

Characteristics of a Rubber Stamp Board: The Curious Case of Enron

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Abstract

To empirically identify a board as a rubber stamp board, we reason that two conditions must exist. First, the board must have a very high percentage approval voting record, and second, board votes must include one or more proposals that can reasonably be judged as poor decisions on an *ex-ante* basis. Through an in-depth examination of the Enron corporate records between 1997 and 2001, evidence provided by public reports, and a behavioral study we conduct with 94 graduate students, we conclude that Enron operated with a rubber stamp board. We examine characteristics of the Enron Board and its processes and find that a rubber stamp board co-exists with directors who are highly qualified and leaders in their field, routinely challenge management, and are financially incentivized to engage in diligent monitoring. We find that the combination of accomplished directors driven to finish crowded meeting agendas and their lack of healthy skepticism with management provided a perfect storm for rubber stamping. Rubber stamping by the Board was prevalent during times of rising and/or high stock prices, and less so as Enron was collapsing. This highlights the importance of director vigilance during both good and bad times.

Keywords: Corporate governance, board of directors , rubber stamp board, motivated reasoning, gullibility, corporate scandal

JEL Codes: G30, G40, M12

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I. Introduction

The chances are, that if you went up to ten random people in the street and asked them to name a major corporate scandal, many would cite Enron. The Enron case remains prominent in people's minds, even though the company filed for bankruptcy over twenty years ago. The Enron Board of Directors is notoriously viewed and colloquially referred to as a "rubber stamp board," but surprisingly the corporate governance literature fails to provide a definition that allows the empirical identification of a rubber stamp board. Furthermore, there is uncertainty regarding the characteristics surrounding both a board and its processes that make a rubber stamp board more likely. The goal of this work is to begin a conversation. What is a rubber stamp board, how would you reasonably identify a rubber stamp board ex-post, and what director characteristics and board processes co-exist with a rubber stamp board? Looking forward, we also ask, are there processes a board can engage in to reduce the likelihood of rubber stamping? The Enron bankruptcy and public spotlight, including U.S. Senate hearings, provide us with a unique opportunity to look under the hood of the Enron Board and examine these questions.

The Merriam Webster dictionary defines rubber stamp as a "routine endorsement or approval".¹ In the context of a corporate board, this suggests the board consistently and unanimously votes to approve management proposals. As we discuss subsequently, this definition aligns with the existing corporate governance literature. It is important to remember, though, that board processes are such that a vote rarely takes place unless any dissension has already been sorted out before the vote. Hence, even if a Board had a one hundred percent

¹ See <https://www.merriam-webster.com/dictionary/rubber-stamp> (accessed May 15, 2023).

approval voting record, this would not necessarily mean it was a rubber stamp board because the proposals that did not make it to a vote would not be observable. We therefore suggest that to empirically identify a board as a rubber stamp board, two conditions must exist. First, the board had a one hundred or very high percentage approval voting record, and second, the board voted to approve one or more proposals that can reasonably be judged as poor decisions on an *ex-ante* basis.

We examine these two rubber stamp board conditions for the case of Enron. Evaluation of the first condition is straightforward. With access to the Enron Board (hereafter the “Board”) and Committee minutes between 1997 and December 2001, we tabulate the voting record of all directors for all votes recorded.² The second rubber stamp condition is subjective, but we argue that reasonable identification remains possible. To this end, we analyze two closely scrutinized and publicized Board decisions, and reason that on an *ex-ante* basis they were clearly bad decisions. The two decisions, which we later describe in detail, are known as LJM1 and LJM2. Additional support for our contention that it is reasonable to consider the LJM decisions as poor *ex-ante*, is provided by a behavioral study we conducted with graduate students of business, a vast majority of whom believed such decisions are unwise. Furthermore, the Board approved hundreds of decisions that ultimately resulted in the Enron bankruptcy, which again provides support for our view that the Board, even on an *ex-ante* basis, made many important, poor decisions. Thus, we conclude that it is reasonable to classify the Enron Board as a rubber stamp board.

² Herbert S. Winokur, Jr. served on the Enron Board and in 2010 donated his collection of 1997-2002 Enron Board Records to the Hagley Museum and Library available at <https://digital.hagley.org/2487> (Hagley Digital Archives, accessed May 15, 2023). Through courts cases, public records can be found on the Pacer system, case number 06CV3905 Enron Creditors Recovery Corp v St. Paul Fire & Marine Insurance Company, et al.

Why would a board appear to simply rubber stamp the proposals brought forth by management? Since board decisions result from both board processes (e.g., meetings, information flows etc.) and the people on the board (e.g., interactions amongst themselves and with other people such as management), we reason that the answer must stem from factors either to do with “people,” “processes,” or both.

Related to “people,” we examine characteristics of the Board and provide reasons for why they are potentially relevant to rubber stamping. This includes the number of people on the Board and their independence, the qualifications and experience of the outside directors, the level of “busyness,” financial incentives to monitor, interactions with management, and the psychology of the group. For example, a rubber stamp board implies that the directors are followers, rather than leaders. If, as our findings confirm, one hundred percent of the outside directors on the Board had a record of success and were viewed as leaders in their field, this finding would be curious or surprising. An important implication is that even a board of top leaders is not a sufficient shield to protect it from being a rubber stamp board.

Also, curious or surprising is evidence in the minutes that directors routinely asked questions and challenged management at Board and Committee meetings. Nevertheless, as our results indicate, virtually every management proposal was approved without any changes by the Board. Hence, another important implication is that even a board that routinely and vigilantly challenges management with questions is not a sufficient shield to protect it from being a rubber stamp board. One reason for this may be that when board members are gullible, they accept the views of others rather than engaging in healthy skepticism. If the Board pays more attention to the messenger than the message, it may engage in a ceremony of raising numerous questions, but in the end the decision will be approved. We cite evidence that key members of management,

including Kenneth Lay (hereafter “Lay”), Jeffrey Skilling (hereafter “Skilling”), and Andrew Fastow (hereafter “Fastow”) were highly respected as executives, and therefore arguably on a pedestal to the outside directors.³

Also relevant to the psychology of the directors is that humans are social beings who are greatly impacted by the beliefs of others (Gilovich 1991). Due to evolutionary forces, social ties are important to promote survival. Real people, including board members, sometimes favor consensus building over the truth (Baumeister, Maranges, and Vohs 2018). Instead of evaluating all available information in an unbiased manner, people form beliefs that are self-serving, referred to as motivated reasoning (Kunda 1987, 1990). People are motivated to form desirable views of themselves and their in-group when they evaluate information. Accepting the views of others is not necessarily cognitive bias and has adaptive value (Forgas and Baumeister 2019). We argue that if we are to understand how to promote board effectiveness, we must consider the psychology of the group.

As it relates to board processes, we look for clues from the minutes as an indicator of how crowded the meeting agendas were. If, as we conclude, the Enron Board and Committee meeting agendas and materials were excessive given the time allotted, the Board may have placed priority on rushing through decisions to achieve the agenda tasks, rather than giving important decisions their due weight and deliberation. Under this circumstance, approving poor decisions (as evaluated on an ex-ante basis) would not be surprising.

In the following section of this paper, we discuss the relevant literature. Next, we analyze whether we can reasonably conclude that Enron had a rubber stamp board. We then examine

³ During the 1997-2001 period, Lay’s Enron service included Chairman and Chief Executive Officer, Skilling also included Chief Executive Officer and Board member, and Fastow was the Chief Financial Officer.

director characteristics and board processes as potentially relevant to a rubber stamp board. The final section provides a summary and directions for future research.

II. Rubber Stamp Boards and Related Corporate Governance and Psychology Literature

The idea that corporate directors are sometimes accepting and simply rubber stamp the proposals brought forward has received attention by researchers. For example, according to Kemp (2006) a rubber stamp board fails to exert influence in the boardroom. Similarly, Weidenbaum (1986) notes that in such case a board “is merely ceremonial, rubber-stamping the views of management.” The corporate governance and psychology literatures are vast, and here we briefly review existing studies that are arguably related to the identification of a rubber stamp board at Enron.

Corporate Governance Literature and Rubber Stamping

Since rubber stamping is a form of inferior monitoring, we highlight themes in the corporate governance literature that are relevant to the quality of monitoring by the Board. Such themes include director independence, the director nomination process, board ownership, director busyness, and board size.

Director Independence

Both case law and state statutes have long established that directors have a fiduciary duty of loyalty to the corporation.⁴ If directors are rubber-stamping decisions proposed by

⁴ For example, Enron was incorporated in Oregon and as such the directors were subject to the fiduciary duties codified under the Oregon Business Corporation Act. This includes that a director should act in a manner that he “reasonably believes to be in the best interest of the corporation”. See Oregon Business Corporation Act, Title 7, Chapter 60, Section 60.357 General standards for directors. See https://oregon.public.law/statutes/ors_60.357 (accessed October 12, 2023). The Act today is referred to as the Oregon Revised Statutes.

management because their loyalty to management trumps their loyalty to the corporation, then they are not serving in an independent-minded manner. This explains the abundance of rules and regulations on director independence,⁵ as well as a wealth of literature that explores the topic.

In a general sense, many studies examine the impact of director independence on board monitoring, firm performance, or an event. For example, Post-SOX, Chen et al. (2017) document a negative relation between board independence and the disclosure of internal control weaknesses (SOX 404). This negative relationship is strongest for firms with the CEO also serving as chairman (duality). A meta-analysis study by Dalton et al. (1998) suggests the absence of a systematic correlation between director independence and firm performance. Despite calls for dismantling the common wisdom on board (e.g., Johnson et al. 2013) and individual director independence (e.g., Nicholson et al. 2017), some recent studies also profess its benefits. Marra (2021) offers some reconciliation although with idealistic conditions. That is, the effective independent directors are the ones who are non-busy, have accounting expertise, and are appointed by non-controlling shareholders. Independent directors can still improve internal governance by forging internal ties with non-director executives (Hoitash and Mkrtchyan 2022) and can positively influence the inner working of the board (Drymiotes 2021).

Relevant to director independence, Coles, Daniel, and Raveen (2014) define a director as “co-opted” if he or she joins the board after the appointment of the CEO. Their measure of co-option is the fraction of the board appointed after the CEO assumes office. In their study they find that when co-option increases, board monitoring declines.

Chief Executive Officer and the Director Nomination Process

⁵ For example, Section 303A of the New York Stock Exchange listing requirements include that a majority of directors of non-controlled corporation must be independent. See https://www.nyse.com/publicdocs/nyse/regulation/nyse/FAQ_NYSE_Listed_Company_Manual_Section_303A_7_28_2021.pdf (accessed October 12, 2023).

Related to director independence, and hence rubber stamping, is the degree of influence that the CEO has over the director nomination process. Even if a director is legally or technically deemed to be independent, the director nomination process could affect how independent-minded a director may be. A CEO with enough influence over the nomination process may propose a seemingly independent director but with previous ties to the CEO. For example, Fink (2006) notes that at Disney, CEO Michael Eisner nominated directors classified as independent but who, in fact, had close social ties. Because of these relationships, Eisner's decisions were not questioned. Fink (2006) provides another example of adverse consequences of social ties with Hollinger's CEO Conrad Black whose proposals were rubber stamped by a hand-picked board of friends, who often failed to even read the proposals. Wilbanks et al. (2017) extend the perverse influence of CEOs to include the audit committee. The study implies that audit committee members with social and personal ties to a CEO tend to cut back on oversight, fraud risk assessment, and are reluctant to engage in any action that could jeopardize their social ties to the CEO.

The nomination process can also promote loyalty to the CEO even when a director has no former ties to the CEO prior to his or her nomination. For example, as we subsequently discuss, part of the nomination process at Enron was for Lay to be the first person to initiate discussions and form a relationship with a prospective director nominee. In a show of gratitude, these directors may be biased to vote in favor of the CEO. Consistent with this, Zajac and Westphal (1996) report that powerful CEOs aim to maintain control by selecting and retaining directors who behave passively toward managers. In their analysis, passive directors did not assert control over decision making, and instead "rubber-stamped management's decisions" (Zajac and Westphal 1996, p. 511).

The degree of CEO influence on the nomination process is also examined in Clune et al. (2014) who find evidence of a tension for nominating committees who must decide between the desire for “comfort and chemistry” that a new director with ties may have with the board and/or CEO, and the ideal of a director being truly independent with no ties to the CEO. Hence the optimal level of CEO influence over the nomination process is likely at neither end of the spectrum in which the CEO plays no role at all in who joins the board, or conversely, dictates who can join the board.

Board Ownership

If directors on a Board own a great deal of the firm’s stock, they are incentivized to engage in superior monitoring with the goal of improving firm performance. *Ceteris paribus*, they are therefore less likely to engage in rubber stamping. Bhagat and Bolton (2019) find that the dollar value of stock ownership of the median director is the most consistent and positive predictor of future corporate performance, as compared to other governance measures including the percent of independent directors, CEO-chair duality, and the percent of directors on the board who are active CEOs.

Director Busyness

The director busyness hypothesis posits that directors who are too busy will inadequately perform their monitoring duties because they are too time-constrained by other professional duties such as working as a CEO and serving on multiple boards (e.g., Fich and Shivdasani 2006, Tanyi and Smith 2015, Hauser 2018). Relevant to rubber-stamping, a director has a fiduciary duty of care which includes attending board and committee meetings in a prepared manner. If a director is too busy to adequately read and understand the meeting materials, then he or she will

be relatively more uninformed at the meeting and arguably more likely to rubber stamp decisions as the director follows the collective consensus.

Several studies find evidence of a relation between directors who are “too busy” and negative outcomes for shareholders. For example, Tanyi and Smith (2015) find a negative correlation between financial reporting quality and the number of other memberships held by the audit committee chair and the audit committee financial experts. Busyness has an adverse effect on independent directors’ fiduciary responsibility and monitoring roles and leads to significantly higher CEO compensation (Pathan, Wong, Benson 2019). In a similar vein, Moursli (2020) examines the aftermath of the 2005 Swedish regulatory change mandating majority independent boards and found that firms’ compliance resulted in a significantly negative effect on shareholders’ equity. Moursli (2020) relates the negative equity valuation to the busyness of independent directors. In addition, Fich and Shivdasani (2006) report that corporate governance and profitability are weak for firms with busy boards comprised of outside directors who have three or more directorships.

Board Size

A logical framework for board size is that the firm should increase (decrease) its board size when the marginal benefits of the increase (decrease) exceed the marginal costs (Ning, Davidson, and Wang 2010). Resource dependence theory touts the benefits of a larger board because through the capital inherent in directors, they become providers of resources to the firm (e.g., Hilman and Dalziel 2003, McNulty and Pettigrew 1996). In particular, directors bring both relational capital, such as social networks and other ties to external resources, as well as human capital, such as experience, expertise, and reputation. The board capital serves as a provider of resources to the firm, including for example, advice and counsel, access to external resources and

enhanced legitimacy. *Ceteris paribus*, a larger board should therefore improve firm performance (Dalton, Daily, Johnson, and Ellstrand 1999, Gales and Kesner 1994).

A board that is “too large” also comes with costs. Such costs may include a lack of cohesiveness, free-riding, and board member compensation (Dalton et al. 1999). *Ceteris paribus*, a smaller board should therefore improve firm performance (Yermack 1996, Hauser 2018).

Board size is relevant to rubber stamping because it can negatively affect the dynamics in the board room when the costs associated with the larger board exceed the benefits. For example, Cheng (2008) finds that larger boards have lower variability of corporate performance. He reasons that “it takes more compromises for a larger board to reach consensus, and consequently, decisions of larger boards are less extreme, leading to less variable corporate performance.” Jensen (1993) suggests that when “boards get beyond seven or eight people they are less likely to function effectively and are easier for the CEO to control”. Lipton and Lorsch (1992) contend that “when a board has more than ten members, it becomes more difficult for them to express their ideas and opinions in the limited time available. This contributes to the expectation that directors are not supposed to voice their opinions freely and frequently. Dalton, Daily, Johnson, and Ellstrand (1999) point to the literature on “social loafing” or free riding which is more likely to occur as board size increases (e.g., Kidwell and Bennett 1993). This is consistent with social psychologists who report that decision quality falls with increases in group size (McCauley 1998). Yermack (1996) finds that the loss in firm value as a board grows from six to twelve directors is the same as the loss in firm value for a board that grows from twelve to twenty-four directors. In other words, most of the value that is lost occurs when the board grows from small to medium size. However, a board can also be sub-optimally small, for example Yermack finds an increase in Tobin’s Q as the board grows from four to five.

Psychology Literature and Rubber Stamping

Groupthink

O'Connor (2003) concludes that the Enron Board failed to protect stakeholders through a lack of diligence that may have resulted from behavioral influences. She argues that groupthink likely played a significant role.⁶ Groupthink is defined by Janis (1972, p. 9) as “a mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members’ striving for unanimity overrides their motivation to realistically appraise alternative courses of actions.” Janis (1991) outlines eight symptoms of groupthink. An empirical test of groupthink for any firm is difficult, as measurable evidence regarding all eight symptoms is required.⁷ For example, one symptom of groupthink is pressure on dissenters. For Enron, we see no evidence of pressure on dissenters in reading the Board minutes, but it is possible that this pressure existed and was undocumented. Though we cannot dismiss a role for groupthink in understanding the behavior of the Enron Board, there is clear empirical evidence that social forces impinged on boardroom decisions as we describe subsequently. For example, the behavior of Board members is consistent with the view that they were gullible, paying more attention to the messenger, rather than the message.

Motivated Reasoning

Traditional economic theory assumes that decision makers evaluate all available information in an unbiased manner. However, psychologists recognize that real people form beliefs that are self-serving, referred to as motivated reasoning (Kunda 1987, 1990). Put simply,

⁶ See also Sims and Brinkmann (2003) on Enron’s culture and groupthink.

⁷ There is a parallel to groupthink reflected in the analysis provided by Nicholson et al. (2017). Their analysis of board meetings revealed that individuals on the board (including independent directors) switched between support and skepticism depending on the agenda item. At the same time, they displayed consistent behavior at the group level. This tacitly agreed routine builds trust and accountability leading to group-based agreement.

people believe what they want to believe (Gilovich 1991). Because social ties promote survival, people generate and evaluate theories in ways that benefit themselves *and* their in-group. While it is desirable to have an information set that is free of contradictions and matches reality, a group may function better if the members have the same understanding of the world.

Importantly, a “shared reality is not a list or collection of bits of information so much as it is a body of interconnected beliefs, values, assumptions and understandings” (Baumeister, Maranges, and Vohs 2018, p. 45). Members of a group will sacrifice accuracy if such sacrifice enhances group harmony. Information will be withheld from, or selectively shared with, the social group. People sometimes favor consensus building above the truth. As such, they are gullible and tend to view what they are told by others in their group favorably. Accepting the views of others may mean that all information is not considered in an unbiased fashion, which suggests non-optimal behavior in traditional economics. However, people are motivated to evaluate information selectively for self-serving reasons. This behavior has adaptive value and can benefit the individual and group (Forgas and Baumeister 2019).

Motivated reasoning can explain why a board may rubber stamp the proposals of management. Our goal in moving forward, however, is to develop and empirically examine a testable definition of a rubber stamp board. While prior research has discussed the concept of a rubber stamp board, only one study, to our knowledge, has conducted an empirical test related to rubber stamping. Minton, Taillard, and Williamson (2014) consider whether the expertise of independent directors of U.S. banks was associated with risk taking before the 2007-2008 financial crisis. The authors posit that powerful CEOs would hire independent experts to rubber stamp their decisions, and if CEOs sought higher risk, we would observe an increase in the expertise of independent directors along with an increase in risk taking. They proposed four

measures of CEO power, including whether CEO tenure is longer than director tenure, so that the directors are co-opted as described earlier (Coles, Daniel, Raveen 2014). If so, the CEO is believed to be a more powerful force on the board. Minton et al. (2014) conclude that rubber stamping did not play a significant role in understanding risk-taking behavior among banks during the pre-crisis period. While insightful regarding behavior around the financial crisis, Minton et al. (2014) did not seek to empirically identify firms with rubber stamp boards.

In the following section we provide empirical support for the two conditions that classify the Enron Board as a rubber stamp board. First, the Board had a one hundred or very high percentage approval voting record, and second, the Board voted to approve proposals that can reasonably be judged as poor decisions on an ex-ante basis.

III. Did Enron Have a Rubber Stamp Board?

Analysis of Enron and Board and Committee Votes 1997-2001

We analyze the Board operations based on the meeting minutes between January 1997 and Enron's bankruptcy filing on December 1, 2001. The full Board had regularly scheduled meetings five times per year. When necessary, the full Board also had special or ad hoc meetings to conduct business that could not wait until the next regularly scheduled meeting. The Board also operated with an Executive Committee which was a subset of the Board and with some exceptions,⁸ had the same voting authority as the full Board.

Enron's Board also operated with four permanent committees: Compensation, Audit, Finance, and Nominating committees.⁹ These committees met both on a regularly scheduled and

⁸ For example, the Executive Committee could not fire the Chief Executive Officer.

⁹ During our sample period the Compensation, Audit, and Nominating committees changed their names to Compensation and Management Development, Audit and Compliance, and Nominating and Corporate Governance, respectively. In this paper we use the original names.

ad hoc basis with the purpose of delving deeper into specific decisions and monitoring processes, and as mandated by their charter, making vote recommendations to the Board. The Board would therefore vote on decisions both with and without prior Committee deliberations.

Table 1 shows an analysis of Board (regularly scheduled), Special Board (ad hoc), and Executive Committee meetings and votes. During our sample period, there were 24 Board, 49 Special, and 43 Executive Committee meetings. Although regularly scheduled meetings accounted for only about a fifth of the meetings, over half the votes occurred at these meetings. Of the 208 votes cast at the Board meetings, about half had prior consideration by one of the permanent committees.¹⁰

<Insert Table 1 about here>

We classify votes as either passing or being rejected. We designate passing votes as either being with or without exception. A vote that passes without exception is one that is unanimous and without any Board or Committee mandated adjustments to the management proposal. A passing vote labelled as an exception is therefore one that did not pass unanimously and/or included a mandated adjustment by the Board or Committee. We also tabulate delays. We note a delay when there is evidence in the meeting minutes of a discussion on a matter and a vote expected, but the vote does not take place. This could be because a committee wants additional information, and/or they decide not to vote and refer it to the Board for deliberation. A delay is either subsequently passed or not reconsidered. There were no delays that were subsequently voted on and rejected.

As discussed earlier in this paper, we argue that a necessary, but not sufficient, condition for a rubber stamp board is that it has a one hundred or very high percentage approval voting

¹⁰ We do not include votes to approve the minutes or calendar dates in the analysis.

record. Panel A of Table 1 shows that 100%, 99% and 98.9% votes of the Board, Special Board and Executive Committee, respectively, were passed without exception. On an aggregate basis, 99.5% of all votes pass unanimously and without any mandated Board or Committee adjustment to the management proposal. There are only four delay actions, and of these, only two were not reconsidered. We believe that these results reasonably meet the threshold of the first rubber stamp condition entailing a very high percentage approval voting record.

Table 2 shows an analysis of the voting record for the four permanent committees. The Compensation Committee was the most active in terms of number of meetings (46) as well as votes (304). The Finance Committee was also active with the number of its votes (104) and met 25 times. The Audit Committee met about as often as the Finance Committee but had fewer votes (23). Of all the committees, the Nominating Committee had the fewest number of meetings (18) and votes (21).

<Insert Table 2 about here>

Of the 452 combined votes for the four committees, 99.3% passed unanimously and without any modifications. There was only one vote that resulted in a rejection, and this was by the Compensation Committee, representing 0.2% of all votes. Furthermore, there were only five delay actions, of which four were eventually passed and one not reconsidered. In short, it is reasonable to suggest that the high voting approval record without exceptions is indicative of the board committees also meeting the first necessary condition for a rubber stamp board.

Given the rarity of exception votes, rejection votes, and delays, in Table 3 we provide additional detail on each instance. If we believe on a *de facto* basis that a delay that is not reconsidered is equivalent to a rejection (even though a vote does not occur), there is a total of four rejections. One of these occurs in September 1999 when the Executive Committee chooses

not to vote on the “Project Mountaineer” acquisition, while the other three occur within four months of bankruptcy. In Section IV we relate this finding to Enron’s changing circumstances as its stock price plummets and the Board arguably goes into crisis mode.

<Insert Table 3 about here>

Analysis of the LJM1 and LJM2 Decisions

As we argued earlier, to be classified as a rubber stamp board the Board must not only have a high voting approval record, but also have made poor decisions on an ex-ante basis. In this section we provide background on the LJM decisions known as LJM1 and LJM2 and support for our argument that these were poor decisions, ex-ante. More detailed discussion on the LJM decisions can be found in three extensive reports: Batson Report (2003), Powers Report (2002), and U.S. Senate Report (2002).^{11,12}

A board not only has a responsibility to make decisions, but as appropriate, to also monitor such decisions. In judging a decision to be good or bad, it is not possible to decouple the two interdependent board responsibilities. For example, a parent may decide to allow a four-year-old child to ride a bicycle for the first time, which may be a great decision if the parent plans to closely watch the child riding the bike on the back lawn, but a poor decision if the child without monitoring takes the bike out on the street in traffic.

¹¹ LJM1 and LJM2 were approved on June 28, 1999 and October 11, 1999, respectively. The Board also approved LJM3 on October 6, 2000, but per the Powers Report (2002), this entity did not close.

¹² William C. Powers was elected to the Enron Board on October 30, 2001 to become Chair of a Special Committee to review transactions under investigation by the Securities and Exchange Commission. He released his report on February 1, 2002. Available at: <http://i.cnn.net/cnn/2002/LAW/02/02/enron.report/powers.report.pdf> (accessed May 16, 2023). The U.S. Senate released a report on the Enron Board on July 8, 2002. Available at: <https://www.govinfo.gov/content/pkg/CPRT-107SPRT80393/pdf/CPRT-107SPRT80393.pdf> (accessed May 16, 2023). Neal Batson was the court-appointed bankruptcy examiner who released his final report on November 3, 2003. Available at: https://www.concernedshareholders.com/CCS_ENRON_Report.pdf (accessed May 16, 2023). We refer to these as the Powers, Senate, and Batson reports respectively.

LJM1 and LJM2 were off-the-book entities to which Fastow was both the Managing Partner and an equity investor. The entities were designed to include engagement in significant financial transactions with Enron. For example, according to the U.S. Senate Report (2002), “in 1999, LJM1 purchased an interest in the Cuiaba power plant project in Brazil which allowed Enron to move the project off its balance sheet while recognizing certain earnings. In 2001, Enron repurchased LJM’s interest at a much higher price, notwithstanding the project’s having experienced in the interim severe construction problems, cost overruns and legal difficulties.”¹³

As Chief Financial Officer of Enron, and the General Partner of the LJM entities, Fastow was on both sides of the negotiation table when buying from and selling assets to Enron. As such, there was a clear conflict-of-interest and the Board for each LJM decision voted to waive Enron’s “Code of Conduct” policy. Panel A of Table 4 shows an excerpt of the meeting minutes of the Board for the LJM2 decision in which the conflict-of-interest is clearly documented.

<Insert Table 4 about here>

It is reasonable to expect that effective monitoring would have included information on both Fastow’s compensation from the LJM entities as well as processes to ensure arms-length and fair dealing with each LJM-Enron transaction. There were no controls mentioned in the June 28, 1999 minutes for the LJM1 entity. Per the October 11, 1999 Finance Committee minutes, for LJM2 the controls would “include review and approval of all transactions by the Chief Accounting Officer and the Chief Risk Officer of the Company” and the “Audit and Compliance Committee would, on an annual basis, review all transactions completed within the last year and make any recommendations as appropriate”. In other words, the Board approved controls in which management at the same hierarchal level as Fastow would provide oversight over each

¹³ See footnote 113 of the U.S. Senate Report (2002).

transaction, and the Audit Committee would annually receive a report of transactions that presumably would have already occurred.

Given the information that the Board had at the time, it is reasonable to believe that they made poor decisions when they approved LJM1 and LJM2. We acknowledge that judging these decisions as poor on an ex-ante basis is subjective. Although some Board members were not “troubled by the conflicts of interest posed by the LJM partnerships due to the controls” (U.S. Senate Report 2002, see Table 4), we have not found any evidence that suggests LJM1 or LJM2 were good Board decisions. Panel B of Table 4 provides quotes from the Batson Report (2003), Powers Report (2002), and U.S. Senate Report (2002) that support our judgment that the Board made poor decisions on an ex-ante basis when they approved the LJM entities with no or ineffective controls.

Behavioral Study of Conflicts-of-Interest

To explore the judiciousness of our argument that the LJM decisions were easily recognized to be bad decisions, even on an ex-ante basis, we conducted a research study with graduate business students.¹⁴ We gave 94 students working toward a Master of Business Administration a scenario based on the LJM entities and asked them to assume they were members of the board of directors of a large, highly successful publicly traded company in the energy sector. The participants were asked whether they would approve of an LJM-type entity and its accompanying conflict-of-interest without any controls. Eighty-four percent said they would not approve or table the matter, and only sixteen percent approved the decision.

¹⁴ The research is approved by the Institutional Review Board. The complete instructions are included in the Appendix. Of the 94 participants, 49 were asked to provide a written justification to shareholders for their recommendation. Although explicit justification to a known audience has been shown to impact decision making, we found no impact in our setting (Lerner and Tetlock 1999). Thus, we report the decision frequencies collapsed across the two treatments.

Although these participants were asked to assume that they were members of a board, they obviously were not subject to the important social influences that pressure board members in natural settings. Without the motivation to evaluate the scenario as a member of a shared social group, the vast majority clearly recognized the chicanery of the resolution. Participants' open-ended responses reflected a clear understanding of the perils of conflicts-of-interest. For example, one said "I do not agree (ever) with conflicts of interest, regardless of whether or not I respect the individuals involved." Another said "(t)his proposal can quickly lend itself to a slippery slope situation, not to mention it just seems like a way to manipulate the balance sheet." In contrast, many of the responses of participants who approved the resolution seemed to reflect gullibility, even though the social group was assumed. For example, one participant said "I voted to approve the resolution to adopt the vote because the board has rarely rejected any proposals that have been suggested. All of the executives are highly respected and experienced individuals, and there is a huge amount of trust in the integrity & capability of the CFO to carry out the proposal."

In summary, we believe that based on evidence from three different expert reports on the Enron Board, as well as the overwhelming judgment of nearly a hundred graduate students, it is reasonable to classify the LJM Board decisions as poor, even on an ex-ante basis. In addition, we re-emphasize the point that these and other Board decisions ultimately led to the Enron bankruptcy, which is supportive evidence (albeit with ex-post data), of the Board making unwise decisions on an ex-ante basis. When we consider both the high percentage approval voting record with examples of poor ex-ante Board decisions, we conclude it is reasonable to classify Enron as having a rubber stamp board.

IV. Characteristics and Processes of the Enron Board

As we described earlier, a board's operations are the product of its people and processes. In this section we highlight characteristics and processes of the Enron Board that coexist with its rubber stamp designation. We begin with the people on the Board.

The Outside Directors

The Batson Report (2003) lists nineteen outside directors on the Board between 1997 and 2001.¹⁵ Lay and Skilling also served as inside directors. Board size during the period ranged from fifteen to nineteen directors. Per our literature review, we cannot with certainty argue this board is sub-optimally large because there are both costs and benefits to a larger board. However, as a benchmark, Enron's board is larger than the typical board reported in two surveys conducted around the year 2000. A study by the National Association of Corporate Directors (2000) finds that 89% of their public company respondents have boards in the eight to twelve range. The global consulting firm Korn/Ferry International reports that for companies with revenues over \$20 Billion, the average board size is fourteen, and for energy companies it is eleven (Korn/Ferry International 2000). This is relevant to our study because the larger the Board, the more likely that a director may assume understanding of a matter by another director.¹⁶ In addition, per our literature discussion, as Board size increases, directors are more time-constrained to express their views, and the potential for free riding increases. Social psychologists report that decision quality falls with increases in group size (McCauley 1998).

<Insert Table 5 about here>

¹⁵ See Batson Report (2003), Attachment A "Biographies of Outside Directors".

¹⁶ Per the Batson Report (2003, p. 139), several of the outside directors testified that when they did not understand a particular issue, they were not concerned since another director probably did.

Table 5 summarizes the qualifications and backgrounds of the outside directors. The outside directors are on average a highly educated group. In their respective fields, eight, seven, and two directors have earned their doctorate, masters, and bachelor's degrees respectively. Areas of educational expertise and work experience include finance, energy, accounting, engineering, technology, trading, medicine, and banking, among others. Every director without exception has evidence of strong leadership. Thirteen have experience as President or Chief Executive Officer and/or Chairman, and other leadership titles include, for example, Leader of the United Kingdom House of Commons and Dean of the Stanford University School of Business. In short, the outside directors represent a slate of very successful people who are highly educated, are leaders in their respective fields, and have strong records of career achievements. In our view, it is both surprising and interesting that a rubber stamp board co-exists with a group of highly accomplished people who collectively comprise a strong portfolio of qualifications and experience.

It is understandable that such an accomplished group would be in demand for service on other boards. Table 5 indicates that thirteen outside directors have experience on an average of 4.8 for-profit boards (including the Enron Board), and eleven of those sit on three or more boards. Furthermore, the Batson report states that "all the outside directors appear to have been either employed full time or otherwise engaged in activities that required significant commitments in addition to their service to Enron".¹⁷ In short, consistent with the director busyness hypothesis, a contributing factor to rubber stamping may have been the fact that a majority of the Enron outside directors met the three-board "busyness" threshold (Fich et al.

¹⁷ Batson Report (2003, Appendix D, p. 34).

2006), and were too busy outside of the Enron meetings to be adequately prepared to diligently engage during the meetings.

While an outside director is one who, by definition, is not an Enron employee, this does not necessarily mean the director is truly independent.¹⁸ The U.S. Senate Report (2002), for example, cites eight outside directors whose “independence and objectivity had been weakened by financial ties” to Enron. Such ties included consulting and vendor contracts, as well as donations to charities that were affiliated with Enron directors.¹⁹ While it is therefore possible that an outside director may rubber stamp decisions due to loyalty to management, none of the outside directors were found to have violated their fiduciary duties. This, perhaps, is not surprising given that they too lost hundreds of millions of dollars in stock value with the collapse of Enron. Median dollar stock ownership of all the Enron directors at year-end was \$830,765 in 1998, \$837,007 in 1999 and \$1,765, 349 in 2000.²⁰ Per Table 2 of Bhagat et al. (2019), this compares to median director ownership of \$596,847 for firms (2976 observations) on the ISS database between 1998 and 2001. Median stock ownership of the Enron directors is well above the median benchmark per the Bhagat et al. (2019) paper. As we discussed, they find that this measure is the most consistent and positive predictor of future corporate performance as compared to other governance variables including, for example, the percent of independent directors. This suggests that rubber stamping by the Enron Board was not due to a lack of financial incentive.

¹⁸ Per Enron’s Nominating Committee charter, the “Committee will determine the independence of current and prospective Board members prior to recommending a candidate to the Board of Directors” (Hagley Digital Archives).

¹⁹ See U.S. Senate Report (2002, p. 54-56).

²⁰ We obtain Enron director stock ownership from the Thompson Reuters database.

To further complicate the matter, even a director who is classified as independent is not necessarily independent-minded and may therefore be more prone to rubber stamping decisions if the director has a great deal of loyalty to management. The high degree of influence that Lay had on the Nominating Committee certainly impacted the Board's ability to identify and seek out truly independent-minded directors.²¹ During our sample period, the Nominating Committee met eighteen times, and the meeting minutes show that Lay was in attendance seventeen times. The minutes indicate that it was often Lay who would present candidates for the Committee to consider. In addition, he would typically make the initial contact with a prospective director. Per the Batson Report (2003), Lay initiated an invitation to eleven outside directors.²² Hence, even before setting foot in the boardroom, many of the outside directors may have felt beholden to Lay because he personally invited them to join a prestigious Board. A quote from the August 11, 1998 Nominating Committee minutes illustrates both Lay's influence on this Board Committee and his preference to be the initial contact for a new Board member (Hagley Digital Archives).

Mr. Lay led a general discussion concerning director candidates. He reviewed the birthdays of the members of the Board, and he stated that he continued to search for a minority candidate and a candidate who had substantial experience in the financing industry. He reviewed a list of individuals for consideration by the Committee as appropriate director candidates, and he requested Committee assent to the initiation of discussions with one of the individuals. The Committee indicated its agreement to the request. Mr. Lay noted that the firm of Spencer Stuart continued to assist in the director candidate search.

Of the outside directors, twelve were on the Board during the entire 1997-2001 period with an average of eleven years of Enron Board service. Lay served as Chairman and CEO of Enron's predecessor, Houston Natural Gas since 1984 and therefore had significant history with

²¹ See, for example, Clune et al. (2014).

²² See Batson Report (2003), Attachment A "Biographies of Outside Directors".

the directors.²³ This history can be measured through the co-option variable as introduced by Coles et al. (2014) who find that when co-option increases, board monitoring declines. As shown in Table 5, of the nineteen outside directors on the Enron board, twelve directors, a majority, are co-opted, having joined the Board after 1984. It is therefore not surprising, as the U.S. Senate Report (2002) indicates, that “several had close personal relationships with Board Chairman and Chief Executive Officer (CEO) Kenneth L. Lay. All indicated they possessed great respect for senior Enron officers, trusting the integrity and competence of Mr. Lay; President and Chief Operating Officer (and later CEO) Jeffrey K. Skilling; Chief Financial Officer Andrew S. Fastow; Chief Accounting Officer Richard A. Causey; Chief Risk Officer Richard Buy; and the Treasurer Jeffrey McMahon and later Ben Glisan.”²⁴ While great respect for management is generally a desirable circumstance for a director, as we discuss in more detail subsequently, the risk is that directors do not fulfill their decision-making and oversight responsibilities with healthy skepticism because they pay more attention to the highly respected messenger rather than the message.

Enron Board Processes

To understand the factors related to rubber stamping in the boardroom, we examine some of the processes around the Board meetings. The Board meeting minutes provide us with an opportunity to analyze how crowded the meetings were. If the directors were overwhelmed with the volume of agenda topics, meeting materials, necessary votes, resolutions, and so forth, given the limited amount of Board meeting time, it would not be surprising if such crowding coexisted with a rubber stamp board. This analysis complements Healey and Palepu (2003) who note that

²³ Per the Batson report (2003, Appendix D, p. 11), in 1984 Lay joined Houston Natural Gas (HNG) as its Chairman and CEO. Enron was formed in May 1985, when InterNorth Inc. merged with HNG. The merged entity changed its name to Enron in 1985.

²⁴ See U.S. Senate Report (2002, p. 8).

the outside directors on Enron's audit committee relied heavily on information provided by managers, as well as internal and external auditors. If managers or auditors provided the committee with excessive or ineffectively communicated information, it would have been difficult for them to uncover problems particularly with the documented, significant demands on their time.

<Insert Table 6 about here>

Table 6 includes information on the twenty-four regularly scheduled board meetings during the 1997-2001 period. The Board met five times per year over the course of one or two days with a total average meeting time of five hours. An evaluation of whether the Board meetings were crowded is subjective. Nevertheless, we provide a sense of both the quantity and complexity of activities that occurred in the Enron boardroom.

Boardroom activities are highlighted in the meeting minutes which include a description of Committee reports, presentations, discussions, votes, resolutions, attendees, and processes such as executive sessions. Board meetings would typically begin with the approval of minutes followed by Committee reports and management presentations. Executive sessions in which all non-directors left the room were generally held at the end of the meeting, but as directors, Lay and Skilling were part of these sessions. Hence there is no record that the outside directors would meet outside the presence of management.

The meeting minutes were on average twenty-seven pages (single spaced), which means that six pages per meeting hour were needed to document Enron's boardroom activities. To provide a glimpse of the complexity documented in the minutes, the quote below is from the August 11, 1997 Board meeting minutes and represents about a quarter of a page. This is an

example of a vote that went directly to the Board and did not initially go through committee vetting (Hagley Digital Archives).

Ms. Mark next described the East Java power project which is owned 50.1 % by EI (or its affiliate). She stated that the facility was a 500-megawatt combined cycle, gas fired plant. She reviewed the financing structure and the economics of the project. She recommended that the Board approve in respect of the project an equity investment of \$68 million. the assumption of 50% of \$7 .5 million performance bonds, a corporate performance guaranty for the \$330 million turn-key construction contract, and standby equity in the amount of \$26,437 million for cost overruns. Following discussion, upon motion duly made by Mr. Foy, seconded by Mr. Winokur, and carried, the following resolutions were approved:

Five resolutions followed the East Java power plant vote described here. For a Board vote, if it were a simple matter, there may not be an accompanying set of resolutions, but in general it is fair to say that as the issue became more complex, a vote would be accompanied by a longer list of resolutions. Panel B in Table 6 shows an average of about nine votes and fifty-two resolutions per meeting. This translates into the Board being time-constrained to a median of 36 minutes per vote and 6 minutes per resolution.

An additional voting process was practiced when committees, primarily the Finance and Compensation committees, had recommendations that required a Board vote. Instead of voting on each committee recommendation separately, the committee may have a list of recommendations that the Board would vote on with one motion that was accompanied by a list of resolutions. In Table 1, we refer to these as blanket votes, which represent about 40% of the Board votes that initially went through committee consideration. Although according to the Oregon State Statutes, a director has the legal right to rely on its committees unless she has reason to believe otherwise,²⁵ this does not give license to rubber-stamp the committee

²⁵ See Oregon Business Corporation Act, Title 7, Chapter 60, Section 60.357 General standards for directors. https://oregon.public.law/statutes/ors_60.357 (accessed May 17, 2023). This section includes the clause related to a director reliance on a board committee.

recommendations. While a blanket vote format is more time-efficient, it is arguably not conducive to promoting boardroom discussion on the individual issues listed by the Committee. An excerpt of the December 14, 1999 Board minutes is shown below in which the Finance Committee Chair is seeking a single blanket board vote on eight different issues entailing 38 resolutions (Hagley Digital Archives).

He stated that the Finance Committee had approved the following items for recommendation to the Board: 1) a revision to the Company's Cash Management Policy, 2) an Enron Caribbean/Middle East project that would require an initial investment of \$30 million to develop a three Bcf/day gas pipeline system from Qatar through UAE to Oman in partnership with the UAE government and Elf Aquitaine, 3) a proposal for three business units of the Company to purchase a combined total of 38 turbines for a total cost of \$919 million, 4) a project proposed by ENA to acquire up to 60 Bcfe of gas, over a five-year period, for up to \$117 million, by entering into a prepaid agreement with a special purpose entity of EEX Corp., a Houston-based independent oil and gas company, 5) proposed revisions to the Enron Corp. Risk Management Policy, primarily relating to changes in the position limits in Europe, that had been discussed in the Joint Audit and Compliance and Finance Committee meeting, 6) a proposed subsidiary preferred stock financing, 7) a proposed sale of a portion of the Company's interest in Empresa de Generacion Electrica Bahia Las Minas, S.A. in Panama, and 8) a proposed contract extension with Eastern Power & Energy Trading Ltd. He moved approval of the revisions to the Enron Corp. Risk Management Policy and the other proposals discussed, his motion was duly seconded by Mr. Urquhart, and carried, and the following resolutions were approved:

Thirteen single-spaced pages of minutes describe the thirty-eight resolutions that followed the Board vote described above.

The Batson Report (2003), as cited below, also provides evidence on how overwhelming the Board meetings could be.

This criticism is not meant to imply that there was not any information being supplied to the Board. In fact, in some circumstances it appears that there was so much information presented that it inhibited any meaningful discussion.²⁶

In addition, the length of Board and committee meetings, given the complexity and the number of agenda items covered, raises questions of whether sufficient time was devoted to allowing the Outside Directors to understand the transactions.²⁷

²⁶ Batson Report (2003, p. 127).

²⁷ Batson Report (2003, p. 133).

Because people are time constrained to search out relevant information, they will often resort to heuristics or rules of thumb. They sometimes fall prey to Acceptance Bias, a well-documented tendency to accept rather than reject a hypothesis (Forgas and Baumeister 2019). Trusting has adaptive value so when a person is overloaded with information or has time pressure, gullibility is likely to result. It is easy to overlook information that is not sought after. When looking for cues that support a view, negative information, and even bright red flags, can be passed over.

As packed as the board meetings were, interestingly, there is evidence that the directors routinely asked questions. Table 6 shows that the minutes specifically document questions by the directors for over 80% of the meetings, which likely means they asked questions and challenged management at every board meeting. Some examples from the Board minutes follow (Hagley Digital Archives):

Mr. Skilling illustrated regulated versus non-regulated earnings and individual operating group earnings for the period 1992 estimated through 1998. He also reviewed operating results in developed versus emerging countries for the same period. He discussed the Company's debt-to-total capital and debt-to-total obligations ratios estimated for year-end 1998. He reviewed current status and future opportunities for each of the Company's core businesses and for its other businesses, such as telecommunications, water, EOTT Energy Corp., renewable energy and methanol/MTBE. He addressed key concerns and unexpected strengths. and explained acquisition strategies that could have a significant impact on the Company's future direction. A copy of Mr. Skilling's report is filed with the records of the meeting.

Following Mr. Skilling's presentation, Mr. Lay opened the meeting to discussion during which he and Mr. Skilling responded to Director questions and an extended discussion ensued.

Messrs. Rice and Skilling joined Mr. Hirko in answering questions from the Board regarding key competitors, dependency on physical assets, and the anticipated market in three to five years.

Mr. Rice then discussed the IS segment and commented on the number of transactions and new customers over the last five quarters. Mr. Skilling joined him in answering questions from the Board and discussing competitors, the similarities between the

broadband and gas markets, and the timing of the growth in EBS's markets and customers.

In short, this is counterintuitive evidence that a rubber stamp board coexists in an environment in which the directors challenge management and routinely ask questions.

Table 6 also shows the closing stock price when the Board met. As late as the February 2001 meeting the stock price was \$81.15 per share, still at a respectable level relative to Enron's all-time high of \$90.75 per share on August 23, 2000. By the October 8, 2001, meeting, the stock price tumbled to \$33.39 per share with bad news that was unique to Enron such as the Skilling resignation at the August meeting. The October Board meeting is somewhat of an outlier in that it is one of the longest meetings with only two votes and two resolutions. Furthermore, that same month there were six Special Board meetings to follow as Enron faced an informal inquiry by the Securities and Exchange Commission, and Fastow was placed on a leave of absence. The Board was arguably in crisis mode. From Table 3 we note that of the four rejections/delays without reconsideration, three occurred within four months of bankruptcy. The implication is that while the rejections are still very few, the Board appears more likely to be in a rubber stamp mode during times of rising stock prices, and vice versa for falling stock prices. Yet, many of the poor decisions that ultimately resulted in the Enron bankruptcy likely occurred when the stock price was rising. This highlights the importance of a board being vigilant during good times, because if it waits until times are bad, it is too late.

V. Summary and Concluding Remarks

The importance of corporate governance is not only indicated through a plethora of academic literature, but tangible evidence is found by investors who pay for governance data, policymakers who regulate improvements in corporate governance, and governance watchdogs

such as pension funds, activist investors, and the media who expend resources to track firm-specific corporate governance structures and resources. Furthermore, there is no shortage of companies that have ended in the corporate graveyard due to poor governance. In the case of Enron, thousands of innocent people were hurt with its collapse through lost jobs, lost vendor and customer contracts, and the evaporation of retirement and other savings accounts among other things. While there is no guarantee that stronger governance would have prevented the Enron disaster, it is reasonable to argue that a more engaged board may have prevented the Enron demise. We therefore believe our paper is an important analysis with significant implications that contribute to the lessons learned from the Enron case.

Our key findings, or areas of “curiosity” include that a rubber stamp board can co-exist with a board comprised of highly qualified leaders in their field, who are vigilant in challenging management, and who through significant stock ownership are financially incentivized to monitor. While the size of the board at Enron was arguably too large and the directors were busy outside of the board meetings, the combination of accomplished directors who are presumably driven to “get it done,” their lack of healthy skepticism with management, and the crowded agenda of decisions needing votes, was all a perfect storm or recipe for rubber stamping. An additional important lesson includes the timing of rubber stamping. In the case of Enron, it was prevalent during times of rising and/or high stock prices, and less so as Enron was collapsing. However, the decisions that arguably led to Enron’s demise were during the “good times,” which highlights the importance of director vigilance at all times.

Future research might examine practical methods to prevent a board from serving in a rubber stamp capacity. In the case of Enron, it was the responsibility of the Board to ensure processes resulting in quality information to avoid the crowded agendas. This includes

information that is credible, timely, relevant, and effectively communicated. What distinguishes boards that succeed in ensuring they receive quality information for making decisions?

With respect to healthy skepticism, is it possible that greater awareness of this major corporate governance pitfall could help avoid it? Could this be achieved through education at business schools, corporations, seminars, roundtables, and mentorship programs? A person with healthy skepticism will ask “why do I have to accept this?” instead of “can I accept this?” Asking “must I?” instead of “can I” will nudge toward skepticism, and away from gullibility (Dawson, Gilovich, Regan 2002). Mayo (2019) argues that a skeptical mindset can be encouraged by contextual cues and individual dispositions. A skeptical mindset starts with distrust, which can be triggered by a cue (e.g., John is not trustworthy) or personal tendency (e.g., I am, as a rule, a distrusting person). A gullible person’s default is acceptance, whereas a skeptical person begins at rejection. Mayo argues that even a person with a gullible mindset can use negation as the primary process if the person has a model in mind that supports rejection and approaches a decision ready to reject, *before* receiving information. As Mayo puts it, we can avoid being gullible when “we know better.”

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Table 1: Enron Board Votes, 1997-2001

Regularly scheduled and ad hoc meetings of the full Enron Board are designated as “Board” and “Special Board,” respectively. The Executive Committee is a subset of the Board that votes on matters with the same authority as the full Board. Votes are between January 1997 and the date of the bankruptcy filing, December 1, 2001. Approving meeting minutes and calendar items are not included in the vote counts. An “exception” is a vote that is either passed non-unanimously, and/or passed with a Board/Committee mandated adjustment. A delay occurs when there is evidence in the meeting minutes that a discussion on the matter first occurs with a vote expected, but the vote does not take place. The delay either results in the vote not being reconsidered or is ultimately passed at the full Board or Executive Committee level. Table 3 provides additional details on delayed and “exception” votes. Board votes include those that are first vetted by the Audit, Compensation, Finance, or Nominating Committee, and those that go straight to the Board. “Blanket” (“non-blanket”) votes are when a committee recommends approval of multiple (single) decisions voted on at the committee level, that are voted on by a single Board vote.

		Board	Special Board	Executive Committee	Total
Number of Meetings:		24	49	43	116
(%)		(21%)	(42%)	(37%)	
Panel A: Board Votes and Delays					
Votes:	Total	208	96	92	396
	(%)	(53%)	(24%)	(23%)	
	Passed without exceptions (%)	208	95	91	394
		(100%)	(99.0%)	(98.9%)	(99.5%)
	Passed with exceptions (%)	0	1	1	2
		(0%)	(1.0%)	(1.1%)	(0.5%)
	Rejections (%)	0	0	0	0
		(0%)	(0%)	(0%)	(0%)
Delays:	Eventually passed	0	0	2	2
	Not reconsidered	0	1	1	2
Panel B: Board Votes with Committee Consideration					
Total		97	8	0	105
(% Panel A Total Votes)		(46.6%)	(8.3%)	(0%)	(26.5%)
Non-Blanket Votes		59	6	N/A	65
(% Panel B Total Votes)		(60.8%)	(75.0%)		(61.9%)
Blanket Votes		38	2	N/A	40
(% Panel B Total Votes)		(39.2%)	(25.0%)		(38.1%)
Panel C: Board Votes without Committee Consideration					
Total		111	88	92	291
(% Panel A Total Votes)		(53.4%)	(91.7%)	(100%)	(73.5%)

Table 2: Enron Committee Votes, 1997-2001

Excluding the Executive Committee, Enron operated with four permanent Board Committees: Compensation, Audit, Finance, and Nominating. Votes are between 1997 and the date of the bankruptcy filing, December 1, 2001. Approval of meeting minutes and calendar items are not included in the vote counts. An exception is a vote that is either passed non-unanimously and/or passed with a committee mandated adjustment. A delay is where there is evidence per the meeting minutes that a discussion on the matter first occurs with a vote expected, but the vote does not take place. The delay either results in the vote not being reconsidered or is ultimately passed at the full Board or Executive Committee level. Table 3 provides additional details on delayed and exception votes.

		Compensation	Audit	Finance	Nominating	Total
Number of Meetings:		46	28	25	18	117
Votes:	Total	304	23	104	21	452
	Passed without exceptions (%)	302 (99.3%)	23 (100%)	103 (99.0%)	21 (100%)	449 (99.3%)
	Passed with exceptions (%)	1 (0.3%)	0 (0.0%)	1 (1.0%)	0 (0.0%)	2 (0.4%)
	Rejections (%)	1 (0.3%)	0 (0%)	0 (0%)	0 (0%)	1 (0.2%)
Delays:	Eventually passed	1	0	3	0	4
	Not reconsidered	1	0	0	0	1

Table 3: Rejection Votes, Exception Votes, and Delays			
An exception is a vote that is either passed non-unanimously or passed with a Board/Committee mandated adjustment. A delay is where there is evidence per the meeting minutes that a discussion on the matter first occurs with a vote expected, but the vote does not take place. The delay either results in the vote not being reconsidered or is ultimately passed at the full Board or Executive Committee level.			
Date	Meeting Type	Exception	Comment
Aug 10, 1997	Finance Committee	Delayed. Ultimately passed.	Finance Committee requests analysis prior to approval of stock repurchase program. On August 21, 1997 the Executive Committee approves the stock repurchase program with knowledge of the Finance Committee's request, but without the analysis in advance of the vote.
Jun 12, 1998	Executive Committee	Delayed and adjustment. Ultimately passed.	Management requests amendment to Risk Management Policy to increase Global Liquids limits. Committee grants temporary amendment until full Board can vote. Full Board votes on June 22, 1998 at a special meeting and approves amendment
Jun 12, 1998	Executive Committee	Delayed and adjustment. Ultimately passed.	Management recommends resetting the amount of funds available to the Office of the Chairman for capital expenditures back to \$75 million. Executive Committee votes to allow temporary authority to exceed the existing limit of the pool of funds available until the full Board can vote. Full Board votes on June 22, 1998 at a special meeting and approves resetting the available funds back to \$75 million.
Jul 21, 1998	Special Board	Adjustment and passed. Not unanimous.	Management seeks to give Office of the Chairman authority to acquire Wessex, even if on a hostile basis. Directors delete authority for a hostile takeover. Vote passes with two no votes and one abstention.
Aug 10, 1998	Finance Committee	Delayed. Ultimately passed.	Management proposes issuing Enron stock as financing for Enron Energy Services Inc. to make two acquisitions. Without a vote, Finance Committee suggests the acquisitions be presented directly to the Board. Board approves the acquisitions at the August 10/11 meetings.
Aug 10, 1998	Finance Committee	Delayed without committee recommendation.	Management proposes acquisition of Koch Industries assets. Committee consensus without a vote is that the matter be taken to

		Ultimately passed.	the Board without the recommendation of the Committee. Board approves the acquisitions at the August 10/11 meetings.
Aug 10, 1998	Compensation Committee	Passed with adjustment.	Management proposes amendment to Phantom Stock Plan. Committee approves subject to removing the words “in his sole discretion”, following any reference to the President in the amendments.
Jan 25, 1999	Compensation Committee	Delayed and adjustment. Ultimately passed.	Management recommended modifications to the Enron Capital and Trade Resources Long-Term Compensation Plan. Revisions proposed by the Committee and vote postponed until the next meeting. It is approved at the next Compensation Committee meeting on February 7, 1999.
Jun 7, 1999	Executive Committee	Passed with one abstention.	Acquisition of “Blue Range”.
Sep 14, 1999	Executive Committee	Delayed and not reconsidered.	Committee has concerns and wants additional information before it can consider “Project Mountaineer” acquisition. Management does not resubmit.
Feb 12, 2001	Finance Committee	Passed with adjustment.	Management proposes six changes to the Risk Management Policy. Committee approves four and rejects two changes.
Aug 13, 2001	Compensation Committee	Rejected unanimously.	Management proposes accelerating the annual equity grant to certain employees.
Sep 14, 2001	Compensation Committee	Delayed and not reconsidered.	Management proposes potential modification to Fastow’s employment agreement. Committee agrees to future consideration with more information. Matter is not reconsidered as on October 24, 2001 the Board votes to replace Fastow and place him on a leave of absence.
Oct 9, 2001	Special Board	Delayed and not reconsidered.	Acquisition of Georgia Pacific’s Leaf River Pulp Mill. September 25, 2001 the Executive Committee defers approval until consideration by the Finance Committee and full Board. Finance Committee does not subsequently review it. October 9, 2001 the Special Board reviews it and proposes a delay. Matter is not reconsidered.

Table 4: LJM Decisions	
The Board unanimously approved what are known as LJM1 and LJM2 on June 28 and October 11, 1999, respectively. Panel A is an excerpt from the meeting minutes for LJM2. Panel B provides quotes from the U.S. Senate (2002), Powers (2002), and Batson (2003) reports, respectively.	
Panel A: Enron Board Meeting Minutes Excerpt for LJM2, October 11, 1999	
WHEREAS, Andrew S. Fastow serves as the Executive Vice President and Chief Financial Officer of the Company [Enron];	
WHEREAS, Mr. Fastow has the opportunity to participate in the formation of an investment partnership (the “Partnership”) that would not be affiliated with the Company;	
WHEREAS, it is anticipated that Mr. Fastow will serve as the managing partner/manager of the Partnership;	
WHEREAS, it is anticipated that the Partnership will invest in energy and communications-related businesses and assets. including businesses and assets of the Company;	
WHEREAS, the Partnership, as a potential ready purchaser of the Company’s businesses and assets or as a potential contract counterparty, could provide liquidity, risk management, and other financial benefits to the Company;	
WHEREAS, the Office of the Chairman of the Company has determined, for the foregoing reasons, that Mr. Fastow’s participation as the managing partner/manager of the Partnership will not adversely affect the interests of the Company;	
NOW, THEREFORE IT IS RESOLVED, that the Board hereby adopts and ratifies the determination by the Office of the Chairman pursuant to the Company’s Conduct of Business Affairs/Investments and Outside Business Interests of Officers and Employees that participation of Mr. Fastow as the managing partner/manager of the Partnership will not adversely affect the interests of the Company;	
Source	Panel B: Excerpts from the Senate, Powers, and Batson Reports
U.S. Senate Report pg. 24	Finding (3): Despite clear conflicts of interest, the Enron Board of Directors approved an unprecedented arrangement allowing Enron’s Chief Financial Officer to establish and operate the LJM private equity funds which transacted business with Enron and profited at Enron’s expense. The Board exercised inadequate oversight of LJM transaction and compensation controls and failed to protect Enron shareholders from unfair dealing.
U.S. Senate Report pg. 25 - 26	Benjamin Neuhausen, a member of Andersen’s Professional Standard Group, wrote in a 5/28/99 email to David Duncan: “Setting aside the accounting, idea of a venture entity managed by CFO is terrible from a business point of view. Conflicts galore. Why would any director in his or her right mind ever approve such a scheme?” Mr. Duncan responded in a 6/1/99 email as follows:

	“[O]n your point 1 (i.e., the whole thing is a bad idea), I really couldn’t agree more. Rest assured that I have already communicated and it has been agreed to by Andy that CEO, General [Counsel], and Board discussion and approval will be a requirement, on our part, for acceptance of a venture similar to what we have been discussing.”
U.S. Senate Report pg. 29	At the Subcommittee hearing on May 7, all three of the expert witnesses expressed surprise and dismay that the Enron Board had approved the LJM arrangement in light of the clear conflicts of interest. The arrangement essentially permitted Enron’s top financial control officer – an individual with personal knowledge of Enron’s assets, liabilities and profit margins – to set up his own company and sit on both sides of the table in negotiations between his business and his employer. The expert witnesses could not recall a similar situation at any other publicly traded company; nor could any Board member identify a precedent for the Board’s decision.
U.S. Senate Report pg. 38	While the evidence seems to bear out the claims that the Board did not have complete information about LJM’s owners, employees, transactions and profits, the facts also establish that the Board members were given ample information about the conflicts of interest underlying the LJM partnerships, the many related party transactions that went on between LJM and Enron, and the huge amounts of money flowing through the LJM structures. The information it had should have triggered a demand for more detailed information and, ultimately, a change in course. But the Board allowed the LJM-Enron transactions to go forward with few questions asked. All of the consequences that followed, including the Raptor debacle, flowed from the initial Board decision to allow the LJM partnerships.
U.S. Senate Report pg. 29	Most of the interviewed Board members said they had not been troubled by the conflicts of interest posed by the LJM partnerships due to the controls adopted to mitigate the conflicts. But the evidence indicates that these controls were poorly designed and implemented, and the Board itself paid insufficient attention to the LJM partnerships. The original LJM1 presentation in June 1999 did not specify any controls.
Powers Report pg. 23	The Board substantially underestimated the severity of the conflict and overestimated the degree to which management controls and procedures could contain the problem. After having authorized a conflict of interest creating as much risk as this one, the Board had an obligation to give careful attention to the transactions that followed. It failed to do this. It cannot be faulted for the various instances in which it was apparently denied important information concerning certain of the transactions in question. However, it can and should be faulted for failing to demand more information, and for failing to probe and understand the information that did come to it.
Powers Report pg. 23	As complex as the transactions were, the existence of Fastow's conflict of interest demanded that the Board gain a better understanding of the LJM transactions

	that came before it, and ensure (whether through one of its Committees or through use of outside consultants) that they were fair to Enron.
Powers Report pg. 151	When it approved LJM 1, the Board does not appear to have considered the need to set up a procedure to obtain detailed information about Fastow's compensation from or financial interest in the transactions. This information should have been necessary to ensure that Fastow would not benefit from changes in the value of Enron stock, as Fastow had promised. Even though the Board was informed that "LJM may negotiate with the Company regarding the purchase of additional assets in the Merchant Portfolio," it did not consider the need for safeguards that would protect Enron in transactions between Enron and LJM 1.
Powers Report pg. 156	At bottom, however, the need for such an extensive set of controls said something fundamental about the wisdom of permitting the CFO to take on this conflict of interest. The two members of the Special Committee participating in this review of the Board's actions believe that a conflict of this significance that could be managed only through so many controls and procedures should not have been approved in the first place.
Batson Report App. D. pg. 51-52	The Board heard a presentation about the Rhythms transaction, and approved the necessary components relating to the use of Enron stock, on June 28, 1999 at a specially called meeting. The Board also ratified a determination by Enron's Office of the Chairman (meaning Lay and Skilling) under the company's Code of Ethics that Fastow's role as general partner of LJMI would "not adversely affect the interests of the Company." The following discussion describes the information presented to the Board, which included facts about the transaction from which the Outside Directors could reasonably have determined that the hedge was non-economic and had no rational business purpose. If, as several of the Outside Directors testified, they did not in fact understand the transaction, it may have been the result of a meeting process, also described below, that did not allow them to consider carefully all material information reasonably available.
Batson Report App. D. pg. 57	The Board authorized Fastow's involvement in LJMI, however, without requiring any controls be implemented to ensure that Enron's transactions with LJMI would be fair to Enron. Also, there is no evidence that the Board discussed how Fastow's compensation from LJMI would be monitored to ensure that it would not adversely affect his performance for and loyalty to Enron.

Table 5: Enron Outside Directors, 1997-2001

Information is obtained from the Batson Report (2003, Appendix D). In 1984 Lay joined Houston Natural Gas (HNG) as its Chairman and CEO. Enron was formed in May 1985, when InterNorth Inc. merged with HNG. The merged entity changed its name to Enron in 1985. “Board year begin” includes beginning Board service either with HNG or InterNorth prior to the merger. Inside directors include Lay and Skilling. Skilling was voted to the Board in 1997 and was CEO of Enron from February 2001 until his resignation in August. A director as “co-opted” by Lay is one whose board service begins after 1984.

Name	Board Year		Highest Degree / Area / University	Job Titles	Other For-Profit Boards	Co-Opted
	Begin	End				
Robert A. Belfer	1983	2002	JD; Law; Harvard	CEO Belco Petroleum; Retired	2	No
Norman P. Blake, Jr.	1993	2002	Masters; International relations and international economics; Purdue	Chair and CEO Heller Financial Chair and CEO USF&G (Insurance) Chair and CEO Promus Hotels	6	Yes
Ronnie C. Chan	1996	2002	Masters; Business; University of Southern California	Chairman Hang Lung Group Lt. (real estate)	2	Yes
John H. Duncan	1968	2002	Bachelor; Business, Texas at Austin	Founder and President, Gulf& Western		No
Joe H. Foy	1970	2000	JD; Law; Vanderbilt	President and CEO of HNG (Enron predecessor)	1	No
Wendy L. Gramm	1993	2002	Ph.D.; Economics; Northwestern	Chair of Commodity Futures Trading Commission	4	Yes
Ken L. Harrison	1997	2001	Masters; Counseling psychology; Oregon State	Chairman and CEO of PG&E	2	Yes
Robert K. Jaedicke	1984	2002	Ph.D.; Business Administration; Minnesota	Dean, Stanford University School of Business	6	No
Rebecca Mark-Jusbasche	1999	2000	Masters; Business; Harvard University	Chairman and CEO of Azurix Chairman and CEO of Enron International		Yes
Charles A. LeMaistre	1980	2002	MD; Medicine; Cornell	Chancellor, Texas Southwestern Medical School President, M.D. Anderson Medical Center	2	No

John Mendelsohn	1999	2002	MD; Internal medicine, hematology, medical oncology; Harvard Medical School	President of MD Anderson Cancer Center	1	Yes
Jerome J. Meyer	1997	2001	Bachelor; Economics and Math; Minnesota	CEO and Chair of Tektronix CEO of Honeywell Computer Business	3	Yes
Paolo Ferraz Pereira	1999	2002	Masters; Business; Harvard University	CEO of Meridional Financial Group CEO of State Bank of Rio de Janeiro		Yes
Frank Savage	1999	2002	Masters; International Relations; John Hopkins	Chairman of the Board of Equitable Capital Management	7	Yes
John A. Urquhart	1990	2001	Engineer; Georgia Institute of Technology and Virginia Polytechnic Institute	General Electric Senior Manager Chairman and CEO of Amoco/Enron Solar Partnership	8	Yes
John Wakeham	1994	2002	Public accountant	Leader of House of Commons (U.K.)		Yes
Charls E. Walker	1984	1999	Ph.D.; Finance; The Wharton School, University of Pennsylvania	Deputy Secretary of the Treasury Executive Vice President of The American Bankers Association		No
Bruce G. Willison	1997	1998	Masters; Business; University of Southern California	Chairman and CEO of First Interstate Bank of California CEO of H.F. Ahmanson Dean of Anderson Graduate School of Management at UCLA		Yes
Herbert S. Winokur, Jr.	1984	2002	Ph.D.; Applied Math; Harvard	Senior Executive Vice-President and director of Penn Central Corporation President of Pinehurst, Inc.	5	No

Table 6: Analysis of Enron Regularly Scheduled Board Meetings 1997-2001

Board meetings include those that are regularly scheduled between 1997 and the date of the bankruptcy filing, December 1, 2001. Board meetings occurred on a single day unless indicated with a * when they continued the next day. Meeting length is in hours and minutes. Approving meeting minutes and calendar items are not included in the vote counts. Each vote includes at least one resolution and are indicated in the meeting minutes. Questions asked is shown if the meeting minutes specifically indicate that directors asked questions. Stock price is the closing price on the date of the Board meeting.

Panel A: Data for Each Regularly Scheduled Enron Board Meeting

Meeting		Pages in Minutes		Votes		Resolutions		Questions Asked	Stock Price
Date	Length	Number	Per Hour	Number	Per Min.	Number	Per Min.		
11-Feb-97	4:05	24	5.9	14	17.5	46	5.3	Yes	\$41.13
6-May-97	2:40	28	10.5	9	17.8	75	2.1	Yes	\$39.75
11-Aug-97	4:30	25	5.6	12	22.5	55	4.9	Yes	\$36.75
14-Oct-97	4:30	25	5.6	12	22.5	50	5.4	Yes	\$39.63
9-Dec-97	4:50	40	8.3	9	32.2	86	3.4	Yes	\$40.19
9-Feb-98*	6:15	23	3.7	12	31.3	54	6.9	Yes	\$41.94
4-May-98*	5:30	21	3.8	9	36.7	47	7.0	Yes	\$50.06
10-Aug-98*	6:55	35	5.1	16	25.9	69	6.0	Yes	\$49.25
12-Oct-98*	6:05	37	6.1	8	45.6	86	4.2	Yes	\$50.94
8-Dec-98	5:30	39	7.1	16	20.6	74	4.5	Yes	\$54.31
8-Feb-99	5:30	23	4.2	11	30.0	51	6.5	Yes	\$64.69
4-May-99	5:15	20	3.8	8	39.4	39	8.1	Yes	\$76.19
10-Aug-99	2:35	22	8.5	4	38.8	52	3.0	Yes	\$88.56
11-Oct-99*	6:12	28	4.5	7	53.1	38	9.8	Yes	\$38.88
14-Dec-99	3:55	32	8.2	5	47.0	64	3.7	Yes	\$36.63
7-Feb-00*	5:25	22	4.1	7	46.4	29	11.2	No	\$62.50
2-May-00	3:55	24	6.1	5	47.0	36	6.5	No	\$76.00
7-Aug-00*	5:10	34	6.6	7	44.3	77	4.0	Yes	\$80.25
7-Oct-00	4:40	19	4.1	3	93.3	32	8.8	No	\$81.63
12-Dec-00	4:40	30	6.4	8	35.0	56	5.0	Yes	\$77.19

13-Feb-01	4:05	24	5.9	8	30.6	42	5.8	Yes	\$81.15
1-May-01	3:40	35	9.5	8	27.5	59	3.7	Yes	\$62.41
13-Aug-01*	6:00	20	3.3	8	45.0	34	10.6	Yes	\$42.15
8-Oct-01	6:27	10	1.6	2	193.5	2	193.5	No	\$33.39
Panel B: Summary Statistics									
Mean	4:55	27	6	8.7	43.5	52.2	13.7	# / % Yes: 20 / 83.3% # / % No: 4 / 16.7%	
Median	5:00	25	6	8.0	35.8	51.5	5.6		
Minimum	2:35	10	2	2.0	17.5	2.0	2.1		
Maximum	6:55	40	11	16.0	193.5	86.0	193.5		
Panel C: Summary Statistics without Meeting Outlier October 8, 2001									
Mean	4:51	27	6	9.0	37.0	54.4	5.9	# / % Yes: 20 / 87.0% # / % No: 3 / 13.0%	
Median	4:50	25	6	8.0	35.0	52.0	5.4		
Minimum	2:35	19	3	3.0	17.5	29.0	2.1		
Maximum	6:55	40	11	16.0	93.3	86.0	11.2		

Appendix [Not for publication]

Experimental Instructions

Following are complete experimental instructions for the No Justification treatment in which participants are not asked to explain their choices. Changes in the instructions for the Justification treatment are noted in italics and brackets. The experiment is conducted with pencil and paper.

Participant Number _____

Instructions

In this experiment you will be provided with a scenario and asked to consider a proposal presented to a public corporation. For this decision task, you will take the role of a member of the Company's board of directors. As you know, a director on a Board has a duty to make decisions that are in the best interest of the corporation.

[Sentence added: You will be asked to provide a written justification for your recommendation.]

We sincerely appreciate your attention. If you have a question at any time, please raise your hand and an experimenter will come to you.

[page break]

Scenario

For this decision task, assume you are one of 13 members of the board of directors of a large, highly successful, publicly traded corporation in the energy sector. As an independent director, it was an honor to be invited to serve on such a prestigious Board and you hope to serve for many more years. Serving on the Board has been very enjoyable for you because it is a cohesive group of friendly individuals who are leaders in their field.

The executives in the firm include highly respected, experienced, and talented individuals. Along with the Board, you believe that the chairman, who is also the chief executive officer (CEO), has provided outstanding leadership for the Company. The Board has rarely rejected any proposals put forth.

At a recent board meeting the CEO discussed a complex proposal that would enable the Company to engage in transactions for the purpose of taking multimillion dollar capital asset items on and off the Company's balance sheet. To do this the chief financial officer (CFO) would invest in and head an outside entity that buys from and sells assets to the Company. Because of this conflict-of-interest, the Board needs to approve a waiver to the Company's Code of Conduct policy.

While there are no controls in place to address the conflict-of-interest, both the CEO and the Board have the utmost confidence in the integrity and ability of the CFO. The CEO recommends approval of the proposal as the projection of a strong balance sheet is important to the strategic goals of the Company.

Please record your vote below:

_____ I approve the resolutions to adopt this proposal.

_____ I do not approve the resolutions to adopt this proposal.

_____ I move to table the resolutions needed to adopt this proposal.

[Sentence and text box added: In the box below, please provide a justification for your vote. The firm's shareholders expect at least a couple sentences.]

[page break]

Post-Experimental Questionnaire

Please answer the following questions.

1. What semester and year did you begin your Graduate degree (e.g. Fall 2021)? _____
2. Your gender is _____.
3. Your age is _____ years.
4. What is your major or concentration (e.g., accounting, finance, none etc.)? _____
5. How interesting did you find this experiment? (circle the appropriate number)

Not very
Interesting

Very
Interesting

1-----2-----3-----4-----5-----6-----7-----8-----9-----10-----11

[Question added: You were asked to explain the reasoning behind your decision. Do you think providing a justification impacted your decision? Please circle one. (Yes / No) Please explain.]

Thank you for your participation in our research. Your responses are important to us.