Diversity and Reimagining the Internal-External Dichotomy

Elizabeth Pollman
Diversity and Reimagining the Internal-External Dichotomy

Elizabeth Pollman*

I. PROMOTING DIVERSITY THROUGH CORPORATE LAW ............. 89
II. THE INTERNAL-EXTERNAL CONNECTION AND OPEN QUESTIONS ........................................................... 92
CONCLUSION ..................................................................................... 94

Recent years have ushered in a variety of reforms aimed at increasing Diversity, Equity, and Inclusion ("DEI") in corporations. From new state law requirements to market initiatives, a range of public and private actors are prompting corporations to increase the diversity of their boards and provide more information about their efforts. Although these developments are encouraging signs of change, a number of important limitations remain.

In Duty and Diversity, two distinguished voices in business law, Professor Chris Brummer and former Chief Justice of the Delaware Supreme Court Leo E. Strine, Jr., make the case that corporate law provides "critical tools" to support corporations in taking effective action to help reduce racial and gender inequality.1 Specifically, they argue that "the pursuit of Diversity, Equity, and Inclusion is solidly authorized by the operation of traditional corporate law principles and can even be easily squared with the views of those who embrace what has come to be known as ‘shareholder primacy.’"2 Examining demographics in corporate boards and executive suites, the related empirical debate, and issues of corporate reputation and risk management, Brummer and Strine conclude that a sound business rationale exists for corporations to cultivate diversity in their organizations and to welcome working with a wide range of stakeholders.3

* Professor of Law, University of Pennsylvania Law School.
2. Id. at 5.
3. Id. at 48 ("[W]e therefore believe that a plausible, indeed sound, business rationale exists for businesses to cultivate collaboration by diverse minds; value merits-based factors instead of
Relying on foundational corporate law principles, Brummer and Strine highlight that corporate directors not only have broad authority to promote a diverse and inclusive workforce and corporate culture, “their affirmative obligation to act in the best interests of the corporation can be understood to require it.” 4 Boards must “attend to DEI, by monitoring company policies and practices that assure the company’s compliance with important laws that focus on the equal treatment of diverse applicants, employees, customers, communities, and business partners.” 5 Furthermore, the wide discretion afforded to corporate leaders to go beyond mere legal compliance provides an opportunity to robustly address DEI within their organizations. 6

The Article makes a major contribution to corporate law, and more specifically to the promotion of DEI within the field. Many aspects of this excellent Article deserve attention, but this brief Response modestly aims to amplify one: its embrace of a dynamic approach to understanding fiduciary principles that is tightly connected to external laws and social norms.

Above all, Brummer and Strine orient the pursuit of DEI as a fiduciary matter. In doing so, they build on scholarly work that has made the business case and emphasized the moral imperative of corporations promoting diversity. 7 And they set their sights on grounding DEI practices in everyday corporate law concerns by incorporating “external” laws and evolving investor preferences into the “internal” realm of fiduciary duty and board oversight. Importantly, their approach treats corporate law as part of a broader legal framework for corporate and fiduciary accountability, rather than as an independent silo. 8 This approach deserves highlighting and raises thought-provoking questions for future examination.

social origins; and welcome working with customers, communities, and partners from all segments of society and the globe. These businesses will be better positioned to thrive. . . .”).

4. Id. at 5 (emphasis added).
5. Id. at 4.
6. Id. at 67.
8. For examples of other work that similarly takes a broad approach to understanding corporate law in the wider context of legal frameworks concerning business regulation and corporate accountability, see Colleen Honigsberg & Robert J. Jackson, Jr., The Many Modern Sources of Business Law, in THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP? 206 (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019); Ann Lipton, Beyond Internal and External: A Taxonomy of Mechanisms for Regulating Corporate Conduct, 2020 Wis. L. Rev. 657; Elizabeth Pollman, The Supreme Court and the Pro-Business Paradox, 135 Harv. L. Rev. 220 (2021).
I. PROMOTING DIVERSITY THROUGH CORPORATE LAW

Over a half century has passed since Milton Friedman’s famous essay that asserted that it is “nonsense” that “harm[s] the foundations of a free society” to speak of corporations having a “social conscience” or “responsibilities” such as “providing employment, eliminating discrimination, avoiding pollution and whatever else may be the catchwords of the contemporary crop of reformers.”9 Brummer and Strine begin by conjuring up Friedman’s controversial assertion and providing a warning that its rhetorical appeal could continue to impede necessary corporate action. As Brummer and Strine point out, in the decades since Friedman wrote, “racial inequality, income and wage inequality, and environmental harm remain huge societal problems.”10 And there is reason to “fear that when the current moment passes,” some will continue to take Friedman’s position on contemporary issues of DEI practices and “argue that corporate leaders may not take action to assure that their companies are going beyond the bare legal minimum to promote these important values, because by doing so they would be improperly diverting their focus from profit maximization.”11

But the key move of the Article is not to interrogate corporate social responsibility generally or even to reconcile DEI efforts with profit maximization, but to center diversity as a mainstream issue of corporate law and governance. One of the primary ways it does this is to connect the “external”—legal sources for accountability such as federal antidiscrimination laws—with the “internal”—corporate law principles such as fiduciary duties. And this move by Brummer and Strine helps to reveal one the weaknesses of Friedman’s approach in the first instance—Friedman assumed that the social aspects of corporate activity could be easily separated from profit-making such that corporate leaders could simply choose to focus on making profits for stockholders while “stay[ing] within the rules of the game.”12 As Brummer and Strine explain, “[a]ll too often, the issue of Diversity is viewed as a cost center or something external to the mission of the modern firm—driving criticisms of Diversity-oriented corporate reforms as ‘virtue signaling at the expense of someone else.’”13 Yet legal

10. Brummer & Strine, supra note 1, at 3 n.1.
11. Id. at 4.
12. See Friedman, supra note 9.
13. Brummer & Strine, supra note 1, at 5.
rules, shareholder preferences, and profitmaking are embedded in social issues.

Moreover, the very framing of the internal-external dichotomy has oversimplified the relationship between corporate law and other areas of law. Viewing corporate law as “internal” and focused on shareholders and profit maximizing, and other areas of law as “external,” suggests that the purview of these two categories or spheres is fundamentally different and that they can be clearly separated.

Just looking at the variety of laws and initiatives aimed at promoting diversity in corporate boards and workforces, which Brummer and Strine comprehensively examine, illustrates the difficulty of this task. Federal antidiscrimination laws might be deemed “external,” but what about state laws such as California’s board diversity statutes? In recent years, California has passed two separate board diversity statutes, the first aimed at increasing gender diversity on corporate boards, and the second aimed at increasing diversity from “underrepresented communities” in terms of race, ethnicity, gender identity, and sexual orientation. Diversity has been a relatively neglected topic in corporate law, not one that has been traditionally viewed as central to its enterprise, therefore it is conceivable that some observers might view such state laws as “external” rules for promoting “social” values. Yet board composition is a bread-and-butter concern of corporate governance. And California’s new laws are part of its corporate code. The latter points clearly weigh on the side of understanding laws such as these as “internal” to corporations and their governance. Taking another example, Nasdaq’s recently adopted disclosure standard, approved by the Securities and Exchange Commission, requires listed companies to disclose board-level diversity statistics using a standardized template and have at least two “diverse” directors or provide an explanation for not doing so. Exchange rules and disclosure mechanisms could easily fit into traditional conceptions of internal governance, but are not state corporate law.

The categorization of laws or issues as “internal” and “external” is not only subject to debate, however; the line between these purported spheres is permeable. As Brummer and Strine observe: “the

---

15. CAL. CORP. CODE §§ 301.3–.4 (West 2021).
16. They have also been challenged as unconstitutional. Brummer & Strine, supra note 1, at 60–61.
internal/external dichotomy of the Friedman view is highly misleading: the very DNA of corporate law’s most foundational duty, that of loyalty, is as much outwardly facing as it is inwardly to the extent to which it creates obligations to comply with all laws.18 This is because the duty of loyalty requires fiduciaries to advance the best interests of the corporation and its shareholders, which they must do by conducting lawful business by lawful means.19 Courts have interpreted this duty to require making a good faith effort to ensure that the corporation has in place information and reporting systems for the board to monitor compliance with relevant laws.20

Brummer and Strine pursue this vein of argument to call attention to the mandatory and discretionary aspects of fiduciary duty that support corporations pursuing strategies to address DEI.21 The duty of loyalty imposes affirmative obligations to comply with laws that are important to the corporation and society. Fiduciaries must therefore seek to assure corporate compliance with antidiscrimination laws and cannot ignore red flags that indicate violations. This includes, for example, Title VII of the Civil Rights Act, that prohibits employment discrimination based on race, color, religion, sex, and national origin, as well as laws that require corporations to provide equal access to important services.22 Corporate law is “not a field of law operating in hermetic isolation of others”23—it incorporates antidiscrimination obligations.

But Brummer and Strine realize that this is likely not enough to prompt corporations towards adequately addressing DEI, and thus they also highlight the normative aspect of fiduciary duty for driving behavior even when the risk of personal liability is remote.24 The oversight duty known as the Caremark doctrine plays a key role toward this end.25 Notably, Brummer and Strine believe that “Caremark’s primary value is in the incentives it provides to corporate fiduciaries to

---

19. Id. at 4–5; see also Elizabeth Pollman, Corporate Oversight and Disobedience, 72 VAND. L. REV. 2013 (2019); Elizabeth Pollman, Corporate Disobedience, 68 DUKE L.J. 709 (2019).
22. See id. at 49–52, 82.
23. Id. at 66.
24. Id. at 68 (noting “the duty of care was always important because normative duties, even without liability potential, still had an important effect on behavior, and that is particularly so of reputationally and mission-driven people like corporate directors” and that the Caremark doctrine under the duty of good faith similarly drives behavior even though the standards for showing a breach are difficult to satisfy).
take proactive, preventative action to ensure that the corporation complies with society’s fundamental expectations.” Good faith efforts at monitoring key compliance risks and responding to issues that arise provide the basis for a record that might deter litigation or a defense to Caremark claims that could support a motion to dismiss. Combined with the deferential business judgment rule, which provides substantial room for boards to create a corporate strategy and culture that rationally advances the best interests of the corporation and its shareholders, Brummer and Strine conclude that corporate law supports corporations taking robust action to address DEI.

To the extent these components of corporate law analysis—obedience to “external” laws, oversight duties, and business judgment protection—strike readers as unsurprising, that is indeed the point. Brummer and Strine make a convincing case, with extensive detail, that shows that the pursuit of DEI can easily be fit into traditional principles of corporate law. This makes the increasing focus of investors on environmental, social, and governance (“ESG”) issues all the more important as a cultural shift toward prioritizing DEI could drive change in a system that supports it.

II. THE INTERNAL-EXTERNAL CONNECTION AND OPEN QUESTIONS

Although beyond the scope of Brummer and Strine’s argument, their Article and its approach to corporate law connects to a number of debates to watch in coming years. To start, the wide variety of public and private initiatives aimed at promoting diversity in corporations


27. Brummer & Strine, supra note 1, at 74–75; see also Pollman, Corporate Oversight and Disobedience, supra note 19, at 2045 (discussing the standard for liability under Caremark and good faith efforts at compliance as a defense); Roy Shapira, A New Caremark Era: Causes and Consequences, 98 WASH. U. L. REV. 1857, 1870–72, 1880–83 (2021) (discussing record-keeping of board monitoring and the use of section 220 books and records requests for investigating potential Caremark claims).

28. Brummer & Strine, supra note 1, at 78 (“This forgiving test means boards have wide discretion to promote corporate norms that treat employees and consumers with respect, and that connect a reputation for integrity and fairness to long-term sustained profitability.”).


30. See Dorothy S. Lund & Elizabeth Pollman, The Corporate Governance Machine, 121 COLUM. L. REV. 2563, 2631–33 (2021) (discussing the enlightened shareholder value approach and how investors have pushed for increases in board diversity).
have largely been embraced, but challenges have also surfaced. In particular, California’s state corporate law mandates on board diversity are currently being litigated on constitutional grounds. These lawsuits raise questions about the ongoing viability of legal efforts that have taken quota-like approaches in the recent era of reforms. In turn, these legal battles raise interesting issues about whether fiduciaries have obligations to comply with rules of questionable constitutional status and what is the appropriate scope of relations for corporate law to regulate. Further, some of the sources of the new generation of reforms are from nonstate actors such as exchanges and market players such as banks, which raise questions about what types of policies and rules boards must oversee compliance with to act consistent with their fiduciary obligations.

Deeper issues also emerge from new laws such as California’s board diversity mandates concerning the scope of the internal affairs doctrine and its legal basis. Putting the internal-external dichotomy into more nuanced context reveals tensions in foundational doctrines of corporate law that have yet to be fully resolved.

Another important set of related issues is the trajectory of the Caremark doctrine alongside the rising ESG movement. Brummer and Strine argue that “[c]orporations have increasingly recognized that effective DEI compliance efforts are required by Caremark[.]” Given the centrality of employment matters to most corporations and federal


33. See generally Pollman, Corporate Disobedience, supra note 19 (discussing corporate law’s fiduciary obligations in the face of legal gray areas).

34. See, e.g., Brummer & Strine, supra note 1, at 56–64 (discussing “market ‘ESG’ initiatives”).

35. See Jill E. Fisch & Steven Davidoff Solomon, Centros, California’s “Women on Boards” Statute and the Scope of Regulatory Competition, 20 EUR. BUS. ORG. L. REV. 493, 515 (2019) (examining California’s SB 826 and arguing that the internal affairs doctrine is a rule of “internal ordering of shareholder economic relations”).

36. Brummer & Strine, supra note 1, at 84.
antidiscrimination laws, their argument has significant force. At the same time, it is not clear how far courts will (or should) apply Caremark oversight duties with regard to other issues that might fit under the moniker of ESG, particularly those which are not yet subject to legal requirements.

Finally, much remains to be seen about the course of the ESG movement itself. Recent years have witnessed a meteoric rise of investment interest in ESG, with trillions of assets under management. Major institutional investors have embraced board diversity as a priority in recent years, but other issues that might be associated with the “S” in ESG might be harder to generate sufficient agreement among investors. Coming years will reveal the range of topics under the ESG umbrella that gain traction.

None of these open questions and related debates impact the strength of Brummer and Strine’s case—they show through detailed analysis and traditional corporate law principles that they are on solid ground. And it is to their enormous credit that their contribution will likely spark many fruitful further scholarly inquiries.

CONCLUSION

In Duty and Diversity, Brummer and Strine show that corporate law can play a positive role in supporting business leaders in their efforts to promote DEI. They do a great service to the field by carefully detailing the current state of play in empirical research and corporate law doctrine that not only allows corporations to take action on these important issues but encourages it. Although oversimplified narratives about maximizing profitmaking and the internal-external dichotomy have had rhetorical appeal for decades, a clear-eyed examination of foundational corporate law principles suggests that these narratives...

37. See id. at 81 (“Civil rights laws comprise material, systemically important bedrock rules that are essential for corporations to honor as a function of their fiduciary duties and due to their charters from society to conduct only lawful business by lawful means.”).


40. See supra note 29; Brummer & Strine, supra note 1, at 57.
should not be used as an excuse to impede progress toward more diverse and inclusive organizations. Illuminating the connection of fiduciary principles to external laws and social norms also shines a light on related issues and debates that will shape corporate activity in times ahead.