Policy and Legal Overview of Best Corporate Governance Principles

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HOW did we get here, what have we learned, and where do we go from here? In the 1990s a paradox was developing that we see clearly now only by the clarity of 20:20 hindsight. First, the economy and the securities markets were on the ascendency. Second, reform movements were gathering momentum in the areas of voluntary best practices of corporate governance and lawyer ethics.

As for the economic scenario, the decade of the 90s, as we all know, represented the halcyon days of the boom. We also now know—painfully well—that the malignant tumors that would lead to the bust that was to follow were growing undetected and perhaps camouflaged by the joy of the boom. As for the reform movements of the 1990s in corporate governance and lawyer ethics, many major corporations were strengthening their boards through voluntary best practices. Institutional investors were demanding greater independence and accountability of directors, while the Delaware courts were exhorting enhanced standards of director conduct as the right policy and as an arguable safe harbor from state fiduciary duty liability concerns. The American Law Institute was developing its “Restatement of the Law Governing Lawyers,” and the American Bar Association was reviewing, evaluating, and revising the Model Rules of Professional Conduct through the “Ethics 2000” Commission. In the words of Charles Dickens:

It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us, we were all going direct to Heaven, we were all going direct the other way . . . .

Boom and bust cycles are an inevitable phenomenon that we have seen throughout American economic history. The reasons for the bust often have their seeds in the reasons for the boom. And so it was in our most recent dramatic boom/bust where more than $7 trillion of market value

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was lost from the peak in the Spring of 2000 to the nadir of 2002. Part of the boom was due to "irrational exuberance," in Chairman Greenspan's words. Part was due to managers and accountants pushing the envelope of "flexible" accounting principles by some "creative" accounting. Part was due to the fixation of some CEO/Senior Officers on their version of "enhancing shareholder value," by driving inexorably to meet or beat their quarterly earnings targets in order to win high marks from analysts, just to drive up the stock price.

Driving up the stock price also had the frequent consequence of driving up the (sometimes obscene) levels of compensation of the CEOs and Senior Officers, whose pay packages were often based in large part on options and bonuses that were driven by stock prices. This explains the ever-accelerating, upward spiral. The allegations we are now seeing are that the upward spiral tended to tempt some managers to commit out-and-out fraud. These allegations are now being—and will be for some time—played out in various investigations and courtrooms. But, in my view, the main corporate governance failure in this period was the lassitude and indifference of some boards of directors who were not proactive in their oversight and strategic roles. Often—as the Powers Report on Enron and the Thornburgh and McLucas Reports on WorldCom were to conclude—the directors did not carry out their duties. In my view, these allegations show that they failed to follow the statutory mandate under state law.

And what is that statutory mandate under state law? Section 141 of the Delaware General Corporation Law requires that "the business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . . ." The key phrase is "managed under the direction" of the board. In most public companies, the board does not—and should not—act as the managers of the day-to-day operations of the business enterprise. But they are obligated to direct both the business and the affairs of the corporation. This means that the board has the duty of overseeing business operations and directing the strategy and structure of the affairs of the firm. The very plain and forceful dictionary meaning


5. See Floyd Norris, Ebbers and Passive Directors Blamed for WorldCom Woes, N.Y. TIMES, June 10, 2003, at C1; see also E. Norman Veasey, State-Federal Tension in Corporate Governance and the Professional Responsibilities of Advisors, 28 J. CORP. L. 441, 441-43 (Spring 2003).

of the noun "direction" is: "guidance or supervision of action, conduct, or operations . . . something that is imposed as authoritative instruction or bidding . . . an explicit instruction." The meaning of the verb "to direct" is equally clear:

to cause to turn, move, or point undeviatingly or to follow a straight course with a particular destination or object in view; to dispatch, aim, or guide [usually] along a fixed path . . . to show or point out the way . . . to regulate the activities or course . . . to guide and supervise . . . to carry out the organizing, energizing, and supervising of [especially] in an authoritative capacity . . .

Directors must honor, and courts must enforce, this mandate when a case is presented that raises these issues. This is done through the common law development of the judge-made principles of the fiduciary duties of loyalty, good faith, and due care.

I. FEDERALISM AND CORPORATE GOVERNANCE

We start with the premise that the internal affairs of corporations are governed primarily by the law of the state of incorporation. This principle was established over twenty-five years ago by the United States Supreme Court in *Santa Fe Industries v. Green*. Federal securities laws were primarily designed to regulate markets, principally in the area of disclosure. Although there are emerging federal statutory duties and SEC Rules, Delaware law is the default repository for the rich and comprehensive common law regarding fiduciary duty of directors and officers. Delaware law applies to its 300,000-plus corporations, including about 60% of the Fortune 500, and the principles are followed by many courts to guide the law of other states.

The reach of the Sarbanes-Oxley Act and the proposed listing requirements of the self-regulatory organizations ("SROs") exemplified by the NYSE and NASDAQ into the internal affairs of Delaware corporations is extensive. It is intrusive, but it does not entirely supplant the Delaware law by any means. Some examples of ways in which Sarbanes-Oxley and SRO regulations have preempted or occupied areas of internal affairs include the following, to name only a few:

- The composition of the board of directors
- The composition of the audit, compensation, and nomination/governance committees
- Some of the activities and requirements of the board and its committees (e.g., executive sessions and evaluations)
- Detail on definitions of independence of directors
- Reporting and certification requirements of the CEO and CFO
- Certain prohibitions (e.g., consulting fees, loans to officers)

8. *Id*.
Both state law governing internal affairs and federal regulatory law are at work here. As a result of Sarbanes-Oxley, there are new interrelationships between state and federal law that create tension and challenge the concepts of federalism; however, much of the new federalism will play out in state courts in various ways in the future.10

Unlike the SEC in its sphere of operation, state courts are not regulatory. Judges are like clams in the water. They must wait for a case to come before them. Because of this and the constraints of the Ethical Code of Judicial Conduct, I cannot make ex cathedra pronouncements of how a case should be decided or comment on a pending or impending case in any jurisdiction.11 So, my disclaimer is that I intend to make no comment on any matter likely to come before any court. I refer to the Powers, Thornburgh, and McLucas Reports as illustrations of allegations of the failure of those boards to direct the management of the business and affairs of those firms.

The Powers Report on the Enron failure and the Thornburgh and McLucas Reports on the WorldCom demise alleged two common themes: (1) officers ran amok, wallowing in greed-driven schemes and other abuses; and (2) supine directors allowed it to happen, tolerating officers who were managing to the market while the officers contented the directors with ever-rising stock prices. The New York Times for June 10, 2003, in reporting on both the Thornburgh Report and the McLucas Report on WorldCom, said:

"As WorldCom grew through a series of large acquisitions—and as it used fraudulent accounting to mask growing financial problems—the company’s board did little to monitor or influence what was going on at the company, two official reports indicated yesterday.

. . . .

"The board repeatedly approved acquisitions and other actions," Mr. Thornburgh stated, "with little or no information and almost no inquiry." He added that, "A board vigilant about fiduciary duties would not have been so passive."12

In the wake of Enron, WorldCom, and other debacles, the major SROs, as well as members of Congress, rushed to cobble together solutions to such problems. The congressional legislation, known as the Sarbanes-Oxley Act, was adopted with bipartisan fury in July 2002. New listing requirements were also approved in the summer of 2002 by the SROs and recommended to the SEC. The SEC has adopted a spate of new rules and is considering more. These rules extensively regulate the management, directors, accountants, and lawyers in the area of internal corporate affairs, which is normally reserved for state law.

12. Norris, supra note 5.
Also at work in this milieu are the Principles of Corporate Governance adopted by the Business Roundtable in May 2002\(^\text{13}\) and the recommendations of the ABA Task Force on Corporate Responsibility (the "Cheek Task Force"—named for its chair, Jim Cheek of Nashville) released in the Spring of 2003.\(^\text{14}\) The Cheek Report deals both with board practices and lawyer ethics. The Conference Board and other groups are at work as well. Meanwhile, voluntary codes of best corporate practices within many major and mid-sized corporations continue to emerge, and courts are continuing to deal with evolving applications of principles of fiduciary duty and securities issues on a daily basis.

II. EVOLVING EXPECTATIONS

We have been seeing evolving expectations of directors for years. I will mention only one area where the common law approach of the Delaware law of fiduciary duty has been progressing. This is the area of the fiduciary duty of good faith. As I see it, the development of the common law in this area is the antithesis of the "one size fits all" rigidity of certain aspects of the Sarbanes-Oxley regulatory law and SEC Rules.

Although the law of fiduciary duty recognizes the evolving expectations of the standards of conduct of directors and others, we must keep in mind that the business judgment rule still applies to protect directors' decisions made in good faith. What has evolved in this new era is a sharper judicial focus on process.

The overarching concept of corporate internal affairs revolves around the standard of conduct for directors, as distinct from the standard of review or standard of liability sometimes imposed by courts when directors violate a standard of conduct.\(^\text{15}\) The standard of conduct of directors is that they shall act loyally, with due care, in good faith, and in the honest belief that they are acting in the best interests of the corporation.\(^\text{16}\) Judges, along with institutional investors and others, often assume that directors will seek and implement best practices and expert counseling in carrying out these standards of conduct.

At the end of the day, the enabling model—at least in Delaware—rests on a two-fold trust in the board of directors and in the judiciary. That trust, in turn, is predicated on two fundamental principles. The first is character—integrity, expertise, diligence, good faith, independence, and professionalism. These qualities apply both to directors and to the courts.


\(^{16}\) Brehm v. Eisner, 746 A.2d 244, 264 n.66 (Del. 2000) (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).
The second fundamental principle is a coherent economic rationale dedicated to the best interests of stockholders in the context of court encouragement of careful, independent, good faith, entrepreneurial risk-taking by boards of directors.\(^\text{17}\)

First, the directors. All the attributes of character are important. But perhaps the most effective stockholder protection device is the independence of directors. Stockholders vote for directors and expect proper governance from them. The expectation is a strong bond of trust vested in the directors, whose primary motivation must be the best interests of the corporation and its stockholders. Thus, competent and ethical corporate counselors are key to the proper corporate conduct by directors.

Second, the courts. It is the courts that enforce the trust vested in the directors. Courts should be reluctant to interfere with good faith business decisions of directors and should not create surprises or wild doctrinal swings in their expectations of directorial behavior. Investors, as the owners of corporations, have certain expectations about the role of courts in the enforcement of fiduciary duties. Central to that expectation is that courts will be prompt, fair, clear, predictable, stable, intellectually honest, and economically coherent.

The expectations of director conduct have evolved to the point where, today, it goes without saying that directors must be careful and work hard to understand the facts behind that which they are deciding. But, significantly, no one suggests that the courts should second-guess the merits of their business decision. This is the quintessential application of Delaware’s common law fiduciary duty and business judgment rule. Common law, in its classic form, is dynamic and balanced as it flows with the times.

For example, in the 1960s directors could be held liable for failing to heed “red flags” of probable wrongdoing that they saw, or should have seen, when damage to the corporation resulted from that failure. By the same token, directors might escape liability if there were no red flags, and they were not expected to “ferret out wrongdoing.” That was the teaching of the Delaware Supreme Court’s 1963 decision in the *Graham v. Allis-Chalmers Manufacturing Co.* case.\(^\text{18}\)

Perhaps *Graham* is still good law. But in 1996, Chancellor Allen said in dictum in *In re Caremark International Derivative Litigation* that directors might, under certain circumstances, be held liable for lack of good faith for the “utter failure” to institute a systematic law compliance program.\(^\text{19}\)

Such compliance systems could reasonably be expected to identify wrongdoing when a compliance program could benefit the corporation under federal sentencing guidelines. Although *Caremark* is dictum in a Court of Chancery case approving a settlement of a derivative action and is not Supreme Court precedent, my personal view is that the expectations of

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18. 188 A.2d 125, 130 (Del. 1963).
directors had progressed in the thirty-plus years from Graham to Caremark.

It was not a sudden leap of thirty years, however. In a 1980 law review article in The Business Lawyer that I co-authored with William Manning, Esquire, of the Delaware Bar, we noted that such expectations may already have evolved in the then-seventeen years following Graham. Our view in 1980 was that since the Business Roundtable in 1978 had declared that "recent lapses in corporate behavior" emphasized the need for corporate law compliance procedures, "[t]he expected role of a director has grown to include the installation of legal compliance systems." 20

Today, the utter failure to follow the minimum expectations of the evolving standards of director conduct, the minimum expectations of Sarbanes-Oxley, or the NYSE or NASDAQ Rules (when they are finally approved by the SEC) might likewise raise a good faith issue. There is no definitive answer to that question, but counsel should advise the directors of that possible exposure and encourage the utmost good faith behavior.

Therefore, the evolving business and judicial expectations of director conduct over the years are part of the common law grist for the fiduciary duty mill. As Chancellor Allen stressed in Caremark, the kind of sustained inattention of directors exemplified by the failure to institute law compliance programs contemplated by the federal sentencing guidelines and expected of prudent businesses could be held to be a violation of the fiduciary duty of good faith. That standard of conduct—good faith—is key to director conduct, and it must be considered when one looks at the directors' processes and motivations to be certain that they are honest and not disingenuous or reckless.

Take the area of compensation, for example. There is a belief—I suggest it is a myth—that there is no limit to what compensation committees may award CEOs and other senior managers. Of course, there is no bright-line dollar limit. Likewise, there is no such thing as pay that is abstractly too high—it is like asking "how high is up?" But that does not mean there are no limits. Judicial review of these kinds of director decisions is not about dollar amounts in isolation. Rather, it is about process, and process is about due care, good faith, and loyalty.

We are now seeing this play out in real time. I will mention just two cases. The first is the Disney case. The other is the Abbott Laboratories case. The Disney case involved the board's handling of the extraordinary severance pay to Mr. Ovitz, the number two officer brought to the company by Mr. Eisner, the CEO. The issue was process and how the board allegedly permitted a payout of $140 million for a short term, fired officer.

In the year 2000, the Delaware Supreme Court upheld the dismissal by the Court of Chancery of the original derivative complaint. 21 But we re-

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versed the dismissal with prejudice and ordered that it be without prejudice, remanding the case to the Court of Chancery to permit plaintiffs to repled. The plaintiffs redrafted the complaint to survive the motion to dismiss. The case is now in discovery. Here is part of what the Chancellor said on remand:

In this derivative action filed on behalf of nominal defendant Walt Disney Company, plaintiffs allege that the defendant directors breached their fiduciary duties when they blindly approved an employment agreement with defendant Michael Ovitz and then, again without any review or deliberation, ignored defendant Michael Eisner’s dealings with Ovitz regarding his non-fault termination.

... Stated briefly, plaintiffs’ new allegations give rise to a cognizable question whether the defendant directors of the Walt Disney Company should be held personally liable to the corporation for a knowing or intentional lack of due care in the directors’ decision-making process regarding Ovitz’s employment and termination. It is rare when a court imposes liability on directors of a corporation for breach of the duty of care, and this Court is hesitant to second-guess the business judgment of a disinterested and independent board of directors. But the facts alleged in the new complaint do not implicate merely negligent or grossly negligent decision making by corporate directors. Quite the contrary; plaintiffs’ new complaint suggests that the Disney directors failed to exercise any business judgment and failed to make any good faith attempt to fulfill their fiduciary duties to Disney and its stockholders. Allegations that Disney’s directors abdicated all responsibility to consider appropriately an action of material importance to the corporation puts directly in question whether the board’s decision-making processes were employed in a good faith effort to advance corporate interests. In short, the new complaint alleges facts implying that the Disney directors

To survive a Rule 23.1 motion to dismiss in a due care case where an expert has advised the board in its decisionmaking process, the complaint must allege particularized facts (not conclusions) that, if proved, would show, for example, that: (a) the directors did not in fact rely on the expert; (b) their reliance was not in good faith; (c) they did not reasonably believe that the expert’s advice was within the expert’s professional competence; (d) the expert was not selected with reasonable care by or on behalf of the corporation, and the faulty selection process was attributable to the directors; (e) the subject matter (in this case the cost calculation) that was material and reasonably available was so obvious that the board’s failure to consider it was grossly negligent regardless of the expert’s advice or lack of advice; or (f) that the decision of the Board was so unconscionable as to constitute waste or fraud.

This Complaint includes no particular allegations of this nature, and therefore it was subject to dismissal as drafted.

We conclude that ... [the] pleading, as drafted, fails to create a reasonable doubt that the Old Board’s decision in approving the Ovitz Employment Agreement was protected by the business judgment rule. Plaintiffs will be provided an opportunity to repled on this issue.

Id. at 262.
22. Id. at 267.
failed to "act in good faith and meet minimal proceduralist standards of attention."{24}

This case is ongoing. Thus, I cannot comment on what the Chancellor will ultimately decide on the next phase, or what we may decide on appeal.

In the Abbott Laboratories Derivative Shareholders Litigation, the Seventh Circuit permitted a derivative complaint to go forward because the pleading survived a motion to dismiss.{25} This case was governed by Illinois law, but the court looked extensively to Delaware law.{26} Here is what the Seventh Circuit said in that case:

The action was brought in federal court on behalf of Abbott shareholders against Abbott's board of directors alleging that the directors breached their fiduciary duties and are liable under Illinois law for harm resulting from a consent decree which required Abbott to pay a $100 million civil fine to the FDA, withdraw 125 types of medical diagnostic test kits from the United States market, destroy certain inventory, and make a number of corrective changes in its manufacturing procedures after six years of federal violations. The district court dismissed the original complaint for failure to plead demand futility with particularity under Fed.R.Civ.P. 23.1 and has now dismissed the amended complaint for the same reason. We reverse and remand for further proceedings.{27}

Given the extensive paper trail in Abbott concerning the violations and the inferred awareness of the problems, the facts support a reasonable assumption that there was a "sustained and systematic failure of the board to exercise oversight," in this case intentional in that the directors knew of the violations of law, took no steps in an effort to prevent or remedy the situation, and that failure to take any action for such an inordinate amount of time resulted in substantial corporate losses, establishing a lack of good faith. We find that six years of noncompliance, inspections, 483s, Warning Letters, and notice in the press, all of which then resulted in the largest civil fine ever imposed by the FDA and the destruction and suspension of products which accounted for approximately $250 million in corporate assets, indicate that the directors' decision to not act was not made in good faith and was contrary to the best interests of the company.{28}

With respect to demand futility based on the directors' conscious inaction, we find that the plaintiffs have sufficiently pleaded allegations, if true, of a breach of the duty of good faith to reasonably conclude that the directors' actions fell outside the protection of the business judgment rule.

{24} Id. at 277-78.
{25} In re Abbott Labs. Derivative S'holders Litig., 325 F.3d 795, 809 (7th Cir. 2003).
{26} Id. at 803.
{27} Id. at 798-99.
{28} Id. at 809 (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), overruled on other grounds by Brehm v. Eisner, 746 A.2d 244, 253 (Del. 2000)).
The Sixth Circuit followed Delaware law in *McCall* in finding that the directors’ fiduciary duties include not only the duty of care but also the duties of loyalty and good faith, stating that although no “duty of care claims alleging only grossly negligent conduct are precluded by § 102(b)(7) waiver provision, it appears that duty of care claims based on reckless or intentional misconduct are not.” The *McCall* court noted, “To the extent that recklessness involves a conscious disregard of a known risk, it could be argued that such an approach is not one taken in good faith and thus could not be liability exempted under the statute.”

In *McCall*, where the duty of care claims arose from the board’s unconscious failure to act, the Sixth Circuit held that with a Certificate of Incorporation which exempts the directors from personal liability (with language identical to the *Abbott* provision), “a conscious disregard of known risks, which conduct, if proven, cannot have been undertaken in good faith. Thus, . . . plaintiffs’ claims are not precluded by [the company]’s § 102(b)(7) waiver provision.”

Good faith is a key concept. There can be no exculpation for good faith violations. In my opinion, good faith requires an honesty of purpose and eschews a disingenuous mindset of appearing or claiming to act for the corporate good, but not caring for the well-being of the constituents of the fiduciary. Although the concept of good faith is not fully developed in case law and the factual scenarios are difficult to formulate, an argument could be made that abdication of directorial responsibility, reckless, disingenuous, irresponsible, or irrational conduct—but not necessarily self-dealing or larcenous conduct—could implicate concepts of good faith. If the board’s decision or conduct is so irrational or beyond reason that no reasonable director would credit the decision or conduct, lack of good faith may, in some circumstances, be inferred.

Because the jurisprudence on good faith is unresolved, I express no opinion whether or when, upon court review, a separate duty of good faith that is not subsumed in the duty of loyalty should apply. But I would note, as a matter of prudent counseling, that boards should be told that it is arguable—but not settled—that the issue of good faith may be measured not only by the evolving expectations of directors in the context of Delaware common law fiduciary duty, but also against the backdrop of Sarbanes-Oxley and the SRO requirements, even though there may be no express private right of action.

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29. *Id.* at 809, 811 (citations omitted) (discussing *McCall* v. Scott, 239 F.3d 808 (6th Cir. 2001), amended on denial of rehearing by 250 F.3d 997 (6th Cir. 2001)).

30. *Del. Code Ann.* tit. 8, § 102(b)(7)(ii) (2001) (providing that the certificate of incorporation may include, “[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: . . . (ii) for acts or omissions not in good faith); *see also* Malpiede v. Townson, 780 A.2d 1075, 1095 (Del. 2001).

III. THE FUTURE OF A NEW CORPORATE CULTURE

In addition to the evolving standards of good faith, there are two things that I think are likely to happen. One is the near certainty that the Enron fallout and Sarbanes-Oxley will shrink the universe of qualified candidates who are willing to agree to stand for election as directors. The second likely development is a new focus on litigation going after officers as the actors in fraud cases, as distinct from, or in addition to, more litigation against directors for inadequate oversight. There is new legislation in Delaware this year that would subject officers to the personal jurisdiction of the Court of Chancery in the same manner that directors are subject to personal jurisdiction under Section 3114. There is also new Delaware legislation liberalizing the ability of stockholders to obtain books and records of the corporation, if they have a targeted, proper purpose to see what is going on within the corporation.

Returning now to the “new federalism,” one can see that Sarbanes-Oxley and the proposed NYSE/NASDAQ listing requirements have supplanted state internal affairs common law in some areas, such as mandating a specific composition, the duties of the audit committee, and the auditors. But in other areas they may have enhanced the expectations of minimal director conduct. Here, I think the independent nominating/corporate governance committee of the board may hold the key to the future of best corporate practices.

With the guidance of the General Counsel or its own outside counsel, the nominating/governance committee should be the conscience of the board to see that the right things are responsibly and conscientiously carried out and supervised. I can think of several major categories where such an independent committee can contribute to a paradigm of best practices, beyond the critical and independent central duty of establishing the criteria for, and the nominating and training of, directors. I will mention only a few of these categories:

- Define and monitor director independence
- Recommend whether to combine or separate the CEO position from chair of the board or to install a “lead director” or to rotate that role
- Assure a system of executive sessions of independent directors
- Develop and monitor law compliance systems
- Instill internal controls
- Develop business ethics code drafting and compliance
- Review, update, and enforce compliance with charters of all board committees
- Review and evaluate board schedules, quality of board meetings, and workload of committees and individual directors

- Ensure director responsibility for disclosure documents
- Identify conflicts of interest and corporate opportunity issues
- Report malfeasance, misfeasance, or nonfeasance within the corporation
- Anticipate and deal with insider trading issues
- Maintain effective stockholder relations and communications
- Ensure effective systems for evaluation and succession planning for officers
- Instill an evaluation process for directors, the board as a whole, and board committees
- Ensure that management has the proper operational structures in place and functioning

Of course, it is not essential that these responsibilities be assigned to the nominating/corporate governance committee of the board. But, in my view, it is important that these responsibilities be carried out by some committee or committees of the board. It is the responsibility of the entire board to make sure that all these corporate governance principles are carried out and followed through in good faith. There must be a body of independent directors whose duty it is to see that this is done.

Beyond that, pro-active standards of conduct of directors require that each director have the guts to be skeptical, probe, ask questions, and put management to its proof. Directors should not “go along” with any matter that is within their province of “direction” unless they are satisfied that they fully understand it and have prudently evaluated the risks. This advice in the new corporate culture is not intended to stifle risk-taking or to raise undue concerns about increased liability exposure. Courts do not second-guess the decisions of directors on substantive business matters. The business judgment rule is unchanged. The courts’ job is to examine the process used by directors in decision making and oversight. It is in this area of process that the expectations of directors are constantly evolving.

Another dimension that is key in this new world is the counseling and corrective role of counsel—particularly the General Counsel of the corporation. The “up-the-ladder” reporting rules of Sarbanes-Oxley and the SEC, as well as the reporting out of suspected fraud, create extraordinary tensions that open up many avenues that I do not have time to discuss today.34

**IV. CONCLUSION**

The corporate governance regime works only when people of integrity operating in the right corporate culture make it work. The system depends on trust in people—especially in the directors, but also in regulators and courts. In April, the SEC adopted a rule requiring companies

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that list securities on a national exchange to adopt uniform audit committee standards. In releasing this rule, the Chairman of the SEC, Bill Donaldson, said, "We can write all the laws we want, but in the final analysis it's going to be the human characteristic" that helps set the tone for the markets.

In a similar vein, Marty Lipton, who is well known as an outstanding corporate lawyer, said recently that one of the "essential themes for long-term reform of Corporate America [is that] post-Enron regulations will be effective only if accompanied by fundamental changes in corporate culture." In developing this theme, he highlights the "tectonic shift in power away from [the CEO] and toward [independent boards that] will be markedly less passive and will not show the deference to CEOs that often characterized board oversight during the bubble [boom] period."

Some of those challenges are manifest. Others are more nuanced, more subtle. Among the most obscure of the new challenges are those that center on the tension between state fiduciary duty law and the impact of the Sarbanes-Oxley Act—both its explicit, new requirements that reach into corporate internal affairs and its more subtle influence in shaping state fiduciary law.

But at the end of the day, the best prophylactic is for the corporation to implement the best corporate governance practices. Whether we like it or not, we are in a "brave new world," and we will all have to muddle through and make the best of it.

37. Id. at 7.
Articles