CORPORATE GOVERNANCE:
A PRACTICAL GUIDE FOR
DISPUTE RESOLUTION
PROFESSIONALS

By

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Corporate Governance
I. Introduction

Conflict in the corporate boardroom is inevitable. When left uncontrolled, conflict can escalate, leading to economic, emotional, and other costs. It can paralyze, even destroy functioning businesses.

However, conflict also has the potential to be constructive, by bringing to the surface issues, interests, perspectives, and concerns that need to be addressed so that the organization can move forward more efficiently and effectively.

The challenge for effective boards today is to harness the potential for conflict to lead to constructive outcomes rather than destructive outcomes. This calls for special expertise, and while America’s corporate boardrooms are teeming with members who bring a wide array of economic, industrial, and other expertise, knowledge, and skills to the task of corporate governance, rarely do they include people with knowledge and sophistication in conflict and dispute resolution who can help boards successfully manage the conflicts that inevitably arise.

This guide is designed to help bridge that gap by introducing dispute resolution professionals to the unique environment of the corporate boardroom, so that dispute resolvers may bring their skills into this environment most effectively. The issues are sophisticated, the stakes are often high, the environment competitive, and it is in such
circumstances that special skills of the conflict professional are most urgently needed.

Parts II and III of this guide provide the dispute resolution professional with a basic orientation to corporate governance, focusing on what it is that boards do, how they are constituted, what makes them effective, and what makes them ineffective. Part IV then focuses on the types of disputes that commonly arise that can inhibit the organization’s overall effectiveness, how they may be managed effectively to prevent unnecessary escalation, and the types of roles that dispute resolution professionals might play in assisting boards manage conflict effectively. Readers familiar with the essentials of corporate governance may wish to go directly to Part IV.

II. An Overview of Corporate Governance

Corporate governance is generally defined as the relationship among the various participants who are involved in determining the direction and performance of a corporation. The main parties who contribute to the governance of a corporation are the shareholders who contribute capital to the organization, the management that runs the everyday operations of the company, and the directors who oversee the managers and protect the interests of shareholders.

A. Shareholders

The main function of the shareholders is to provide the funding for the corporation. This capital investment effectively makes them the “owners” of the corporation, who benefit by sharing in the profits of the corporation without having to take managerial responsibility or to
assume many of the financial obligations of the corporation. There is some risk involved in being a shareholder, however. In addition to profits being contingent upon the success of the directors and managers of the corporation, the interests of management and owners can diverge. For example, a divergence of interests may arise when management must decide whether to use excess cash to pay dividends to shareholders or reinvest the money in the company.

B. Managers

A corporation’s managers make the decisions that direct the company and guide the everyday operations of the company. Unlike shareholders, managers do not have to provide any capital or place their own personal funds at risk.

Most corporations are led by a highly skilled CEO, who makes the everyday decisions of the company. It is necessary that a CEO have enough power to be able to be an effective leader and make decisions that will guide the company through changing circumstances. However, there must also be some kind of accountability to ensure that the CEO is acting in the best interests of the company. This balance is often struck through executive compensation. Linking management compensation to company performance is one way to ensure that the CEO’s interests are in line with those of the corporation and its shareholders.

C. Boards of Directors

Directors are a key component of the effective operation of a corporation. The board provides management accountability by monitoring and independently evaluating
decisions made by the CEO to ensure they are in the best interests of the company. The board also provides balance between the large group of shareholder owners, who are often spread all over the world, and the small group of managers who control the assets provided by the owners. Boards are often pressed to make difficult decisions, so it is not surprising that its members come into conflict with one another from time to time.

Because of their centrality to corporate governance, the next section focuses on the characteristics of boards and their members, and the qualities of effective and ineffective boards.

III. The Board of Directors

The board of directors of a corporation serves many important functions, and performs several different roles in furthering the success of a corporation. This section explores these attributes of a board, as well as the composition and organization of boards, the nature of the people who serve on them, and the characteristics of effective boards.

A. Functions of the Board

The corporate board typically operates at the policy level, and is entrusted with guiding the corporation’s mission and making sure that the long-term financial and policy goals of the company, as reflected in the corporation’s mission, are being followed.

Another function of the board is to select and support the CEO. Boards can play an important role in advising the CEO and serving as a sounding board to listen
to ideas, evaluate those ideas, and provide encouragement. The board can also ensure that necessary resources are available to pursue the strategies and objectives being pursued by management.

To balance the power between management and ownership, the board is also responsible for monitoring the actions and performance of the CEO and management. It is also important that the board makes sure that the corporation is operating on a certain level of social responsibility by complying with legal and ethical standards. Finally, the board must be able to effectively govern itself and evaluate its own performance. This includes nominating candidates for election to the board by shareholders.

B. Roles of the Board

In fulfilling these crucial functions, the board often takes on different roles.

1. Legitimizing role

The first role that a board fulfills is a legitimizing role, fulfilling formal state legal requirements for the formation of a corporation. Boards that perform this role are generally very passive and simply serve to fulfill the legal requirement in the corporation’s charter that a board be formed. A passive board of this type is often found in smaller firms or at a firm’s beginning stages. Boards that stay in this role are heavily criticized these days because they do not fulfill the important functions that boards must perform in order for corporate governance to work properly. An example of a board performing the legitimizing role might be a small firm started by a family with the board comprised of a father and son, and over time, other family
members, who meet the minimum legal requirements but do not perform active board functions.

2. Auditing role

As auditors the board assumes responsibility for ensuring the accuracy of information that is dispersed to shareholders, to the public, and to the government. The importance of this role has increased over the years because of the potential for director liability. The courts have expanded liability for persons failing to ensure the accuracy of information released to the public or for failing to investigate or verify information released to the public. To protect against this risk, most boards of large corporations now have an auditing committee that performs the auditing function of the board.

The accounting function has also taken on heightened significance in the wake of the Sarbanes-Oxley Act of 2002. SOX, as it is known, was drafted in response to the Enron, Tyco, and other corporate scandals of early 2000s, which suggested a greater need for corporate accountability. One of the act’s requirements is for the chief executive officer and the chief financial officer of a company to personally certify certain items about the annual or quarterly report. While the act’s provisions are directed to the officers of the corporation rather than its directors, board members may still bear ultimate responsibility for violations under state law duties of care, loyalty, or good faith.

3. Directing role

In the directing role, the board helps management shape the direction in which the corporation is headed. To do this effectively, management must become involved with
major decisions being made by management and stay well informed of what is going on both inside and outside the corporation. It is important that the board is able to remain focused on the mission of the corporation and help management develop goals and strategies to further that mission. While it is not the duty of the board to advise management on everyday decisions of the corporation, it is important for the board to contribute to the major strategies and policies that shape the corporation.

4. Fiduciary role

The board as a fiduciary is charged with representing the interests of the shareholders of the corporation; indeed, this is its fundamental responsibility. Some experts argue that the board of directors should also act in the best interests of other stakeholders beyond the owners of the corporation, such as employees, customers, suppliers, banks, communities in which the corporation operates, the government, and society as a whole. This viewpoint looks at the corporation in a broader picture with obligations to more than just shareholders. Regardless of the extent to which one agrees with this point of view, a corporation’s board of directors should at least be mindful of all the stakeholders in and beyond the firm because each of those separate entities affects the success of the corporation.

There are many measures that one can look at to evaluate the effectiveness of the board members in their roles as fiduciaries. For shareholders the determinative factor for how well the board represents their interests lies in the value of the shareholder’s stock. If the stock’s value has risen at a level satisfactory to the level of alternative investments of a similar risk level then the board has done well to ensure a competitive return for shareholders. For
stakeholders, whether the board has effectively represented their interests is generally seen in subjective factors such as employee satisfaction, customer satisfaction, whether they are considered to be a good corporate citizen, the number of lawsuits brought against the corporation, and the corporation’s relationship with suppliers and labor unions.

5. Counselor role

Board members can also provide management guidance and advice. In this role, the board can be a significant asset if the CEO feels comfortable asking its members’ advice on sensitive and important issues. This role can be a source of tension between the board and the CEO, however, because the board is obligated to remain sufficiently independent to monitor the actions and performance of the CEO. A board that is too close to the CEO may be criticized for its lack of independence and may be unable to adequately perform its other functions.

C. Board Size

There is no exact number that a board should strive to meet; however, boards that are either too small or too large can be problematic.

Boards of larger companies that have fewer than 10 members may not have enough diversity of backgrounds, experiences, and perspectives to be effective. A small board also runs the risk of being overly dependent on a few individuals, and problems may arise if they are unable to attend a meeting. Also, smaller boards have fewer members to select from when choosing people to serve in leadership positions, such as committee chairs.
Boards that have more than 15 members can make the group too large to be able to make decisions and perform their functions efficiently. It can be more difficult with a large board to interact genuinely with one another and make group decisions. Large boards can also cause members to lose a sense of responsibility to the corporation if they believe their contribution is less important. This can lead to poor attendance, lack of preparation, and avoidance of difficult issues.

D. Committees

Boards of large corporations often form committees to focus on particular areas of importance to the corporation. A few of the more common committees include: nominating committees, compensation committees, audit committees, finance committees, and executive committees.

The nominating committee is responsible for selecting the candidates for board membership. The compensation committee determines the executive salary amounts and how the executives are compensated. The main decision the committee must make is how much of the executives’ compensation is performance-based stock options and how much is in cash. The audit committee oversees the corporation’s internal auditing and accounting procedures and reviews the reports made by outside auditing firms. The finance committee oversees the investing of the company’s funds and reviews the capital needs and allocations of the company. The executive committee approves important decisions that take place in-between scheduled board meetings.

Other committees may be formed, depending upon the corporation’s needs. Some companies have committees
that ensure that the corporation is a good corporate citizen by working on public policy, corporate responsibility, and social and environmental issues.

E. Board Composition

1. General considerations

Many factors are weighed in the selection of directors for a corporation’s board, including the backgrounds of the directors, whether the directors are insiders or outsiders, and the independence of the directors.

Most directors are likely to have a background in business management. Often boards seek candidates with business experience and specific knowledge of the corporation’s business. However, it is also important to look for directors with other backgrounds who can offer different perspectives and areas of knowledge. Examples of other common backgrounds that boards may want to include are candidates with legal, academic, and investment experience. This increases the board’s expertise in a broader range of areas.

An important element of a director’s background is whether they work for the company (“inside directors”) or work outside the company (“outside directors”). Inside directors can be valuable to the board because of their insight about the actual operation of the corporation. However, their effectiveness can be compromised if they are particularly loyal to the CEO, especially in situations where a conflict exists between the board and the CEO. For this reason, most commentators agree there should be no more than three or four inside directors on a board. Others would argue for even fewer insiders, favoring just two: the CEO and one other member of management.
Independent directors are not employed by the corporation and do not have an excessive loyalty to the CEO or other members of management. For the board to perform its monitoring function effectively it is important that directors be independent and maintain a certain distance from the CEO. Excess loyalty to the CEO can arise when directors are tied to the CEO by personal or political relationships.

Conflicts of interest can also create independence problems. A director who represents a company with whom the corporation does business could create a conflict of interest for that director. Similarly, another obvious conflict of interest arises when a CEO serves on the board of directors for the compensation committee.

2. Characteristics of effective board members

There are many individual characteristics that can have a large impact on the effectiveness of a board. The qualities mentioned in this section are not an inclusive list, but cover many of the most common characteristics shared by the directors who prove to be the most effective board members.

Good directors often have experience or training as a director that makes them more competent to serve in a leadership position of a corporation. A director should also hold himself/herself to high ethical and moral standards. Directors are in a position of power and influence and it is important that they be able to represent the interests of the corporation while upholding the company’s ethical reputation.

Effective board members should also approach their duties with enthusiasm. Board members can greatly benefit
the company by acting as ambassadors for the corporation. A confident director who acts and speaks independently can help a board to provide a different perspective to both question and advise the decisions of management.

Preparation of individual board members is essential to the success of the board as a whole. Directors who attend meetings regularly and stay up to date on business, legislative, and regulatory matters that may have an impact on the corporation will contribute much more to the board than directors who are not well prepared. Because preparation is so important for a director, the most effective directors may be those who serve on only one committee and do it enthusiastically. Directors should be willing to ask the tough questions to hold management accountable, but they must take care to avoid actually trying to manage the corporation themselves.

3. Characteristics of ineffective board members

While there are many characteristics that make board members successful there are just as many that can make a board member less effective. Ineffective board members often lack some or all of the qualities listed above that are found in effective board members.

One of the most apparent problems that can affect the success of a board member is whether he/she is able to devote the requisite time to his/her director responsibilities. Two prominent observers of corporate boards estimate that for a director to perform his/her job properly, he/she must spend at least 100 hours annually on board functions. This can prove to be very difficult when directors overextend themselves by trying to serve on more than one board while still performing their full-time jobs. There is one account of former Secretary of Defense Frank Carlucci, who served on
20 for-profit company boards as well as dozens of non-profit boards. The *Washington Post* reported that Mr. Carlucci had a board meeting for one of his outside interests on every single working day of 1992. It is reasonable to question whether a director can serve on a board of directors effectively with that many commitments.

Another characteristic of ineffective board members is a lack of experience and skill. For example, a company’s financial troubles can sometimes be traced back to poor financial literacy of the company’s auditing committee. In addition to experience, age may also be a factor. Some commentators believe that older board members are less effective, while some see age as an asset. For example, when Michael Dell incorporated his company at age 21 he found it invaluable to have the help of 70-year-old George Kozmetsky, former dean of the McCombs School of Business in Austin, Texas, as a board member.

**F. Board Effectiveness**

1. Characteristics of effective boards

To be effective, a corporate board must be diverse, independent, active, and informed. Boards deal with a broad array of issues, including strategic planning for expansion, taxation, employee morale, and public relations, to name just a few. No single professional orientation or background is sufficient to be able to give full consideration to such a range of issues. Sometimes financial expertise is called for; sometimes industry knowledge most helpfully informs a board question. Sometimes several perspectives are necessary to evaluate an issue and make a decision. For this reason, board leadership should encourage open, robust, but respectful debate about ideas and alternatives to help identify issues and address problems proactively rather than
reactively. Indeed, the board’s ability to consider issues from a variety of perspectives is its strength, and it is vital that the board operate in an environment that embraces rather than stifles this diversity of viewpoints.

A board must also be independent in order to be able to monitor management and prevent opportunism or incompetence. Several recent corporate scandals have underscored the importance of director independence. For example, several members of Tyco International management reportedly looted the firm for hundreds of millions of dollars over several years in a fraud scheme. The board has been criticized for being unaware of what was happening.

Effective boards take an active role to effectively perform their functions. This means that board members must have adequate time to dedicate to their responsibilities as board members in light of their other responsibilities, and be committed to using that time diligently in their service on the board.

Information is vital to the effective operation of a board. There is inevitably an information gap between the CEO and board; however, it is important that management provide the board with all relevant financial data concerning the company’s performance, management comments on that data, market information, information about competitors, consumers and employees, and any other important information that may affect the company’s performance. The management should also provide the most accurate and up-to-date information possible.

For example, according to published reports, RJR Nabisco CEO Tylee Wilson kept the board in the dark while the company spent $68 million developing a “smokeless”
cigarette that ultimately failed. Wilson far exceeded his spending limits without board approval and the directors were enraged when they found out that the CEO had told employees working on the project, an ad agency and outside suppliers and scientists, but did not tell any of the board members about the project. Wilson’s failure to keep the board informed about the “smokeless cigarette” project and the large amount of money spent on its development was just the ammunition needed by his successor as CEO, F. Ross Johnson, to get the board to force Wilson out of his job as President and CEO of RJR Nabisco.

2. Characteristics of ineffective boards

The preceding discussion suggests that boards characterized by poor communication, homogeneity of perspective, dependence, passivity, and inadequate information are likely to be ineffective, often to the great detriment of the company.

As noted above, one of the functions of the board is to provide oversight on management; effective boards are characterized by open, frank discussion on issues that can be controversial and upon which reasonable minds may disagree. These can be difficult discussions, with participants who often have strong personalities and points of view. Conflict can arise when views are aired confrontationally and without respect for the potentially differing views of other board members. Such a dynamic can have a debilitating effect on the board, stifling communications, alienating board members, and leaving many important issues unresolved if they are addressed at all.

Similarly, significant problems also arise when boards are not intellectually diverse and stifle dissent. One
problem in particular has come to be known as groupthink, which refers to the tendency of groups to engage in poor decision making because of the lack of critical thinking. The basic idea behind groupthink is easy and familiar: the members of a group, like a board of directors, simply follow what the leader says to do without question because the dynamics of the group lend themselves to unanimity rather than raising questions.

Some have argued that the Enron scandal was an example of groupthink. To oversimplify, Enron’s managers used creative, allegedly fraudulent, accounting methods to overstate reported assets and disguise liabilities, thereby artificially inflating stock prices. A Senate investigation found that the Enron board approved excessive compensation, waived compliance with the company’s own code of conduct, failed to monitor and question management and its decisions, and did not critically analyze what was going on, even though it had access to information and signs of trouble. The Senate investigation also found that the board fostered a culture of conformity that discouraged diverse views, and operated with a sense of invulnerability in risk-taking decisions; both are characteristics of groupthink.

Experts see groupthink as a failure of the group decisional process that an effective board will want to avoid. Groupthink tends to arise when the group has insular leadership and no tradition of open discussion and dissent, and is characterized by the group’s close-mindedness, extreme pressure to conform to leadership’s beliefs, an illusion of unanimity, and an over-estimation of the group’s power and moral authority.

As Enron’s failure demonstrates, ineffective decision-making processes like groupthink can make a
board ineffective. A lack of board independence and access to relevant and timely information also diminish board effectiveness. Directors who are dependant on the CEO for personal or financial reasons may not be capable of making objective decisions on issues that may affect the CEO’s or their own interests. Even then, the independence of board members does not matter if the board is unable to get timely, relevant and accurate information from company management. The lack of availability of helpful information is one of the most common impediments to effective boards.

The Tyco International scandal provides a high-profile example of another ineffective board characteristic: passivity. In that case, the board failed to heed the smoke signals of confusing and inconsistent information provided by management. In Tyco’s case, senior management made statements only to be contradicted by subsequent statements by the same managers. In one instance, CEO Dennis Kozlowski announced a plan to split the company into four parts and then reversed the plan months later. In another instance, management first announced that a financial unit of Tyco would be sold to individual investors in an initial public offering (IPO), then said it would be sold to an investment house, and finally stated that neither would occur.

The directors have a responsibility to keep themselves informed of the company’s dealings and when management is being difficult or secretive the board should take the initiative to find out what is really going on. Scandal eventually caught up to the Tyco board when it was revealed that Kozlowski spent millions in company money on his own expenses, including a $6,000 shower curtain and a $2 million birthday party for his wife on the island of Sardinia, at least half of which was paid for with company
money. The party featured an ice sculpture of Michelangelo’s David that poured vodka, a live performance by Jimmy Buffett, and models parading around in briefs and togas. In the end, Kozlowski and two other top managers were found to have looted the company of over $600 million. The board’s failure to spot the misuse of company money by the top managers shows the dangers when board members either become too beholden to a CEO or simply fail to monitor the actions of management.

IV. Conflict Management for Boardroom Disputes

The foregoing discussion provides the context necessary to understand the role that dispute resolution professionals might play in working with conflict in corporate governance. In this Section, we look at the kinds of disputes that commonly arise in board rooms, the conditions that will help determine whether disagreements will escalate into disputes, the essential skills of constructive conflict management, and the roles that dispute resolution professionals can perform in assisting a board to deal effectively with conflict.

A. Common Boardroom Disputes

There are many types of disputes that can arise within a board, and it would be impossible to create a complete list. However, there are several common themes of board disputes in which dispute resolution professionals can be expected to become involved. These include shareholder disputes, disputes over company strategy, disputes over company control, conflicts of interest, power struggles, personality conflicts, and executive compensation.
1. Shareholder disputes

Shareholders in a corporation generally have the same ultimate goal: to maximize shareholder value. However, this is not always the case and sometimes the shareholders do not agree on how to achieve this goal. When shareholders disagree on a course of action to be taken by the corporation it is the directors who represent these positions.

In their article, *A Team Production Theory of Corporate Law*, Lynn Stout and Margaret Blair suggest that the most accurate model of the corporation is the team production model. This model asserts that shareholders, management, employees and other groups are all part of a ‘team’ contributing to the success of the firm. Under this model, the main objective of the board of directors is to monitor all members of the team to ensure they are contributing to the enterprise. As monitors of the corporation the directors are often at the center of conflict that occurs when two or more constituencies disagree. That is, when shareholders have a dispute the directors representing the views of these constituencies are also in conflict over the dispute. While this type of conflict is not necessarily unhealthy, if there is not a dispute resolution mechanism in place that can help resolve the dispute constructively, it can grow into a more serious problem that could threaten the success of the firm.

2. Disputes over company strategy

Disagreements between board members over the company’s future strategy are a common source of conflict within a board. As we have noted, board members are often highly accomplished persons of considerable skill and expertise, and often have strong views. Conflict arises
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when these views clash, and if not handled effectively, can lead to destructive rather than constructive outcomes.

Consider the case of Hewlett-Packard. In 2002, the board of Hewlett-Packard became involved in a fight over company strategy, in particular whether HP should merge with Compaq. Every member of the board was behind the merger except for board member Walter Hewlett, the son of HP co-founder Bill Hewlett. Soon after Walter Hewlett voiced his opposition to the proposed merger, the family of David Packard, the other co-founder of HP, joined the Hewlett family in its opposition to the merger. Because the Hewlett and Packard families owned 18% of the outstanding voting shares, the rest of the board was very vocal in its campaign for the merger. Those favoring the merger even sent a letter to the shareholders to discredit the opinions of Walter Hewlett. The letter described Walter Hewlett as a “musician and an academic” and said that “while Mr. Hewlett is a member of the board of directors, he has never worked for the company or been involved in its management.”

Walter Hewlett responded by revealing a proposed compensation package that would pay the CEOs of HP and Compaq a combined $115 million dollars in the event of a successful merger. HP management then criticized Walter Hewlett for disseminating misinformation about employment terms for senior executives. HP management clarified that HP CEO Carly Fiorina would only see a sizeable compensation option if she remained as CEO for three years and delivered a significant increase in share price.

The main problem presented in this dispute was not simply the difference of opinions over company strategy, but also the nature of the escalatory tactics the parties used
in handling the situation. A board works most effectively when there is a culture of open discussion and members speak out about their ideas and opinions forcefully but respectfully. This was not the case at HP. When Mr. Hewlett challenged the proposed merger with Compaq, his point of view was dismissed by corporate insiders and board members, who launched a campaign to diminish his credibility. As a result of this dispute Walter Hewlett was not renominated to serve as a director on the board of the merged HP-Compaq company, marking the first time since HP’s inception that the board will not include an heir of one of the company’s founders. Not only did the conflict between Walter Hewlett and the board end up in a lawsuit costly to both sides, but HP lost the link to the company’s roots in the philosophies represented by Mr. Hewlett.

3. Disputes over company control

Whether the board is run by inside or outside directors is another common area of friction within boards, in part because board members tend to have strong feelings about the issues and their emotions often get involved.

Phoenix Timber Corporation provides a good example. In 1985 a group of dissidents of Phoenix Timber led by a board member sought to appoint three independent board members to the board. The board held a special meeting that was very stormy and emotional, with both sides claiming to represent the legacy of the company’s former CEO. The board chairman, Dennis Cook, wanted to keep executives on the board of directors, while board member Michael Hermann wanted to add some new blood to the board to bring an objective look at the company’s problems. He claimed that the present board structure was counter-productive, with too much internal competition and lacked innovation and team spirit. The result of this
destructive boardroom dispute was that even after the present board prevailed over Hermann’s dissidents, the board’s instability continued as several important board members resigned in the year following the dispute, including board chairman Dennis Cook. Ultimately the instability had an effect on the company’s performance as Phoenix announced a substantial loss for the year.

4. Disputes over conflicts of interest

Given that outside board members are often chosen for their knowledge of the company’s industry, the potential for conflicts of interest is common, and can give rise to disputes within the board. In particular, board members may disagree over the significance of a conflict of interest and whether it should be disclosed to the board. Failure to disclose can foster distrust that affects other deliberations when an undisclosed conflict of interest is brought to the board’s attention.

The key question with respect to conflicts of interest is where to draw the line to avoid them. Does an investment banker who is an outside director of a corporation have a conflict of interest when she or he has clients who are invested in the corporation or its competitors? Is there a conflict of interest if the board includes a member of a law firm that represents the corporation? The extent to which the investment banker is invested in the corporation or its competitors is of great importance in determining whether a conflict of interest exists. If the board member has another interest that would compromise his or her ability to remain objective in making decisions that affect the company on whose board he or she serves, then that board member should be removed from the board to prevent any potential for perceived misconduct.
To be sure, many board members can handle potential conflicts with integrity, and when they are properly handled can inspire trust, confidence, and camaraderie within the board. When they are not, however, such conflicts or perceived conflicts bear great potential for conflict and disputes within a board.

5. Personal disputes between board members

Some of the worst problems between board members can arise when personal issues are involved. Personality disputes can arise between board members who have different perspectives toward a situation, and different styles for handling situations that vary widely along the competitive-cooperative continuum. For example, many directors are motivated by success, see their ideas as the best way to achieve success, and want their ideas adopted. Other board members may prefer different approaches to reach their goals. Another personality dispute that can arise in the context of corporate boards is that some directors are focused on what has worked in the past, while others are more interested in reforming and reshaping the corporation. Perhaps the most common personality dispute is a result of the type of person who is drawn to serving on a board of directors in the first place: leaders.

W.R. Grace & Co. provides a good example of how personal disputes between board members can negatively affect a board. J. Peter Grace was the CEO and chairman of the board of W.R. Grace & Co., a company founded by his grandfather. Grace brought J.P. Bolduc into the company to groom him to be the next CEO of the company. Grace was interested in protecting the family business from outside tampering. After several years of managing Grace’s personal investments and helping run the company, Bolduc became less and less deferential to Grace and eventually it
became clear that Bolduc was trying to push Grace out of the family company. Bolduc believed that if he managed the company well he could overcome the stranglehold that the Grace family and their loyal directors had on the company. Bolduc fueled the bad blood by cutting back on the perks of board members and particularly those enjoyed by Grace, such as his private corporate jet. Grace saw this as an insult coming from the person he had been so close to while preparing him to run the company.

Both Bolduc and Grace were ambitious businessmen with an interest in unfettered control of the company, and it was only a matter of time before their dispute became personal. The situation came to a head when J. Peter Grace’s son, J. Peter Grace III, the chairman of the board of directors of Grace Hotel Services Corporation (GHSC), a wholly owned subsidiary of W.R. Grace & Co., was found to have used company funds improperly. Bolduc and his followers on the board forced out J. Peter Grace III and then put pressure on his father to resign if he did not want news of the scandal to be announced to shareholders. J. Peter Grace then hired a team of private investigators to uncover questionable dealings with friends and look for evidence of sexually inappropriate behavior.

The personal struggle for power between Grace and Bolduc eventually split the board into factions, with most of the board members still loyal to Grace. Despite efforts by Bolduc to mend fences, the damage had already been done and he was forced out of the CEO position amidst sexual misconduct allegations.
6. Executive compensation disputes

The amount of compensation to give to a CEO can also be a source of conflict within a board of directors, and New York Stock Exchange CEO Dick Grasso’s $140 million retirement package provides a good example.

Grasso worked his way up through the NYSE, beginning as a clerk and eventually becoming the protégé of the former NYSE President John Phelan. Grasso then became CEO and took control of the organization. The board of directors of the NYSE included Ken Langone, who was the chair of the compensation committee and believed that executives should be richly compensated for doing a good job. The committee approved the $140 million compensation and retirement package for Grasso that more closely mirrored that of Fortune 500 companies, even though the NYSE was substantially smaller. No one within the compensation committee challenged the committee’s decision because most board members were not paying attention to what was going on and many of them were investors who did not want to cross Grasso for fear he would bring an investigation of their firms in retaliation for their actions.

However, the rest of the members of the full board were stunned when they heard about the compensation package. One director, Hank Paulsen, said “it took my breath away.” To make matters worse, Grasso wanted to take the retirement benefits right away, before he even retired. Several of the board members expressed their concern about the public outcry if the information about the retirement package became public. Before an August 2003 meeting, Grasso agreed that maybe the board should wait until a later meeting to propose the contract. However, at the meeting (with five board members absent) the
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retirement contract was approved – with the Wall Street bankers regulated by Grasso fighting hardest against its approval. After news about Grasso’s compensation became public, Grasso was forced out as CEO of the NYSE, auguring a change in the traditional NYSE board as a secretive club of insiders.

7. Other disputes

The foregoing issues are common disputes that are likely to arise on any board of directors. The specifics of these issues, and other more discrete issues, for any particular board may be identified during the course of a conflict assessment by a competent dispute resolution professional.

The conflict assessment is a common starting point for multi-party conflict resolution. In the corporate board context, an assessment would begin with a review of the corporation by analyzing its recent annual reports, strategic plans, and other such documents, the backgrounds of each of the members of the board, as well as the corporation’s chief executive officer. The dispute resolution professional would then identify stakeholders appropriate for preliminary consultation. The board members and the CEO would almost always be consulted, but it may also make sense for the assessment to include consultations with non-member managers, shareholders, and others as appropriate.

The purpose of the preliminary assessment is to determine the nature of the conflict and the interests and concerns that are particularly at stake, both with respect to the organization as well as how the board will function as a group. What are their aspirations for the corporation and the board? What barriers do they see toward reaching those aspirations? What concerns do they have about the
organization and the board, and what possibilities do they see for satisfying those concerns? What interests compelled them to take the time to serve on the board? What conditions might prompt their departure from the board?

Identifying the members’ various interests and concerns will help the dispute resolution professional greatly in steering the board toward constructive outcomes of conflict. Such consultations also may help identify any ground rules – such as appropriate timetables and standards of conduct – that might help guide the operation of the board, particularly when disputes arise.

B. Essential Conflict Management Skills for Board Members

1. Effective listening and assertion

As a general matter, board members are sophisticated and successful people, often well-respected within their professional communities. One area in which they may lack training or sophistication is in the skills of dialogue about difficult issues. Fostering this capacity in board members individually and as a group may be the most significant contribution the dispute resolution professional brings to the corporate board. After all, much of what boards do is discuss difficult issues of policy about which reasonable people may genuinely disagree. The effective board will be the one that can use disagreement to improve the group’s overall decision making.

Conflict management begins with good listening skills, something that is particularly difficult in the boardroom environment, where there are many distractions from good listening. Our minds tend to wander while we are listening to others. Whether we are searching for the
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next question to ask or comment to make, making judgments about the speaker, working through a problem on another matter, or trying to remember to pick up a present for a child’s birthday, we rarely give speakers our full, undivided attention. The boardroom presents even more challenges to effective listening. The issues are often difficult and inherently divisive. Meetings are only occasional, and time is often short, leaving little room for follow-up questions, much less the kind of substantive relationship-building among directors that can provide the space for effective communications on difficult topics. Such a dynamic places a premium on effective listening skills, and cultivating these skills can be an important function of the dispute resolution professional.

Assertion skills are also important. As noted above, many board members have strong opinions and are not shy about asserting them. For them, the challenge is being effective in their assertion – for example, by not being alienating in their speech or by raising criticisms in a way that invites response and discussion rather than foreclosing it. Some board members, however, may be more reluctant to be assertive, for a variety of reasons that can include lack of substantive expertise on the topic under consideration, a feeling of peer pressure not to take contrary views or raise difficult issues, or a general reluctance to speak in group settings. For them, the challenge is mustering the resolve to assert in the first place.

2. Working effectively with conditions that will affect the escalation or stabilization of board conflicts

Many of the conflicts previously described will initially arise from some disagreement between board members. How those disagreements are handled will play
an important role in whether the disagreement will work itself out, or stabilize, or ripen into a dispute, and whether the dispute will escalate by increasing the number of other board members or other parties are involved, the number of issues it embraces, the amount of time and other resources devoted to the dispute, and the harshness of the tactics that are used.

Other factors, however, will also contribute to the path of the conflict, including the idiosyncrasies of the board members, the relationship between board members, and the physical environment of the board’s meeting places. These conditions are always present in conflict. The question for the dispute resolution professional is how they are playing out in the context of a particular boardroom situation, and how they may be managed to minimize the likelihood of unnecessary escalation and to maximize the potential for the dispute to have a constructive outcome.

a. Idiosyncrasies of board members

Individual personalities are important conditions affecting path of conflict. In the boardroom context, board members – including the chair and CEO – may have personality or professional characteristics that would be more or less likely to escalate conflict when there is disagreement. Strong or weak egos would be one example of a characteristic to look for, as is the members’ personal orientation toward conflict, whether they tend to respond to disagreements more destructively (by competing, accommodating, or avoiding) or whether they tend to respond more constructively (by being more receptive, collaborative, or cooperative).

It is unlikely that these general orientations will always be controlling. However, such tendencies can be
important in terms of assessing the likelihood of a dispute to lead to constructive or destructive outcomes when disagreements do arise. For example, particularly competitive board members may be more likely to respond to disagreement aggressively, thereby increasing the likelihood of a dispute, than members who are less competitive. By the same token, board members who are more conflict averse can be just as problematic because such members may be less likely to press legitimate issues, and more likely to go along with the crowd. Other personality characteristics that can elevate disagreement to disputes in a boardroom include predispositions toward irritability, impulsiveness, and easily threatened self-images, as well as those with codes of personal retaliation, such as “an eye for an eye.” By contrast, personality characteristics that can stabilize conflict when disagreements arise in the board include tendencies toward empathy, reflection, guilt, and a strong need for social approval.

Observation and interviews with the board members and other significant parties are probably the best source of this type information. Testing instruments that help identify an individual’s orientation to conflict, such as the easily administered Thomas-Kilman Conflict Mode Instrument, can also be helpful if that opportunity is available.

b. Relationships between the board members

How the members of the board interact will also play a significant role in whether a disagreement will stabilize or escalate into a more contentious dispute. The key issues here include the level of trust between board members, the strength of interpersonal relations between and among board members, and power dynamics. These
issues should be considered as they apply to individuals on the board, groups within the board (such as inside versus outside directors), and to the board as a group.

Trust is particularly significant because boards often consider issues that are ambiguous, where there are no clearly correct answers and where the motives of individuals in making certain arguments or taking certain positions is open to interpretation. Where board members are generally trusting of each other, it is more likely that these arguments or positions will be construed as benign, and as furthering the larger goals of the corporation. In this situation, trust can act as a stabilizing influence when disagreements emerge. Where board members are distrustful of each other, however, board members are likely to be suspicious and to scrutinize such arguments or positions as furthering other personal or professional agendas, denying untrusted members the benefit of the doubt, and increasing the likelihood that disagreements will escalate into more contentious disputes.

A related consideration about the relationship between the board members involves the strength of the social bond between them. This consideration is broader than the trust inquiry, and goes to how close board members feel to each other. Many perfectly healthy board relationships remain at arm’s length. However, close relationships can also be forged during service on a board, and these relationships can be fortified by other mutual interests, such as political ideology or recreational activities. The more strands of connection there are between board members, the more those strands have the capacity to stabilize disagreement when they arise and prevent their maturing into more formalized disputes.
Part of the relationship between the parties includes the power dynamics within the boardroom. All members of the board may be presumed to have some power by virtue of their selection to the board, but the effect of their power will depend upon the situation. Some members may have greater personal power because of their stature or position or innate charisma. However, power is also a function of the situation, and on some issues some board members may be more powerful or influential than on others. Whether and how members use their power can have important implications for the escalation or stabilization of conflict. When power is used to exert dominance over others – for example, to impose a resolution on a given issue – the potential for escalation exists because the interests and concerns of lower power members may not have been met. However, when power is used to bring people together, or to assure the full consideration of an issue, it can contribute to a more constructive outcome.

c. Environmental conditions

Finally, environmental conditions can also have an impact on whether disagreement is likely to mature into more formal disputes. For example, is the physical location and time of the board meeting conducive to constructive deliberation on difficult issues, or are there distractions that should be avoided, such as noise, extreme temperature, or a sub-optimal time period? The failure to avoid such distractions can create an environment of unnecessary anxiety or discomfort, which can escalate disagreement into more formalized disputes.
D. The Roles of the Dispute Resolution Professional Serving the Board

The dispute resolution professional can serve a board of directors in a wide variety of ways. These generally fall into three major roles: educator, facilitator, and resolver.

1. Educator

The dispute resolution professional as educator seeks to help train board members to deal effectively with conflict themselves. This can be done by working with individual board members, groups of board members, or the board as a whole.

Initially, this training would emphasize communications skills, such as working from a learning stance, listening, and assertion. A learning stance recognizes that people’s perceptions of situations and events vary widely, and that the failure to recognize these gaps can lead to unnecessary conflict. As a result, rather than coming from a posture in which the listener assumes he or she already knows what the speaker is going to say, the listener operates from the posture of inquiring about what the speaker is saying, and why he or she is saying it. The assumptions are reversed. Rather than assuming that the listener fully knows what the speaker is saying and is simply seeking a response, the listener operating from a learning stance assumes he or she doesn’t fully know all of the nuances of what and why a speaker is saying what he or she is saying. It is the stance of inquiry, rather than assumption.

Listening is the heart of a learning stance, and listening training for board members can include discussion
of the challenges to good listening (the nature and pervasiveness of distractions), the characteristics of good listening, as well as the art of active listening – a listening technique in which the listener demonstrates his or her understanding of the speaker’s message. Training can also emphasize the nature and importance of clarifying questions, and how to ask them in a way that opens up rather than inhibits the speaker.

Assertion is also a crucial element of communication for board members. Many board members will have something to add to the group’s consideration of a particular issue, and asserting that perspective effectively is important in order for the board to be able to take advantage of the board members’ experience, expertise, knowledge, and skills. Training on assertiveness for board members can emphasize the importance of communicating respect for the listener as well as the content of the message, and how to avoid appearing defensive or confrontational when asserting.

There are a few micro-skills that can be particularly important in the training of assertion. One is how to emphasize underlying interests, concerns, and preferences rather than merely asserting positions. While this is an early and fundamental lesson for dispute resolution professionals, it is important to remember that board members often have not been introduced to these concepts. Clear understanding of the differences between interests and positions, and how to use a learning stance to work effectively with interests in developing a position can have a significant impact in helping boards discuss sophisticated issues with the constructive benefit of different perspectives and insights, rather than getting bogged down in debates over positions.
A second micro-skill that can be particularly effective in the boardroom context is separating the people from the problem. Boards discuss a wide variety of difficult issues upon which reasonable minds can disagree, such as the company’s strategic direction or the amount of the CEO’s compensation. Just as it is important to keep the discussion focused on interests rather than positions, it is also helpful to depersonalize the discussion to prevent reasonable disagreements from spiraling into personality clashes. This involves not only helping board members learn specific techniques for keeping the discussion focused on the issues when personality or other similarly distracting issues arise, but also helping the board members develop the capacity to set aside the emotional responses to highly charged or ineffective assertions, offensive tactics, or other such behaviors by other board members.

2. Facilitator

The second way that dispute resolution professionals can work with boards is as third-party facilitators of conflict management. Rather than teaching board members how to manage conflict themselves, the dispute resolution professional in this role actually facilitates the management of the conflict. Facilitation can occur at either the committee level or at the level of the full board.

The professional can be brought in to facilitate in a variety of different ways. For example, when a board has found that it has come to impasse on a particular issue, such as an element of executive compensation, a dispute resolution professional can help facilitate the board’s consideration of that issue, fostering dialogue on interests, concerns, problems, and potential solutions. Similarly, to help prevent groupthink problems, it may be helpful to
facilitate the board’s consideration of an issue after a preliminary decision has been made, or in a highly complex situation, to facilitate consideration of an issue under different scenarios.

In addition to substantive dispute resolution skills, the conflict professional brings enormous value to the process as a disinterested third party. Board members bring substantive expertise to issues facing the board, and because they are board members may be presumed to have a strong interest in the outcome of board decisions, if only because of their potential liability. When disagreement rises to the level of a concrete dispute, views can become hardened, so much so that it can become difficult to listen fully to the other points of view being presented, even when they include concessions to one’s interests. Psychologists have come to call this phenomenon “reactive devaluation,” meaning that in conflict situations, we tend to devalue what the other side is saying, even if it is a concession to our preferences. Whether it is consciously or subconsciously, we tend in conflict to view the concessions suspiciously, and keep waiting for “the other shoe to drop.”

Many dispute resolution scholars believe one of the reasons mediators can be effective in facilitating conflict management is because they are able to provide a third-party presence that enables disputing parties to get over problems of reactive devaluation. Facilitators in corporate board disputes can provide the same function, serving as a vehicle for the expression of ideas, opinions, and options that may be unacceptable if brought forth directly by a disputing party.

Finally, as facilitators of conflict management, dispute resolution professionals are in a position to devise processes that help assure the legitimacy of the results. One
of the important teachings that has emerged from the study of conflict, decision making, and compliance with outcomes is the importance of procedural values in determining the acceptability of the decision. Indeed, the legitimacy of the process has been regularly found to be more important than the substance of the decision in terms of assuring compliance with and support for the decision. These process values include the ability to participate in the process, the transparency of the process, the fairness and equality of treatment of the participants in the process, the degree to which the process fosters mutual understanding and respect, and the rationality of the process.

Participation is a primary process value for a number of reasons. It acknowledges the inherent autonomy of individuals to make their own choices about how to proceed, or as is often the case in a boardroom dispute, to recommend how the company should proceed. It also respects their dignity by giving them a voice in that process. This helps assure a diversity of viewpoints that both improves the decisional process by enriching it with different perspectives, but also guards against groupthink and related problems that can undermine the board’s success. Finally, it helps to assure compliance with the decisional process, or “buy in,” precisely because participating board members have been able to have their views aired and considered as appropriate.

Similarly, transparency provides confidence in a boardroom conflict management process by helping to assure that the management of the conflict is not improperly influenced by inappropriate considerations, such as personalities, self-interests, hidden agendas, or other issues that go beyond the merits of the substantive issue before the board. Transparency also helps provide accountability.
Equality and fairness of treatment are also important dignitary interests that accord with deeply held expectations by board members. Apart from positional authority within the board, such as the chairmanship or a committee leadership position, board members can reasonably expect to be treated at least the same as other board members during the management of conflict or a particular dispute, and certainly no worse. While the realities of personal and situational power may and do result in some variations, the conflict manager will work to assure a minimum level of equal and fair treatment of all board members, which in turn will support the overall legitimacy of the process.

Finally, an important effect of a legitimate conflict management process is the social capital it builds within the board – that is, the reservoir of good will, reciprocity, and *esprit de corps* that arises from the healthy relationships and shared sense of purpose among board members. While somewhat intangible, this social capital adds to the energy, synergy, vitality, and effectiveness of the board as a decision-making group, often allowing it to continue to move forward constructively, even during times of disagreement and dispute. This social capital also emanates outward from the board to both management and employees, through the power of positive role modeling and the establishment of companywide norms and expectations for all personnel within the company.

3. Resolver

The final role that the dispute resolution professional may play in addressing boardroom disputes is that of the dispute resolver. In some respects, this role is similar to that of the facilitator role described above, for effective facilitation of conflict can often lead to the
resolution of specific disputes. However the role contemplated here is a more formal role dealing with more formalized disputes. This can include the roles of arbitrator, fact-finder, or mediator.

The board may wish for the dispute resolver to serve as an arbitrator of a specific dispute, at the level of the full board, or at the lower level of a task force or ad hoc committee. In this role, the arbitrator would actually make a decision on a disputed issue that could be either binding or non-binding on the group charged with making the decision or recommendation. For example, the executive compensation committee may be divided on the issue of whether a particular benefit should be available as a part of a larger compensation package, and may wish to simply have the dispute resolver make the decision rather than continue to invest time and other resources into the committee’s consideration of that narrow issue. Given the nature of the common disputes that a board often confronts that were described above, it seems less likely that a board would want a dispute resolver to perform an arbitral function, although it is possible that such a role may be helpful on narrow sub-issues that involve questions of fact rather than questions of policy.

Similarly, board members can also engage dispute resolvers as fact-finders, who would help resolve disputes by serving as neutral third parties investigating facts that are in question and providing an independent report, perhaps with a recommendation. For example, board members within the executive compensation committee may be sharply divided over the definition of cash compensation for chief executives within the industry, and may wish to have a dispute resolver undertake a fact-finding investigation, and tender a report to the group. Such a report could come with or without a recommendation, depending upon the
preferences of the group. The key value that the dispute resolver adds here is the actual and perceived independence from the disputing parties, as well as neutrality or lack of preference as to the outcome of the inquiry or what the committee or ultimately the board may do with the information the dispute resolver provided.

Finally, and perhaps most commonly, the board may wish to ask the dispute resolver to play the role of a mediator of a specific dispute that has arisen at either the full board or subordinate levels. This role would be similar to the facilitator role described above, except that it is set in the context of a specific dispute that has already risen (rather than being set in the context of managing conflict). The dispute resolver would want to work with the board to ascertain what would be most helpful in terms of style (facilitative vs. evaluative), expertise (substantive vs. process), credentials (former board member vs. unknown), and other important considerations.

One final point is worth stressing, and that is the dispute resolver should take care to be clear about the precise role to be performed. If the dispute resolver is a lawyer, this point of clarity is now required under ABA Model Rule 2.4 (Lawyer serving as third party neutral). Moreover, such clarity is important given the crucial distinctions between the dispute resolution processes described above. Finally, it is possible that the parties may wish for the dispute resolver to change roles, for example converting from a facilitator to a mediator. Taking such a step is presumably acceptable as long as there is full disclosure about the different nature of the new role, including potential risks to the disputing parties, and the parties are willing to waive any concerns they may have.
V. Conclusion

Corporate boardrooms are places in which strong and sophisticated people come together to address the many difficult questions that arise from the operation of a corporation. Disputes are a natural part of this process. All too often disputes operate destructively, consuming resources, diminishing board effectiveness, and undermining the larger success of the company. Conflict resolution professionals are uniquely qualified to serve corporate boards in the constructive management of boardroom conflict, and to use the energy of conflict to improve, uplift, and advance the company as it seeks to reach its maximum potential.
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FOR FURTHER READING


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