Sarbanes-Oxley, Corporate Federalism, and the Declining Significance of Federal Reforms on State Director Independence Standards

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Commentators have argued that the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or the "Act")\(^1\) raises federalism concerns because it regulates the internal affairs of a corporation, including the composition of, and qualifications for, corporate boards, in a manner traditionally reserved to states.\(^2\) This Article responds to those claims, arguing that the Act reflects a relatively minimal intrusion into state law, particularly with regard to issues of director independence. This Article further argues that the Act's failure to disturb state law on these issues might impede its ability to tighten director independence standards and by extension undermine its ability to improve the quality of directors' monitoring of corporate behavior.

Upon first glance, commentators' federalism concerns appear to have some merit. Indeed, states grant corporations their existence,\(^3\) and as a by-product, state courts and legislatures have the power to regulate the internal affairs of the corporation, including determining the rights and obligations of corporate directors and officers.\(^4\) Sarbanes-Oxley appears to intrude on this

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3. See, e.g., DEL. CODE ANN. tit. 8 § 101 (2005) (corporation formed under state law); MODEL BUS. CORP. ACT § 2.03 (2002) (corporation comes into existence upon filing of article of incorporation with secretary of state).

4. See Johnson & Sides, supra note 2, at 1192 (states, not the federal government, traditionally regulate corporate governance); see also infra note 43 (discussing internal affairs doctrine).
power. Not only does the Act (and listing agencies acting pursuant to the Act) impose various requirements and restrictions on the behavior of corporate directors and officers, but it also seeks to regulate the manner in which officers and directors monitor the flow of information within the corporation. In doing so, Sarbanes-Oxley deprives states of the authority and discretion to determine the contours of corporate law, leading many to characterize the Act as an attempt to federalize or preempt corporate law.

Such preemption appears particularly evident with regard to issues of director independence. Ordinarily, state law dictates not only the requisite number of directors a corporation must appoint to its board, but also the minimum qualifications for directors, including qualifications for directors who serve on specific committees. Sarbanes-Oxley usurps this traditional state power by mandating that corporations only appoint independent directors to the audit committee. The listing agencies, acting pursuant to the Act, go further, not only requiring that particular committees be comprised solely of independent directors, but also that a majority of the entire board be independent. Then too, Sarbanes-Oxley and the listing agencies do not defer to any state’s definition of director independence, but instead impose their own requirements for director independence; requirements designed to toughen those prevailing under state law. Because of this imposition, commentators conclude that Sarbanes-Oxley preempts state law in this realm, undermining the traditional discretion states had to shape the meaning of director independence.

Such preemption seems to be a deliberate response by Congress to address perceived defects in the manner in which the concept of director independence had evolved under state law. Indeed, corporate governance

5. See id. at 1195 (reforms represent a new federal presence in corporate governance); see also supra note 2 (discussing preemptive impact of Sarbanes-Oxley).
6. This Article uses the term “listing agencies” to refer collectively to the New York Stock Exchange and the Nasdaq Stock Market.
8. See Sarbanes-Oxley Act of 2002 §§ 302 (requiring officer certification of financial reports and the establishment of internal controls) and 404 (requiring inclusion of internal control report in each annual report); Johnson & Sides, supra note 2, at 1179-81, 1182-84 (describing management’s responsibility for financial reports and internal controls of financial reporting systems).
9. See, e.g., Bainbridge, supra note 2, at 28.
10. See infra note 44 and accompanying text.
12. See infra Part IB (discussing independence requirements).
13. See id.
scandals suggested that directors had failed to appropriately monitor corporate officers, and that such failure enabled officers to engage in fraud and other behavior detrimental to shareholders and the markets in general.\textsuperscript{14} In assessing the reason for this failure, many claimed that directors lacked true independence from corporate officers.\textsuperscript{15} In Congress’ analysis, directors’ lack of independence resulted in blind approval of officer’s inappropriate, and in some cases, fraudulent, conduct. In this regard, the scandals not only revealed the manner in which such lack of independence enables corporate misbehavior to remain unchecked, but also underscored the importance of director independence to curbing such misbehavior. As a consequence, the Act’s corporate board reforms centered on increasing the number of independent directors on the board and certain critical committees and tightening the criteria used to determine the kind of people who could qualify as independent directors.

Such issues are the province of state law. By removing them from the hands of state decision-makers, Sarbanes-Oxley reflects Congressional judgment that state law had not appropriately addressed the standards for board membership and qualifications. More importantly, by apparently forcing states to comply with these heightened federal requirements for director independence, the Act also appears to be a true preemption of state law.

However, after analyzing the Act and its impact on corporate boards over the last few years, this Article concludes that the alarming cry by commentators might have raised a false problem, because the federal intrusion into states’ discretion over concepts of director independence appears to be limited at best. This Article further asserts that given the perceived defects with states’ treatment of director independence and the critical role independent directors play in adequate monitoring of corporate affairs, this lack of intrusion might hinder the Act’s ability to alter the corporate governance system in any meaningful manner. In fact, this Article argues that Sarbanes-Oxley should have more forcibly intervened in state law by directing listing agencies and states to alter their director independence standards in a manner that accounts for all compromising affiliations, including personal and social ones.

Part I of this Article discusses the concept of director independence and its importance to our system of corporate accountability, and then demonstrates how Sarbanes-Oxley appears to preempt state law in the area of director independence. Focusing on Delaware law, Part II reveals that the Act does not reflect a significant departure from state law rules and corporate governance norms in existence prior to Sarbanes-Oxley’s enactment. Part II then evaluates Delaware law post-Sarbanes-Oxley and illustrates that the Act

\textsuperscript{14} See infra Part IA (pinpointing reasons for the collapse of Enron and other major public corporations).

\textsuperscript{15} See id.
initially appeared to encourage Delaware courts to alter their independence standards, particularly with respect to considering personal and social relationships when evaluating directors’ independence. Part II, however, also reveals that Delaware now appears to be retreating from this alteration because the Delaware Supreme Court’s recent decision involving director independence significantly discounts the impact of such relationships on directors’ impartiality. Part II concludes that this apparent retrenchment by Delaware might prevent Sarbanes-Oxley from having any lasting impact on that state’s decisions in this area.

Part III explores the impact of this conclusion on the Act’s effectiveness by specifically examining whether issues of social or personal affiliations should affect the determination of a director’s independence. This Part asserts that social science literature as well as studies of boardroom dynamics strongly indicate that such affiliations should play a role in evaluations of director independence. Based on this indication, this Article concludes not only that Sarbanes-Oxley fails to truly preemp state law in this area, but also that this failure might limit the Act’s ability to meaningfully reform our corporate governance system.

I. SARBANES-OXLEY, DIRECTOR INDEPENDENCE AND FEDERAL PREEMPTION

A. The Importance of Independence to Corporate Accountability

The term “independent” director defies easy categorization. By definition, an independent director is not an insider—a director employed by the company on whose board she serves. In other words, an independent director must be an outside director. In addition, courts broadly define an independent director as one who does not have a relationship with, or is not otherwise controlled by, another officer or director in a manner that inhibits the director’s ability to impartially assess that officer or director’s conduct. Such an independent director is distinct from an “interested” director, which refers to a director who receives a benefit from a particular transaction other than the one that shareholders also receive. Very often courts rely upon the independent director to assess the propriety of an interested director’s transaction.

17. See id. at 270, 279.
18. See Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); see also Strine, supra note 2, at 1371.
19. See Aronson, 473 A.2d at 812.
Reforms pressuring corporations to increase the number of independent directors on their boards and tighten the standards for measuring their independence pre-date Sarbanes-Oxley. Indeed, after corporate governance failures in the 1970s, many corporate scholars insisted that boards needed to become more independent in order to enhance their ability to effectively oversee the corporation.\(^{21}\) Thus, in 1979 Harold Williams, the former chairman of the Securities and Exchange Commission (the “SEC”), argued that increasing director independence would enhance public companies’ accountability.\(^{22}\) This argument gained momentum so that by the mid-1980s, there was significant support for independent directors.\(^{23}\) Managerial abuses in the 1980s triggered a renewed focus on the independent director.\(^{24}\) As a result, by the late 1990s there was broad support for the notion that independent directors should dominate the boards of major public companies.\(^{25}\)

Reformers not only viewed independent directors as critical checks on managerial abuses of power, but also as substitutes for judicial interference with corporate affairs and government regulation of corporations. Corporate officers and agents have tremendous authority to operate the corporation. Courts and legislatures have struggled to determine the best means for making those officers and agents accountable to the corporation and its shareholders and ensure that they do not abuse their awesome authority.\(^{26}\) Reformers viewed independent directors as the solution to this accountability problem.\(^{27}\) Such directors have no stake or connection to management. Thus, their independence appears to enable them to impartially assess management’s actions and thus protect the interests of the corporation and its shareholders.\(^{28}\)

\(^{21}\) See Victor Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597 (1982) (describing reform proposals). These reforms were not without their criticism. See id. at 609-39.

\(^{22}\) See Irwin Borowski, *Corporate Accountability: The Role of the Independent Director*, 9 IOWA J. CORP. L. 455, 455-56 (1984) (describing Williams as the “person who probably more than anyone else has placed the independent director at the heart of the accountability system”).

\(^{23}\) See Brudney, *supra* note 21, at 598 (noting strong support for independent directors).

\(^{24}\) See Lin *supra* note 20, at 899-900.


\(^{26}\) See Fisch, *supra* note 16, at 268 (noting mechanism created to reduce the agency costs inherent in public corporations); Lin *supra* note 20, at 900 n.4 (noting that independent directors are a part of an ongoing effort to align shareholder and management interests).

\(^{27}\) See id. at 900 n.5; see also Gilson & Kraakman, *supra* note 25, at 873.

Then too, reformers viewed directors as better suited to monitor corporate affairs than courts or legislators. Courts have long acknowledged that they are not in the best position to determine the feasibility of management’s decisions. Judges are not business people. Moreover, given the complexities of the business world and the importance of innovative thinking to that world, it is often too difficult for judges and others to assess the merits of any given business decision, particularly after it has occurred. Courts therefore prefer to rely on independent directors. Such directors not only presumably have greater expertise than judges, but they also might be deemed to have greater authority because shareholders have elected them to oversee the corporation. Then too, directors’ oversight responsibilities allow them to be proactive in a manner that courts cannot. From this perspective, so long as courts can be assured that directors will be impartial, such directors appear best suited to oversee managerial conduct. In this regard, reliance on independent directors enables courts to justify their lack of judicial interference in corporate affairs. A similar reliance enables legislators to justify a relatively noninterventionist stance on corporation affairs. Thus, many came to view independent directors as substitutes for protective government regulation. In fact, former SEC Chairman Williams believed that independent directors were the only effective means of holding corporate agents accountable to their legal and fiduciary responsibilities. As a former associate director of the SEC’s Division of Enforcement points out, the independent director appears to be at the heart of corporate accountability. Reformers viewed director independence not only as a vehicle for ensuring that corporate officers were adequately monitored, but also as the mechanism for decreasing judicial and governmental intervention into corporate affairs.

The collapse of Enron and other major public companies not only suggested significant defects in our accountability system, but also by extension

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29. Indeed, courts analyze breaches of a directors’ duty of care under the business judgment rule which reflects the notion that directors’ decisions will be granted deference because such directors are better suited to understand the corporation’s business and make decisions that benefit that business. See e.g., Charles Hansen, The ALI Corporate Governance Project: Of the Duty of Care and the Business Judgment Rule, 41 BUS. LAW. 1237, 1238-42 (1986).
30. See id.
31. See Borowski, supra note 22, at 457.
32. See Brudney, supra note 21, at 624.
33. See id. at 623 n.73 (citing Chairman Williams).
34. See Borowski, supra note 22, at 455-56 (explaining former SEC Chairman Harold Williams’ role in placing the independent director as the primary focus of corporate accountability).
35. See id. at 455 (one of the major attractions of the independent director is that it will lessen the need for government to play a role in corporate accountability).
casts in doubt the lack of judicial and government intervention on which that system rested. As a general matter, directors owe a duty of care to the corporation, that includes a responsibility to oversee the corporation’s affairs and monitor corporate officers. 37 Scandals revealed that directors failed to adhere to their duties. 38 Thus, Congressional investigations and other reports involving Enron revealed that directors failed to sufficiently monitor corporate officers and check their abuses of power. 39 Similarly, reports regarding WorldCom’s demise found a “series of deep-rooted failures with the mechanisms of its governance,” pursuant to which directors abdicated their role of providing adequate checks on officer’s power. 40 Investigations surrounding the corporate governance scandals indicated that directors’ failure to adhere to their responsibilities stemmed in part from their lack of independence. Directors had extensive financial, social, and professional ties with management that impeded their ability to impartially judge management’s actions. 41 Instead, those ties caused them to rubber stamp actions that ultimately led to the downfall of the company they were elected to supervise. 42 Because they abdicated their oversight responsibilities, courts and legislators apparently could no longer use independent directors to justify their lack of intervention. Thus, the federal government passed Sarbanes-Oxley. Sarbanes-Oxley’s focus on director independence sought to rectify defects in directors’ monitoring capabilities by tightening the standards for their independence and seeking to eliminate those ties that hindered directors ability to objectively monitor corporate officers. In this regard, Sarbanes-Oxley intervened in corporate affairs, but primarily in an effort to reinvigorate the independent director.

39. See id; see also Troy A. Paredes, Enron: The Board, Corporate Governance and Some Thoughts on the Role of Congress, in ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS, supra note 36, at 495, 503-15.
41. See id. at 817-18.
42. See id.
B. Sarbanes-Oxley and the Apparent Preemption of State Director Independence Standards

At first glance, Sarbanes-Oxley’s intervention appears to be a direct intrusion upon states’ traditional authority to regulate directors. State law governs the internal affairs of a corporation, giving state courts and legislatures the power to determine the rights and responsibilities of directors and officers.\textsuperscript{43} As part of this power, state statutes determine the proper number of directors who must serve on a corporation’s board as well as the qualifications for directors who serve both on the entire board and on any committees of the board.\textsuperscript{44} Sarbanes-Oxley’s regulations concerning independent directors encompass these matters, therefore appearing to preempt or federalize that portion of state law governing directors and their qualification for board and committee membership.

Specifically, post-Enron reforms mandate that certain committees and the entire board be comprised of independent directors. Sarbanes-Oxley’s independence standards only apply to the audit committee of reporting companies. Hence, Section 301 of the Act requires every member of the audit committee to be independent.\textsuperscript{45} In this regard, the Act’s director independence provisions appear limited in scope. However, Sarbanes-Oxley required the SEC to direct each national securities exchange and national securities association to adopt rules in compliance with Section 301.\textsuperscript{46} Pursuant to this direction, listing agencies adopted rules requiring each member of a listed company’s audit committee to be independent.\textsuperscript{47} However, the listing agencies’ rules extend beyond the audit committee. Thus, the New York Stock Exchange (the “NYSE”) and the Nasdaq Stock Market (“Nasdaq”) require listed companies to have both a nominating committee and a compensation committee.

\textsuperscript{43} See Mark J. Roe, Delaware’s Competition, 117 HARV. L. REV. 588, 596-97 (2003) (discussing the internal affairs doctrine); Edgar v. MITE Corp., 457 U.S. 624, 645 (1982) (noting that the laws of the state of incorporation govern the internal affairs of the corporation).

\textsuperscript{44} See DEL. CODE ANN. tit. 8, § 141(b) (providing that articles of incorporation or bylaws shall set forth any qualifications for directors), (c) (allowing board to establish committees). See also MODEL BUS. CORP. ACT § 8.02 (articles of incorporation or bylaws may prescribe qualifications for directors) and § 8.25 (allowing board to create one or more committees).


\textsuperscript{46} See id.

comprised entirely of independent directors. 48 Finally, the NYSE and Nasdaq require their listed companies to have a majority of independent directors on their boards. 49 These reforms collectively mandate director independence both within various committees and on the board as a whole.

Additionally, Sarbanes-Oxley, together with the listing agencies, define independence in a manner designed to tighten that definition. Sarbanes-Oxley narrowly defines independence with respect to compensation and a director’s affiliation with the company. Hence, an audit committee board member will not be considered independent if she has an affiliation with the company (such as being a company officer or employee, for example) or if she receives any compensation from the company other than her director’s fees. 50 The listing agencies go further, not only broadly defining independent directors as those who have no material relationship with the corporation on which they serve, 51 but also listing categories of relationships that automatically preclude a director from being deemed independent. First, like Sarbanes-Oxley, the NYSE and Nasdaq exclude those directors who are affiliated with the company through employment or who receive some compensation from the company other than directors’ fees. 52 Moreover, the exchanges are more stringent than Sarbanes-Oxley with respect to employment, disqualifying directors employed with a listed company within the past three years. 53 However, while Sarbanes-Oxley precludes directors who receive any non-fee related compensation from being deemed independent, the listing agencies set a threshold

48. See NYSE, NYSE Listed Company Manual § 303A.08 (requiring that all nominating committee members be independent); Nasdaq, NASD Manual Rule, 4350(c) (requiring that all compensation committee members and all nominating committee members be independent). The American Stock Exchange ("AMEX") has a similar rule. See AMEX, AMEX Company Guide § 804 (requiring all nominating committee members to be independent) and 805 (requiring all compensation committee members to be independent).

49. See NYSE, NYSE Listed Company Manual, § 303A.08; Nasdaq, NASD Manual Rule, 4200(a)(15) and 4350 (c). See also AMEX, AMEX Company Guide § 802.


51. See NYSE, NYSE Listed Company Manual § 303A.08. Nasdaq requires that directors have no relationship that would interfere with the exercise of a director’s independent judgment in carrying out her responsibilities. See Nasdaq, NASD Manual Rule 4200(a)(15).

52. See NYSE, NYSE Listed Company Manual § 303A.02(b) (a director who is an employee shall not be deemed independent for a period of three years after the end of such employment relationship and a director who receives more than $100,000 in compensation other than board and related fees from the company shall not be deemed independent until three years after she ceases receiving such compensation); Nasdaq, NASD Manual Rule 4200(a)(15) (excluding for independence a director who is or was during the past three years employed by the company; and a director who accepted any payments from the company other board and related compensations in excess of $60,000 during the current or past three fiscal years).

53. See NYSE, NYSE Listed Company Manual § 303A.02(b); Nasdaq, NASD Manual Rule 4200(a)(15).
barring only those directors who receive more than $100,000 in compensation in the case of the NYSE and $60,000 in the case of Nasdaq. 54

Unlike Sarbanes-Oxley, both Nasdaq and the NYSE specify relationships other than those based on compensation and affiliation that preclude a director from being considered independent. First, those agencies preclude directors who, within the past three years, either have had particular relationships with the company’s auditors or who have been employed with a company that has had a significant business relationship with the company. 55 Second, both Nasdaq and the NYSE provide that a director who is employed as an executive officer of another company where any of the listed company’s current executives serve on the compensation committee would not be independent until three years after such employment ends. 56 Finally, the NYSE and Nasdaq disqualify directors whose immediate family members are involved in any of the aforementioned prohibited relationships. 57

By mandating that corporations have a specific number of independent directors and by defining the meaning of that independence, Sarbanes-Oxley directly interferes with states’ discretion in this area. While several federal securities laws govern corporations—and by extension directors within those corporations—those laws focus mainly on disclosure obligations, leaving states primarily free to regulate the rights and duties of directors. In this regard, concerns regarding federal preemption seem justified.

54. See id.

55. The NYSE excludes directors who are affiliated with or employed by a present or former internal or external auditor of the company from being independent until three years after the end of such relationship. See NYSE, NYSE Listed Company Manual § 303A.02(b)(i). The NYSE also excludes a director who is an executive officer or employee of a company that makes payments to, or receives payments from, the listed company for property or services in an amount which, in any single fiscal year exceeds the greater of $1 million, or 2% of such company’s consolidated gross revenue from being deemed independent until three years after falling below such threshold. See id. at 303A.02(b)(v). By contrast, Nasdaq excludes a director who is a partner in, or a controlling shareholder or an executive officer of, any organization to which the company made, or from which the company received, payments for property or services within the past three fiscal years in an amount which, in any single fiscal year exceeds the greater of $200,000, or 5% of such company’s consolidated gross revenue from being deemed independent. See Nasdaq, NASD Manual Rule 4200(a)(15). The Nasdaq exclusion for auditor relationships is narrower than the NYSE definition, excluding directors who are current partners of the company’s outside auditor, or were partners or employees of the company’s outside auditor who worked on the company’s audit at any time during the past three years. See id.

56. See id.

57. See id. at 4200(a)(14). Immediate family members include spouses, parents, siblings, children, in-laws and anyone living with the director. See id.
II. The More Things Change...

However, an analysis of state law rules and norms prior to Sarbanes-Oxley reveals that the Act does not reflect a significant departure from those rules and norms. As the state whose law governs most public corporations, this analysis will focus on Delaware. 58

A. The Direct Impact of Reforms on State Independence Standards

1. Delaware Law and Corporate Trends on Director Independence

At first glance there does not appear to be any concern with regard to Sarbanes-Oxley displacing state law because Delaware statutes leave the issue of board qualifications to the discretion of individual corporations. Indeed, while the Delaware corporation statute covers boards and their committees, it does not establish any specific requirements for being a board member or for serving on a committee of a board. 59 Instead, it grants corporations the power to set forth the number and qualifications for board membership in their governing documents. 60 Given that Delaware appears already to have ceded this authority to corporations, Sarbanes-Oxley does not appear to deprive the state of any power vis-à-vis director qualification.

Moreover, Sarbanes-Oxley's focus on increasing director independence on corporate boards is consistent with Delaware law. While there is no statutory requirement of director independence, Delaware courts have crafted an analytical framework that as a de facto matter require corporations to ensure that at least some portion of their board be independent. Boards enjoy a presumption that their actions are the product of good faith and taken in the best interests of the corporation. 61 This presumption, known as the business judgment rule, operates to shield directors from liability because, absent a showing of self-interest or severe abuse of discretion, the rule dictates that courts defer to directors' decisions. 62 However, Delaware courts only will apply this presumption to independent and disinterested directors. 63 As a

58. See Sale, supra note 38, at 457 (referring to Delaware as the "mother of all corporate law"); Jones, supra note 2 at 632 (noting that most public corporations incorporate in Delaware).
59. See DEL. CODE ANN. tit. 8, § 141(b) (2005) (providing that articles of incorporation or bylaws shall set forth any qualifications for directors), (c) (allowing board to establish committees). See also MODEL BUS. CORP. ACT § 8.02 (2002) (articles of incorporation or bylaws may prescribe qualifications for directors) and § 8.25 (allowing board to create one or more committees).
60. See id.
61. See Aronson, 473 A.2d at 812; Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360-61 (Del. 1993).
62. See Aronson, 473 A.2d at 812 (noting that a court will not substitute its judgment for the board so long as the board's decision can be attributed to any rational reason).
63. See id.
consequence, while courts will probe more deeply into decisions made by directors who lack independence, courts are extremely reluctant to overturn decisions made by independent directors.\textsuperscript{64} Thus, as a general matter, Delaware's application of the business judgment rule encourages corporations to appoint independent directors to their board. Such encouragement at least softly echoes recent reforms.

More specifically, Delaware's focus on director independence in the context of derivative suits pressures corporations to make their boards more independent in a manner consistent with Sarbanes-Oxley. Having a sufficient number of independent directors on the board enables corporations to dismiss shareholder derivative suits alleging a breach of director's fiduciary duty.\textsuperscript{65} In order to hold directors liable for breaching their fiduciary duties, shareholders must bring a derivative action against those directors.\textsuperscript{66} Corporations, however, can dismiss those actions in one of two ways, both of which rely upon concepts of director independence. First, the corporation can dismiss the action if shareholders have not either made a demand upon the board or demonstrated that demand is excused because it would be futile.\textsuperscript{67} Proving demand futility requires satisfying at least one component of a two-pronged test articulated in \textit{Aronson v. Lewis}.\textsuperscript{68} Under the first prong, shareholders must raise a reasonable doubt that directors upon whom they would have made a demand were disinterested or independent in the challenged transaction.\textsuperscript{69} This means that if shareholders can prove that a majority of such directors lacked independence, then their suit can move forward on the basis of demand futility. By contrast, a corporation can avoid a finding of demand futility if

\textsuperscript{64} See Strine, \textit{supra} note 2, at 1374 (2002); E. Norman Veasey, \textit{Should Corporation Law Inform Aspirations for Good Corporate Governance Practices—or Vice Versa?}, 149 U. PA. L. REV. 2179, 2182 (2001) (noting that a board dominated by independent directors will find a safe harbor from liability).

\textsuperscript{65} Delaware courts grapple with issues of independence through the prisms of the dismissal of derivative actions, conflict of interest, and takeover transactions. See, \textit{e.g.}, Lin \textit{supra} note 20. This Article focuses on derivative suits because of its importance to shareholder fiduciary duty claims and the perceived changes with regard to independence related to those suits.


\textsuperscript{67} See \textit{Aronson}, 473 A.2d at 807.

\textsuperscript{68} See \textit{id.} at 814 (shareholders must raise a reasonable doubt that (a) the directors are disinterested and independent and (b) the challenged transaction was otherwise the product of a valid exercise of business judgment).

\textsuperscript{69} See \textit{id.}
its directors were independent. In this way, Delaware courts’ application of Aronson encourages board independence.

When corporations cannot demonstrate demand futility under Aronson, they can seek dismissal of the derivative action under a second route by establishing a special litigation committee to terminate the suit. In reviewing that committee’s decision, courts apply Zapata Corp. v. Maldonado, which shifts the burden to the corporation to prove that the committee was independent and made the dismissal decision in good faith.70 While courts overwhelmingly defer to the decisions of special litigation committees,71 such deference is only given to committees comprised of independent directors.72 Like their role in the demand-futility context, the ability of independent directors to terminate shareholder litigation under Zapata encourages corporations to populate their boards with independent directors.73

The strength of this encouragement should not be underestimated. The derivative suits serve as the primary means for shareholders to impose liability on directors and officers who breach their fiduciary duties.74 As a consequence, the ability to dismiss those suits serves as one of the primary means of shielding directors and officers from liability. In this sense, having a sufficient number of independent directors on a board decreases both managements and the entire board’s exposure to liability. Such a decrease is a strong incentive for corporations to appoint independent directors to their boards.

Thus, similar to the federal rules, Delaware courts strongly encouraged, if not implicitly required, corporations to have independent directors on their boards. While certainly the new reforms are more rigid because they mandate that a specific number of directors be independent, they are not inconsistent with Delaware law and hence represent a limited interference of that state’s power.

Then too, Sarbanes-Oxley is consistent with the trend among major public corporations towards increasing board independence. As Part IA reveals, by 1990, many corporate experts, including the American Law

70. Zapata Corp. v. Maldonado, 430 A.2d 779, 788-89 (Del. 1981). Zapata has two prongs. First, the corporation must establish that the special litigation committee was independent, and acted in good faith. Second the court weighs in to determine if the committee’s dismissal motion should be granted. See id.
71. See id. at 784 (committee’s decisions will be respected unless wrongful).
72. A special litigation committee must show that it is independent, its members acted in good faith, and had a reasonable basis for its recommendation. See id. at 788-89.
73. See Lin, supra note 20, at 907 (noting that the judicial interpretation of the demand futility requirement encourages companies to appoint outside directors to their boards).
Institute, the Conference Board, the American Bar Association and the Business Roundtable, agreed that corporations should be dominated by independent directors.\textsuperscript{75} Mirroring this agreement, prior to the enactment of Sarbanes-Oxley, most public corporations, including Enron,\textsuperscript{76} had boards with a majority of independent directors. Thus, by 2001, about 75% of companies listed on the NYSE or Nasdaq had a majority of independent directors.\textsuperscript{77} Similarly, a 1997 survey of 484 Standard & Poor (S&P) 500 companies not only revealed that 98% of those companies had a majority of outside directors, but that 80% of the directors on the average board were outside/independent.\textsuperscript{78} That study therefore demonstrates that most S&P 500 companies have a supermajority of outside/independent directors.\textsuperscript{79} While not as dramatic, some board committees also exhibited this trend towards greater independence. Thus, a 1996 study of S&P 500 companies revealed that 40% of those companies had nominating committees comprised solely of independent directors.\textsuperscript{80} In addition, a 2000 study revealed that average independence levels at compensation committees of S&P companies were 90%, while 64% of their audit committees were completely independent.\textsuperscript{81} Based on these statistical trends, Sarbanes-Oxley’s insistence on director independence both on the board and on its key committees appears consistent with prevailing corporate governance norms.

This consistency suggests that the impact of Sarbanes-Oxley on board composition would have been fairly minimal. Recent reports confirm this suggestion. The 2004 Korn/Ferry study of the boards of 904 publicly-held Fortune 1000 companies report that new regulations have not impacted the balance between inside and outside/independent directors.\textsuperscript{82} Instead, the

\textsuperscript{75} See Bhagat & Black, supra note 25, at 921 (noting commentators approval of boards with majority outside directors); Ira M. Millstein & Paul W. MacAvoy, The Active Board of Directors and Performance of the Large Publicly Traded Corporation, 98 Colum. L. Rev. 1283, 1288 n.21 (1998) (describing various reforms); Gilson & Kraakman, supra note 25, at 873.

\textsuperscript{76} See Paredes, supra note 39, at 504.

\textsuperscript{77} See Press Release, Investor Responsibility Research Ctr., IRRC Data Guides New Listing Rules for NYSE (Mar. 7, 2002), \textit{available at} http://www.irrc.org/company/06062002_NYSE.html. See also Bhagat & Black, supra note 25, at 921 (noting that most public companies had a majority of independent directors as of 1997).

\textsuperscript{78} See Bhagat & Black, supra note 25, at 921-22 (the term outside directors includes both those directors who are not employed by the company, but have some affiliation with the company as well as those directors who were not employed by the company and do not have any affiliation with the company).

\textsuperscript{79} See id.

\textsuperscript{80} See Millstein & MacAvory, supra note 75, at 1286 n.15 (describing study).


\textsuperscript{82} See Korn/Ferry International, 31st Annual Board of Directors Study 2004, 11 [hereinafter Korn/Ferry Study].
average number of outside directors is 9, the same average reported since 1990. These statistics underscore the notion that many of the corporate reform measures related to board composition had already been implemented prior to Sarbanes-Oxley. Because Sarbanes-Oxley appears to mirror state and corporate governance trends, its preemptive impact appears to have been fairly minimal.

Either as a result of Delaware law, or corporate governance trends more generally, most corporate boards prior to Enron’s collapse were independent. Hence, the focus of Sarbanes-Oxley and related listing requirements on increasing the number of independent directors appears duplicative. Certainly those rules impose a specific mandate that was not codified in Delaware law. Regardless, the independence standards were embodied in Delaware law sufficiently enough to make the reforms on this issue unobtrusive, thereby minimizing their preemptive force.

2. Preemption and Delaware’s Assessment of Director Independence

By contrast, Sarbanes-Oxley’s focus on defining director independence might be more invasive on state law. Delaware statutes do not define independence. Instead, courts determine a director’s independence on a case-by-case basis. Under this approach, Delaware courts have articulated a broad definition of independence similar to the one adopted by the NYSE and Nasdaq. Thus, Delaware defines an independent director as one who is not under the domination of, or beholden to, another director or officer. However, Delaware courts have not identified any specific categories of relationships that would presumptively prohibit a director from being independent. In fact, those courts have specifically refused to adopt such rigid categorizations. In doing so, Sarbanes-Oxley reforms appear to deprive Delaware courts of the discretion to make individual assessments of directors’ independence. This deprivation may reflect a significant intrusion upon state’s power.

Moreover, at least one of the relationships that would disqualify a director from being independent under the reforms would not have the same impact under Delaware law. Sarbanes-Oxley disqualifies directors who have received payment of consulting, advisory, or other compensatory fees other

83. See id.
84. See Veasey, supra note 64, at 2182.
85. See id.
86. See Levine v. Smith, 591 A.2d 194, 205 (Del. 1991); Aronson, 473 A.2d at 815-16.
87. See Veasey, supra note 64, at 2183 (noting that the adoption of such categories was not the province of the courts and that such rules would probably not be appropriate for the legislature to adopt either).
than director fees.\textsuperscript{88} By contrast, Delaware courts do not view receipt of such fees as compromising a director's independence.\textsuperscript{89} To the extent that Sarbanes-Oxley would require Delaware courts to follow its rules for director independence, this inconsistency suggests a true preemption of that state's law.

However, Sarbanes-Oxley and related reforms do not require Delaware to apply their concepts of independence to the derivative suit analysis or in any other context where issues involving independence traditionally arise under state law. Indeed, Sarbanes-Oxley's independence rules only govern the audit committee and hence have a very limited application to state law. Certainly the listing standards apply more broadly to the majority of the board and at least two additional board committees. Yet even those standards do not mandate that states apply such criteria to other committees of the board, such as the special litigation committee, or in other contexts involving directors. Because of this lack of mandate, Professors Lyman Johnson and Mark Sides argue that Sarbanes-Oxley does not reflect an express federal intention to "occupy the field" in the area of director independence, and hence cannot be construed as a form of federal preemption.\textsuperscript{90} In their views, Sarbanes-Oxley introduces a system of dual regulation of directors, which system leaves state law standards of independence largely intact.\textsuperscript{91} Given that the listing standards apply to at least a majority of the board, it is hard to imagine that those standards will not generate some spillover intrusion into state's discretion, ensuring that most directors satisfy federal standards of independence. However, this spillover effect appears to be a limited intrusion into state's authority, underscoring the notion that Sarbanes-Oxley allows states tremendous freedom to fashion their own director independence rules.

Then too, even this intrusion is not as significant as it appears because there are many parallels between the reforms' definitions of director independence and the manner in which Delaware assesses such independence. For example, the reforms address familial relationships in a manner similar to Delaware law. Thus, reforms not only disqualify directors whose family members are involved in prohibited relationships, but they broadly define family to include a wide range of familial relationships.\textsuperscript{92} Thus, under both NYSE and Nasdaq rules, immediate family members include spouses, parents,

\textsuperscript{88} See Sarbanes-Oxley Act of 2002 § 301.

\textsuperscript{89} See In re The Walt Disney Co. Derivative Litig., 731 A.2d 342, 356-60 (Del. Ch. 1998) (finding that several directors who were paid consultants for Disney were nevertheless independent).

\textsuperscript{90} See Johnson & Sides, supra note 2, at 1214.

\textsuperscript{91} See id.

\textsuperscript{92} See NYSE, NYSE Listed Company Manual § 303A.02(b); Nasdaq, NASD Manual Rule 4200(a)(15).
siblings, children, in-laws, and anyone living with the director. In this same vein, Delaware courts have recognized the compromising nature of such relationships and broadly construed construing those relationships. Hence, courts have found the grandson of an interested director to lack independence as well as the brother-in-law of an interested officer. Delaware’s disqualification of these relationships appears consistent—and in some cases more expansive—with those covered under the listing standards.

Most importantly, the reforms mirror state law’s failure to focus on close social or personal ties when assessing a director’s independence. With the exception of familial bonds—which both the reforms and state law address—the reforms appear to view independence in terms of financial ties, without specifically focusing on personal and social ties among directors. Given that reports surrounding corporate governance scandals recognized that social and personal ties might have comprised director independence, this exclusion appears both significant and troubling. Like many aspects of the reforms, however, this exclusion is consistent with Delaware law. Indeed, Delaware courts have been reluctant to conclude that non-economic relationships compromise independence. Thus, Delaware courts consistently have held that allegations of close personal friendships among directors and corporate officers, even lifelong friendships, would be insufficient to discredit directors’ independence. In one case, for example, a fifteen-year personal relationship between a CEO and a director was not sufficient to raise a reasonable doubt as to a director’s independence from the CEO. Emphasizing this point, Delaware Supreme Court Chief Justice Norman Veasey has insisted that courts should not rely on any presumption that “friendship, golf companionship, and social relationships” jeopardize directors’ independence. His position underscores Delaware’s basic refusal to give credence to such relationships when assessing director independence. This refusal appears to be mirrored in federal reforms’ failure to specifically characterize those relationships as detrimental to directors’ independence.

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93. See id.
96. See infra notes 162-164 and accompanying text.
97. See Strine, supra note 2, at 1378.
100. See E. Norman Veasey, The Defining Tension in Corporate Governance in America, 52 BUS. LAW. 393, 406 (1997). In the chief justice’s opinion, courts should not rely on the “dubious presumption that the director would sell his or her soul for friendship.” See id.
As this discussion reveals, Sarbanes-Oxley reflects rather than alters existing corporate rules and norms regarding director independence. This reflection minimizes any preemptive impact that the Act has on state law in this area.

B. The Derivative Impact of Reforms

It is certainly possible that Sarbanes-Oxley could indirectly preempt state law by pressuring state courts to alter their independence standards in a manner that goes beyond the specific regulations embodied in the law. Given that the specific reforms embodied in the Act appear to mimic state law, this encouragement must stem from a perceived threat that federal legislators would make further and more significant inroads into state law if states did not voluntarily make alterations. 101 Alternatively, this encouragement might stem from some implicit understanding that reformers desired states to examine director independence with more expansive criteria than those adopted under federal law. 102 Indeed, given the difficulty with capturing every relationship that might undermine a director's independence, federal legislators might have deemed it more appropriate to allow states discretion to continue making these assessments on a case-by-case basis. Then too, given that federal reforms do not reflect a direct preemption, the Act might serve as a general signal for states to reexamine their independence standards just as federal reformers did. In this way, while federal law might not directly intrude on states' autonomy, it nevertheless could have an important impact on states by encouraging them to more closely scrutinize directors and take into account relationships that they had not previously considered. Delaware judges and corporate scholars have argued that just such an impact would arise, encouraging courts to reexamine director independence in an effort to strengthen corporate norms and prevent abuses of power. 103 This Part reviews the relevant case law post-Sarbanes-Oxley and reveals that this kind of derivative impact seems to have occurred, lending credence to such arguments. However, Delaware now appears to be retreating from this re-examination, suggesting that such an impact might not be sustained in the long term.

101. See Jones, supra note 2, at 627 (discussing the impact of federal law's threat on state decisions).
103. See infra notes 108, 109 and 128.
1. Early Indicators of Derivative Impact

Initially it appeared that Enron and Sarbanes-Oxley would have no impact on the manner in which states analyzed director independence. In the immediate aftermath of Enron and the federal reforms aimed at tightening criteria for directors and officers, neither state legislatures nor state courts followed suit.\textsuperscript{104} As one scholar asked, “given the severity of the governance problems exposed after Enron... where are the states?”\textsuperscript{105} Not only did states appear unwilling to alter their own rules, but they also appeared to be ignoring any signals from federal law. In fact, a Westlaw search reveals that only thirteen state cases have cited Sarbanes-Oxley since its enactment.\textsuperscript{106} More than half of these cites do not relate specifically to state fiduciary duty concerns.\textsuperscript{107} This appears to discredit the notion that federal reforms would have some trickle down impact on state law.

However, beginning in 2003 the Delaware courts appeared to respond to federal signals, applying greater scrutiny to board decisions and refusing to defer to the business judgment of directors. Indeed, Professor Renee Jones noted that during 2003, the Delaware Supreme Court reversed the chancery court and ruled in favor of shareholder plaintiffs six times, a sharp departure both in the number of reversals and pro-shareholder decisions.\textsuperscript{108} Professor Jones argues that this departure reflects the state’s reaction to the federal

\textsuperscript{104} See Robert B. Thompson, Corporate Governance After Enron, 40 Hous. L. Rev. 99, 107 (2003); Sale, supra note 38, at 457 (noting that Delaware has been largely absent from the debate on corporate governance changes).

\textsuperscript{105} Id. at 107.


\textsuperscript{107} See id.

\textsuperscript{108} See Jones, supra note 2, at 645.
threat of preemption. During this same period, Delaware court's have exhibited a willingness to expand upon and enforce the duty of good faith. This willingness appeared to reflect Delaware's renewed effort to encourage directors to pay heed to their fiduciary duties and to encourage better corporate governance norms.\textsuperscript{109} As Professor Hillary Sale argues, Delaware's effort to breathe life into the duty of good faith reflects a subtle shift in its jurisprudence, a shift no doubt triggered by federal reforms.\textsuperscript{110}

This shift was particularly evident in the context of director independence where Delaware courts demonstrated an unexpected willingness to focus on social and professional relationships when analyzing a director's independence. In In re Oracle Derivative Litigation, shareholders brought suit against various officers and directors alleging they had breached their fiduciary duties of loyalty by selling their shares in the company based on inside information that the company was doing more than poorly than expected.\textsuperscript{111} The corporation, apparently foregoing the Aronson analysis, responded to the suit by establishing a special litigation committee to investigate the trading transactions. The special litigation committee, comprised of directors not involved in the challenged trades, hired legal and financial experts to assist them.\textsuperscript{112} After an extensive investigation, the special litigation committee filed a motion to dismiss the shareholders' lawsuit.

The court analyzed the committee's decision—and its independence—under Zapata. The corporation insisted that the court should honor the dismissal decision of the special litigation committee because its members had no economic ties to the defendant directors. Indeed, while the committee members were Stanford professors and three of the defendant directors had significant connections to Stanford, the members of the committee did not have a fundraising role at Stanford and hence were not directly beholden to any of the defendant directors for money.\textsuperscript{113} Moreover, both committee members were tenured professors at Stanford and hence had no fear that their jobs were at risk if they made decisions adverse to the defendant directors.\textsuperscript{114} The corporation insisted that the lack of these economic factors rendered committee members independent of the interested directors. The Delaware chancery court agreed that the committee members lacked any economic ties with defendant directors. According to the court, this lack meant that their relationship with the interested directors did not represent the "relatively easy"

\begin{itemize}
\item \textsuperscript{109} See Sale, supra note 38, at 469-82 (discussing recent cases where the Delaware courts have used the duty of good faith to better monitor corporate decisions).
\item \textsuperscript{110} See id.
\item \textsuperscript{111} See In re Oracle Corp. Derivative Litig. Consol., 824 A.2d 917, 920, 923 (Del. Ch. 2003).
\item \textsuperscript{112} See id. at 925.
\item \textsuperscript{113} See id. at 929.
\item \textsuperscript{114} See id. at 923.
\end{itemize}
circumstance where independence is compromised based on economic considerations.\textsuperscript{115} However, the court insisted that the question of independence should not depend only upon financial interest, but also on “personal or other relationships” committee members had with the defendant directors.\textsuperscript{116} Examining these relationships, the court maintained that the long-standing social and professional ties among the directors were so substantial that they would undermine the ability of the directors on the committee to provide an impartial decision.\textsuperscript{117} Thus, the court concluded that the committee members could not be considered independent.

The \textit{Oracle} court acknowledged that its conclusion was in tension with other decisions that did not focus on social or personal relationships in the independence analysis.\textsuperscript{118} However, the court went on to say that by focusing solely on economic considerations, prior Delaware decisions improperly suggested that courts should not give other considerations any weight. In the court’s view, “Delaware law should not be based on a reductionist view of human nature that simplifies human motivations on the lines of the least sophisticated notions of the law and economics movement.”\textsuperscript{119} \textit{Oracle} therefore is not only a shift, but an open and direct alteration of Delaware’s jurisprudence with regard to director independence.

Similarly, the Delaware chancery court in \textit{Beam v. Martha Stewart}, appeared to recognize that some professional or personal relationships might hinder a director’s independence, especially when the director is called on to impose civil or criminal liability on close friends.\textsuperscript{120} The \textit{Beam} court assessed independence in the context of \textit{Aronson’s} demand futility. In that case, shareholders brought a derivative action against Martha Stewart, claiming that she breached her fiduciary duty by illegal “selling stock and jeopardizing the financial future of Martha Stewart Living Omnimedia, Inc. (“MSO”).\textsuperscript{121} The shareholders further claimed that demand would be futile because close personal and social ties between Stewart and the other directors undermined such directors’ independence. Shareholders pointed out that one director,
Martinez, not only was recruited to the board by Stewart’s longtime personal friend, but also was identified in a magazine article as an “old friend” of Stewart’s. While it ultimately found such allegations insufficient, particularly because they appeared to rest on a single affirmation of friendship, the court did not dismiss them out of hand. Instead, rejecting defendant’s assertion that such ties had no bearing on the issue, the court argued that some personal and professional friendships could raise a reasonable doubt as to a director’s independence. Like the Oracle court, the court in Beam pointedly acknowledged that such an argument was in tension with the weight of Delaware law, which did not give weight to non-monetary factors in the independence analysis. Hence, the fact that the court even considered shareholders’ allegations of personal ties in its independence analysis appears noteworthy.

Moreover, the court gave significant weight to personal ties between Stewart and Moore, another director of the company who was a longstanding friend of Stewart. Shareholders identified the following ties: (a) Moore attended a wedding reception hosted by Stewart’s personal lawyer, (b) a Fortune magazine article described Moore and Stewart as close personal friends, and (c) Moore was nominated to serve on MSO’s board after Stewart’s longtime friend resigned. The court called these allegations “quite a close call” as to the director’s independence. Again, the court’s willingness not only to entertain, but also to give serious weight to these personal relationships reflects a shift in Delaware’s assessment of this issue. Moreover, at least two other Delaware decisions similarly focused on social and personal ties when considering the question of director independence—a focus seemingly out of line with pre-Sarbanes-Oxley opinions involving director independence.

This new focus appears to be prompted by Sarbanes-Oxley and related corporate governance scandals. Indeed, Vice Chancellor Leo Strine not only predicted that Enron and federal reforms would pressure Delaware courts to alter their standards for assessing independence, but also predicted that the pressure would focus on encouraging courts to explicitly consider personal,

122. See id. at 979-80.
123. See id. at 979.
124. See id. at 979 n.60.
125. See id. at 980. See Beam ex rel. Martha Stewart Living Omnimedia, Inc., 833 A.2d at 980.
126. See id.
127. See Telxon Corp. v. Meyerson, 802 A.2d 257, 265 (Del. 2002) (suggesting a personal friendship between chairman and other directors could jeopardize independence); Biondi ex. rel. HealthSouth Corp. v. Scrushy, 820 A.2d 1148, 1165 (Del. Ch. 2003) (long standing social and professional ties impeded committee members independence).
social, and professional relationships.\textsuperscript{128} Echoing this prediction, the \textit{Oracle} court noted, “recent reforms reflect a narrower conception of who [Congress and the stock exchanges] believe can be an independent director.”\textsuperscript{129} A similar impact appears apparent in other states. Indeed, while only a few state decisions cite Sarbanes-Oxley, those that do indicate the importance of that reform to the reassessment of their own corporate governance principles.\textsuperscript{130} This suggests that while Sarbanes-Oxley did not serve as a direct preemption, the threat of such preemption has triggered states to voluntarily alter their governance standards.

2. Signals of Retreat

However, it appears that this preemptive threat might not generate lasting changes. Indeed, almost as soon as Delaware courts revealed a willingness to go beyond traditional criteria for measuring directors’ independence, they quickly retreated. The relative forcefulness of the retreat indicates that any shift in Delaware’s jurisprudence on this issue might have been short-lived. It further suggests the relative weakness of Sarbanes-Oxley’s derivative impact on state law, at least with regard to director independence.

Indeed, even the \textit{Beam} court, while appearing to acknowledge the impact of personal ties on directors’ independence, ultimately insisted that most of those ties should not be given any significant weight in the independence analysis. That opinion clearly admits that close personal friendships could undermine a director’s independence—an admissions at odds with prior Delaware cases. Yet in the very next sentence after that admission, the court noted, “not all friendships, or even most of them” raise a reasonable doubt as to a director’s independence.\textsuperscript{131} The court then cited a New Jersey decision for the proposition that a director’s independence was not compromised by allegations suggesting close friendships, familial or business relationships.\textsuperscript{132} This language, together with the \textit{Beam} court’s ultimate finding that the directors’ relationships at issue did not undermine their independence, suggests a reluctance to give significant weight to personal associations.

\begin{itemize}
\item \textsuperscript{128} \textit{See} Strine, \textit{supra} note 2, at 1382.
\item \textsuperscript{129} \textit{See Oracle}, 824 A.2d at 941 n.62.
\item \textsuperscript{130} \textit{See In re} Wachovia S’holders Litig., 2003 WL 22996328, at *1 (noting that the case arises at a time “when the importance of sound corporate governance to the health of our capital markets is a matter of national concern”); \textit{Atchison Casting Corp.}, 2003 WL 1847665, at *2 n.1 (“In light of current events in the business world, e.g., the problems faced by Enron, MCI WorldCom and many others, it might behoove the Pennsylvania legislature to step in, as the federal government has attempted to do, to find a way to prevent or punish deceitful acts committed by corporations, their officers, employees, and agents”).
\item \textsuperscript{131} \textit{See Beam ex. rel. Martha Stewart Living Omnimedia, Inc.}, 833 A.2d at 979.
\item \textsuperscript{132} \textit{See id.} at 979 n.61 (citing Abrams v. Koether, 766 F. Supp. 237, 256 (D.N.J. 1991)).
\end{itemize}
The Delaware Supreme Court—whose decisions obviously have more authority—goes further, seeming to almost completely discredit reliance on personal or social ties to undermine directors’ independence. The Delaware Supreme Court reviewed the chancery court’s Beam decision.\(^{133}\) That court emphasized that allegations of close business or social ties generally were not enough to negate independence, even if those allegations revealed lifelong friendships.\(^{134}\) The court also noted that personal collegial relationships, whether they arise before board membership or as a result of that membership, would not render directors dependent.\(^{135}\) Turning to the facts of the Beam case, the court specifically adopted that portion of the chancery court’s decisions emphasizing that most personal ties do not undermine a director’s independence.\(^{136}\) Hence, with regard to Martinez, the court stated that allegations that directors move in the same social circles, developed business relationships, and described each other as “friends” were insufficient to rebut the presumption of independence.\(^{137}\) The Delaware Supreme Court then took issue with the chancery court’s characterization of the question of independence as it related to Moore. In contrast to the chancery court, the Delaware Supreme Court insisted that Moore’s close personal relationships with Stewart did not present a close call at all on the matter of her independence.\(^{138}\) Instead, it reflected the kind of bare social relationship that does not undermine a director’s independence.\(^{139}\)

Moreover, the Delaware Supreme Court took great pains to limit the Oracle decision’s assessment of director independence. While not rejecting its focus on non-economic relationships, the Supreme Court insisted that the case involved a different contextual setting than Beam, apparently requiring a different consideration of a director’s independence.\(^{140}\) In the Court’s assessment, Beam involved issues of demand futility under Aronson, pursuant to which shareholders carried the burden of demonstrating the director’s lack of independence.\(^{141}\) In such a context, directors’ independence is presumed, and in the Court’s view, allegations of social or personal relationship could

\(^{133}\) See Beam ex. rel. Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1044 (Del. 2004).
\(^{134}\) See id. at 1051-52.
\(^{135}\) See id. at 1051.
\(^{136}\) See id.
\(^{137}\) See id.
\(^{138}\) See Beam ex. rel. Martha Stewart Living Omnimedia, Inc., 845 A.2d at 1053-54.
\(^{139}\) See id. at 1054.
\(^{140}\) See id. at 1055 (noting that the two context may make the independence query outcome determinative).
\(^{141}\) See id. at 1054.
not be used to rebut that presumption. Oracle, however, involved an analysis under Zapata where shareholders had satisfied Aronson, and hence the burden had shifted to the corporation to prove directors’ independence. According to the Court, this required a “Caesar’s wife-above reproach” where apparently issues of social and personal ties could be considered. In this regard, the Delaware Supreme Court made clear that while considerations of personal or social ties might be justified in the Zapata analysis, they could not be broadly utilized in all contexts.

This distinction does at least recognize that personal relationships will at some point play a role in the independence analysis. However, that point represents a significant limitation. Indeed, shareholders must satisfy Aronson in order to get to the Zapata stage where courts can recognize relationships beyond financial ones. Yet if shareholders cannot comply with Aronson, corporations can dismiss their suit, and hence shareholders might never reach Zapata. This means that if personal or social relationships cannot be used to rebut independence at the Aronson stage, then shareholders might never be able to utilize them, rendering the personal connections that can be considered at the Zapata stage moot. Hence, by making it difficult for shareholders to use personal ties to proceed beyond Aronson, Delaware effectively diminishes the impact of those ties on considerations of independence.

This result appears deliberate. In a subsequent writing, Chief Justice Norman Veasey (who wrote the Delaware Supreme Court’s Beam decision) stated that Beam represented an “answer” to the independence question by holding that friendship and social relations did not standing alone rebut the presumption of independence. In this way, Justice Veasey, speaking for the Court, appears to have abruptly ended any “shift” in the court’s jurisprudence on director independence. This also might have abruptly ended the derivative impact of Sarbanes-Oxley on Delaware law. Other scholars agree that viewed in total, Delaware’s recent decisions “are significant for their reaffirmation of and fidelity to long-standing Delaware precedents. . . .” Chief Justice Veasey underscores this point, arguing that Sarbanes-Oxley only reflects a limited intrusion into Delaware’s corporate regime.

Taken together, this Part II reveals that any concerns that Sarbanes-Oxley reflects a federal preemption of state law appear to be unwarranted. Indeed, while federal reforms might intrude on the traditional authority states have

142. See id.
143. See id. at 1054 (quoting Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981)).
144. See E. Norman Veasey, Musings from the Center of the Corporate Universe, 7 DEL. L. REV. 163, 173 (2004).
146. See Veasey, Musings from the Center of the Corporate Universe, supra note 144, at 174.
over directors, this intrusion is slight because most of the new reforms require composition and independence rules substantially similar to those in existence prior to Sarbanes-Oxley. Moreover, to the extent state law differs from the requirements of these federal reforms, such reforms do not require states to alter their own analysis of director independence. Finally, while Delaware courts initially appeared willing to voluntarily alter their rules to enhance the criteria for director independence (perhaps in response to a threat of preemption), the Delaware Supreme Court’s most recent pronouncement appears to halt those efforts. That Court’s actions indicate that the federal threat of preemption might have proved insufficient to sustain any long-term alteration of state corporate governance rules on director independence.

III. THE RELEVANCE OF SOCIAL TIES TO DIRECTOR INDEPENDENCE

The conclusion in Part II raises the question of whether federal law should preempt state law or otherwise encourage states to consider non-economic ties when assessing director independence. Indeed, it is possible that both Sarbanes-Oxley and Delaware have gotten it right—the law should not presume that social or professional relationships interfere with director independence, or should do so only in extremely limited settings.

This Part assesses the validity of this possibility, and ultimately rejects it. At first glance, the mixed empirical evidence on the impact of director independence on board behavior suggests such independence might not deserve to be a central focus of government reforms. Yet that evidence also suggests that boards cannot be effective until reforms remove or otherwise acknowledge any impediments to that effectiveness. Social ties represent one of those impediments. From this perspective, it seems inadvisable to ignore the overwhelming evidence on the impact of these relationships on directors’ abilities to impartially judge their fellow directors and officers. On the one hand, courts should not ignore the advantages of social cohesion in the boardroom by automatically precluding directors with social ties from being deemed independent. On the other hand, courts need to strike a better balance that gives sufficient, if not undue weight to those ties by affirmatively recognizing them when assessing director independence.

A. The Equivocal Empirical Support

From one perspective, empirical evidence does not appear to support the notion that independent directors improve corporate performance. At best, the evidence on the effectiveness of independent boards is mixed. Numerous studies exist concluding that independent directors have no demonstrably positive impact on corporate effectiveness. Those studies indicate that companies with majority independent boards do not necessarily perform any better
than those with majority insider boards. This is true both with regard to the impact of such boards on discrete tasks like replacing poorly-performing CEOs, monitoring companies in poor financial distress, or controlling financial fraud, as well as on a firm’s overall performance. In addition, a study of nominating, audit, and compensation committees—committees that are now required to be completely independent—found little evidence that total independence on those committees positively effected a company’s performance. Instead, the evidence revealed the opposite, concluding that having inside directors on those committees correlated with improved performance. This evidence suggests that board independence does not have a positive impact on a company’s effectiveness. Such evidence undermines the Act’s presumption that director independence will decrease incidences of corporate misbehavior or otherwise enhance a corporation’s performance.

However, some studies suggest a correlation between independent directors and strong corporate performance. For example, Professor Laura Lin’s comprehensive review of all the empirical evidence on this issue revealed that independent directors can make a difference in some settings. Others go further. In 1998, Professors Ira Millstein and Paul MacAvoy conducted a study of directors that demonstrated a strong connection between board independence and positive corporate performance. Millstein and MacAvoy point out that other studies might have been defective because they concentrated on earlier data where boards were less active, and used single indicators to measure performance. Their study focused on more proactive directors and revealed a statistically significant relationship between board independence and superior corporate performance.

After surveying the empirical evidence on the impact of independent directors, Professors Sanjai Bhagat and Bernard Black suggested that the mixed evidence indicates that independent directors can be effective, but only if impediments to their effectiveness are removed. Others concur that

147. See, e.g., Bhagat & Black, supra note 25, at 931.
148. See id. at 924-26.
149. See id. at 932-33.
150. See id. at 933.
151. See id. at 950 (finding no convincing evidence that increasing board independence improves corporate performance).
152. See April Klein, Firm Performance and Board Committee Structure, 41 J. LAW & ECON. 275, 283 (1998).
153. See id.
154. See Lin, supra note 20, at 922-25, 938.
155. See Millstein & MacAvoy, supra note 75, at 1318.
156. See id. at 1317.
157. See id. at 1318.
158. See Bhagat & Black, supra note 25, at 931.
independent directors' effectiveness might turn on whether one can remove barriers to their abilities to act impartially. Following up on the work of Bhagat and Black, the next section of this Article argues that socials ties represent one of those barriers that needs to be removed.

B. The Evidence on Social Ties that Bind Directors

1. Strong Social Ties

As an initial matter, evidence from the recent corporate governance failures suggests that directors' close personal or social relationships might undermine their ability to rigorously monitor corporate officers and their conduct. Pursuant to the district court's permanent injunction against WorldCom, Richard Breeden wrote a report entitled "Restoring Trust," detailing the results from his extensive investigation of that company's demise and proposing a host of corporate governance changes based on that investigation. The Breeden Report noted that at least 80% of WorldCom's directors probably would have met the new standards for directors independence. Despite such overwhelming independence, the Report found that directors' extensive personal and social ties with CEO Ebbers compromised their seeming independence. The Report pointed out that directors had been associated with Ebbers for years through business or personal dealings. Such long-standing association led directors to rubber stamp management programs that proved disastrous for shareholders. Thus, the Breeden Report concluded that the relatively deferential stance these associations fostered illustrated that "close or extended personal ties between directors and the CEO can lead to just as much trouble for shareholders as lack of financial independence."

Moreover, the Breeden Report insisted that boards could not rely on the recent reforms' standards for independence because they did not account for the impact of these personal ties. Instead, the Report recommended that the WorldCom board implement specific measures aimed at reducing personal connections between directors and management. In this way, corporate governance scandals document the compromising nature of personal ties, that

159. See Brudney, supra note 21.
160. See Breeden, Breeden Report, supra note 40, at 761.
161. See id. at 791.
162. See id.
163. See id. at 817.
164. See id.
165. See id. (recommending that strong personal affiliations with the CEO be a disqualifying characteristic for an independent director).
ties interfere with directors’ ability to independently assess managerial actions and perform their monitoring role with sufficient rigor.

Social science literature on group dynamics confirms that strong social ties among groups might constrain the ability of seemingly independent group members from contradicting one another. That literature reveals that groups with common social and professional affiliations tend to be extremely cohesive, which can undermine their ability to behave independently.166 This literature applies to corporate board behavior.167 Professor Victor Brudney has noted that directors tend to share common business and professional backgrounds and live in the same social and economic milieu as does management.168 As the social science literature suggests, such social ties undermine a director’s ability to impartially assess management and fellow directors.169

Applying this literature to Enron, Professor Marleen O’Connor notes that Enron’s board members had similar social and professional backgrounds and had developed close personal ties.170 Professor O’Connor concludes that the board exhibited a high level of cohesion that fostered conformity while hindering critical reflection and strong scrutiny of board policies.171 Based on her analysis of the social psychology literature, she argues that these barriers are typical of strongly cohesive groups and that such barriers must be removed before board members can serve as effective monitors of corporate behavior.

2. Length of Service

Studies of boardroom behavior and reports of recent corporate governance scandals also indicate that directors who serve for long periods of time develop strong social ties that might inhibit their independence.172 In assessing the problems at Enron, Delaware Vice Chancellor Strine pointed out that intrinsic to the role of an audit committee chair “is a certain amount of distance, and perhaps freshness.”173 However, the chairman of the audit committee of Enron had served in such capacity for sixteen years. In Vice Chancellor Strine’s view, “[a]fter that period of time, it is only human for feelings of collegiality and kinship between the director and management to run rather deep. . . .”174 In this regard, the social affinity the director

167. See id.
168. See Brudney, supra note 21, at 612-13.
169. See id.
170. See O’Connor, supra note 166 at 1263.
171. See id. at 1263-64.
172. See e.g., Breeden, Breeden Report, supra note 40 at 805; Bhagat & Black, supra note 25, at 953.
173. See Strine, supra note 2, at 1391.
174. See id.
developed for management might have hindered his ability to objectively assess their actions, which in turn enabled such managers to engage in improper conduct without significant director interference.

Along these same lines, Professor O’Connor found that Enron board members served exceedingly long terms, fostering a form of cohesion that hindered such directors’ ability to oversee managerial policies.175 Similarly, several directors at WorldCom had served together for extended periods of time, and the social ties they developed as a result of that lengthy service might have eroded their abilities to aggressively challenge management.176 These observations are not unique to the most recent corporate scandals. In fact, based on their study of board behavior, Professors Bhagat and Black confirm that directors who serve for a long time might develop strong social affinities with management that make them ill-suited to independently assess management’s actions.177

3. Boardroom Norms

In addition to these social relationships, studies demonstrate other non-economic factors that inhibit directors’ abilities to critically assess their fellow directors and officers.

For example, after studying directors’ behavior in the boardroom, Professor Jay Lorsch found that boards develop particular norms that limit their willingness to actively and vigorously monitor other directors’ and officers’ behavior.178 The most prevalent of these norms are those that disfavor criticism of the CEO.179 This norm counsels against directors’ intervention in management decisions. Other scholars confirm the existence of boardroom norms that stifle anything but mild criticism of directors or executive officers.180 As one scholar notes, boardroom culture is characterized

175. See O’Connor, supra note 166, at 1246 (noting that many directors served more than 20 years on the Enron board). See also Paredes, supra note 39, at 511 (noting that four Enron directors had served since 1985, and another fifth had served since 1983).

176. See Breeden, Breeden Report, supra note 40, at 805.

177. See Bhagat & Black, supra note 25, at 953 (directors on board for long time may be less energetic).


179. See id. at 91-93.

180. See Bhagat & Black, supra note 25, at 921; Gilson & Kraakman, supra note 25, at 875 (noting that directors who are financially independent still have social ties that prevent them from engaging in effective monitoring); Charles M. Elson, Director Compensation and the Management-Captured Board—The History of a Symptom and Cure, 50 SMU L. REV. 127, 161 (1996) (“It is always tough to challenge a friend, particularly when the challenging party may one day, as an officer of another enterprise, end up in the same position”).
by politeness that too often discourages dissent against directors and management.\textsuperscript{181} Instead, Professors Coffee and Schwartz argue that boardroom norms encourage directors to acquiesce in management decisions.\textsuperscript{182} These observations of boardroom behavior confirm that social dynamics in the boardroom might stifle the ability of directors to critically assess managerial and director action.

4. Director Characteristics

Additionally, because most board members tend to be CEOs or former CEOs, they might overly empathize with the managers they oversee, failing to fulfill their role as impartial watchdogs. According to the most recent Korn/Ferry report, retired executives represent the most prevalent kind of director and their prevalence has increased over the years.\textsuperscript{183} Thus, 95\% of Fortune 1000 companies have such directors, compared to 88\% in 1994.\textsuperscript{184} Then too, 82\% of companies have CEOs or COOs of other companies serving on their boards.\textsuperscript{185} This composition makes it more likely that directors will give broad discretion to management, and less likely that they will intensely scrutinize managerial decisions.\textsuperscript{186} As Professors Ronald Gilson and Reinier Kraakman note, since they are either current or former executives, most independent directors “share management’s ideological disposition toward the single issue most central to their monitoring responsibilities: how intensely outside directors should monitor management.”\textsuperscript{187} In other words, such directors tend to grant managers the unfettered authority they would like to have in managing their own company.\textsuperscript{188} Then too, some executives sit on the boards of companies whose officers serve on boards of companies for whom they work. In fact, one survey of some of the nations leading corporations revealed that several executives serve on one another’s boards.\textsuperscript{189} These cross-directorships further compromise directors’ ability to effectively monitor other officers and directors.\textsuperscript{190} Indeed, such cross-directorships increase

\textsuperscript{181} See Lin, supra note 20, at 915.
\textsuperscript{182} See Coffee & Schwartz, supra note 74, at 283-84.
\textsuperscript{183} See Korn/Ferry Study, supra note 81, at 11.
\textsuperscript{184} See id.
\textsuperscript{185} See id. The trend of having existing directors serve on boards may decline as more companies limit the number of directorships their CEOs can take. See id. at 16.
\textsuperscript{186} See id.
\textsuperscript{187} See Gilson & Kraakman, supra note 25, at 875.
\textsuperscript{188} See Bhagat & Black, supra note 25, at 953; Arch Patton & John C. Baker, Why Won’t Directors Rock the Boat?, 65 HARV. BUS. REV. 10, 10 (Nov.-Dec. 1987) (noting that directors who are CEOs have managerial mindset).
\textsuperscript{189} See Elson, supra note 181, at 159 n.118 (describing study).
\textsuperscript{190} See id. at 158-59.
the likelihood that directors will be deferential to those managers who have the ability to determine the nature of the authority they will receive from boards of their own companies. The NYSE and Nasdaq limit these cross-directorships, but only with regard to the compensation committee. However, such a focus on financial cross-directorships fails to capture the negative impact that arises when directors serve on other committees or boards of the same company.\footnote{191}

Despite the foregoing evidence, the Delaware court now seems disinclined to give any significant weight to the impact of these social ties on directors’ independence. This is demonstrated by the Delaware Supreme Court’s analysis in \textit{Beam}. Moreover, the Court in \textit{Beam} referred to assertions about these non-economic factors as “structural bias” arguments, which “presuppose that the professional and social relationships that naturally develop among members of a board impede independent decision-making.”\footnote{192} In the courts’ view, judges should instead presume that directors’ concern for their business reputation and personal integrity would outweigh what the court termed “personal friendships.”\footnote{193}

One flaw in this view is that it presupposes that directors’ business and personal reputations would be damaged if they made decisions based on their personal friendships. To be sure, the reputations of directors at Enron, WorldCom, and other companies embroiled in the most recent corporate governance scandals suffered as a result of the perceived role in those scandals.\footnote{194} However, the damage to their reputations occurred too late, suggesting that directors’ actions must be relatively severe before their reputations suffer.\footnote{195}

Moreover, the above discussion regarding board dynamics suggests that decisions based upon personal loyalty and those based upon business reputation might not be in tension. In fact, being loyal to management might enhance a director’s business reputation because such loyalty makes one an

\footnote{191}{Even without this ideological bent, directors’ narrow self-interest may encourage them to advocate a very low threshold for dismissal of derivative suits. See Borowski, supra note 22, at 466. Directors who serve as CEOs or in other managerial positions as well as those who hold multiple directorships, may be concerned about being sued in other context and hence have an incentive to set the threshold very low. See id. at 467. Even those who are not executives or who only hold one directorship have such an incentive because they may be concerned about later lawsuits. See id. Delaware courts have refused to give any significant weight to directors’ concerns regarding current or potential lawsuits. See Aronson, 473 A.2d at 812.}

\footnote{192}{See Beam ex. rel. Martha Stewart Living Omnimedia, Inc., 845 A.2d at 1050-51.}

\footnote{193}{See id. at 1052 n.32.}

\footnote{194}{See Lisa M. Fairfax, \textit{Spare the Rod, Spoil the Director?: Revitalizing Director Fiduciary Duty Through Legal Liability}, 42 HOUS. L. REV. 393, 428-29 (2005) (noting damage to Enron board’s reputation).}

\footnote{195}{See id. (noting limits on ability of reputational sanctions to curb director misconduct).}
attractive candidate for board service. Indeed, as one commentator notes, independent directors get most of the benefits of their directorship from being a director.\textsuperscript{196} Thus, directors will behave in a way that makes them attractive as directorial candidates.\textsuperscript{197} Such behavior might include complying with boardroom norms that emphasize cohesion and loyalty over sharp criticism.\textsuperscript{198} In this sense, a director who makes decisions based upon “personal friendship” should not be concerned that the choice will undermine her business reputation because such decisions will most often be consistent with prevailing boardroom norms. This observation weakens the Delaware court’s arguments against considering social ties.

Of course when considering personal or social ties, courts need to strike a balance to ensure that all such ties in the boardroom are not discouraged. Indeed, there are advantages to social ties in the boardroom that should not be overlooked. Boards must have cohesion in order to be effective.\textsuperscript{199} Even the Breeden Report notes that “positive chemistry” among the CEO and board members is very important to a successful company.\textsuperscript{200} Then too, it is somewhat inevitable that board members will have social ties with one another. Indeed, entrée into the board often stems from the professional relationships people have with one another, and hence directors often come to the board with a familiarity and shared background.\textsuperscript{201} Moreover, even if board members do not know each other prior to serving on the board, membership on the board fosters close personal and social ties. Sarbanes-Oxley and other reforms ensure that these ties will be closer than ever because such reforms impose increased responsibilities on boards and committees, ensuring that they work together for longer hours.\textsuperscript{202} This practice necessarily deepens the social and professional bonds between board members. If such bonds jeopardize directors’ independence, then it would be difficult for any board member to be viewed as truly independent. Hence, if courts considered all social ties to pose problems for director independence, then that characterization would be rendered meaningless. Given the critical role independence plays in our corporate governance regime, it certainly seems inadvisable to categorize all social ties as problematic. Instead, a balance needs to be struck that gives such ties adequate, but not undue, weight in the independence analysis.

\textsuperscript{196} See Borowski, supra note 22, at 461.
\textsuperscript{197} See id.
\textsuperscript{198} See id.
\textsuperscript{199} See Strine, supra note 2, at 1378.
\textsuperscript{200} See Breeden, Breeden Report, supra note 40, at 795.
\textsuperscript{201} See Aronson, 473 A.2d at 812.
\textsuperscript{202} Korn/Ferry Study, supra note 82, at 14-15 and 25-26 (noting increased meetings and time commitment caused by Sarbanes-Oxley).
When considering that balance, courts should rely both upon the lessons learned from recent scandals and relevant research on board behavior. This does not entail generating a specific formula. Hence, courts should not create categorical exclusions for directors with personal or social ties because there are advantages to those ties. However, both the scandals and the relevant research on board behavior reveal that there are some general factors involving those ties that should be considered. First, scandals suggest that lengthy service is especially problematic and hence not only should corporations consider limiting board service for their directors, but courts should consider directors’ length of service when assessing their abilities to impartially judge corporate actors. Second, given the structural biases that result from boards dominated by CEOs, corporations should consider altering the mix of directors on their board to include those with other backgrounds, while courts should give some weight to directors’ occupation when determining their independence. Third, courts should give greater weight to the possibility that the natural cohesion among board members and managers, as well as norms against heavy criticism in the boardroom, might jeopardize directors’ ability to assess others’ conduct, particularly when such assessment could have negative repercussions. In that regard, Delaware courts should allow such ties to rebut directors’ independence at the demand futility stage. Indeed, in light of the import of derivative suits in policing directors and officer’s fiduciary responsibilities, as well as the role directors play in terminating shareholders ability to litigate their claims on the merits, it is especially critical that Delaware courts recognize all the impediments, including the social ones, that hinder directors’ complete independence. Hence, the Delaware Supreme Court should not have limited Oracle to the Zapata stage, but should have allowed its analysis of director independence to apply more broadly to all stages of the derivative action.

Then too, at the very least Sarbanes-Oxley and the listing authorities should have specifically required boards to consider unusually strong social ties when assessing a director’s independence. This requirement would have emphasized the significance of those relationships, while sending a strong signal to states that they should consider such relationships in their own independence analysis. Instead, by failing to highlight in any manner the possible negative repercussions of personal and social affiliations, Sarbanes-Oxley and related reforms might have improperly suggested these affiliations should not be a significant component of the director independence question.

This Part III demonstrates that social ties can hinder directors’ abilities to objectively assess officer conduct. Failing to account for these ties, therefore, might hinder directors’ independence and thus their abilities to positively impact corporate performance.
IV. CONCLUSION

Sarbanes-Oxley does not appear to preempt state law's treatment of director independence in any meaningful manner. States have the discretion to determine the qualifications of directors and to assess whether directors should be viewed as independent. Federal reforms now govern these issues, at least with regard to certain committees. However, most of the reforms imposed under the Act mirror state law and corporate governance norms both with respect to increasing director independence and with respect to defining independence in a manner that does not account for social and personal relationships. Even if the reforms are not compatible with state law, neither the Act itself nor the listing agencies require states to adopt their independence rules when assessing directors' independence in the contexts of their own corporate fiduciary decisions. Hence, the Act reflects a limited disturbance of state law.

Then too, while it initially appeared that Sarbanes-Oxley would encourage states to voluntarily alter their own analyses of director independence, Delaware courts have retreated from this position. This retreat is significant because currently there exists no mechanism to ensure that states consider social ties when examining issues of director independence.

The lack of such a mechanism is unfortunate because corporate scandals and relevant empirical data reveal that such ties can compromise director independence. Certainly there are advantages to some such ties and those ties might be an inevitable by-product of board service. However, such ties might hinder critical assessment of management conduct and policies, leading to less than rigorous monitoring by directors. This means that social or personal ties might undermine directors' ability to adequately perform their oversight responsibilities, thereby undermining directors' independence. Because director independence represents the crux of our corporate accountability system, states need to more aggressively consider such ties if they want to ensure the effectiveness of that system. From this perspective, Sarbanes-Oxley's failure to preempt state law on this issue might hinder that Act's ability to realistically reform the corporate governance system.