSON, *supra* note 149; M. SHAW, *supra* note 23.

171. R. MUELLER, *NEW DIRECTIONS FOR DIRECTORS* 11 (1978).

process.¹⁷²

At least two "process-of-decision" provisos limit the use of the business judgment rule as a shield to judicial inquiry on the merits of a business decision. At the most mundane level, a director ordinarily must attend the meeting to share information and ideas necessary to render a decision. An early Delaware case is illustrative: "If not present in person to give out, or receive, business knowledge needed in conducting the affairs of the company . . . [the director] has not performed his duty, because he has not in fact participated in the deliberations of the board."¹⁷³ The directors must also have adequate information to exercise business judgment. As Judge Hand observed in *Barnes*, directors have a "duty to keep themselves informed in some detail, and it is this duty which the defendant in my judgment failed adequately to perform."¹⁷⁴ The courts have given a mixed reception to this informational prerequisite to the exercise of business judgment, but it appears to be backed by the weight of the authority. It is supported by decisions in the leading corporate states of Delaware and New York, and by statute in California.¹⁷⁵ A New York court put this process point well: "When courts say that they will not interfere in matters of business judgment, it is presupposed that judgment — reasonable diligence — has in fact been exercised."¹⁷⁶

172. *Arsht*, *supra* note 54, at 100.

173. *Lippman v. Kehoe Stenograph Co.*, 11 Del. Ch. 80, 89, 95 A. 895, 899 (1915). *See also* *Stevens v. Acadia Dairies*, 15 Del. Ch. 248, 135 A. 846 (1927) (directors cannot act by proxy). Decisions requiring that notices of special meetings be sent to directors and that the notice set forth the precise agenda can be viewed as first-step process rules for decision-making. *See* W. CARY & M. EISENBERG, *supra* note 94, at 165-66, for collected cases and statutes. Statutes permit participation by telephone when "all persons participating in the meeting can hear each other" DEL. CODE ANN. tit. 8, § 141(i) (1974). However, if the directors unanimously consent in writing to a decision, they need not meet to discuss the action. DEL. CODE ANN. tit. 8, § 141(f) (1974).

174. *Barnes v. Andrews*, 298 F. 614, 615 (2d Cir. 1924). However, the defendant was held not liable because the plaintiff did not prove that the defendant's failure to become informed caused the damage.

"This duty of attention is becoming increasingly important as additional emphasis is placed on the director's monitoring role." STAFF REPORT, *supra* note 16, at 663 (footnote omitted).

175. *See* STAFF REPORT, *supra* note 16, at 663-64. The California statute requires that a director carry out his or her duties "with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would under similar circumstances." CAL. CORP. CODE § 309(a) (West 1977). In *Royal Indus., Inc. v. Monogram Indus., Inc.*, [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,863 (C.D. Cal. 1976), Royal sought to buy Sar, a competitor of Monogram, so as to ward off Monogram's tender offer for Royal. The court enjoined the purchase of Sar, noting, among other factors, that the transaction was created in extreme haste and without reasonable investigation by Royal. [1976-1977 Transfer Binder] FED. SEC. L. REP. at 91, 139-40.

176. *Casey v. Woodruff*, 49 N.Y.S.2d 625, 643 (Sup. Ct. 1944). In *Kaplan v. Centex Corp.*, 284 A.2d 119, 124 (Del. Ch. 1971), the court said: "Application of the [business judgment] rule

Under some recent decisions it is unclear whether proof that the directors were present and informed ends the inquiry or whether there is still another process-of-decision proviso to the business judgment rule — that the board actually deliberated before reaching its business decision. Certain decisions in Delaware seem to support the latter process inquiry. In *Lutz v. Boas*,¹⁷⁷ the Delaware Chancery Court held the directors were liable because they had “made no efforts to be informed”¹⁷⁸ and “gave almost automatic approval”¹⁷⁹ to certain agreements.

In a more recent case, *Gimbel v. Signal Co.*,¹⁸⁰ the Delaware Chancery Court preliminarily enjoined Signal's sale of a subsidiary for an apparently grossly inadequate price. A board meeting to discuss the sale was called on very short notice, and the outside directors were not notified of the meeting's purposes. The court reviewed a handwritten memorandum and handwritten minutes to evaluate the decision-making process. After two hours of discussion, the directors approved a \$480,000,000 transaction. The court noted that “the meeting was short for a transaction of this size”¹⁸¹ It discussed a number of factors suggesting imprudence, including management's failure to give the board adequate advance notice of its prolonged negotiations, the board's failure seriously to consider certain views on the legality of the sale, the failure to delay the sale to provide adequate time for board consideration or to obtain an updated evaluation, the failure to consider how the corporation

. . . depends upon a showing that informed directors did, in fact, make a business judgment authorizing the transaction under review.”

The federal courts under the federal securities laws, particularly § 11 of the Securities Act of 1933 and under the proxy rules under § 14(a) of the Securities and Exchange Act of 1934, have also imposed substantial “due diligence” duties upon directors. In *Gould v. American Hawaiian S.S. Co.*, 351 F. Supp. 853 (D. Del. 1972), *vacated on other grounds*, 535 F.2d 761 (3d Cir. 1976), the Third Circuit held outside directors liable for negligence in failing to review carefully a proxy statement sent to shareholders. The court said: “When possible, the . . . [statute] should be interpreted to afford incentives to directors to undertake active and rigorous scrutiny of corporate activities. . . .” 351 F. Supp. at 859. The federal cases are concerned with the procedures used by the directors in seeking out and evaluating information for public disclosure under federal law. The Investment Company Act of 1940 requires that at least 40% of a mutual fund board consist of independent directors. In a number of cases under that Act, the courts have required that the board engage in “meaningful” inquiry and decision-making. See *Cambridge Fund, Inc. v. Abella*, 501 F. Supp. 598 (S.D.N.Y. 1980), and cases collected therein. In *Cambridge Fund*, the Court found that the proposed indemnification of an interested party was presented to the board “in such a one-sided and incomplete manner that it discouraged any meaningful evaluation by the unaffiliated directors.”

177. 39 Del. Ch. 585, 171 A.2d 381 (Ch. 1961).

178. 39 Del. Ch. at 609, 171 A.2d at 396.

179. 39 Del. Ch. at 609, 171 A.2d at 395.

180. 316 A.2d 599 (Del. Ch.), *aff'd. on other grounds*, 316 A.2d 619 (1974).

181. 316 A.2d at 613.

would use the sale proceeds, and the indication in the "limited record [of] a gross disparity between the fair market value" of the subsidiary and the sale price.¹⁸² Although the court said that "the ultimate question is not one of method but one of value,"¹⁸³ the case serves as a possible precedent for examination of the board's decision-making process.

Judicial inquiry into the processes of board decision-making has also gone beyond the "directors must be informed" condition in the recent take-over cases that have granted the business judgment defense to the target corporation's board. This type of in-depth inquiry into processes may be peculiar to the take-over area because the substantive rules all touch upon the subjective motivations of the target board (*e.g.*, whether the "sole," "principal," or "primary" motive of the board was the improper one of seeking to perpetuate its control for its own sake).¹⁸⁴ But the courts might extend the process inquiry to other types of business decisions, under the "bad faith" exception to the business judgment rule. As the Second Circuit recently stated, "directors are presumed to have acted properly and in good faith, and are called to account for their actions only when they are shown to have engaged in self-dealing or fraud, or to have acted in bad faith."¹⁸⁵ Plaintiffs could argue that failure to deliberate or merely rubber stamping the recommendations of the chief executive is bad faith.

In any event, the process of decision figured prominently in the lengthy facts recited and the reasoning of the courts in recent take-over cases. In *Treadway Cos. v. Care Corporation*,¹⁸⁶ Care sought to acquire Treadway. Treadway successfully warded off Care, the unwanted suitor, by merging with a "white knight" of Treadway's own choosing, Fair Lanes. At the conclusion of its lengthy opinion granting the business judgment defense to the Treadway board (except for Lieblich, Treadway's President), the Second Circuit observed:

[T]here was evidence that the directors did in fact exercise their independent judgment. . . .

The record as to what steps the Treadway directors took, and exactly what information they sought, preparatory to the exercise of their

182. 316 A.2d at 614-15.

183. 316 A.2d at 615.

184. *See, e.g.*, *Johnson v. Trueblood*, 629 F.2d 287, 292-93 (3d Cir. 1980).

185. *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 382 (2d Cir. 1980). Plaintiffs would have a potential opening wedge in all cases: They need depositions of directors regarding the decision process to make the good or bad faith determination. Failing to deliberate or merely rubber-stamping the chief executive, they could assert, is bad faith.

186. 638 F.2d 357 (2d Cir. 1980).

judgment is somewhat sparse. Care would have us believe they did nothing. A close reading of the record, however, reveals that they had engaged an investment banking firm [Swordco] to negotiate and help them evaluate proposed mergers; that between meetings of the Treadway board they . . . were informed of negotiations with Fair Lanes; that during the negotiations they sent Swordco to Fair Lanes armed with a number of questions to which they wished answers; that they asked Swordco for pro forma balance sheets for the combined company; that they adjourned their deliberations for one week thereafter to reflect on the information they had received and to obtain more; and that they conditioned their approval of the proposed transactions on obtaining an opinion from Swordco that the transactions were fair to Treadway.

Thus the record provides no adequate basis for finding that Care carried its burden of proving that the directors did not exercise their judgment in good faith or that any other circumstances make the business judgment rule inapposite.¹⁸⁷

Treadway seems to have equated "good faith" with keeping an open mind, seeking outside advice when critical to a decision, and adjourning for a second-round review when time permits.

In *Crouse-Hinds Co. v. InterNorth, Inc.*,¹⁸⁸ Crouse-Hinds had negotiated a merger with Belden Corporation before the unwanted suitor, InterNorth, came upon the scene. Crouse-Hinds stoutly resisted the new suitor and merged with Belden. The Second Circuit granted the business judgment defense to the Crouse-Hinds board. The court detailed the decision-making process just before and at the critical meeting of the Crouse-Hinds board, when the board decided to resist InterNorth's tender offer and to reaffirm its prior decision to merge with Belden. The court emphasized that the Crouse-Hinds board was "advised not to formulate conclusions," had consulted "its expert advisers," and relied "in part" on the opinion of its financial adviser in its decision. The court held that plaintiff had failed to rebut the presumption under the business judgment rule that the board had acted properly and in good faith.¹⁸⁹

In *Panter v. Marshall Field & Co.*,¹⁹⁰ the Seventh Circuit recently

187. 638 F.2d at 384 (footnotes omitted). In a footnote to the above, the Court said: Care has also argued, and persuaded the district court, that bad faith should be inferred from the haste with which the Treadway-Fair Lanes negotiations proceeded, and from the very terms agreed to, which Care asserts grossly disadvantaged Treadway. We see nothing in the course of the board's deliberations, nor in the agreements themselves, that would permit the drawing of such an inference with regard to the directors other than Lieblich.

638 F.2d at 384 n.53.

188. 634 F.2d 690 (2d Cir. 1980). See text at notes 67-69 *supra*.

189. 634 F.2d at 702.

190. 646 F.2d 271 (7th Cir. 1981). See text at notes 66-68 *supra*.

protected the target board of Marshall Field from liability to its own stockholders for successfully opposing takeover efforts by Carter Hawley Hale, the national retail chain. The court had to summarize the decisional process rather superficially because it affirmed the lower court's directed verdict for the director defendants at the close of the plaintiff's case. It tersely indicated that the "presumption of good faith the business judgment rule affords is heightened when the majority of the board consists of independent outside directors."¹⁹¹ The court stated: "[b]ecause our examination of the board's conduct does not reveal . . . bad faith, we do not believe an evaluation of the fairness or wisdom of the board's conduct is called for as long as it can be attributed to any rational business purpose."¹⁹² Although its opinion is unclear, the court seemed to be referring to the process of decision, in which the board consulted with counsel and investment bankers.¹⁹³

The board's consultation with outside experts before making a decision has been held a factor in other cases granting the business judgment defense to directors;¹⁹⁴ conversely, some courts have cited the failure to consult experts as evidence of a failure to exercise business judgment.¹⁹⁵ A board's plan to "paper up" a decision previously reached by seeking an expert opinion will not always work. In one takeover case, the court disregarded the hastily prepared report of an investment banker on the ground the board had not in fact relied on it.¹⁹⁶

These cases are consistent with an actual deliberation or "stop-and-think" requirement in the business judgment rule, with the burden of proof on the plaintiff. "Good faith" could thus become the rubric for imposing on the board a "stop-and-think" rule for all

191. 646 F.2d at 294.

192. 646 F.2d at 295 n.7.

193. 646 F.2d at 279-80.

194. See *Anaconda Co. v. Crane Co.*, 411 F. Supp. 1210, 1215 (S.D.N.Y. 1975) (reliance on investment banker's report that tender offer price was inadequate); *Cheff v. Mathes*, 41 Del. Ch. 494, 507, 199 A.2d 548, 566 (Del. 1964) (reliance on Dunn & Bradstreet report and advice of investment bankers); *GM Sub Corp. v. Liggett Group, Inc.*, No. 6155 (Del. Ch. April 30, 1980) (unreported opinion) (tender offerer sought denial of temporary restraining order to prevent target corporation from selling its major asset; target's consultation with investment bankers was cited by the Chancellor as evidence that the directors had exercised their business judgment in good faith); *Kaplan v. Goldsamt*, 380 A.2d 556, 568 (Del. Ch. 1977) (reliance upon advice of investment bankers in setting price of stock repurchased from dissident shareholder).

195. See Pitt & Israel, *Recent Cases Chart Use Of Business Judgment Rule*, Legal Times of Washington, Jan. 19, 1981, at 35.

196. *Royal Indus., Inc. v. Monogram Indus., Inc.*, [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,863, at 91,135-36 (C.D. Cal. 1976).

business decisions. Whether the courts should apply this developing "process-of-decision" law to the new board is a difficult question. A "stop-and-think" rule would encourage independent directors to "lift themselves up by their own psychological bootstraps,"¹⁹⁷ and to seek to avoid pressures toward conformity and quick decisions. But such a rule would allow plaintiffs to enter the boardroom too easily, fishing for substance under the guise of process. The incentives for independent directors to serve are fragile as it is. Given the overriding goal of encouraging truly independent directors to serve and to participate actively, the courts should strengthen the business judgment defense applicable to such directors, not weaken it by adding further uncertainties to its invocation.

The courts can create an incentive for the adoption of "stop-and-think" procedures by closing the boardroom door upon a showing by an independent board that (1) the chief executive is not chairperson of the board; or (2) the board uses the devil's advocate technique; or (3) voting at various stages of the decision-making process is anonymous; or (4) the board made the particular decision at a "second round" review.¹⁹⁸ Other techniques could be added to the list as they receive empirical support. And, if the new board sought outside advice prior to making the particular decision, a court could foreclose further inquiry into the process of decision, as in *Panter*. Such consultation makes the independent directors stop and think as much as the confirmed techniques. It has especial application in the takeover cases, where target boards uniformly consult outside counsel and investment bankers despite the pressures for a quick and uniform response by the directors.¹⁹⁹

Even this somewhat superficial process-of-decision rule would flush out evidence as to whether the board has any "stop-and-think" procedure whatsoever. But once the new board has come forward with such evidence, the court will have to close the boardroom door; otherwise the plaintiff will try to fish for substance while challenging the *bona fides* of the process.²⁰⁰

197. R. MUELLER, *supra* note 171, at 11.

198. The "simple" showing would involve testimony by an independent director that the new board regularly uses one of the procedures and in fact used it in the process of making the challenged business decision. The second round review is an exception to the suggestion of proof of regular use.

199. A recent SEC rule requires the board to respond to a tender offer within ten business days after it is made. 17 C.F.R. § 240.14e-2 (1980).

200. The proposed rule is "superficial" in the sense that the new board can merely "go through the motions" at meetings simply to get the benefits proposed. The devil's advocate,

IV. THE NEW BOARD AS BUSINESS-DECIDER

This section of the Article uses the empirical findings already discussed and other recent literature on decision-making to sketch a tentative framework for allocating decision-making between the new board and the chief executive in the large corporation. The evidence indicates that, all things being equal, peer group decisions will qualitatively surpass those made by individuals. On this basis, this Article has argued that the law should protect as strongly as possible the decisions of that important and new peer group in the very large corporation — the board composed of a majority of independent directors. A nearly absolute business judgment defense for the new board would not only encourage the board to make important decisions; it would also provide incentives for truly independent direc-

for example, could regularly be a sheep in wolf's clothing by implicit agreement among group members.

Any process rule is subject to manipulation, particularly by persons who face potential liability. If courts require board meetings to be tape recorded, would the directors wink or use hand signals? If they require board meetings to be videotaped, would the directors informally meet and thereafter conduct the formal meeting as television actors would? Many legal rules are imposed despite the high potential for evasion, because most people will comply with them. Further, the affected persons include businesspersons, government officials, and academics. Most are honest and responsible individuals, who will refuse to evade a procedure which both the law has embraced and the members have decided is best designed to reduce the very pressures of which they are aware. Further, once an ongoing group develops a procedure it rarely deviates from it. For example, if the board selected the rotating devil's advocate procedure it would slowly but surely incorporate the role as part of its "culture" or "norms." Each member would experience the role, and the group itself would be exposed to it meeting after meeting.

A more direct approach might be "to activate the board of directors" to adopt one of the techniques by mandating disclosure, under the federal proxy rules, of the decisional procedures used by the board. This idea derives from several unrelated proposals of Professors Elliot J. Weiss and Donald E. Schwartz. Weiss & Schwartz, *Using Disclosure to Activate the Board of Directors*, LAW & CONTEMP. PROB., Summer 1977, at 63; Weiss & Schwartz, *Disclosure Approach for Directors*, HARV. BUS. REV., Jan.-Feb. 1978, at 18; Weiss & Schwartz, *Using Disclosure to Activate the Board of Directors*, in CORPORATIONS AT THE CROSSROADS: GOVERNANCE AND REFORM 109 (D. DeMott ed. 1980) (updated version of their previous articles). Under the proxy rules (or the reporting requirements of the 1934 Act), the SEC could require the board to disclose whether it utilizes one of the empirically recognized techniques or another technique reasonably designed to accomplish the same purposes. However, proxy statements are cluttered as it is and costly and shareholders of large corporations may not be interested in this kind of information. The SEC should therefore give the new board time to choose decision-making procedures or decide not to impose new federal burdens on it. A possible alternative would be legislating process rules. Professor Christopher D. Stone has recently analyzed the efficacy of achieving corporate control through various types of liability rules. This author's suggestion that the process rules be imposed only indirectly and at the instance of a shareholder in a derivative suit (in Stone's phrase a "harm-based liability rule") may be less efficacious in inducing the adoption of such rules generally (and may be more costly) than the adoption of "standards," presumably through legislation. See Stone, *The Place of Enterprise Liability in the Control of Corporate Conduct*, 90 YALE L.J. 1, 41 (1980) (submitting that monitoring and enforcement costs could be reduced by adopting "standards").

tors to serve, and might encourage those companies that do not have a majority of such directors to reach at least that goal.

The peer group superiority evidence also supports the corollary argument that, all other things being equal, the chief executive should make fewer decisions. And other recent evidence further indicates that the chief executive should refer decisions to the board whenever practicable. This recent evidence, from the cognitive psychologists, pierces the mystique of individual intuitive and cognitive skills and leads to somewhat pessimistic conclusions. The individual's capacities for processing information and making decisions are more limited and error-prone than had previously been supposed. The same research also indicates that all individuals — especially the chief executive — have “cognitive conceit”: they are unwilling to recognize their natural limitations.²⁰¹ As Dr. Harlan Meal, then a manager for the preeminent business consultant Arthur D. Little, has observed: “Very few executives think of themselves as gamblers or of making the best kind of decisions in a gambling situation. They want, instead, to think of themselves as individuals whose greater grasp of the available information and whose greater insight remove the uncertainty from the situation.”²⁰² This widely-shared article of faith poses its own dangers.

A framework for allocating decision-making in the very large corporation must also take into account the work of the scholars of organizations and bureaucracies. Those scholars have ably demonstrated that all things are not equal in the real world of the large corporation. Substantial time and informational constraints impede ideal decision-making by both the chief executive and the board. Any allocation between the two must recognize those types of decisions that the board, as a practical matter, cannot make. These organizational and practical considerations even foreclose the chief executive from making many major decisions. The development of autonomous divisions in many of the very large corporations, with each division a separate “profit center” under the management of a different senior executive, has radically changed the functions of the chief executive. The chief executive of such a corporation now serves as a board of directors, advising and monitoring the divisional chiefs, subject to the same informational constraints on decisions as

201. This is the classic “double-bind.” Dawes, who presents the most pessimistic version, coined the term “cognitive conceit”: our limited cognitive capacity is such that it prevents us from being aware of its limited nature. See Dawes, *Shallow Psychology*, in *COGNITION AND SOCIAL BEHAVIOR* 3 (1976).

202. Brown, *Do Managers Find Decision Theory Useful?*, *HARV. BUS. REV.*, May-June 1970, at 78, 86.

the board.²⁰³

Given the superiority of the new board over the chief executive in decision-making, a re-examination of the functions of each is in order. In the divisionalized large corporation, the new board could assume responsibility for decision areas in which the chief executive now exclusively operates, subject to the same informational constraints that the chief executive now confronts. But the limited amount of time available to independent directors and the absence of time constraints on the chief executive demand that the new board take over only a few decision-making categories. In addition to the traditional decisions that the law requires the board to make, such as mergers and stock issuances, the board should: (1) make all long-term and strategic planning decisions; (2) fix the annual corporate budget and allocate funds among the various divisions or departments; (3) fix the standards of compensation for all executives; and (4) make those decisions placed before the chief executive that involve stark or "all-or-none" choices, unless an immediate decision is required, and the board or an independent board committee is unavailable. This list should not, however, obscure the main point of the findings: All other things being equal (and the organization usually imposes equal informational constraints on both the board and the chief executive), the board and not the chief executive should be encouraged to make business decisions.

The first three items are part of emerging trends, and their inclusion is neither radical nor new. A recent survey of Fortune 500 directors pointed to annual plans and budgets for the corporation and long-range corporate plans as some of the new board's most important information needs.²⁰⁴ Establishing compensation standards has been the principal work of the independent compensation committee for quite a while.²⁰⁵ The fourth item, involving stark choices, may

203. A *Wall Street Journal* article about Thomas A. Murphy, the recently retired chairman and chief executive of General Motors, stated:

Mr. Murphy suggests that the power of the chairman of GM is in part illusory, that GM's management system almost dictates important decisions be made before they arrive for formal approval at the top, and that the company is nearly as self-governing as a Cadillac on cruise control.

. . . Mr. Murphy jokes that the main decisions he makes are "what time to get up and whether to go to church." He says that all subjects at scheduled meetings are carefully worked over by staffers and scrutinized by committees beforehand. By the time he sees the material, he says, "the data suggest the decision" and he often just concurs. *Top Men at General Motors Look at Their Jobs*, *Wall St. J.*, Sept. 16, 1980, at 33, col. 3.

204. See Shanklin & Ryans, *supra* note 19, 24. Another recent survey of directors found that most directors already think that long-range planning for the company is an important part of their job. See *THE NEW DIRECTOR*, *supra* note 12, at 20, 21, 29, 32.

205. See note 6 *supra*; *THE NEW DIRECTOR*, *supra* note 12, at 21.

well represent the types of decisions that the chief executive today does present to the new board, if only for sage advice from the directors on "high-stress" decisions.²⁰⁶

The law can provide the incentives for the board to make more decisions in these four areas by strengthening the board's business judgment defense. With this almost absolute protection accorded to board decisions, the board will probably delegate fewer major decision areas to the chief executive than in the past. At the same time, the courts can encourage the chief executive to advise the board on a timely basis of the major decisions required to be made. Professor Weber has referred to the "fait accompli" problem. The board must instruct the chief executive to report on ongoing projects, not just accomplished projects. Otherwise the chief executive

will tend to report to the board only those aspects of corporate activities which have reached a consensus stage, eliminating from his progress report any information in evolution or in question due to changes in the corporation's internal life or environment. Yet it is precisely this kind of information which can indicate to the director whether or not s/he needs to assume the decision-maker's role.²⁰⁷

The courts can ensure the timely provision of this essential information by exploiting the present ambiguity in the applicability of the business judgment rule to important decisions made by the chief executive without meaningful prior consultation with the board, or by directly applying agency law to the duties of the chief executive to the new board.

A. *Decision-Making by Individuals*

It has long been recognized that the individual has a "bounded rationality,"²⁰⁸ and recent findings show that the individual's cogni-

206. Psychologists have found that the best decision-making occurs with "moderate" stress levels. See I. JANIS & L. MANN, *supra* note 160, at 51; Zander & Medow, *Strength of group and desire for attainable group aspirations*, 33 J. PERSONALITY 122 (1965).

207. Weber, *Advise or Decide: Corporate Identity Crises and the Director's Decision-Making Role*, DIRECTORS & BOARDS, Fall 1979, at 52, 53 (citation omitted). Louis W. Cabot concurs: "Present important issues to directors before, not after, management has taken a firm position." Cabot, *On an Effective Board*, 54 HARV. BUS. REV. Sept.-Oct. 1976, at 46. Professor A.M. Weimer polled "over forty corporate directors with long records of service" and reports: "Many board members believe that they are not brought into the decision-making process at an early enough stage. In some cases they are simply called upon to ratify the decisions that management has already reached or decisions that have, for practical purposes, been made by the executive committee." Weimer, *Corporate Boards: Improving Their Job Performance*, 22 BUS. HORIZONS, June 1979, at 28, 28, 31.

208. See R. CYERT & J. MARCH, A BEHAVIORAL THEORY OF THE FIRM 10 (1963) (order in which environment is searched largely determines the decisions that will be made); I. JANIS & L. MANN, *supra* note 160, at 15 (vulnerability to gross errors in arriving at a decision through superficial search and biased information processing); J. MARCH & H. SIMON, ORGANIZATIONS 138-42, 169-71 (1958) (authors describe the effect of the boundaries of rationality on

tive capacities are severely limited. The average individual can process an average of five to seven information "chunks" at any one time in making a decision.²⁰⁹ And each individual has systematic methods for processing, storing, and retrieving information. We call these "points of view," or use other euphemistic terms for what is in essence a severe limitation on individual capacity.

In the business world, behavioral scientists have identified at least four cognitive or "mental" approaches by chief executives to making major corporate decisions.²¹⁰ These approaches are not different management philosophies, but radically different ways of seeing the world and making decisions. They range from the purely intuitive chief executive to the very systematic and detail-oriented boss. Free market economists might urge that cognitive style, like other variables, enters into the efficient fit of the proper chief executive with the particular successful corporation. This may be so, but let us explore further.

In addition to vastly different cognitive styles, individuals rely upon a limited number of intuitive principles to simplify the complex tasks of assessing probabilities and predicting events when making judgments under uncertainty — the very essence of business decisions. When used by an able and intelligent individual, these principles are highly economical and usually effective, but they lead to systematic errors.²¹¹ These findings are but a small part of the recent empirical assault by behavioral scientists upon the intuitive

organizational structure); J. STEINBRUNER, *supra* note 43, at 130-32, 136 (author describes and gives examples of the cognitive dimensions of political and organizational phenomena); Pfeffer, *Power and Resource Allocation in Organizations*, in *PSYCHOLOGICAL FOUNDATIONS OF ORGANIZATIONAL BEHAVIOR* 278, 280-83 (B. Staw ed. 1977) (man desires to be rational and is rational within the limits of his cognitive capabilities); Suedfield, *supra* note 43, at 209 (1978) (decision-making under high information loads tends to become stereotyped); Mayhew & Levinger, *On the Emergence of Oligarchy in Human Interaction*, 81 AM. J. SOC. 1017, 1021 (1976) (humans cannot simultaneously conceptualize an array of more than five to nine significant events from recent experience); von Holstein, *Probability Encoding in Practice*, in *THE ROLE AND EFFECTIVENESS OF THEORIES OF DECISION IN PRACTICE* 148, 150 (D. White & K. Bowen eds. 1975) [hereinafter cited as WHITE & BOWEN]. Cf. Johnson, *Conflict Avoidance Through Acceptable Decisions*, 27 HUMAN REL. 71 (1974) (top management makes the second best decisions in order to increase certainty and reduce interpersonal friction). One review of the findings on the cognitive limitations of individuals states that "decision makers utilize information primarily to *reinforce* — not change — their predispositions toward the information and alternatives available." Robertson, *supra* note 125, at 168 (emphasis in original).

209. See Mayhew & Levinger, *supra* note 208, at 1021-22.

210. See McKenny & Keen, *How Managers' Minds Work*, HARV. BUS. REV., May-June 1974, at 79, 80-81, 83 (identifying managers as systematic thinkers, intuitive thinkers, receptive thinkers, preceptive thinkers). See generally B. BASS, *ORGANIZATIONAL PSYCHOLOGY* 388-90 (1965) (differences in personality and position held cause managers to view the same problem in different ways).

211. More simply put, "individuals get into ruts in their thinking." Maier, *Assets and Liabilities in Group Problem Solving*, in *READINGS IN ORGANIZATIONAL BEHAVIOR* 163 (1979).

and cognitive abilities of the individual.²¹²

These scientists have shown, for example, that most individuals misinterpret highly relevant evidence in making intuitive judgments. Imagine an urn filled with balls, of which two thirds are one color and one third another. *X* has drawn five balls from the urn and found that four were red and one was white. *Y* has drawn twenty balls and found that twelve were red and eight were white. Which of the two individuals should feel more confident that the urn contains two-thirds red and one-third white balls rather than the opposite? *Y* should feel twice as confident as *X*. But research findings indicate that most individuals select *X*. Many individuals intuitively feel that the smaller sample provides stronger evidence that the urn is predominantly red because the proportion of red balls is larger in the smaller sample than in the larger one.²¹³

Behavioral scientists have also found that individuals are "often confident in predictions that are quite likely to be off the mark."²¹⁴ For example, most individuals tend to overestimate the probability that chain or sequentially related events will occur.²¹⁵ Intuitively, these individuals harbor unwarranted optimism that each of a series of very likely events necessary to a successful result will occur, even if the number of events is large.²¹⁶ The development of a new product is an example.²¹⁷ And, many individuals tend to underestimate the probability that nonsequential or "disjunctive" events will occur.²¹⁸ A complex system will malfunction if any of its key elements fails. Although the likelihood of failure of any key element is slight,

212. See, e.g., Tversky & Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124 (1974).

213. *Id.* at 1125.

214. *Id.* at 1126. See Tversky & Kahneman, *Availability: A Heuristic for Judging Frequency and Probability*, 5 COGNITIVE PSYCH. 207 (1973).

215. See Bar-Hillel, 9 ORGANIZATIONAL BEHAVIOR — HUMAN PERFORMANCE 396 (1973), cited in Tversky & Kahneman, *supra* note 212, at 1128-29.

216. See Cohen, Chesnick & Haran, 63 BRIT. J. PSYCH. 41 (1972), cited in Tversky & Kahneman, *supra* note 212, at 1129 n.10.

217. See Tversky & Kahneman, *supra* note 212, at 1129.

218. *Id.* This has been confirmed in studies of choice among gambles and of judgments of probability. In one study, individuals had to bet on one of two events. Three types of events were used in mixes of two at a time: (i) drawing a red marble from a bag containing an equal number of red and white marbles (probability is .50); (ii) drawing a red marble seven times in a row from a bag containing nine times as many red as white marbles (probability is .48); or (iii) drawing a red marble at least once in seven tries from a bag containing nine times as many white as red marbles (probability is .52). After each draw, the marble was placed back in the bag. The subjects preferred to bet on (ii) rather than (i), and preferred to bet on (i) rather than (iii). Thus, most preferred to bet on the less likely event in both cases, having overestimated the likelihood that sequentially related events would occur (the preference of (ii) over (i)), and underestimated the likelihood that nonsequential events would occur (the preference of (i) over (iii)). *Id.*

the probability of malfunction can be high if the system contains many elements. Although presumably aware of Murphy's law, these individuals intuitively underestimate the probabilities of failure of complex systems.²¹⁹

According to Janis and Mann, psychologists and others are directing more effort toward elucidating hitherto unexplored flaws and limitations in human information processing, such as the propensity of decision makers to be distracted by irrelevant aspects of the alternatives, which leads to loose predictions about outcomes . . . the tendency of decision makers to be swayed by the form in which information about risks is packaged and presented . . . their reliance on faulty categories and stereotypes . . . and their illusion of control, which makes for over-optimistic estimates of outcomes that are a matter of chance or luck . . .²²⁰

In another recent review of the evidence, Slovic, Fischhoff, and Lichtenstein stated:

[R]esearch provides dramatic support for Simon's concept of bounded rationality. The experimental results indicate that people systematically violate the principles of rational decision making when judging probabilities, making predictions, or otherwise attempting to cope with probabilistic tasks. Frequently, these violations can be traced to the use of judgmental heuristics or simplification strategies. These heuristics may be valid in some circumstances but in others they lead to biases that are large, persistent, and serious in their implications for decision making.

Much evidence suggests that the laboratory results will generalize. Cognitive limitations appear to pervade a wide variety of tasks in which intelligent individuals serve as decision makers, often under conditions that maximize motivation and involvement.²²¹

Another authority recently encapsulated the evidence in dramatic fashion. "[O]ur cognitive capacities have obviously evolved in a less complex environment than we presently inhabit."²²²

219. Tversky and Kahneman summarize the recent evidence as follows:

Although the statistically sophisticated avoid elementary errors . . . their intuitive judgments are liable to similar fallacies in more intricate and less transparent problems.

. . . What is perhaps surprising is the failure of people to infer from lifelong experience . . . fundamental statistical rules . . .

. . . [P]eople usually do not detect the biases in their judgments of probability.

Id. at 1130. *But see* Einhorn & Hogarth, *Behavioral Decision Theory: Processes of Judgment and Choice*, 32 ANN. REV. PSYCH. 53 (1981) (review of the literature, noting some dissent from the dominant Tversky & Kahneman view; Cohen is the most prominent dissenter).

220. I. JANIS & L. MANN, *supra* note 160, at 16. *See* A. GEORGE, *PRESIDENTIAL DECISIONMAKING IN FOREIGN POLICY* 19 (1980); Langer, *The Illusion of Control*, 32 J. PERS. & SOC. PSYCH 311 (1975).

221. Slovic, Fischhoff & Lichtenstein, *Cognitive Processes and Societal Risk Taking*, in *COGNITION AND SOCIAL BEHAVIOR* 165, 169, 173 (1976).

222. Greene, *Social Perception as Problem Solving*, in *COGNITION AND SOCIAL BEHAVIOR* 155, 161 (1976).

Fortunately, the evidence to date does not prove that an individual makes the same systematic errors as most other individuals or that an individual repeats the same systematic errors all or most of the time. All that can reasonably be inferred from the evidence is that corporations are safer committing major business decisions to an intelligent peer group than to any intelligent individual.

B. *Strategic and Stark-Choice Decisions*

There is another dimension to be considered when allocating decision-making authority between the board and the chief executive: Decision-making under risk and uncertainty involves a choice among strategies. According to various decision theories, the decision-maker assigns a value to each possible outcome of a particular decision and judges the corresponding probability that each outcome will occur. A weighted average formula composed of the values and probabilities²²³ then enables the decision-maker to decide whether to act or to gather further information (at further cost) that may change the probabilities previously assigned to each outcome.

This first step recognizes, albeit in a formal manner, that practical decision-making under uncertainty involves subjective judgments. The next step reveals the biases or "strategies" of the decision-maker. A complex decision problem permits a number of possible values or "payoffs" for each strategy, depending on conditions that the decision-maker cannot control. Analysis of strategies can be visualized by creating a "payoff matrix."

Assume the simplest case — only two possible selections, heavy investment in plant and equipment (S_1) *versus* no investment (S_2), and only one condition beyond our control, the state of the general economy, expressed as extremes: depression (N_1) *versus* prosperity (N_2). Assume N_1 and N_2 are equally probable.²²⁴ The decision-maker has estimated the payoffs, expressed as whole numbers. The payoff matrix looks like this:

223. The expected value of an outcome, symbolized as $E(X)$, is a weighted average of the values of the various outcomes, $X_1, X_2, \dots, X_n$, and is expressed by the formula:

$$E(X) = P_1X_1 + P_2X_2 + \dots + P_nX_n$$

where P represents the probability and X represents the reward or value of the outcome. $P_1 + P_2 + \dots + P_n = 1$. Spencer, *Administrative Science*, in *MANAGEMENT OF THE URBAN CRISIS* 261, 280 (1971).

224. This assumption simplifies the succeeding analysis. In the real world, the decision-maker will weight the probabilities that N_1 and N_2 will occur, and this will be reflected in the numbers in the succeeding matrices.

	N ₁	N ₂
S ₁	2	10
S ₂	4	6

This will unmask the strategic bias of the decision maker, which is rarely articulated in individual decision-making. Some urge the selection of S₁ because it maximizes the average payoff (6) over the S₂ payoff (5).²²⁵ Others urge S₂ because it assures that the worst payoff we can get is four if a depression occurs.²²⁶ This is a "pessimistic" or "maximin" strategy. The decision maker seeks to maximize the minimum possible payoff. Still others urge S₁ because it minimizes "regret."²²⁷ Regret is the difference between the actual payoff received and the payoff that would have been received had we known in advance whether depression or prosperity would occur. S₁ minimizes our regret (-2) as contrasted with S₂ (-4).

This rather formal analysis serves merely to dramatize the subjectivity involved in assessing probabilities, determining "payoff" values, and making the final decision.²²⁸ Actually there is a blurred subjective relationship among the three seemingly separate steps. Decision-makers introduce an upward bias when estimating the probability of a highly valued outcome occurring under their preferred strategy.²²⁹

Forcing the decision-maker to articulate these critical subjective matters before making a decision should lead to higher quality decisions.²³⁰ The peer group setting of the boardroom will produce this result. But delegating major decisions to the chief executive alone or in consultation with subordinates may not lead to articulation of their strategic choices, and, in any event, such choices may be unduly biased toward the short-term results that determine their level of compensation.

225. See P. LAPLACE, A PHILOSOPHICAL ESSAY ON PROBABILITIES 20-21 (6th ed. 1951).

226. See A. WALD, STATISTICAL DECISION FUNCTIONS 8 (1950).

227. See L. SAVAGE, THE FOUNDATIONS OF STATISTICS 163-64 (1954).

228. See Conrath, *Prescriptive Versus Descriptive Decision Theory: Where Might the Twain Meet?* in WHITE & BOWEN, *supra* note 208, at 97, 100; A. GEORGE, *supra* note 220, at 38-39 ("bolstering"). See generally H. RAIFFA, DECISION ANALYSIS (1968).

229. See A. GEORGE, *supra* note 220, at 38.

230. See Brant, *Derivation of Subject Probabilities to Aid in the Decision Processes in Defence Weapons Acquisition*, in WHITE & BOWEN, *supra* note 208, at 162, 168. At the lower levels, the individual decision-maker can be forced to make the process explicit by using a "strawman." The strawman articulates the decision process and the decision-maker critiques the strawman. *Id.*

Neither the formal decision matrix nor the various strategies employed in decision analysis fully capture the business decision-maker's usual emphasis on avoiding an alternative that may lead to failure and the corresponding neglect of potentially good alternatives.²³¹ And the decider may not perceive strategies as independent of each other. In short:

[The decision maker] is concerned with *partial commitment* . . . trying to reduce uncertainties as he goes along until he makes the final decision. . . . He would like to know what he has to pay to keep options open, what he has to pay to delay final commitment. . . . The decision is not so much *disappearing*, perhaps, as less definite than analysts make it seem.²³²

Long-range and other overall corporate planning require the corporation to select a strategy explicitly and knowingly. Given the importance of long-range and strategic planning and the relative lack of time and informational constraints imposed by the organization itself on such decisions, the board, and not the chief executive, should make these decisions. The payoff matrix also emphasizes the desirability of peer group decision-making by the new board when any major decision, short- or long-term, involves stark or "all-or-none" choices. Only time constraints will limit the board in this area.

C. Corporate Projects and Budget Allocation Among the Divisions

According to the organizational experts, strategic planning, sponsorship of major projects, and the annual corporate budgeting process are more akin today to politics than to optimal economic decision-making. The various divisions or "subunits" of the corporation engage in a species of coalition bargaining with their counterparts before bringing proposals to their superiors. Individuals campaign for "pet projects,"²³³ and the chief executive in the large

231. The avoidance of the bad alternatives is a Type I error in statistics; the relative neglect of potentially good alternatives is a Type II error.

232. *Discussion — Prescriptive and Descriptive Choice*, in WHITE & BOWEN, *supra* note 208, at 113, 114 (remarks of G.D. Kaye).

A summary of some of the empirical evidence as to what decision-makers actually do is contained in Barron, *An Information Processing Methodology for Inquiring into Decision Processes*, in WHITE & BOWEN, *supra* note 208, at 195. For example, individuals quite often make the decision with the higher probability of winning rather than the decision with the higher winning payoff. *Id.* at 202.

233. See Stagner, *Corporate Decision Making: An Empirical Study*, 53 J. APPLIED PSYCH. 1 (1969). Not only do departmental heads seek to gain support for their "pet projects" but they also tend to perceive problems from the point of view of their specific department. See Dearborn & Simon, *Selective Perception: A Note on the Departmental Identifications of Executives*, 21 SOCIOMETRY 140 (1958).

divisionalized firm "tends to ratify strategic investment proposals developed by managers heading operating units throughout the firm."²³⁴ In the words of Professor Coffee, "operations make policy" in these firms.²³⁵

If the chief executive cannot modify these powerful organizational dynamics, then perhaps the board cannot do so either. But the independent board can at least assess these proposals from a more objective viewpoint, separating to some extent the personalities from the proposals. Two distinguished organizational scholars have stated that "[t]he strategic planning process would be far more effective if the proposed actions could be divorced from individual sponsorship."²³⁶ Based on the previously discussed evidence, the new board or an independent committee thereof could improve upon what "little" decision-making the chief executive makes in these areas.

D. *Organizational Constraints on Decision-Making at the Top*

As the previous section indicated, the complex organization solves many problems involving uncertainty by forcing decision-making downward to the specialists or unit closest to the scene. Each unit deals with the slice of the complex environment that the corporation has assigned to it and programs everything else out. The specialists "hedge" by making a decision with foreseeable short-term consequences. This permits fine-tuning from time to time based on continuous feedback. Decisions are made only when a problem arises, and the responses are usually highly programmed. The need to act quickly requires that the decision be made at the lowest practicable organizational level. As experts in "the art of muddling through"²³⁷ and "satisficing,"²³⁸ the affected parties form a coalition and adopt the first solution to meet the minimum level of acceptability. The various and changing coalitions bent on solving today's pressing problems subtly and slowly dilute, multiply, or postpone the corporation's goals, and only those decisions that vitally affect the entire organization, such as annual budgets, reward systems, and increasing or decreasing the size of the organization, filter up to the

234. Kinnunen, *Hypotheses Related to Strategy Formulation in Large Divisionalized Companies*, ACAD. MGT. REV., Oct. 1976, at 7, 7.

235. Coffee, *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 VA. L. REV. 1099, 1129-30 (1977).

236. Cohen & Cyert, *Strategy: Formulation, Implementation, and Monitoring*, 46 J. BUS. 349, 361 (1973).

237. *See id.*

238. *See note 43 supra.*

top.²³⁹ These constraints on decision-making at the top apply equally to the chief executive and the board. It is only those major decisions that the chief executive makes or is organizationally able to make that can form the basis for any allocation of decision-making between the chief executive and the board.

Even those matters that filter to the top for decision suffer from "upward information distortion." According to Professor Coffee, "some corporations have today between twelve and fifteen hierarchical levels between the first-line supervisor and the company president, suggesting that much 'noise' and only a very diluted message will reach the top through regular lines of communication."²⁴⁰ This obviously imposes severe informational constraints on the chief executive. But the chief executive should not introduce any further significant distortion when he transmits this information to his or her peers on the new board in the decision areas that the board takes over.

As the Business Roundtable recently observed: "Cutting across all these board functions is the board's responsibility to establish in conjunction with the chief executive officer and his operating and staff colleagues, systems and procedures to assure that there is a flow of information to the board sufficient to permit the effective discharge of its obligations."²⁴¹ This may be easier said than done. Lawler and Rhode noted that "managers who are not involved in setting up information and control systems often don't have the expertise to interpret them and thus all they can do is rubber stamp the decisions of those who have the knowledge."²⁴² And, the board will have to protect itself against informational "overload," which may be as bad as or worse than too little information. As experienced businesspersons, however, most directors should be able to handle the "overload" problem effectively.²⁴³

E. *The Role of the Law in Allocating Decision-Making Between the Chief Executive and the Board*

The legal model of the corporation traditionally required that the board "manage" the business, make business decisions, and hire and

239. See *id.*; Van de Ven, *A Panel Study on the Effects of Task Uncertainty, Interdependence and Size on Unit Decision Making*, 8 ORGANIZATION & AD. SCI. 237, 239, 244 (1977).

240. Coffee, *supra* note 235, at 1138 (footnote omitted).

241. Business Roundtable, *The Role and Composition of the Boards of Directors of the Large Publicly-Owned Corporation*, 33 BUS. LAW. 2083, 2103 (1978).

242. E. LAWLER & J. RHODE, INFORMATION AND CONTROL IN ORGANIZATIONS 140 (1976).

243. See Coffee, *supra* note 235, at 1139, 1145.

fire the officers. Recently, the model has been modified by statute in many states to permit the officers "under the direction" of the board to manage the corporation's business.²⁴⁴ The modification recognizes that directors do not have the time to manage and that the chief executive or his subordinates make most major business decisions.²⁴⁵ Under these statutes, the courts can and should require the new board to "direct" in a sense quite different from the "monitoring" model, but involving far less work than the old (and fictional) "managing" model.

Under the "monitoring" model the directors are to monitor the "performance" of the chief executive. If this requires only a review of the financial statements, and a continuous grading of the chief executive's intellect and ability, the director's job would be demeaning and unacceptable to most truly independent, highly motivated, and capable persons. And the cost in total compensation to those persons who accepted might outweigh the benefits to the corporation. The financial reports are for all to see, and this kind of corporate "performance" is closely monitored today by the stock market. The only difference between monitoring by the stock market and the independent board is that the latter can fire or discipline the chief executive more quickly. This difference is important — the primary rationale for the monitoring model. But the instances in which the new board considers the guillotine are relatively rare, although undoubtedly more frequent than when the chief executive dominated the board.

The persons who would accept a "monitoring" job as so defined would do so for the "wrong" reasons — pay and prestige for little or no work. A "one hand washes the other" ethic would spread such directors on a subtle reciprocal basis across the Fortune 500 and beyond. Many persons undoubtedly believe that this is the reality today. Of optimistic bent, this author would assert that the honest, conscientious, and successful people on the new board — the "achievers" with a strong sense of personal worth — would rather do something meaningful with the time they have committed to devote to the role.²⁴⁶

244. See DEL. CODE ANN. tit. 8, § 141(a) (Supp. 1980); W. CARY & M. EISENBERG, *supra* note 94, at 140, 193.

245. See W. CARY & M. EISENBERG, *supra* note 94, at 193.

246. See generally R. MUELLER, *supra* note 171; D. MCCLELLAND, *supra* note 60. The predominant reason given by prospective outside directors for declining an invitation to serve was "the time commitment involved." KORN/FERRY 1981, *supra* note 6, at 8, 21.

Professor Eisenberg, however, has proposed a more tantalizing job description for the "monitoring" director:

Under a monitoring model, . . . the role of the board is to hold the executives accountable for adequate results (whether financial, social, or both), while the role of the executives is to determine how to achieve such results. Of course, the board cannot perform this function without regard to policy: objectives must be set, explicitly or implicitly, against which to measure management's results, and the selection of objectives will partly depend on the directors' broad notions of policy

The monitoring model, moreover, is not simply mechanistic; monitoring must begin with results, but it cannot end there. . . . The concept of monitoring for results . . . does not preclude the monitors from going behind the result and either accepting as satisfactory a level of performance which falls short of the applicable objective, or criticizing as unsatisfactory a level of performance which exceeds it. What the concept of monitoring does require is the availability of sophisticated and independent information-gathering systems . . . and directors who are equally sophisticated in interpreting both financial and nonfinancial data.²⁴⁷

If the directors are to fix financial objectives, go "behind results," and plug into sophisticated and independent information-gathering systems in their role as monitors, then they will work quite hard. But not at what they do best.

Some proponents of the monitoring model also have in mind the prevention of illegal corporate acts through directorial diligence. Although preventing illegal acts is an important goal, Professor Coffee has ably demonstrated that the organizational obstacles to uncovering these handiworks, largely of middle management, are awesome. It is one thing to make the obvious statement that independent directors must be adequately informed so as to be able to exercise their judgment, and another to place upon them the duty of reasonable diligence or ordinary care to ferret out information. If the latter is a correct summary of present law, then strong disincentives to service by truly independent directors exist. Firmly placing such a monitoring duty on the independent directors would require them to devote part of their time to developing sophisticated and independent information-gathering systems, a task at which they are not especially adept, to the detriment of the task at which they excel — making business decisions. Put to choices in the real world of time constraints, directors should be decision-makers not detectives.²⁴⁸

247. M. EISENBERG, *THE STRUCTURE OF THE CORPORATION* 165-66 (1976) (footnote omitted).

248. This is not to suggest that monitoring for illegality, a function loosely assigned today

The difference between the independent directors acting as “deciders” or as “monitors” is one of degree. Both contemplate firing the chief executive when necessary. Both contemplate setting policies and objectives. Both contemplate perceptive evaluation of information, but they skew at a critical point: Should the independent directors spend most of their time gathering information or making business decisions? Directors should devote their available time to what the evidence shows they do best — making business decisions. Courts should require them to do this, within the limits of their time commitment as directors, and then protect them to the hilt. The monitoring movement has brought us the new board, but we should now seek to capitalize on the new situation. The law cannot offer strong protection to the independent directors for the business decision itself, but only uncertainty as to the information existing in the very large and complex organization that may later be held to have been quite relevant thereto. Ordinary negligence liability cannot be any part of a realistic formula for attracting independent directors, whether as monitors or deciders. And, requiring plaintiff to prove that the director’s “negligent” inattentiveness caused the loss, as in *Barnes*,²⁴⁹ is insufficient protection for the new board, now controlled by the independents. There is still room for director liability for utter and reckless disregard of the duty to be informed.

If the courts accept the “decider” model, the chief executive will make fewer business decisions. What can the chief executive constructively do with the time that he might then have available for other tasks? The very things that some proponents of the monitoring model have suggested for the new board. Specifically, the chief executive should exercise due diligence in gathering accurate information about corporate activities. The chief must dip down a few levels in the hierarchy to counteract, to the extent possible, upward information distortion. Monitoring the vast activities of the corporate giant is a job for the highly compensated chief executive, not the board. And the courts should require the chief executive to report this more accurate information to the board, or at least that information critical to business decisions by the new board and any information that the chief executive obtains regarding illegal activities. In other words, the legal liability for failure adequately to monitor and report on corporate activities, legal or illegal, should be squarely placed on the chief executive (and upon other responsible senior executives),

to the audit committee, should be abrogated nor that directors should stick their heads in the sand.

249. *Barnes v. Andrews*, 298 F. 614 (S.D.N.Y. 1924).

and unambiguously taken off the backs of truly independent board members.

This tentative equation should increase the incentives for truly independent persons to serve as directors of large corporations, provided that the rates of directorial compensation are raised to realistic levels.²⁵⁰ Given the limited time that capable and independent directors can devote, the chief executive will still make most of the business decisions. But the board should decide and make explicit to the chief executive those categories of decisions that it will generally make, leaving either the unspecified balance or specified categories of decisions to the chief executive. Unless patently spurious, this decision should be fully protected under the business judgment rule. However, the deciding model would not tolerate the "pro forma" or blanket delegation of all major decisions to the chief executive, even though that has apparently sufficed to protect directors under present law.²⁵¹

The law could promote the directorial decision model by exploiting the present ambiguities in the applicability of the business judgment rule to decisions made by corporate officers as such. Under the influence of the older legal model that directors "manage," the courts articulated the business judgment rule in terms of protecting directors from liability as directors for decisions reached by the board. In the past, top management comprised a majority of the board. Since the "board" (or at least a majority thereof) had the same information that top management had, the courts had no compelling need to encourage top management to convey information to the board. The officers, in their status as directors, received the protection of the rule for any decision that they chose to make or have rubber-stamped at the board level. Today, the boards of substantially all the largest corporations consist of a majority of nonmanagement directors. The courts can restrict the business judgment rule to those decisions that are (1) actually made at the board level (*i.e.*, by directors acting as such); (2) explicitly delegated by the board to the chief executive; and (3) in the overlap or gray area and are made by the chief executive after meaningful consultation with the board.²⁵²

250. See note 41 *supra*.

251. See *Kelly v. Bell*, 254 A.2d 62, 72 (Del. Ch. 1969), *affid.*, 266 A.2d 878 (Del. 1970); W. CARY & M. EISENBERG, *supra* note 94, at 193, 202.

252. Although the standard corporate texts state that the business judgment rules applies to officers (as well as directors), there is little case law to support the proposition. See W. FLETCHER, *supra* note 54, at § 1032. One Delaware case states this proposition in dicta, *Kelly v. Bell*, 254 A.2d 62, 75 (Del. Ch. 1969), *affid.*, 266 A.2d 878 (Del. 1970). In affirming, however, the Delaware Supreme Court appeared to stress the fact that the officers' decision was "tacitly acquiesced in [by the full board] without formal resolution." Another Delaware case, while

The courts may not have to manipulate the business judgment rule to impose informational duties upon senior management and confer informational rights upon the new board. Instead, they can revitalize the hornbook law of agency as to the relationship between the board, as principal and employer, and the chief executive, as agent and employee. Agency law applies not only to the external acts of the chief executive and others, its most common application, but also to the corporation's internal affairs. The officers, as agents, have clear duties to the board, as principal. Seavey's Hornbook on Agency confirms an agent's duties to convey information to, and to obey, the principal:

An agent who acquires information relevant to matters within his province and of which he should know the principal would want to know, has a duty to reveal it

. . . [A]n agent has a duty to act only in accordance with what he reasonably believes the principal has directed or, if he knew the facts, would direct the agent to do at the time and place of action.²⁵³

And, the agent must be duly diligent and act with ordinary care.²⁵⁴

The new board could sue the officers in a direct corporate action for violating their informational and ordinary care duties. Although the new board is not likely to do so (unless it is prepared to dismiss the chief executive at the same time), the shareholders could sue the chief executive and other responsible senior executives derivatively for a clear violation that caused corporate damage and that the new board failed to pursue. A pattern of repeated and knowing failure by the new board to pursue such claims against, or to discipline or to fire, the chief executive might well constitute "gross negligence plus more," rendering the board liable.²⁵⁵ This narrow exception aside, the courts should fully protect the independent directors from shareholders' derivative suits when key officers have violated their informational duties to the board.

Since the key officers of the largest corporations are today's

citing *Kelly v. Bell* for the proposition that "the decision of the executive officers may also come within the [Business Judgment] Rule," preferred to base its decision on grounds other than "the broad cutting edge of the Rule," and held, in the process, against management. *Kaplan v. Centex Corp.*, 284 A.2d 119, 124-25 (Del. Ch. 1971).

253. W. SEAVEY, *HANDBOOK OF THE LAW OF AGENCY* §§ 143, 145 (1964).

254. *See id.* at § 40, at 235-36; H. HENN, *supra* note 57, at § 219, at 432, § 234, at 456: "Unlike directors, who, . . . are *sui generis*, officers are agents of the corporation, and, as such, subject to the usual principles of agency law, including the fiduciary duties of agents.

. . . If officers, agents, or employees violate their duties to the corporation, they are, of course, liable to it."

255. *See* text at notes 49-59 *supra*.

"deep pockets," the imposition of this duty upon them, coupled with the elimination of independent directors as potential contributors to any damage judgment, should strongly encourage the flow of critical information to the board. Although fewer defendants will be available for paying any judgment, the prime purpose of the stockholder's derivative suit, as Professors Coffee and Schwartz recently argued, should be deterrence rather than compensation.²⁵⁶ And, because these key officers receive very large compensation payments, the imposition of the duty should not create strong disincentives for able persons to serve as officers.

These suggestions are not intended to turn corporate decision-making topsy turvy. As to the informational duties suggested, the courts should define information "critical" to major board decisions narrowly and cautiously to permit today's trends in the corporate establishment to continue to evolve slowly and intelligently. As to the suggested allocation of decision-making, many chief executives will welcome the opportunity to pass the buck to the new board on certain stressful decisions,²⁵⁷ drawing both legal and organizational comfort from the process. And the new board would not be placed in the position of having to overrule or criticize the chief executive, nor will the latter be organizationally embarrassed by participating with peers as a business decision-maker.

CONCLUSION

The independent directors are looking, in this new era, for a way to structure the "interval of time" that they have committed to a task that, as yet, has no precise job description. Corporate law could be a powerful influence during this period of flux. The courts should cautiously mold this vast resource of directorial talent, integrity, and high motivation toward its highest and best use — business decision-making.

256. See Coffee & Schwartz, *supra* note 49, at 302-09.

257. See note 214 *supra*.