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Establishing Norms for Director Behavior to Enhance Board Culture and Effectiveness

In her regular column on corporate governance issues, Holly Gregory discusses how shared expectations about standards of behavior for directors strengthen the internal culture of the board of directors.



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Holly counsels clients on a full range of governance issues, including fiduciary duties, risk oversight, conflicts of interest, board and committee structure, board leadership structures, special committee investigations, board audits and self-evaluations, shareholder initiatives, proxy contests, relationships with shareholders and proxy advisors, compliance with legislative, regulatory, and listing rule requirements, and governance best practice.

Board culture — the shared values, beliefs, assumptions, and expectations that influence behavior in the boardroom — plays a considerable role in the board's ability to govern in an effective and efficient manner. It affects how directors engage with one another and with management, the candor with which differing viewpoints are raised and deliberated, and the ease with which directors determine priorities and reach consensus. A positive board culture marked by trust, respect, and candor provides the foundation for collaborative and constructive discussions as the board assesses corporate opportunities and risks, manages transitions, and navigates crisis. Attentiveness to issues of board culture in normal times helps boards withstand stress in times of volatility and crisis.

This article discusses:

- The value of positive behavioral norms for directors.
- The legal framework in which behavioral norms are developed.
- The importance of developing and articulating behavioral norms.
- Appropriate dissenting behavior.
- How to identify and address problematic behavior.
- Considerations in setting behavioral norms.
- Practical guidance for establishing behavioral norms.

THE VALUE OF POSITIVE BEHAVIORAL NORMS

Effective governance depends on how directors weigh in with their perspectives, stimulating discussion that challenges assumptions and biases in constructive ways. Moving from identification and deliberation of options and alternatives to formation of consensus (or at least a majority agreement) in an efficient manner requires a positive board culture built on norms for how directors will conduct themselves in undertaking their service as fiduciaries and in interacting with one another and management.

Whether established implicitly through pattern and practice or explicitly through board policies, behavioral norms:

- Help set the tone for the board's deliberations, resolution of disagreement, and ability to reach consensus.
- Assist in defining and establishing the board's relationship with management and how the board and management engage, including through expectations about when the board becomes informed of and involved in a matter.
- Serve as the foundation for the trust that supports the board's ability to act in times of stress.
- Reduce the likelihood of interpersonal discord and the potential for related misconduct.

Given that the board is often constrained in its ability to take meaningful action against a director who strays from agreed policies and norms, attending to the health of the board's culture by underscoring what is expected is an important preventive measure.



Search [Corporate Crisis: Board Preparation and Response](#) for more on the importance of an effective board culture.

THE LEGAL FRAMEWORK

The board's authority to act is as a collective body. Individual directors are fiduciaries who have duties to act with care, loyalty, and good faith in participating in board activities and decisions. Individual directors do not have authority, unless delegated by the board, to authorize action by the company, bind the company to agreements, issue directives to members of management or other employees, or speak on behalf of the board or company.

In monitoring performance and determining how to vote on a matter, directors are expected to review all relevant information reasonably available. In addition to considering information provided by management, experts, and advisors, directors should consider the views of other directors that are explored and developed in board and committee deliberations, including as the board works toward building a consensus about potential courses of action. Well-functioning boards are normally able to achieve a consensus that all directors can support, only rarely resorting to a majority position that a minority of directors oppose. However, reasonable directors may disagree on important matters from time to time.



Search [Fiduciary Duties of the Board of Directors](#) for more on directors' obligations.

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EXPECTATIONS FOR DIRECTOR BEHAVIOR

For a board to be effective as a decision-making body in which a variety of views are raised, explored, and debated, directors must respect, trust, and rely on one another and at times defer to one another's judgment. From a board culture perspective, the goal is to achieve a supportive atmosphere where dissent and disagreement can be both expressed and resolved. A well-functioning board culture encourages directors to ask questions and engage in healthy skepticism. Ideally, directors develop an understanding of one another's styles and strengths and adapt to, and accommodate, one another's weaknesses.

Abiding by agreed behavioral norms helps develop trust and a cooperative and collegial atmosphere among directors that supports the candor and rigorous discussion that is fundamental to the deliberative process. This helps the board resolve disagreements, reach a consensus, and make timely decisions.

Generally, directors are expected to:

- Show respect for one another and for executives and employees, including respect for expertise and viewpoints.
- Listen actively, with an open mind.
- Be constructive in questions directed to management or other directors.
- Promote discussion and debate, including through the exercise of self-control in the use of discussion time, respecting the interests of other directors to also participate.
- Commit to working towards a consensus after an informed and deliberative process.
- Support, and not undermine, decisions reached by the board.
- Protect board confidentiality.
- Avoid acting or speaking on behalf of the company or board without authorization.
- Raise any concerns in as open and transparent a manner as possible.
- Identify and disclose conflicts of interest, and recuse themselves from discussion of and voting on these matters.

DISSENTING BEHAVIOR

Directors should freely share their viewpoints in board and committee meetings and seek to persuade other directors through deliberations. After thorough discussion, it is uncommon for a director to continue to disagree with what is apparent as the emerging position of the board majority, and the director often votes in favor of the emerging majority position out of respect for and reliance on the informed judgment of the other directors.

A director who disagrees with a board position should consider their own assumptions and biases to identify the source of the disagreement, and should be particularly wary of an internal rationale that the matter is complex and the other directors “just do not understand.” If the director’s view has been articulated clearly, concisely, and without animus or emotion, yet has failed to persuade fellow directors, it is likely that the other directors understand the matter but simply have drawn a different conclusion about the best course of action. The director also should consider whether the board’s decision-making process is appropriately robust, including whether any conflicts have been disclosed and handled appropriately, and whether directors have the relevant information to be able to assess strategic options and come to an informed decision.

If the disagreement remains unresolved, the director has a range of possible responses, depending on the level of and reasons for the disagreement. The director may take one or more of the following actions:

- Persist in trying to convince the majority to agree with their point of view before the vote.
- Seek to have the decision-making process reformed to remedy possible procedural flaws by, for example, removing the influence of conflicted directors or tabling the discussion

until additional information or advice that the director believes would be helpful can be obtained and reviewed.

- Vote against the proposal and either:
 - respect the will of the majority; or
 - request that the dissent be recorded in the meeting minutes to express significant disapproval of the decision (this also protects the director from fiduciary liability for the particular decision at issue).
- Seek to have the board reconsider or modify the decision.
- Consider resigning, in a case of serious and continuing disagreement, where the director believes that their point of view is disregarded on a regular basis and therefore the director feels they cannot be effective in influencing board decisions.
- Seek legal advice about options if the director believes that significant issues of compliance or risk are not being addressed after raising the issues with the board. There are circumstances in which the courts look with disfavor on directors who resign rather than seek to address significant issues (for more information, search [In re Puda Coal: Delaware Court of Chancery Describes Efforts Required of Directors of Foreign-Based Delaware Corporations](#) on Practical Law).

For a public company, a disagreement concerning the company’s operations, policies, or practices that results in a director’s resignation or refusal to stand for re-election, if known about by an executive officer of the company, triggers a Form 8-K disclosure obligation (Item 5.02(a), Form 8-K). In this Form 8-K, the company must disclose a description of the disagreement that it believes caused the director to resign or refuse to stand for re-election, and any correspondence the director has sent to the company regarding their resignation or refusal to stand for re-election must be filed as an exhibit. The company must provide the director with a copy of the disclosure on or before the day the Form 8-K is filed, and offer the director the opportunity to state in writing whether they agree with the company’s description and, if not, indicate how they disagree. The company must amend the Form 8-K to include any written statement provided by the director within two days after receipt.



Search [Form 8-K](#) for more on filing and amending Form 8-K to publicly disclose director departures and other material information.

PROBLEMATIC BEHAVIOR

Problematic director behaviors come in a variety of forms, including:

- Acting in an abrasive, abusive, or disrespectful manner.
- Monopolizing discussions.
- Unduly interfering in management operations.
- Overstepping one’s authority.
- Failing to respect and abide by company protocols and policies.
- Leaking confidential information.

- Failing to disclose a conflict, acting on a conflicted basis, or both.
- Taking any action that breaches a fiduciary duty or violates a law or regulation.

Boards have limited options to curb problematic director behaviors. Possible board responses include:

- **Informing, educating, and coaching a director.** In many cases, simply pointing out the errant behavior to the director may be sufficient. If the behavior reflects a lack of understanding of policies or obligations, education may be appropriate and helpful. Coaching may assist a director in modifying a problematic personal style. Individual director evaluations can help focus feedback about more generalized problematic behaviors (for more information, search [Board Evaluation Processes and Related Disclosures](#) on Practical Law).

A board may threaten to or actually issue a formal reprimand.

For a public company, if the director's actions constituted a breach of the company's code of conduct and ethics, a reprimand for their actions avoids the need for public disclosure that the board waived the code.

- **Reprimanding a director.** A board may threaten to or actually issue a formal reprimand. For a public company, if the director's actions constituted a breach of the company's code of conduct and ethics, a reprimand for their actions avoids the need for public disclosure that the board waived the code.
- **Choosing not to re-nominate a director or requesting their resignation.** The board may decide (absent a specific contractual arrangement) not to re-nominate the director. If change is needed mid-term, the board may request that the director resign.
- **Forming a board committee and removing a director from committees.** If a director refuses to resign, the board may take action to protect the integrity of board decisions from conflicts of interest, confidentiality breaches, and other harm. Forming a board committee and delegating certain decisions to it may prevent these decisions from being influenced by the director's behavior. The board should seek

the advice of counsel if considering this approach. The board may also remove the director from committees on which the director serves.

- **Removing a director.** A board's ability to "remove" a director is usually limited to a decision not to re-nominate the director for re-election by the shareholders at the end of the director's term. Many states allow director removal only by a vote of shareholders. In some jurisdictions, a court may be petitioned to remove a director for fraudulent or dishonest acts, gross abuse of authority, or a breach of duty. Judicial removal of directors is a public process, which could cause reputational harm to the company.



Search [The Challenge of Director Misconduct](#) for more on responding to director misconduct.

CONSIDERATIONS IN SETTING BEHAVIORAL NORMS

While diversity in director viewpoints should be highly valued and encouraged, and a range of director styles is to be expected, the board should establish behavioral norms for directors. These norms should set expectations about the behaviors that are valued and acceptable in board and committee discussions and in company-related interactions outside the boardroom. The governance committee and the board should periodically revisit these expectations, which can be reflected in the code of conduct for directors, corporate governance guidelines, or both.

Behavioral norms should be premised on a clear understanding of the roles of the board and management. Directors offer outside perspectives that can provide a stable foundation in times of tension and crisis, which is valuable in supporting effective governance. However, directors need to respect the limits of the board's role, which is focused on policy-setting and oversight, and avoid operating in the zone of management. To that end:

- The board and management should agree on behavioral norms that support a clear delineation of board and management authority, while recognizing that this line is difficult to draw and shifts based on the context.
- The CEO and independent board chair (or lead independent director) should agree on their respective roles and responsibilities, given the importance of mutual trust, respect, and candor between them. The board leader plays a key role in ensuring the board has policies and practices that facilitate a healthy board culture. Practices that may strengthen board culture include:
 - scheduling frequent executive sessions;
 - ensuring the board has sufficient in-person interactions;
 - encouraging all directors to participate and express differing views in meetings; and
 - developing norms around director communications outside the boardroom (between directors and between directors and management).

- The board should agree on behavioral norms that respect the limits of individual director authority (see above *The Legal Framework*).

PRACTICAL GUIDANCE

As noted above, trust and candor improve the board's ability to navigate challenging situations. Behavioral norms related to the flow of information and communications can help foster a culture where management is candid and shares negative news promptly, and directors are constructive and deliberative. For example, management and the board should develop a shared expectation about the circumstances that call for prompt and substantive board notification and engagement. Directors should be alerted about significant matters in a timely manner, including matters that implicate board responsibilities or may receive negative publicity. To that end:

- Directors should respect the impact that their requests may have on other work priorities, and the interest that all directors have in access to the same base of information. The board should establish procedures for directors to suggest board meeting agenda items and identify information to be provided by management that would be helpful to both their understanding of the business generally and their consideration of specific matters.

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- The board may wish to develop clear policies in consultation with management on how to coordinate meetings and other contacts with key employees to ensure that priorities are established and that directors have equal access to information.
- Given the highly confidential nature of information provided to directors and of the proceedings and deliberations of the board and its committees, directors should periodically be reminded not to share information outside the boardroom unless specifically authorized by the board (for example, by a director who represents a significant shareholder).

- Behavioral norms should reflect the limited time available for board and committee meetings and the interest that all directors have in actively participating. Care should be taken to promote interaction and equal opportunity for participation.
- In communicating with one another outside board and committee meetings, directors should be mindful that the work of the board and its committees be undertaken through discussions in duly convened meetings. Email and text messaging among directors about substantive matters raise confidentiality and litigation risks, given their susceptibility to a security breach and their quick, informal tone, and because they form an incomplete record. Substantive communication should take place in the security of a duly convened meeting in which all directors share the same base of information. (For more information, search [Managing Litigation Risks: Board Minutes and Electronic Communications](#) on Practical Law.)

The following additional actions help to create a positive board culture and support appropriate director behaviors:

- Discussing board culture and expectations about director conduct and reviewing related board policies periodically.
- Addressing behavioral norms in corporate governance guidelines or other appropriate board policies.
- Reminding directors of confidentiality requirements and other key policies periodically.
- Assessing board culture in the annual board evaluation.
- Underscoring expectations about director conduct in individual director evaluations.
- Considering a director's behavior in making re-nomination decisions, including:
 - how they have handled board disagreements in the past;
 - whether they abide by company and board policies;
 - whether they uphold their fiduciary duties; and
 - their commitment to confidentiality.
- Discussing periodically in governance committee meetings and with counsel the avenues for addressing problematic behaviors.
- Addressing problematic behaviors when they arise.

The board is responsible for developing an internal culture of trust, respect, and openness, and that culture is in large measure a product of accepted behaviors among directors. Periodic consideration of the behaviors expected of directors, the behaviors that are unacceptable, and the mechanisms for handling disagreements helps shape a positive board culture.



Search [Board Oversight: Key Focus Areas for 2022](#) for more on board-management relationships and board culture.

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The views stated above are solely attributable to Ms. Gregory and do not necessarily reflect the views of Sidley Austin LLP or its clients.