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THE MILIEU OF THE BOARDROOM AND THE PRECINCT OF EMPLOYMENT*

DEBORAH A. DEMOTT**

INTRODUCTION

Although directors who serve on a large corporation's board share an association with the corporation's employees, the law defines their roles, duties, and rights very differently. So differently, in fact, that, metaphorically, directors and employees occupy different spaces within the corporation. Employees occupy a hierarchically-structured precinct oriented around the corporation's right to exercise control over them. In the law's view, the right extends from the depths to the heights of a managerial hierarchy because all employees at all ranks have a duty to comply with lawful instructions, however lofty their position within the corporation.[1] The right of control is not eliminated if a particular corporation structures its employees' work into teams or otherwise confers discretion on them to determine how best to do their work.[2] Moreover, and less legalistically, the precinct—a space with enclosures—occupied by employees is designed in many ways to reinforce employees' identification with the corporation and its objectives in performing their work.

In contrast to the hierarchically-structured precinct of employment, the law assigns ultimate managerial responsibility to a corporation's board of directors.[3] The milieu of a board's members

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1. *See* RESTATEMENT (THIRD) OF AGENCY § 8.09 cmt. c (2006); *see also id.* § 7.07 cmt. f (noting that an employer retains a right of control over employees despite infrequent exercise of the right and that right extends to senior executive officers); Reilly v. Polychrome Corp., 872 F. Supp. 1265, 1268–69 (S.D.N.Y) (holding that a corporation's vice president committed a material breach of duty by disregarding the president's order that he report to work although the vice president claimed that he believed his presence at work was unimportant to the corporation at the time), *aff'd*, 71 F.3d 405 (2d Cir. 1995).

2. *See* RESTATEMENT, *supra* note 1, § 1.01 cmt. c (noting that a principal's failure to exercise its right of control does not eliminate the right).

3. For the most influential statutory formulations on this point, see DEL. CODE ANN. tit. 8, § 141(a) (2008) (stating that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors," unless the statute or corporation's certificate of incorporation provides

differs in many ways from the precinct of employment. The law requires that board members, in discharging their responsibilities, bring independent judgment to bear in the best interests of the corporation.[4] This requirement presupposes intellectual and emotional distance from the corporation's management and their project. Structurally, directors act as members of a board and as members of board committees.[5] Directors exercise original undelegated power that is not subject to the control of others, most particularly the corporation's shareholders.[6]

Thus, the simple fact that shareholders are unlikely to vote in favor of a transaction that requires shareholder approval does not establish that the board breached its duties to the corporation by entering into the transaction. As one court recently stated the basic point, "[d]irectors are not thermometers, existing to register the ever-changing sentiments of stockholders. Directors are expected to use their own business judgment to advance the interests of the corporation and its stockholders."[7]

Moreover, a board is comprised of members, most not otherwise associated with the corporation, whose duties to the corporation typically coexist with other financially-significant associations and allegiances, including full-time employment in the past or present by another corporation or large institution, such as a major university. To be sure, all directors owe duties of loyalty and care to the corporation in question,[8] but the operation of those duties is specific

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otherwise); MODEL BUS. CORP. ACT § 8.01(b) (2007) (stating that "[a]ll corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors" subject to any limitation set forth in corporation's articles or in legally-effective shareholder agreements).

4. *See* 2 JAMES D. COX & THOMAS LEE HAZEN, THE LAW OF CORPORATIONS § 10:11, at 182–86 (3d ed. 2010).

5. *See* MODEL BUS. CORP. ACT § 8.30 cmt. (recognizing that directors, although individually subject to duties, discharge them as members of a collegial body, either the entire board or a committee of the board).

6. *See* RESTATEMENT, *supra* note 1, § 1.01 cmt. f(2).

7. *In re* Lear Corp. S'holder Litig., 967 A.2d 640, 655 (Del. Ch. 2008) (holding that directors did not breach their duty of loyalty in approving proposed merger agreement containing $25 million termination fee on the basis that the board knew shareholders were unlikely to approve the agreement and imposing liability on directors would require "speculative second-guessing" inconsistent with the business judgment rule).

8. *See* MODEL BUS. CORP. ACT § 8.30(a) cmt. 1 (stating that a statutory mandate requiring a director to act "in good faith" and "in a manner the director reasonably believes to be in the best interests of the corporation" is a mandate that "governs all aspects of directors' duties: the duty of care, the duty to become informed, the duty of inquiry, the duty of informed judgment, the duty of attention, the duty of disclosure, the duty of loyalty, the duty of fair dealing, and finally, the broad concept of fiduciary duty

to an association of a particular scope.[9] For many directors, the scope of the connection—among all the connections that a successful adult may have—is far from all-encompassing. Multiple associations may create the risk of conflict with the corporation's interests or of indifference to its fortunes. Somewhat paradoxically, multiple associations may also create reputational constraints on how directors act in the face of conflicts and risks to the corporation, given directors' wider web of business and professional relationships in which reputation matters. Observed a Delaware court:

> [C]orporate directors are generally the sort of people deeply enmeshed in social institutions . . . [which] have norms, expectations that, explicitly and implicitly, influence and channel the behavior of those who participate in their operation. Some things are "just not done," or only at a cost, which might not be so severe as a loss of position, but may involve a loss of standing in the institution.[10]

Thus, directors' wider associations carry risks for the corporation because they may trump fidelity to the corporation's best interests among a director's array of loyalties. However, conduct in the milieu of the boardroom is also subject to extramural constraints and influences that may prove beneficial for the corporation. That is, widely-connected directors have an interest in developing and preserving a reputation for probity and effectiveness that transcends their service in any particular boardroom.[11] Moreover, directors' extramural connections may bear no material relationship to a

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that the courts often use as a broad frame of reference when evaluating a director's conduct").

9. Thus, a nonofficer director is free, absent an agreement stipulating otherwise, to engage in business activities that do not compete with the corporation and to pursue business opportunities that are unrelated to the corporation and its business. *See* 2 COX & HAZEN, *supra* note 4, § 11:8, at 274 ("What opportunities are so related to the corporation's business . . . is answered only in the context of the circumstances of the particular case and sometimes depends on the particular test followed by the jurisdiction.").

10. *In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 938 (Del. Ch. 2003) (citation omitted), *aff'd*, 872 A.2d 960 (Del. 2005).

11. Along these lines, Adams, Hermalin, and Weisbach observe that "a director who develops a *public* reputation as a poor monitor is hurt with respect to the number of board seats he or she holds." Renée B. Adams et al., *The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey*, 48 J. ECON. LITERATURE 58, 95 (2010). On the other hand, "a director who develops a *private* reputation as a poor monitor—that is, as someone unlikely to rock the boat—might be favored by CEOs who are looking to acquire power at the expense of the board." *Id.*

corporation's activities or may be aligned with it as a source of profitable business opportunities.

This brief Commentary sketches functional differences between employment and service on a board with the objective of considering whether and how the research findings on diversity management surveyed by Brooke and Tyler in this issue[12] might be translated from the employment context to the boardroom. On the one hand, the law and corporate practice do not posit that an outside director's membership on a board requires comprehensive identification with the corporation and its interests, but much of Brooke and Tyler's argument assumes that employers should structure dealings with employees to reinforce their identification with the corporation and its objectives in performing their work.[13] On the other hand, although effective outside directors bring a capacity for emotional and intellectual distance to their duties, they possess and exercise ultimate power over the corporation's management. Thus empowered and positioned, outside directors have the capacity to focus senior management's attention on diversity issues, in particular those within the precinct of employment.

I. LEGAL AND FUNCTIONAL DIFFERENCES

A. *Directors and Employees*

In assessing whether scholarship focused on the consequences of diversity in corporate workforces has salience if extrapolated to the board, it is helpful to consider how boards are structured and how they operate. In fundamental respects, a director's position is at opposite poles from that of an employee. In contrast to employees, directors have a relatively strong tenure within the corporation because, once elected (for terms of at least one and potentially four years),[14] directors can be removed only by action supported by a majority of the voting shares.[15] In Delaware corporations, if directors'

12. Jennifer K. Brooke & Tom R. Tyler, *Diversity and Corporate Performance: A Review of the Psychological Literature*, 89 N.C. L. REV. 715 (2011).

13. *See id.* at 724 ("Fairly treated employees will identify more with their organization . . . .").

14. *See* DEL. CODE ANN. tit. 8, § 141(d) (2008) (directors may be elected for staggered terms of up to three years); N.C. GEN. STAT. § 55-8-06 (2009) (directors may be elected for staggered terms of up to four years); MODEL BUS. CORP. ACT § 8.06 (directors may be elected for staggered terms of up to three years).

15. DEL. CODE ANN. tit. 8, § 141(k) (stating that "the holders of a majority of the shares then entitled to vote at an election of directors" may remove any director or the entire board); MODEL BUS. CORP. ACT § 8.08(d) (stating that a director may only be

terms are staggered, they are removable only for cause and not because holders of a majority of the voting shares would prefer new directors.[16]

In contrast, in the absence of a contract providing otherwise, employees in the United States have an at-will relationship that the employer may terminate at any time.[17] Directors' relative security of tenure should buttress their ability to bring independent judgment to bear, awkward though that might be in the face of disagreement with senior management. It is also the board's responsibility to hire the chief executive officer ("CEO") and other chief officers and, most directly for the CEO, to determine when the relationship should come to an end, even when the board has operated in a CEO-centric fashion up to that point.[18] Thus, although CEOs tend to be heavily involved in selecting and recruiting directors and many historically thought of the board as "their" board, formal legal structure allocates ultimate power to the board in relationships with the CEO and other senior officers.[19] This allocation of power differentiates the milieu of the boardroom from the precinct of employment in both obvious and subtle ways. To be sure, there is no "cult" of the independent director comparable to the "cult" of the celebrity CEO.[20] But, both board and CEO are aware of the ultimate allocation of managerial power.

B. *Board Structure and Committees*

How a board is structured and how it performs its work also bear on the contrast with employees. Much work is done by contemporary

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removed by shareholders at meeting called for that purpose); *id.* § 7.25(a)–(c) (stating that unless the articles of incorporation require a greater number of affirmative votes, action on a matter requires that votes cast in favor exceed votes cast in opposition).

16. DEL. CODE ANN. tit. 8, § 141(k)(1) (stating that unless the certificate of incorporation provides otherwise, members of a staggered board are removable only upon a showing of cause); MODEL BUS. CORP. ACT § 8.08(a) (stipulating that directors are removable by shareholders with or without cause unless articles of incorporation provide for removal only for cause).

17. *See* RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 3.01 cmt. a (2006) (explaining the presumption that employment is at-will is recognized in forty-nine states, except Montana, which has enacted a wrongful-dismissal statute).

18. *See* 2 COX & HAZEN, *supra* note 4, § 9:1, at 2.

19. *Id.*

20. *See* Adams et al., *supra* note 11, at 102 (commenting that "[i]t is interesting to speculate about the extent to which the 'cult of the CEO' that has emerged in the last twenty years helps explain the rise in CEO turnovers" and belief that CEO is crucial to a firm's success or failure may lead directors "to over attribute bad outcomes to the CEO and under attribute them to circumstances").

boards within committees.[21] Federal law requires that the crucial audit committee be comprised entirely of outside directors.[22] Likewise, stock exchange listing requirements mandate that only independent directors serve on compensation committees.[23] A consequence of this fact is a shift in the texture of meetings of the full board, with more time and attention focused on engagement with the work of committees, arguably diminishing the force with which the entire board might be characterized as a team.[24] Additionally, boards discharge more than one function—somewhat in tension with one another—and which function is the most significant evolves over time and with circumstances, sometimes in response to legal mandates. For example, contemporary boards are subject to a general duty to monitor the company's compliance with legal and regulatory mandates, while an earlier era limited the board's function to reviewing and approving corporate strategy.[25] Although outside directors may serve as sources of advice to the corporation's senior management, the effectiveness of a contemporary board increasingly turns on the success with which it monitors, in particular (and most directly through the board's audit committee), the quality of the corporation's financial accounting, control, and risk-management systems.

C. *Duties to Monitor*

A contemporary board's monitoring function necessarily presupposes a measure of distance from senior management, and arguably, from the immediate preferences of at least some of the corporation's shareholders.[26] This function may operate somewhat in tension with the board's advisory role. The board's monitoring function also suggests another metric of firm performance, which is

21. *See* 2 COX & HAZEN, *supra* note 4, § 9:18, at 101 ("Indeed, the boards of the large, publicly held corporations could not function effectively without committees.").

22. *See* 15 U.S.C. § 78j-1(m)(3)(A) (2006) (stating that the SEC by rule shall direct stock exchanges and national securities associations to revise rules to prohibit the listing of any security by any issuer unless each member of the issuer's audit committee is a member of the issuer's board and is otherwise independent).

23. *See* N.Y. STOCK EXCH., NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 303.A.05(a) (2009) ("Listed companies must have a compensation committee composed entirely of independent directors.").

24. *See* 2 COX & HAZEN, *supra* note 4, § 9:18, at 101 ("In most large corporations, many important board of director decisions are made by committees ... not by the full boards themselves.").

25. *See id.* § 9:2, at 6.

26. *See* William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1335 (2002).

whether the company has restated its financial reports or disclosed deficiencies in its internal controls, the latter disclosure required of large public companies since 2004.[27] This metric does not appear to be one considered in the academic literature that examines indicia of board diversity in relationship to measures of corporate performance. The metric comes to mind because female directors in a 1996 to 2003 study were more likely than males to serve on audit, corporate governance, and nominating committees,[28] but, interestingly, not compensation committees.[29]

That female directors are more likely to serve on board committees—in particular the audit committee—to which explicit monitoring functions are assigned, bears directly on the relevance to the milieu of the boardroom of the employment-based research findings explored by Brooke and Tyler. In particular, women and other directors who are dissimilar from their colleagues on the entire board may be especially well-suited to discharge monitoring responsibilities. Brooke and Tyler report that when an organization appropriately manages diversity in a workforce, diversity may enable the organization "to have franker discussions and make better decisions"[30] by reducing "groupthink, . . . the tendency of group members to value unanimity at the expense of rational debate."[31] Groupthink is antithetical to effective monitoring. Indeed, effective monitoring may require a perspective broader than that of the interests of a particular corporation and its shareholders; the integrity with which a corporation prepares and reports its financial results has systemic implications. The structural insulation of the audit committee from senior management and directors affiliated with management may buttress its monitoring capacity through exclusion. Its separateness from the remainder of the board emphasizes the necessity of compliance with externally-set norms that should orient the committee's members and the company's external and internal auditors. Moreover, in Brooke and Tyler's assessment, "there is no

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27. Between January 1, 2004 and May 2, 2005, eleven percent of large public companies disclosed deficiencies in internal controls on the basis of evaluations by their external auditors. JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 164–65 (2006).

28. Renée B. Adams & Daniel Ferreira, *Women in the Boardroom and Their Impact on Governance and Performance*, 94 J. FIN. ECON. 291, 298–300 (2009). The likelihood of service on an audit committee by a female director was 7.5% higher than for a male director. *Id.* at 300.

29. *See id.*

30. Brooke & Tyler, *supra* note 12, at 731.

31. *Id.* at 730–31.

evidence suggesting that the interpersonal dynamics of diversity change depending upon the level of management involved."[32]

D. *The Board and Personnel Practices Deeper Within the Organization*

Separately, potential relationships between a board's composition and employees' identification with the corporation deserve further empirical scrutiny. The board may, for example, strongly encourage—if not order—the implementation of personnel practices that develop and reinforce employees' identification with the corporation. The board's composition may bear on the likelihood that it will do so. Broome, Conley, and Krawiec's respondents suggest that this may be so, with one reporting that without a director's "insistence," management would not have reported on gender and racial diversity within the company.[33] Another respondent reports "hold[ing] the CEO's feet to the fire on these things" and making employment metrics a factor in determining the CEO's compensation.[34] The goal was not one "that the CEO came to you with, it's one the board went to him with."[35] Of course, these responses also illustrate that within the milieu of the boardroom, the CEO's power is subject to constraints not present in the precinct of employment. Directors, that is, are not consultants whose advice a CEO may safely ignore, but members of a board to whom the CEO is accountable and who may redefine the CEO's agenda.[36] Further empirical investigation might usefully investigate relationships between board composition and board-led redefinitions of senior management's agenda.

More indirectly, might the board's composition itself shape how employees view the corporation? In exploring how employees perceive a corporation's interest in their input, Tyler and Brooke differentiate between superficial gestures and credible practices

32. *Id.* at 746.

33. Lissa L. Broome et al., *Dangerous Categories: Narratives of Corporate Board Diversity*, 89 N.C. L. REV. 759, 798 (2011) (reporting that the board began receiving " 'data on both gender and racial diversity at levels in the company' " at the " 'insistence' " of the board's sole African American member) (quoting interview respondent).

34. *Id.* at 798–99.

35. *Id.* at 799.

36. Thus, as advisers to the CEO, directors' value may stem from the structural fact that "the CEO cannot ignore them," although external consultants may have greater subject-matter expertise. Adams et al., *supra* note 11, at 100. Alternatively, a CEO may be "especially careful when it comes to those dimensions on which a director's expertise could cause her to block what the CEO wishes to do." *Id.*

reflecting that an employer took its employees' concerns seriously.[37] Viewed in this light, is the diverse composition of a corporation's board analogous to a suggestion box into which employees may make deposits that are never read? To a one-day diversity training program? Organizationally, the board is situated several steps from the day-to-day experiences of most employees, which vitiates the significance of the board's composition. In contrast, diverse composition of a corporation's supervisory workforce bears more directly and immediately on most employees.

Although senior management's position is more remote from rank-and-file employees, its composition may be salient throughout a corporation's ranks of employees because senior management constitutes the site of effective power over operations. On the other hand, perhaps the composition of the board has a broader symbolic import, in light of its ultimate managerial responsibility. On this score, the responses elicited by Broome, Conley, and Krawiec are intriguing, with one respondent "emphasiz[ing] that the presence of female board members had been important to her when she was an employee,"[38] and another female director reporting that senior female managers told her "how much it meant to them to have a woman sitting there."[39]

CONCLUSION

The milieu of the boardroom and the precinct of employment interact in ways that deserve further scrutiny, as Brooke and Tyler conclude.[40] Bearing in mind the nature of the duties discharged by the board, definitive evidence of these interactions may prove elusive, just as the impact of the board itself is hard to demonstrate in the absence of major lapses in the effectiveness with which the board has monitored management.[41] Nonetheless, a diverse board may be more effective in monitoring management because "groupthink" phenomena may be less prevalent. Separately, diverse members on a board may be especially willing to refocus the attention of senior management on diversity issues within the corporation's workforce.

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37. Brooke & Tyler, *supra* note 12, at 730.
38. Broome et al., *supra* note 33, at 793.
39. *Id.*
40. Brooke & Tyler, *supra* note 12, at 740.
41. Adams et al., *supra* note 11, at 58 (noting that although the board's "day-to-day impact is difficult to observe ... when things go wrong they can become the center of attention").