In this groundbreaking work, Stephen M. Bainbridge and M. Todd Henderson change the conversation about corporate governance by examining the origins, roles, and performance of boards with a simple question in mind: Why does the law require governance to be delivered through individual board members? While tracing the development of boards from quasi-political bodies through the current “monitoring” role, the authors find the reasons for this requirement to be wanting. Instead, they propose that corporations be permitted to hire other business associations – known as “Board Service Providers” or BSPs – to provide governance services. Just as corporations hire law firms, accounting firms, and consulting firms, so too should they be permitted to hire governance firms, a small change that will dramatically increase board accountability and enable governance to be delivered more efficiently. Outsourcing the Board should be read by academics, policymakers, and those within the corporations that will benefit from this change.

Stephen M. Bainbridge is the William D. Warren Distinguished Professor of Law at UCLA School of Law, where he teaches courses in corporate law and governance. Bainbridge has written over a dozen books and a hundred law review articles. He is best known as the originator of the director primacy theory of corporate governance. In 2008, 2011, and 2012, he was named by the National Association of Corporate Directors as one of the hundred most influential people in the field of corporate governance. His blog, ProfessorBainbridge.com, has been named five times by the ABA Journal as one of the Top 100 Law Blogs.

M. Todd Henderson is the Michael J. Marks Professor of Law and Mark Claster Mamolen Research Scholar at the University of Chicago Law School. Henderson researches and teaches in a wide range of fields from corporate law to American Indian law. His work has appeared in leading law reviews and has been covered in publications including The Wall Street Journal and The Economist. Henderson is a frequent commentator in the media and at conferences around the world on topics of corporate governance. He serves as a strategic advisor to several start-up companies.
Outsourcing the Board

HOW BOARD SERVICE PROVIDERS CAN IMPROVE CORPORATE GOVERNANCE

STEPHEN M. BAINBRIDGE
UCLA School of Law

M. TODD HENDERSON
University of Chicago School of Law
In memory of my friend and mentor, Mike Dooley.
Stephen M. Bainbridge, Los Angeles

For Mom & Dad, who gave me everything, and
for Saul Levmore, my intellectual hero.
M. Todd Henderson, Chicago, Illinois
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Preface

Corporations are central to our modern society, and the board of directors is the central node of control of corporate power. In the popular imagination, boards are sinecures for friends of the CEO, and this is certainly true in some cases. But it is also certainly the case that corporate boards perform much better today than when either of us was in law school. Nevertheless, boards are still underperforming. Don’t take our word for it: Directors themselves routinely report that most directors are not up to the task of managing ever-increasingly complex and risky global businesses. Failures abound, both big and small. This should not surprise us. The board is a group of part-timers of loose affiliation who do not work at the company they are hired to manage. And yet the board is the way that shareholders, creditors, employees, and governments regulate the behavior of corporate activity.

We are law professors who study this odd phenomenon – the law leaning so heavily on boards despite their obvious shortcomings. Over the past several decades, we have read countless articles and judicial opinions that criticize boards and propose fixes to improve them. We’ve written a few too. But, while there have been improvements on the margin, large and persistent gaps remain. The world is only getting more complex for corporations, as markets expand and share ownership transitions increasingly to passive investing, and the need to rethink corporate governance is acute.

Undeterred by the failures of reformers of all kinds, including ourselves, we decided to rethink boards at a fundamental level. Instead of proposing a tweak – More independence! Less independence! More diversity! More elections! – we went back to first principles, asking why boards exist at all, why they have persisted for so long despite the shortcomings, and why the law prescribes the way in which corporate governance services are delivered. We were surprised with the answers we came to when we dug into the first
two questions, but it is really the last question – why the law mandates boards look the way they do – that hints at our proposal to remake the corporate board. Unlike other services provided to corporations, like legal, accounting, or strategic consulting, governance or board services must be provided by a group of unaffiliated, sole proprietors. Corporations hire law firms and accounting firms but legally must not hire board service firms. Board members must be individuals.

This book explores those questions and the answers we came up with. It explains why we find the current state of corporate governance woefully lacking in many respects. More importantly, however, it offers both a solution and a roadmap for making the legal and cultural changes necessary to effect that solution. We hope you will come to agree that one major advantage of our proposal vis-à-vis most corporate governance reform proposals is that we do not rely on complicated fixes. Our mantra is simple: Let markets work.

Although this book is intended for corporate governance scholars and policy makers, we hope it is accessible to board members, corporate executives, legislators, judges, and the interested public. It is a book by two academics, but it is not written in high academic style. So, if you’ve got this far, don’t be turned off thinking this is going to be a dry casebook filled with citations and equivocations. We hope this ride through the history, practice, and (hopefully) future of corporate boards is as entertaining as it is informative and thought provoking.¹

¹ We originally proposed the BSP idea in a law review article aimed at an academic audience, Stephen M. Bainbridge & M. Todd Henderson, Boards-R-Us: Reconceptualizing Corporate Boards, 66 Stan. L. Rev. 1051 (2014). This book vastly expands, as well as updates, revises, and repurposes that article so as to reach a general audience.
Acknowledgments

There are too many people to thank, so we won’t try to thank everyone who contributed ideas to this book. The idea originated at a conference hosted by Stephen M. Bainbridge at the Milken Center at the UCLA Law School several years ago, and has been road-tested in various forms with countless colleagues at universities, law firms, business schools, and other venues across the world. We have received valuable contributions from scholars, board members, executives, pundits, and our friends. You know who you are, as do we. We are grateful for your help.